GENERAL DISTRIBUTION

OCDE/GD(93)139

ACCOUNTING REFORM IN ESTONIA, LATVIA AND LITHUANIA

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

Paris 1993

>

COMPLETE DOCUMENT AVAILABLE ON OLIS IN ITS ORIGINAL FORMAT

PREFACE

At the heart of the upheavals in Central and Eastern Europe which are driving the transformation process from planned economies to market systems is the question of economic performance. In order to meet the expectations which the political revolutions have stimulated, the management of the economy's assets has to be drastically improved. In the majority of cases this improvement will only be achieved if the assets are transferred to the private sector.

Accounting reform is vital in this context as the recording systems developed for the purposes of central planning do not provide the information that is needed for the management of businesses in a market environment, nor for the valuation of these assets, which is a prerequisite for their transfer into private hands.

The urgency of the issue cannot be put too strongly, given the precarious state of the economies of the region. Price liberalisation which in most cases has preceded supply side measures has led to high rates of inflation. Given the monopoly control of business assets by the state and the subsequent lack of competition, an adequate supply response requires large scale privatisation of state assets. This privatisation in turn has been held up by the poor level of financial information, which has hindered both privatisation officials and investors in their appraisal of the enterprises designated for privatisation.

The purpose of this report is to add to the understanding of the problems which the policy makers in the three Baltic Republics face in designing and implementing accounting reforms. It reviews current accounting legislation in Estonia, Latvia and Lithuania discusses the objectives and concepts of accounting reform, the main elements of financial statements and the role and organisation of the accounting profession.

The report is intended to provide a contribution to the activities of the Joint Working Group on Accounting Reform in Estonia, Latvia and Lithuania. This Group was established in 1992 with the support of the OECD Centre on Co-operation with Economies in Transition (CCET) to serve as a forum for exchanges of views among policy makers, representatives of the accounting profession and academics, to transfer experience from OECD Member countries and to promote harmonisation among the three Baltic Republics.

The report has been edited by Marie Nigon, Consultant to the CCET. It is issued on the responsibility of the Secretary General of the OECD.

Salvatore Zecchini
OECD Assistant Secretary-General
Director of the CCET

ACCOUNTING REFORM
IN ESTONIA, LATVIA AND LITHUANIA

Table of Contents

Preface

Chapter I
Implementing Accounting Reform in Estonia, Latvia and Lithuania

Main Issues
Marie Nigon 9
Accounting Research and Training in the Baltic Republics
Toomas Haldma 15

Chapter II
Objectives and Fundamental Concepts of Accounting Reform

Accounting in a Period of Transition
OECD Secretariat 23
Accounting as a Tool for Management
Marcus Bracklo 35
The Information Needs of Users of Financial Statements
David Moore 39
Concepts in Financial Statements
Olaf Hasselager 45
Legal Infrastructure of Accounting and Reporting
Frank Jenkins 49

Chapter III
Elements of Financial Statements

Income Statement and Profit Allocation
Geoffrey Harris 55
Valuation of Assets Liabilities under Directives of European Communities
Herbert Biener 63
Valuation Principles in Eastern Europe
Jens Roder 65
Valuation Aspects of Privatisation
Wienand Schruff 69

Copyright, OECD 1993

Chapter IV
The Accounting Profession

Role and Organisation of the Accounting Profession
Gisela Nagy 75
Professional Qualification and Control
Eero Prepula 85

Annexes

Annex 1: The Accounting Law of Estonia 89
Annex 2: The Accounting Law of Latvia 99
Annex 3: The Accounting Law of Lithuania 123

List of Authors 131

Chapter I

Implementing Accounting Reform in Estonia, Latvia and Lithuania

ACCOUNTING REFORMS
IN ESTONIA, LATVIA AND LITHUANIA

MAIN ISSUES

Marie Nigon

The First Meeting of the Joint Working Group on Accounting Reform in the Baltic Republics was held in Riga (Latvia) on 12 and 13 November 1992. The present article is based on a discussion paper prepared for this meeting. It reviews the main elements of the accounting reforms undertaken in Estonia, Latvia and Lithuania, describes the difficulties encountered in the reform process and identifies issues for future cooperation.

I. MAIN ELEMENTS OF THE ACCOUNTING REFORMS IN ESTONIA, LATVIA AND LITHUANIA

1. Accounting legislation

Since 1990 all three countries have adopted new accounting legislation. The Estonian Accounting Act was adopted on 6 July 1990 and entered into force on 1 January 1991. Lithuania followed on 16 July 1992 in adopting its law on the principles of accounting. In Latvia the laws "on accountancy" and "on the annual reports of enterprises" entered into effect on 1 January 1993. In all three countries this new legislation constitutes a significant departure from the former accounting system based on the Soviet chart of accounts. It has been inspired by the accounting legislation of three Nordic countries (Denmark for the Latvian Law, Sweden and Finland for the Estonian Law) and the EC Accounting Directives. It is therefore not surprising that the new laws of the three republics while different in scope and contents show many common elements.

a) Scope of the legislation

The Lithuanian law expresses the most general rules: it sets out basic principles and rules for accounting and bookkeeping but does not contain any detailed provisions on the contents of financial statements. The Estonian law, in addition, provides basic rules on the presentation of the balance sheet and income statement and the accounting treatment of assets and liabilities. The Latvian Act on Financial Statements contains the most detailed provisions on the layout of the balance sheet and the income statement and is the only one which requires groups of companies to prepare consolidated accounts.

All laws are very comprehensive in their scope of application: they cover not only commercial companies (State owned, private and mixed) but also:

— State and municipal bodies funded from State and local budgets (Estonia, Latvia, Lithuania)

— other institutions and organisations (Estonia)

— non profit organisations and political and social institutions like trade unions and political parties (Latvia).

Exemptions are generally provided for small farms and enterprises run by self employed persons. Special provisions may also apply to different sectors like banks and agricultural cooperatives.

Issues for Consideration:

1. What is the reason for including business forms which are not organised as limited companies and non profit organisations within the scope of the legislation?

2. Are these organisations required to prepare financial statements on the same basis as commercial companies or are they simply subject to bookkeeping requirements?

3. State organisations have to prepare their accounts according to special rules issued by the competent Ministries. How do these rules relate to the general accounting legislation? Do banking laws contain specific accounting requirements?

b) Reference to general accounting principles and international standards

All new accounting laws contain such references. Under the Estonian law the accounting system has to comply with internationally recognised basic principles of accounting in a market economy. The Lithuanian law explicitly refers to the EC Accounting Directives. The Latvian Accounting Acts stipulate that the information contained in financial statements should be timely, meaningful, true and comparable and mention a number of fundamental accounting principles (like going concern, matching and prudence) which have to be respected.

Issues for Consideration:

4. What is the meaning of the references to general accounting principles and international standards?

5. Are these to be used for the interpretation of the national accounting legislation?

6. What happens in case of conflict with national rules and regulations?

c) Elements of financial statements

According to the Estonian Law annual financial statements have to contain a balance sheet, a profit and loss account, a statement of changes in financial position and the notes to the accounts. The Latvian legislation requires a balance sheet and profit and loss statement and also contains detailed provisions on the notes to the accounts. It is the only legislation among the three republics to require consolidated financial statements.

Issues for Consideration:

7. What is considered to be the objectives of financial statements? Why does the Latvian law require consolidated financial statements? Do these requirements apply to all groups of companies regardless of their size?

d) Publication of financial statements

Only the Latvian law requires companies meeting size criteria to publish their financial statements. In the other two countries it is sufficient that they are filed with the statistical office interested government agencies and private organisations (such as creditors). In all countries it is possible to obtain copies from the statistical offices against a fee.

2. Implementation of Accounting Legislation

In all three countries implementing regulations are issued by the Ministry of Finance. In addition sectoral ministries (such as industry, energy, transport) may issue specific rules for the state enterprises they supervise.

Estonia has established, under the aegis of the Finance Ministry, an Accounting Board with the task to issue mandatory instructions and recommendations on accounting methodology. The Board has its own budget, the Chairman is nominated by the Government of Estonia for a period of three years and appoints the other members. In Latvia a Council of Accounting Methodology was established recently by decree of the Council of Ministers.

Issues for consideration:

8. What will be the composition of National Accounting Boards or Councils?

9. Are enterprises, independent auditors and academics represented in these bodies?

10. What is the legal status of the decisions of these bodies?

11. Do these decisions have to be approved by the government to become legally binding?

12. Are these bodies competent to interprete the provisions of the accounting legislation?

3. Accounting practices by enterprises

In all three Republics accounting practices are in a state of transition. In Latvia and Lithuania the new legislation entered into force on 1 January 1993. Consequently enterprises in these countries still apply the soviet chart of accounts with some changes to reflect the transition to a market economy system. In Estonia the soviet chart of accounts has been revised to comply with the new accounting act (eg to introduce accruals accounting; it will be replaced shortly by a new chart of accounts.

Some enterprises are using charts of accounts which are developed in house. Others try to conform to new regulations which are often not published and therefore insufficiently understood. In some areas sectoral rules are applied which may or may not conform to the general chart of accounts. This often creates a state of confusion and enterprises frequently must have recourse to auditing firms in order to reconcile the differences and have their financial statements accepted by tax authorities.

Many enterprises do not seem to be familiar with modern accounting techniques: risk management for example and the concepts of provision for risk and doubtful claims are not sufficiently understood by enterprises and tax authorities.

Issues for Consideration:

13. What will be done to explain the accounting concepts of the new legislation to company accountants?

16. Are chief accountants of enterprises consulted in the elaboration of implementing rules and a new chart of accounts?

17. Have techniques and software programmes been developed to facilitate transition from the old to the new system?

4. Auditing of financial statements

. . . . Independent auditing for enterprises meeting certain size criteria will become mandatory in Estonia in January 1993. Similar rules are contained in the new Latvian Law on Financial Statements. Under the present system audit of state companies is performed by state audit firms which may be privatised in the near future. For large enterprises and joint ventures involving foreign partners, foreign auditing firms play a significant role in all three Republics.

In Lithuania detailed rules on auditing activities have been enacted (Law of 17 December 1991) and a Supervisory Commission for the qualification of auditors established. This Commission is composed of representatives of the Finance Ministry, the professional association of accounting and auditing and university professors. In Estonia the task of licensing auditors has been entrusted to the Accounting Committee established by the Accounting Act.

Issues for Consideration:

18. What are the professional qualifications required for auditors?

19. Are there accelerated procedures provided for accountants with longstanding professional experience but insufficient academic background?

20. Is training provided by foreign auditing firms recognised to meet the qualifications?

21. Are there any restrictions on the activities of foreign auditing firms?

22. Are there any rules of professional conduct, including conflicts of interest, for auditors?

II. PROBLEMS IN IMPLEMENTING ACCOUNTING REFORMS

The adoption of new accounting legislation is not the end but the beginning of the reform process. The new law has to be understood by practioners. Measures have to be taken to adjust accounting practices and raise the professional skills of enterprise accountants to a higher degree of responsibility. Accounting laws can only provide a framework. They can only become operational if definitions, concepts and standards are developed for their implementation. These rules have to be sufficiently flexible to adjust to the dynamics of a market economy.

Accounting reforms in the three countries (as well as in other parts of Central and Eastern Europe) are faced with the following difficulties:

1. Insufficient understanding of the concepts contained in the new laws

To the extent that the new legislation reflects concepts developed in foreign accounting systems it may not be sufficiently understood by those who are in charge of its application. Implementing rules have to be consistent with these laws and concepts. In addition the objectives of financial statements (ie the information needs of users) need to be clarified to provide guidance for implementation and to avoid excessive regulation.

2. Problems of implementing rules and standards

New accounting laws are of little value if there are no clear procedures for developing technical accounting rules and standards. These standards should reflect the economic realities of a changing market environment and changing enterprise structures. Detailed unflexible rules should be avoided. At present there is a serious problem of transparency of accounting rules and regulations. Many of them are not published, excessively detailed and frequently changed. There is no clear hierarchy between the law, regulations and administrative practices and the resulting legal uncertainty significantly adds to the cost of business operations.

3. Predominance of tax rules

Accounting is still dominated by tax considerations. Tax rules for instance do not necessarily allow for the deductibility of certain business expenses or provisions for risks or bad debts. Tax incentives are provided to encourage foreign investment but similar tax relief may not be available to national enterprises. As a result enterprises may be induced to look for foreign partner simply on the basis of tax considerations. In Estonia income statements do not show extraordinary profits and losses because these items are not recognised by tax rules. In case of conflicts between accounting and tax rules the latter generally prevail.

4. How to assimilate foreign advice?

There are frequent complaints that national authorities are exposed to conflicting advice by foreign experts. Foreign advisers may advocate their own national system without taking into account the needs of the country and without understanding the local tradition and the legal and institutional environment. International organisations are perceived to act in an uncoordinated manner duplicating work and creating confusion for national authorities. A better pooling of efforts on their part would provide more consistent and effective assistance. Training activities are badly needed but governments and local professional institutions are insufficiently informed on the variety of programmes offered by foreign advisors.

III. PERSPECTIVES FOR COOPERATION

A. Building Bridges between the Old and the New System:

Harmonised accounting practices contribute to promote trade and investment in the three Baltic Republics and facilitate their integration into a common economic space in Europe.

For this reason, it would be desirable for the new accounting laws to be implemented in conformity with the Directives of the European Communities and, where relevant, with International Standards.

To facilitate the transition from the old to a new accounting system, the OECD will sponsor a study on specific issues of implementation of the new accounting legislation in the three Republics. The

conclusions of this study will help develop common approaches to the development of accounting standards and practices.

B. Promoting Cooperation:

In April 1992 the three Baltic Republics, with the support of the OECD established a Joint Working Group for Accounting Reform. It is the main task of this Group to serve as a Forum for exchange of information and experience on developments in the area of accounting and auditing, both at national and intergovernmental levels.

To facilitate the flow of information, each country has established a national contact point, with the following tasks:

— collect and disseminate information on recent developments in the national accounting system, including legislation, implementing regulations, accounting and auditing standards, training programmes, accounting research and technical assistance offered bilaterally and multilaterally;

— respond to requests for information by national and international bodies.

The Joint Working Group on Accounting Reform will meet twice a year. At each meeting, it will review recent developments in accounting and auditing in each of the three Republics and discuss specific topics for accounting reform. Its programme of work includes :

1. Valuation Methods for Privatisation

2. Accounting in an Inflationary Environment

3. Foreign Currency Translation

4. The Professional Qualifications of Accountants and Auditors

5. Institutional Aspects of Accounting Standards Development

C. Upgrading the skills and Qualifications of Accountants:

The Joint Working Group will periodically review the state of accounting research and education or training in the three Republics and cooperate with international (governmental and non-governmental) Organisations which are active in the field of accounting and auditing. OECD can make a major contribution in sponsoring training seminars in accounting for tax officials, other government officials in charge of accounting regulations, corporate accountants and academics. OECD will also encourage professional associations of accountants and auditors to provide assistance in the development of the accounting profession in each of the three Republics. The publication of the studies and the proceedings of the Joint Working Group will provide useful reference material for a harmonised approach to accounting reform within the framework of economic cooperation.

ACCOUNTING TRAINING AND RESEARCH IN THE BALTIC STATES

Toomas Haldma

Accounting reform is a integral element of the transition to a market economy. This reform is a prerequisite for introducing the capital market, promoting investment, privatisation and the functioning the economy at large in the Baltic States - Estonia, Latvia and Lithuania. The basic steps of accounting reform include accounting legislation, the strengthening of the accounting profession and accounting training.

I. Background

To introduce the present situation of the training and retraining process in the Baltic countries we should take into consideration some historical aspects, which have a great impact on the present accounting system. The accounting environment in the former Soviet Union was characterised by the following features:

— Budgeting and planning provided information mainly for central planning and control;

— Production and financial decision followed the strict central directives of Gosplan;

— Reporting was primarily adressed to the government authorities;

— Accounting was not a management tool as the decisions were not made at the enterprise level;

— The accounting and reporting system was highly regulated and standardised (uniform chart of accounts; authorised procedures for book-keeping; standardised forms for the accounting documentation, work-sheets, financial statements etc.)

— Most of generally accepted international accounting principles and concepts (realisation principle, matching principle, prudence etc.) were not used.

In addition, accounting training and research in the Baltic States is influenced by the following features from the past:

— Long-term isolation from market economy and development of economic thought (due to the restriction on co-operation with economists from market economy countries) and shortage of modern economic literature;

— Deformation of the fundamentals of international economic science and education (the centrally governed economy was the only accepted line);

— Many fields of international economic studies had been concentrated in Moscow e.g. international economics, international business, international accounting etc.;

— Differences in economic terminology used in the former USSR and market economy countries.

In the period of centrally planned economy the predominant purposes of accounting were centralised control over the fulfilling of the economic plan and the utilisation of assets and funds. In accordance with these goals the education system concentrated on training the accountants in the bookkeeping techniques and procedures applied in a central-planned economy. As accounting was not a management tool, the responsibility and ability to prepare financial decisions in market circumstances were not the main features of an accountant. The most important qualification of an accountant was the ability to meet the requirements of a command economy.

In a centrally planned economy state ownership was predominant and accordingly the accounting personnel was concentrated in state-owned enterprises and institutions. During the transition period the number of privatised or newly created enterprises is rapidly increasing. On the other hand, there are very limited possibilities to undertake the necessary accounting reforms because of the lack of technical personnel with knowledge in market economy in both, public and private sectors. To meet the accounting requirements in the context of the transition to market economy, additional training and retraining will be necessary.

II. Training Development

Proceeding from the present accounting, training and research environment, it is necessary to undertake the training programmes simultaneously in the following fields:

— Accounting training and research at universities and other academic institutions;

— Continuing education and retraining for practitioners;

— Training the trainers or retraining the accounting professors.

In elaborating today's accounting training and retraining system we should take into consideration, on the one hand, the main task of this system: to provide professors, practitioners and students with knowledge of the market economy. On the other hand, the enterprises, firms, academic institutions etc., are continuing their activities simultaneously with the retraining process. All steps of this progress have to be co-ordinated with each other. Substantial efforts are needed in elaborating the accounting curricula in accordance with requirements of the market economy building a bridge between the old and the new accounting system.

Courses

At present courses are delivered at three Estonian, three Latvian and two Lithuanian universities, but also in several business schools in the Baltic States. One of the most important objectives of accounting studies today is to give a systematic overview of the principles and basics of accounting in a market economy, integrating for this purpose accounting, auditing, controlling, decision making corporate finance etc. Only through a systematic approach we can change the state of mind of students and professionals as well as professors. Both a conceptual and practical framework for accounting needs to be created. The main issues connected with the development of such a framework are the following:

It is necessary to move away from a sectoral approach to accounting training. For example, up to now in some universities courses like "accounting in the agricultural firm", "accounting in light industry" "accounting in a trading company" are predominant over basic accounting courses.

— Legal training for accountants needs to be reinforced.

— New accounting courses that are included in the curricula of other European universities need to be introduced, e.g. management accounting, analysis of financial statements, international accounting. In the process of teaching new courses visiting professors from Western universities are often involved.

— The new courses need to show the transition process from the old system to a new one and the connection with the present accounting legislation and practices in the three Baltic Republics.

The above mentioned steps are prerequisites to achieve the following objectives:

— development of professional skills through teaching international accounting principles;

— upgrading of professional qualifications of certified accountants and auditors;

— introduction of continuous retraining programmes for accounting professionals;

The implementation of these goals is restricted by the following factors:

— lack of training and research staff with good knowledge in the international accounting principles;

— lack of study and research literature.

At some national and also university libraries, there is a significant amount of accounting textbooks, research materials and journals in English and German, received largely as gifts from different foreign institutions. Unfortunately, often only one or two copies of each are available. Also western textbooks published in Russian are almost inaccessible.

— A weak command of foreign languages, even of English and German.

Methods

Accounting training should be based on comparative studies, The Baltic republics are rather small and they are just creating their own accounting system and legislation in accordance with basic needs of market economy. This can be accomplished on the basis of international comparative materials. There is no ready made solution for the Baltic republics.

The present transition period has also to be the transition to active methods of teaching. The mastery of theoretical knowledge has to be achieved on the basis of independent work with textbook and terminology in connection with an intensive control system (through tests and exams). This problem is one of the key-points in implementation of accounting training reform. Main attention in classes has to be paid to using case studies developed in a local business environment. The first experiences in this field are already available. Lectures concentrate on explaining theoretical problems. Case studies are used for practical subjects such as managerial accounting, cost accounting, auditing and controlling.

Most of accounting departments of Baltic universities already endeavour to build up their lectures in line with practical experience. In each accounting department practitioners who are interested in academic life lecture usually about two hours per week. They generally focus on practical subjects such as financial accounting, auditing, financial statement analysis, accounting in banking, accounting in non-profit organisations. Some departments invite experts in financial accounting from industry and the auditing

profession to give lectures on practical skills and experiences. A number of diplomas are written with the support of practitioners and information supplied by companies.

It is important to provide the trainers with the necessary practical skills. Practical training in accounting firms plays a significant role in this process. In Estonian universities, for instance, about half the senior-level students with majors in accounting are working as accountants in different firms, mainly on part time basis.

Retraining

In all three Baltic republics accounting practices are in a state of transition. The Estonian Accounting Act entered into force on 1 January 1991, in Latvia and Lithuania new legislation took effect two years later on 1 January 1993. To support implementation of accounting reforms, attention has to be paid to retraining of accounting professionals.

Since the adoption of new accounting legislation the evolution of the retraining process can be divided into the following stages:

1. Design and explanation of the formats for financial statements.

2. Development of practical skills for analysis of financial statements and annual reports.

3. Producing a familiarity with international accounting principles (realisation principle, matching principle, prudence principle etc.) and how they can be integrated into the present accounting system.

4. Training in modern management accounting , e.g. in the areas of risk management, cost accounting, and controlling.

In addition to the professional skills, the participants in the training process have to be provided with a systematic overview of the basics of accounting in a market economy, also on the basis of international comparative materials and information.

One of the most convenient forms of retraining is on-the-job training, where the seminars are held by experienced practitioners of the accounting firm. These seminars concentrate mainly on practical and technical questions of financial and management accounting. Some enterprises also arrange meetings , where actual problems of financial and management accounting are discussed by academics. Sometimes enterprises ask for expert advice on particular accounting questions from accounting professors and other academics; the questions relate often to the interpretation of accounting legislation.

To keep knowledge at an appropriate level, professionals are recommended to participate in continuing accounting training programmes. Such courses are organised by firms, universities and independent training centres. The main emphasis is laid on the short-term (from 1-2 to 5-10 days) intensive courses. Teaching of this type provides scholars with a direct transfer of new ideas and new regulations, also with some insight's into the actual accounting problems. Such courses are mainly taught by university professors or academics, but visiting professors are often involved. The latter often talk about international experience and principles advocating their own approach, which unfortunately is not based on a comprehensive, comparative analysis and local tradition. Assimilation of foreign advice is needed to be co-ordinated, but local professional institutions are insufficiently informed about the various programmes offered by foreign institutions.

III. Research

Research is the methodological basis. Accounting research is carried out in the Baltic countries by universities and other academic institutions, also by the accounting profession, in particular by accounting or research departments of large enterprises and accounting associations, e.g. in Latvia.

Since the initial stages of accounting reform the researchers were involved in the transition process. In all three countries academics are represented in the accounting bodies (councils, boards). The elaboration of accounting legislation for small countries like the Baltic Republics, needs to be based on comparative information - different textbooks, legal texts, monographs and articles.

The main areas of accounting research in the Baltic countries are following:

1. The Setting and Implementation of Accounting Standards

Attention has been paid to the design of the format for financial statements. Unfortunately accounting laws in Baltic countries are develop in an unco-ordinated manner and many items are literally translated from the accounting laws of other countries (eg. Finland, Sweden, Denmark) without any systematic approach. In this field more comparative analysis is needed.

2. International Accounting Principles

In the present accounting legislation the impact of international accounting principles is insufficient and accidental. In most cases only a part of them are introduced, in particular the realisation principle and the matching principle (in Estonia and Latvia) Comprehensive work is going on in this field, which includes the impact of different principles on the financial statements and explores possibilities to integrate these principles into present bookkeeping systems.

3. Accounting Terminology

The problem of translating accounting terminology in to native languages is a significant difficulty for communication among accounting institutions and impedes the transformation of international professional skills into local practice.

Chapter II

Objectives and Fundamental Concepts of Accounting Reform

ACCOUNTING IN A PERIOD OF TRANSITION

OECD Secretariat

Financial Reporting in Market Economies

In market economies, the basic objective of financial reporting is to provide information on the performance and financial position of an enterprise as a basis for economic decision-making. Financial statements are adressed in the first instance at the owners of the enterprise, so that they can make decisions on the level of distribution of profits, on sale or retention of their holding and in extreme cases on the need for new management.

Clearly management can only carry out their duties if the financial implications of their decisions are promptly and accurately reported. Potential investors, suppliers, creditors and employees are other parties who use the financial statements to appraise the economic health of the enterprise with which they are dealing. Tax authorities also require financial statements to make an assessment of the profit based tax to be levied on a company.

The wide range of users involved explains the differences of emphasis in the accounting systems of OECD member countries. In the case of the Anglo Saxon countries with their highly developed capital markets, the needs of investors have been the key influence on the development of financial reporting. In Germany, Switzerland and Japan by contrast, the protection of creditors and the maintenance of capital has played a more important role.

The stance of government policy has also had a profound effect on the differential evolution of accounting systems. The requirements of government statistics have played a role, but uppermost have been the fiscal interests of the state.

The relationship between financial reporting and accounting for tax purposes can take three main forms: uniformity, seperation and adjustment. Achieving uniformity in treatment is not desirable since the objectives of taxation and reporting are not the same. Taxation looks at the past to assess an enterprise's performance in order to determine its taxable income. Financial reporting is the basis for making future economic decisions and hence requires a flexibility which is incompatible with the requirements of tax legislation.

Accounting therefore is an instrument designed to serve a variety of purposes carrying different weights among OECD countries, but complying with the same general objective: to provide a true and fair view of the performance, the financial position and changes in the financial position of an enterprise.

Among the basic accounting principles applied by business enterprises in OECD countries are:

— the accrual principle
— the going concern principle
— the consistency principle

— the substance over form principle
— the principle of prudence

According to the accrual principle, the effects of business transactions should be recognised when they occur, rather than when cash settlement occurs. It also requires revenues to be matched with related costs.

The going concern concept requires financial statements to be drawn up under the assumption that the enterprise will continue trading for the foreseeable future unless there is evidence to the contrary. Should the going concern concept not hold, then financial statements should be prepared using break up values, as otherwise there would not convey a true and fair value of the situation of the enterprise.

The substance over form principle requires that the economic substance of transactions should take precedence over their legal form when they are recorded. Accounting for leased assets as if they were owned by the company which has economic control of them and consolidation accounting are two good examples of the application of this principle.

It is important that a consistent accounting treatment is accorded to financial transactions both within one accounting period and from one period to the next. Changes in accounting policy should only be made in exceptional cases and then their financial impact should be fully disclosed.

Since business transactions are carried out in an environment of uncertainty, it is important that prudence is excercised when preparing financial statements. In some accounting systems the concept of prudence leads to assymetric treatments, requiring in some instances the recognition of unrealised losses, but not permitting the recognition of unrealised gains. The concept of prudence cannot however justify the creation of excessive reserves, a practice which is sometimes engaged in by companies, wishing to smoothe profit flows.

Accounting and Reporting in Centrally Planned Economies

The objective of accounting systems in centrally planned economies is to provide the information which is necessary for the planning process and the control of the national economy, helping government agencies in planning, allocating resources and monitoring plan fulfillment. This recording and reporting is to a large extent carried out in quantitative terms, with prices fixed by the planning authorities. These very different objectives explain the substantial differences to the accounting principles applied in the OECD countries.

Typically transactions are not accounted for on an accruals basis, but on a settlement basis. Both input and output prices are determined by planners and therefore do not reflect relative scarcities. The calculation of profit under such a system is not comparable in any way to that generated by the accounting systems of OECD Member countries.

As central planning requires data which can be summarised to provide a condensed view of the aggregate activities of enterprises by region, industry and economy-wide, accounting policies and procedures of book-keeping are laid down in detailed regulations.

Accounting Issues Arising in the Context of the Transition to Market Economies

As the economic systems in Central and Eastern Europe are being transformed towards a market system, accounting standards have to be changed accordingly. To the extent that new groups of users (eg investors and creditors) require information on the financial position and performance of an enterprise, accounting regulations should reflect their needs as well as those of the government.

This makes it imperative that financial statements are prepared in accordance with the accounting principles which are generally accepted in market economies. Difficult problems will have to be addressed, such as the revaluation of assets so that they reflect relative scarcities rather than state controlled prices and the overvaluation of plant and machinery and equipment which had been stipulated by government instructions. In the context of the privatisati on of state owned enterprises, a clear distinction between equity and debt will have to be introduced into the balance sheet.

When elaborating new accounting and reporting regulations, Central and Eastern European Countries can benefit from the the experience of standard setting bodies in OECD member countries and international organisations. In this context the accountancy profession and its representative bodies can make a major contribution.

Reform of Balance Sheet Accounting

The balance sheet layout in most of the centrally planned economies compares groups of assets with sources of financing (funds) and liabilities in order to indicate whether financial rules are followed by the respective enterprise. For example, the net book value of fixed assets is to be financed by the "statutory fund". Investment in fixed assets has to be financed by investment funds and bank loans. The investments fund (sometimes called fund for the promotion of production, science and technology) is made up of retained earnings. Social funds may be formed to provide material incentives for staff (comparable to a thirteenth salary or bonus) and to increase social welfare. The assets related to these funds (usually specific bank accounts) are to be used exclusively for the purposes for which those funds have been set up.

In OECD member countries, the balance sheets of private enterprises are usually not subject to rules of funding. Total assets are financed by owners equity and liabilities without any link to individual balance sheet items. The ratio of equity to other sources of funds, in particular bank debt is determined by the policies of management, taking into account the state of debt and equity markets respectively. There are fairly established ranges for the various components of a company's financial structure, which vary from industry to industry and which companies will find difficult to transgress for long periods of time without losing their financial backers.

With respect to valuation, the historical cost principle is common practice in OECD as well as in Central and Eastern European countries, although exceptions exist. In several Central and Eastern european countries, periodic changes in the prices of finished goods (as stipulated by the government) are reflected in accounting records, as are occasional changes in the book values of fixed assets. In market economies the justification for revaluations are always market changes.

Given that market changes can easily be reversed by future developments, accounting rules and laws in OECD member countries are very strict in defining the conditions under which such revaluations may be carried out and the degree to which, if unrealised, they are allowed to affect distributable profits.

Finished goods and work in progress are usually accounted for at historical cost. In OECD Member countries effective production cost is normally used for the valuation of inventories, but various interpretations of "production cost" exist with respect to the inclusion of production and other overheads. Selling expenses and research and development costs are not usually included. Inventories are written down to their net realisable value if historical costs (including estimated costs to completion and selling costs) exceed the estimated selling price.

In Central and Eastern European economies, inventories are accounted for at total cost, including general overheads and selling costs. The production cost is often calculated on the basis of standard costs. If total cost of finished goods exceed the net realisable value, the respective items will still be carried at cost. Provisions for expected losses are unusual.

Reform of Income Statements

Income statements have two main objectives. They are used to determine the financial result for a period by comparison of revenues and other income against the related expenditure and serve to complement the balance sheet by providing a breakdown of the change of the company's financial position from one period to the next. In the OECD countries there are two models for the computation of profit or loss: the total cost model and the cost of sales model. Both models yield the same result, but provide different analyses of cost.

The total cost method presents primary costs as they occured during the period irrespective of whether or not the goods produced were actually sold in the market. The corresponding layout of the income statement gives a breakdown of all costs incurred by type of expenditure (eg materials, wages and salaries, depreciation). In order to calculate a result from realised sales, a cost adjustment is undertaken, crediting/debiting the change in inventories at production cost to the profit and loss account. The cost of sales method compares revenues from sales with the costs of the goods sold. Costs are grouped by operational functions (eg production, distribution and general administration).

In centrally planned economies a different model is used for the income statement which is, to a certain extent, comparable to the cost of sales method. Major differences exist however as regards the definition of cost , with items treated as cost which would be treated as profit allocation in accounting systems of OECD countries.

Accounting as a Management Tool

In order to make operational decisions managers require information that is promptly available, at the correct level of aggregation and shaped in a manner suitable for the respective problems. Therefore mangement accounting applies principles different from those applied by financial accounting. As the name implies, these systems are defined at the enterprise level by management to suit their informational needs. Frequently management and financial accounting systems are integrated, with financial accounting supplying input data for management accounting systems and management accounting in turn providing the basic information for the valuation of inventories.

In most cases the accounting systems in centrally planned economies will not yield the kind of information which is required for the management tasks in privatised companies and joint ventures. No distinction is made, for instance, between marginal and fixed costs. As a result, no answer can be provided to the question as to how far costs will increase or decrease when production quantity is changed, or what contribution to fixed costs is made by different products.

In western enterprises management accounting is subject to cost-effectiveness considerations. Therefore information procedures carried out by management accounting departments are focused on items that are considered essential by the management of the enterprise. Usually no regulations are stipulated by government concerning management accounting. In centrally planned economies, however, the management function is, to a certain extent, transferred to government. Thus cost accounting is determined by government regulations and subject to the needs for standardisation, rather than focussed on the informational requirements for the optimal steering of the individual enterprise.

Disclosure Rules, Prospectuses, Stock Exchange Requirements

Financial statements of enterprises in OECD Member countries are subject to disclosure requirements stipulated by corporate law and accounting standards. Additional and more detailed requirements apply to prospectuses which are to be published by companies applying for registration on securities exchanges. Once they are listed they must also comply with the often very detailed reporting and disclosure requirements of the stock exchange authorities.

The Treuhandanstalt has only carried out one (partial) flotation in its privatisation programme, but in Hungary, Poland, and the former Czechoslovakia a number of flotations have occured and are envisaged for the future. In any case the development of stock markets are important as secondary markets for the shares which are to be distributed through the voucher privatisation programmes in the CSFR and Poland. While disclosure rules, registration procedures and requirements for prospectuses are subject to harmonisation and mutual recognition among OECD member countries, such regulations are still being developed in central and eastern european countries.

Financial statements of companies listed on securities exchanges in western countries are required by the exchanges to be published in newspapers or official bulletins and are also available as a brochure from the company's registered office. In several OECD countries financial statements of listed companies are required to be filed additionally with the securities exchange authority. Some OECD Member countries impose such publicity requirements on all companies over a specific size regardless of whether they are listed or not.

The Accounting Profession

There are major differences in the role and organisation of the accounting profession between OECD and Central and Eastern European countries. In a market economy accountants act as independent auditors, tax and management consultants. These services require a high level of competence and experience. Independent auditing plays a major role in the capital markets. Since users of financial statements must be able to rely on the information disclosed by enterprises, an independent audit is necessary. The qualification of auditors is ensured by legislation and rules established by professional bodies. Auditing is exercised as a private professional activity.

In centrally planned economies, accountants are employees of industrial enterprises. The chief accountant in an enterprise is responsible not only for accounting and reporting but also for the compliance of the enterprise with regulations and the central planning objectives. Audit procedures were carried out by governement authorities or may have been delegated to authorised auditing organisations such as, for example, INAUDIT in the former Soviet Union.

Almost all major international accounting firms have already established offices in Central and Eastern European Countries or have formed joint ventures together with local accountants in order to apply for recognition as authorised independent auditors.

In the OECD as well as in Central and Eastern European countries, accountants have formed professional bodies to represent their interests both at national and international level. On the international level, the Fédération des Experts-Comptables Européens (FEE) and the International Federation of Accountants (IFAC) are involved in the elaboration and development of professional standards. In some Central and Eastern European countries, several activities have been initiated to reorganise the accounting profession. Advice is offered by international accountancy bodies such as IFAC and FEE.

Professional Qualifications of Accountants

In OECD countries accounting firms perform independent audit services as well as tax and business consulting. With respect to the prerequisites of approval which are stipulated by legislation, accountants have to pass a professional examination. As a rule, admission to the examination is restricted to persons holding a university degree and posessing professional experience of a certain number of years. Within the EC minimum standards for professional qualification of auditors have been established by the 8th council directive.

Accountants in Central and Eastern European countries have had less exposure than their western counterparts to auditing and consulting practice. In order to bridge this gap and introduce accountants from

Central and Eastern Europe to accounting principles used in market economies, specific training programmes have been launched by the World Bank and the United Nations and by several government authorities and other institutions of OECD countries, including the FEE and other professional bodies.

Accounting Training and Research

Accounting training and research is carried out by universities and other academic institutions as well as the accounting profession, in particular accounting associations, professional bodies and large international accounting firms. After graduating from university a junior accountant benefits from on-the-job training and seminars held by experienced practitioners of his company. To keep knowledge at an appropriate level, accountants are recommended to participate in continuing professional education programmes. The IFAC has issued guidelines on professional education and training addressed to national professional bodies in order to achieve and maintain a high level of professional knowledge and qualification of accountants worldwide.

Whereas academic research in the field of accounting concentrates mostly on theoretical questions as well as international comparison of accounting standards, research on practical problems of accounting is carried out by research departments of professional bodies and larger accounting firms.

As far as professional education in Central and Eastern European countries is concerned, accountants are qualified in the accounting techniques and procedures applied in a centrally planned economy. To meet the accounting requirements of a privatised enterprise or an east-west joint venture, additional training will be necessary. Substantial efforts particularly in the PIT countries have already been undertaken, but much retraining still needs to be carried out. The UN Centre for Transnational Corporations has elaborated such curricula in co-operation with large international accounting firms. The OECD has designated an accounting module for its successful tax training centres in Budapest, Copenhagen, Vienna. and Ankara.

Standard Setting and Harmonisation of Accounting Standards

Capital markets and economic activities are becoming increasingly internationalised and the number of enterprises operating on several national markets at once is constantly growing. The fact that more and more investors are anxious to purchase diversified securities and covering an increasing number of countries leads to the interpenetration of capital markets. International investment is at the very heart of international economic cooperation and financial information plays an essential role in the decision to invest. It is increasingly necessary for this information to be reliable, comparable and framed in terms of generally accepted accounting standards. Thus the harmonisation of international standards is a matter of urgency.

The national private and public standard-setting bodies, the regional organisations, in particular the European Community and the international organisations play a fundamental role in the process of international harmonisation by the complementarity of their efforts.

At the international level the IASC has published 31 International Accounting Standards on various accounting issues. Whereas in the past numerous options of accounting treatment have been permitted, the IASC has launched a process of improving the standards by harmonising the range of permissible options. This project is designed to achieve more comparability of financial statements thereby reducing the costs of cross-border capital market transactions.

The OECD has issued guidelines for multinational enterprises containing a chapter on disclosure of information. Disclosure requirements as stated in this chapter are to be seen as a minimum standard for multinational as well as domestic enterprises. According to the OECD guidelines, enterprises "should

publish within reasonable time limits, on a regular basis, but at least annually, financial statements and other pertinent information relating to the enterprise as a whole, comprising in particular:

1) The structure of the enterprise, showing the name and location of the parent company, its main affiliates, including shareholdings between them;

2) The geographical areas where operations are carried out and principal activities carried on therein by the parent company and the main affiliates;

3) The operating results and sales by geographic area and the sales in the major lines of business for the enterprise as a whole;

4) Significant new capital investment by geographical area and as far as practicable, by major lines of business for the enterprise as a whole;

5) A statement of the sources and uses of funds by the enterprise as a whole;

6) The average number of employees in each geographical area;

7) Research and development expenditure for the enterprise as a whole;

8) The policies followed in respect of intra group pricing;

9) The accounting policies, including those on consolidation, observed in compiling the published information

The OECD Working Group on Accounting Standards acts as a catalyst for international harmonisation by identifying common concepts, seeking a consensus on the objectives to be attained and analysing the means to attain those objectives. The United Nations Group on International Standards of Accounting and Reporting has extended this dialogue on a broad geographical basis.

Experience of Accounting Reform

The first conference on accounting reform was held under the auspices of the OECD Centre for Co-operation with Economies in Transition in Paris in September 1990. Many of the issues discussed at that conference and at subsequent meetings remain valid today. But the field of countries undertaking serious reform in this area has now widened and a significant amount of experience has accumulated as a result of the substantial reform programmes embarked upon by the former Czecholovakia, Hungary and Poland as well as in Eastern Germany. The achievements in this brief period have been formidable, with substantial legislative programmes having been undertaken. There have been variations between these four countries, but they have all made significant progress towards the adoption of internationally accepted accounting standards and in the case of Eastern Germany full adoption, albeit under special circumstances, has taken place.

A key element of the transformation of the economies of Central and Eastern Europe is a revolution of ownership. On a monumental scale business activity is being transferred into joint stock companies, companies are being split off and subdivided to achieve more market oriented organisation, assets are transferred between companies and companies and business assets are being bought and sold at an unprecedented rate. This emphasis of business ownership is much more pronounced in economies in transition than it is in more stable business environments. In order to provide useful information to current and future owners, accounting needs to reflect this tendency. Some countries are finding that this objective is better served by accounting for assets at replacement rather than historical costs, if only as a transitional rule, before reverting back to the tried and tested historic cost convention.

Those countries that have opted to retain historical cost accounts however require market based valuations to be carried out before privatisation transactions will be approved. When carrying out such valuations, a number of difficult issues need to be addressed:

— collectibility of receivables
— revaluation of inventories to net realisable value if this lower than cost
— capitalisation of finance leases
— contingent liabilities (eg property claims)
— valuation of intangible assets
— the embryonic state of asset markets, making it difficult to value assets

Aspects of Accounting Reform in Eastern Germany

Eastern Germany, as is widely recognised, represents a special case in the transition from a planned to a market economy. Through unification with West Germany it experienced immediate integration into the world economy with all its advantages and disadvantages. In the sphere of accounting, the same principle was applied as for its legislative framework generally: from Unification the jurisdiction of West Germany would apply, with the Unification Treaty defining the transition.

The DM Bilanzgesetz required all companies to set up opening balance sheets in DM for the date of currency unification, July 1, 1991. A key decision taken by the drafters of this law was to disregard historic cost information which had been generated under central planning and was regarded as useless for economic decision making. Assets were required by the DM Bilanzgesetz to be stated at replacement cost.

Because it was recognised that the absence of markets would make the valuation of assets and hence a determination of replacement cost difficult, the approach of the DM Bilanzgesetz is to allow the opening balance sheet to be changed up to 31.12.1994 if subsequent information allows values to be assigned with greater certainty. Value uncertainty is not resolved by this approach. For accounting and tax purposes it is deferred by allowing adjustments until 1994, by which time it is felt markets will be sufficiently developed to allow the necessary adjustments to book values to be made.

Since the valuation of land was viewed as a critical problem, a governmental agency established guidelines for land valuations. It devised a system of multipliers which generates values ranging from DM 3.57 to DM 3,137.69 per square metre. These values are based on an average value of land for the Federal Republic of Germany which was determined to be DM 85 which is then adjusted by various multipliers for location, usage and condition. Clearly this system is open to criticism, as the values arrived at depend on a highly contentious average value and also require high levels of judgement in assigning multipliers. In the absence of markets for either land or for the pricing of land related earnings flows however, any alternative method would be equally open to criticism.

The German Institute of Certified Public Accountants (Institut der Wirtschaftsprüfer) issued a guideline on the valuation of East German companies, which addressed the problem that no adequate information was available for carrying out earnings based valuations. Historic costs generated under the planned system were as useless as the post unification cash flows, which documented a truly exceptional period, where markets were lost in the east as a consequence of the introduction of hard currency relations and the domestic market was eroded by competition from more efficient West German and international producers. The Institute therefore recommended that contrary to what it regards as best practice in the western half of the country, namely earnings based valuations, asset based valuations should be carried out, augmented as far as possible by estimates of the earnings capacity of individual assets.

Aspects of Accounting Reform in the former Czechoslovakia

The first steps of accounting reform in Czechoslovakia were taken with the passing of government decree No. 236/89 and the decree of the Federal Ministry of Finance No.23/90. These decrees embody some of the basic international norms such as the business entity forming the reporting unit, money measurement of transactions, the historical cost convention, the going concern assumption and accrual accounting, but still contain elements of the old accounting system, such as a compulsory chart of accounts and detailed accounting instructions.

The new accounting law which became effective on 01.01.1992 builds on these decrees adding considerable flexibility regarding the format of the required balance sheet and profit and loss account. Additionally, new rules on disclosure were introduced. Full disclosure of accounting policies is required as are other disclosures usual in OECD countries: post balance sheet events, related party transactions, contingent liabilities (particularly relevant for property related claims from former owners and liabilities related to environmental damage) to name the most important.

The historical cost convention is upheld, though under specified circumstances, individual assets may be revalued to reflect market changes. Inventories are to be carried at the lower of cost or net realisable value and provisions are required for risks and anticipated losses. Accounting entities are, for the most part, free to set their own depreciation and amortisation policies.

Although the former CSFR has experienced inflation as a result of price liberalisation, no system of inflation accounting is currently envisaged. The new rules allowing the periodic revaluation of assets to reflect market changes are, however, a recognition of the realities of operating in an environment of rising prices. In times of significant inflation price indices are to be used for the revaluation.

Special reporting and valuation rules have been developed to deal with the transfer of ownership from the state to the private sector. The privatisation douments must contain detailed disclosures on the company to be privatised, a three year history of key performance and financial indicators for the company, a listing and vauation of all assets owned and liabilities incurred by the enterprise (including both on and off balance sheet items), the business plan, and details of the privatisation method chosen, to name just the most important elements.

When an enterprise has been privatised, the law requires an opening balance sheet to be prepared. Where foreign investment is involved, fair market values should be used. If the market value of net assets exceed historical book values, the difference is to be transferred to a special account which is comparable to a goodwill account. The law allows the balance on this account to be amortised through the profit and loss account over a period of seven years, but prohibits a transfer directly to reserves. For the small scale privatisation programme, the difference was allocated to the individual fixed asset accounts and any remaining balance treated as reorganisation expenses. This method was chosen because the majority of these enterprises discontinued their former lines of business making the treatment of the reconciling item as goodwill inappropriate.

An important additional challenge for accounting will be dealing with the voucher method which has been chosen for the mass privatisation programmes which are taking place this year. Valuations will be based on book values and the price for the enterprises will be fixed by reference to the total number of coupons that the public will be willing to invest in the enterprise. The most important issue in this context will be the determination of the correct amount of equity and reserves respectively for each enterprise.

Aspects of Accounting Reform in Hungary

The transition towards internationally accepted accounting standards has followed a similar path in Hungary. The first changes to the system of accounting which had evolved under central planning were made in the late 1980's with the passage of the Companies Act and the Transformation Law. These laws introduced some flexibility into the system and represented a departure from the funds based system of accounting.

More substantial reform of the accounting system was undertaken by the Accounting Act which took effect on 01.01.1992. This law requires all economic agents to produce financial statements, comprising balance sheet, income statement, notes to the accounts and a business report. The formats of the new financial statements comply with the EC's fourth directive.

Methods of valuation laid down in the new law accord with internationally accepted accounting standards with the following major exceptions:

— No provisions for bad debts are required
— Inventories are valued at cost, with no writedown to net realisable value being required
— Business combinations are not subject to consolidation requirements, nor is the equity method of accounting for investments used. Temporary investments are accounted at the lower of cost or market value in accordance with international practice, but long term investments are accounted for at cost.
— No adjustments are required for inflation.

These issues are to be dealt with by new legislation scheduled for late 1992 and early 1993.

Under the new accounting law the Ministry of Finance retains responsibility for standard setting but an advisory group, the National Accounting Board has been created by the law, and will include representatives from the ministry, academia and public practice. The brief of the Board is to advise on amending existing standards, drafting new standards and monitoring the implementation of the new accounting system.

The Hungarian authorities have also imposed substantial additional reporting requirements relating to privatisation. The scope of this information is similar to that required by authorities in the format CSFR. There are however differences in the area of valuation. Small enterprises whose assets are to be sold primarily to Hungarian citizens may use their existing financial statements to value the proposed transactions. For trade sales of large enterprises a competitive bidding process is required and additionally an independent market valuation has to be submitted. The procedures for carrying out the valuation are set out in decree 30/89 from the Minisry of Finance and require an asset based valuation on a going concern basis. The SPA, the state property agency, additionally requires a business valuation to be performed.

Once a privatisation transaction has been completed, the company concerned must prepare a "transformation balance sheet". This balance sheet, which is subject to an external audit, is to be based on the market valuation that was carried out. Similarly a closing balance sheet must be prepared at the same date. The difference between the net assets of the two balance sheets is to be charged or credited to the retained earnings of the enterprise. To the extent that the purchase price exceeds the net assets per the opening balance sheet, the difference may be capitalised as goodwill.

Aspects of Accounting Reform in Poland

Poland like its PIT neighbors has passed new accounting legislation to bring its accounting practices into line with internationally accepted standards. Its new accounting law came into force on 01.01.1991.

Given that it is operating in a more inflationary environment than Hungary or the CSFR, inflation accounting, while not dealt with in its new accounting law, has received considerable attention over the last year. In Poland all state enterprises are periodically required revalue fixed assets using inflation indices which are applicable to that asset category. Depreciation is then based on the new revalued amount. This requirement is laid down in the law of July 29 1991 governing the prospectus for an issue of securities to the public. The source of the inflation index and the method of its application has to be disclosed. The magnitude of purchasing power adjustments which have had to be undertaken by Polish companies which have recently issued prospectuses is a testimony to the hyperinflationary conditions.

An Evaluation of the Experience with Accounting Reform

The brief expositions given of the reform experience in several Central and Eastern European countries are not intended to give complete synopses of the accounting reforms undertaken in those countries, but are meant to highlight issues which shed light on the reform process generally and which can be regarded as points of reference for the countries elsewhere in Central and Eastern Europe that are still at an early stage in their reform programmes.

The East German experience with some 6,000 privatisation transactions by 31.03.1992 would have been unthinkable without the financial support of West Germany. For every 1 DM of national product generated in the eastern half of the country, 2 DM of transfer payments were received from the western half. Nonetheless such a high volume of transactions would not have been possible without the accounting framework of the opening balance sheet law. Opting for replacement costs rather than historical costs for the opening balance sheet and using revaluation clauses for the balance sheets and many of the sales contracts meant that the time consuming process of valuation was not required for every privatisation transaction.

Hungary and the former CSFR who opted for historical costs are requiring that an independent market valuation is carried out before approval for the privatisation is given. Clearly the interests of speed need to be weighed against the requirement of public servants to demonstrate probity in the stewardship of state assets, but unnecessary complication in the valuations procedure should, where possible be avoided.

Poland which is experiencing a relatively high inflation rate has gone the furthest in its efforts to account for inlationary price rises, but it also has stopped short of devising a system of inflation accounting. In the hyperinflationary environments of the CIS countries, this issue will need to be given more prominence.

It is undeniable that the scale and the modalities of privatisation are having an important influence on the evolution of accounting rules. In Germany, for instance, the need for restructuring of the giant former Kombinate into smaller more manageable enterprises has led to the passage of a new law on splitting companies, the Spaltgesetz. This specifies the modalities, including the transfer of assets and liabilities, by which one company can be split into several companies, a procedure which, though possible in Anglo-Saxon legal frameworks was previously not possible under German law.

The introduction of the voucher method of privatisation, in some cases through the intermediation of investment funds, also poses significant accounting challenges.

Though the valuation of assets and liabilities has been the focus of attention, the definition and structure of the equity component of the balance sheet should not be neglected. The definition of distributable profits, the rules on transfers to and from reserves will be key determinants of investor behavior in the years to come.

ACCOUNTING AS A TOOL OF MANAGEMENT

Marcus Bracklo

Introduction

Experience in OECD member countries and economies in transition has shown that ownership change through privatisation is not enough to achieve improved performance. Ownership reforms and privatisation programmes will decentralise the decision making process. This new decentralisation will only work, however, if co-ordinating mechanisms of markets develop. Competitive markets provide incentives and the information which is required for enterprise decision making. Market prices provide the basic information and it is the function of accounting to record, process and evaluate this information as a basis for managerial decisions.

Accounting reform is vital in this context as the recording systems developed for the purposes of central planning do not provide the information that is needed for the management of businesses in a market environment.

The Different Objectives of Accounting

The objective of accounting systems in centrally planned economies was to provide the information which is necessary for the planning process and the control of the national economy, helping government agencies in planning, allocating resources and monitoring plan fulfillment. Reporting was to a large extent carried out in quantitative terms, with prices fixed by the planning authorities. These different objectives explain the substantial differences to the accounting principles applied in the OECD countries. Both input and output prices were determined by planners and therefore did not reflect relative scarcities. The calculation of profit under such a system is not comparable in any way to that generated by the accounting systems of OECD Member countries.

As the economic systems in Central and Eastern Europe are transformed towards a market system, accounting standards have to be changed accordingly. To the extent that new groups of users (eg investors and creditors) require information on the financial position and performance of an enterprise, accounting regulations should reflect their needs as well as those of the government. Managers can only operate efficiently in this new environment if their information systems accurately evaluate market signals.

In market economies, the basic objective of financial reporting is to provide information on the performance and financial position of an enterprise as a basis for economic decision-making. Financial statements are adressed in the first instance to the owners of the enterprise, so that they can make decisions on the distribution of profits, on the sale or retention of their holding and in extreme cases on the need for new management.

Potential investors, suppliers, creditors and employees are other parties who use the financial statements to appraise the economic health of the enterprise with which they are dealing. Tax authorities also require financial statements to make an assessment of the profit based tax to be levied on a company.

The wide range of users involved explains the differences of emphasis in the accounting systems of OECD member countries. In the case of the Anglo Saxon countries with highly developed capital

markets, the needs of investors have been the key factor for the development of financial reporting. In Germany, Switzerland and Japan by contrast, the protection of creditors and the maintenance of capital has played a more important role.

The Difference Between Financial Accounting and Management Accounting

A distinction has to be drawn between the information needs of the company's management and the information needs of external users of accounts. Financial accounting addresses the needs of external users who require periodic information in order to appraise the past performance of the company, deciding what level of profits to distribute, whether to invest or sell the company etc. In order to protect external users, financial accounting is subject to legal requirements and subject to an external independent audit. Management on the other hand needs continuous information so as to actively direct the course of the business. This objective is addressed by management accounting.

Management accounting seeks to present information in a way that is useful to management's objectives. In order to make operational decisions managers require information that is promptly available, at the correct level of aggregation and shaped in a manner suitable for the respective problems. Therefore management accounting applies principles different from those applied by financial accounting. As the name implies, management accounting systems are defined at the enterprise level by management to suit their informational needs. There will thus be significant variations in the systems adopted by different companies and different industries. The management accounting systems of manufacturing companies obviously require a higher level of sophistication than those used by trading companies.

In a market economy managers are making decisions about an uncertain future in a dynamic environment. In order to produce suitable information, management accounting requires a significant degree of flexibility. Under inflationary conditions special accounting techniques need to be adopted so as to correctly allow for the effect of rising prices. Similarly a high interest rate environment requires more sophisticated accounting tools for working capital management.

Frequently management and financial accounting systems are integrated, with financial accounting supplying input data for management accounting systems and management accounting in turn providing the basic information for the valuation of inventories. It is important to take account of these interlinkages when designing an enterprise accounting system, so as to avoid unnecessary duplication of effort.

Accounting as a Tool of Management

In most cases the accounting systems in centrally planned economies will not yield the kind of information which is required for the management tasks in privatised companies and joint ventures.

In market economies management accounting is subject to cost-effectiveness considerations. Information procedures are focused on items that are considered essential by the management of the enterprise. Usually no regulations are stipulated by government concerning management accounting. In centrally planned economies, however, the management function is, to a certain extent, excercised by government. Thus cost accounting is determined by government regulations and subject to the needs for standardisation, rather than focused on the informational requirements for the optimal steering of the individual enterprise.

The Key Elements of Management Accounting

While tailored to the individual needs of an enterprise, management accounting systems in OECD countries show certain common features. The main elements are cost accounting, pricing, budgeting, variance analysis, cash/liquidity mangement and investment appraisal.

Cost Accounting: Costs incurred in producing goods and services need to be recorded, so that pricing decisions can be made which are compatible with the enterprise's survival. Similarly costs must be monitored relative to past cost levels and relative to budgeted levels, so that inefficiency and waste are promptly identified and acted upon. In a competitive environment a company that does not use its resources efficiently will not survive.

It is important to classify costs in such a way that decision making is facilitated. This requires a certain amount of consistency, so that costs can be compared from one period to the next. It also requires identification of costs incurred with specific produts, so that pricing takes into account all relevant costs and excludes those relating to other products or activities. The more complex a manufacturing process becomes and the higher the level of costs which are common to several products, the more difficult costing becomes. Methods need to be implemented which allow an accurate apportionment of such common costs.

It is also important to distinguish between fixed and variable costs. This distinction allows to determine how far costs will increase or decrease when production quantity is changed, or what contribution to fixed costs is made by different products.

Budgeting: Budgeting is recognised to be one of the key tools of mangement. Based on the information of historic cost levels and an analysis of market conditions both for inputs and outputs, management prepares a detailed plan, usually spanning a one year time horizon, broken down on a monthly basis. This serves as a guide to order levels for inputs and as a reference point against which to monitor performance. Management action is prompted by significant deviations from budgeted levels. In order to take account of a rapidly changing external environment a system of rolling budgets is typically adopted, subject to monthly or quarterly revision.

Managers make decisions in an environment of uncertainty. It is therefore usual for sensitivity analysis to be performed to test the sensitivity of the budgeted result to key budgeting assumptions. This helps highlight those areas which management needs to monitor particularly closely.

Pricing: Pricing policy represents one of the key decisions which managers are required to make in a market economy. While short term strategies of pricing below cost to increase market share may be desirable, in the long run a company needs to ensure that prices are set at levels which recover costs, generate sufficient funds for necessary R&D expenditure and investment and allow an adequate distribution to the owners of the business.

Cost records, R&D and investment budgets and dividend policy thus all need to be taken account of when making pricing decisions. More important however is an analysis of the market for the company's products, consumer preferences and the behaviour of the competition.

Variance Analysis: Budgeting fulfills its objectives only if regular analysis of actual performance relative to the budget is carried out. The sources of the variances need to be identified and acted upon. It is important in this context to distinguish between price and volume variances. A fall in the price of an input may mask the inefficient use of that input and hence delay corrective action.

Management by exception is a management technique which makes use of variance analysis. Management under this system will only intervene in decisions taken lower down in the company hierarchy, if variances over certain pre-set limits are identified.

Cash/Liquidity Management: An important characteristic of western business is that it must finance its operations in competitive financial and capital markets. In order to determine a company's financing requirements, management needs to monitor the liquidity position of an enterprise. The most common accounting tool used for this purpose is the cash flow budget. This converts the forecast income

and expenditure accounts from an accrual to a cash basis and also takes into account the cash implications of investment and dividend decisions.

Clearly the liquidity position needs to be monitored on a regular basis and appropriate action taken to finance deficits or invest a cash surplus. Even a profitable enterprise will not be able to continue in existence if it cannot maintain adequate liquidity.

Investment Appraisal: Capital intensive business in particular requires well established investment appraisal systems. Budgeted costs and revenues need to be discounted using the company's cost of capital and compared to the capital cost of the project.

Discounting is a technique which equates future cash flows to present day values, making them comparable. The discount rate is effectively the inverse of the interest rate.

The techniques for investment appraisal have become quite refined, to the extent that in comparatively stable economic environments it is possible to secure borrowings on the projected earnings of a project, removing the need for more traditional forms of security.

Conclusion

This article has given a short summary of the major elements of management accounting systems (cost accounting, pricing, budgeting, variance analysis, cash management and investment appraisal) and their objectives. The techniques involved have only been described at a rather general level.

Management accounting provides no guarantee that the correct decisions are taken but is an important tool of management. In order to provide useful answers, its design must reflect the nature of the company's business and the economic environment in which it operates. And, equally importantly, management must be able to interpret and act on the information generated by its accounting system. Only if market signals are correctly interpreted and acted upon will the enterprise be assured a viable future.

THE INFORMATION NEEDS OF USERS OF FINANCIAL STATEMENTS

David Moore

Accounting is an information system designed to serve the needs of a variety of users. Financial statements and associated financial information must, therefore, be designed to meet the sometimes diverse needs of those users.

The "Concepts" statement of the United Nations Working Group of Experts on International Standards of Accounting and Reporting has noted that "certain users have the authority to prescribe the information they need, but even those users usually begin with the financial statements. Other users, however, rely almost exclusively on the information provided in the financial statements and, consequently, such statements must be as meaningful as possible in order to meet their needs. In addition, the application of a sound accounting framework is in the interest of management."

The information included in financial statements largely reflects the financial results of transactions and events that have already taken place. Although the information is largely historical, those who use it may try to predict what future financial results are likely to be. On the other hand, they may use the information to confirm or reject their earlier predictions. Also, the financial statements are but one source of information needed by those who make economic decisions about business enterprises. Those who use the information need to combine it with pertinent information from other sources, for example, information on the state of the economy, the political situation and the outlook for the industry in which the company is operating.

Before getting into the information needs of users, I would like to identify the different types of users. There are a great number of different individuals or groups who have a legitimate interest in receiving and using published financial statements. I would just like to briefly refer to a few of these groups.

- First, there is the **company's management and its directors**. The managers and directors have the responsibility for managing the company on behalf of the owners. A distinction must be made, however, between management accounting, which is designed to assist management decision making, planning and controls at the various levels of a company, and financial accounting, which is concerned with the accounting for, and reporting on, a company's assets, liabilities, revenues, expenses, and earnings. Management needs a higher level of detail, than that which is needed by users outside the company. Published financial statements, therefore, are structured to meet the needs of external users. It is management that has the responsibility for preparing such financial statements, and for objectively determining what the needs of its external users are.

- The primary group of these external users is the **owners, or the shareholders**. This group provides the basic capital that enables the company to operate. The owners, or shareholders, need financial information to help them decide whether they should increase their investment, by putting more money into the company or by buying more shares, whether they should take their money out of the company or sell their shares, or whether they should do nothing at all.

Owners and shareholders also need to assess whether they are likely to receive a return on their investments, for example, by way of dividends.

- Next, there are the **Lenders**. This group supplements the capital provided by the shareholders. Lenders need financial information to determine whether their loans will be repaid, and whether the interest to which they are entitled will be paid to them when it is due.

- **Analysts** and other advisers who service and monitor the needs of the shareholders and lenders, are in themselves an extremely important group of users, especially in respect of the financial statements of large domestic companies and multinational companies. Because of the complexity and sophistication of many companies, it is difficult for shareholders and investors to fully comprehend the financial health of the companies in which they are interested. They therefore rely on this group of experts to provide them with skilled analyses and interpretation of financial statements and associated financial information.

- Next are the **employees** of the company. The stability of the company is of major concern to this group of users. Employees need to receive information such as whether the company is a viable going concern or whether they might have to look elsewhere for employment in the future. They are also interested in matters such as the likelihood of benefits when they retire, and whether there are other employment opportunities within the company.

- **Labour Unions**, who act on behalf of the employees, are also an important user group. These organizations are interested in the financial information of companies with which they are negotiating wage settlements on behalf of their members. They are also interested, for similar reasons, in financial information relating to other companies in the same industry.

- Next are the **Customers**. Present, potential and past customers are interested in the financial affairs of a company so that they can decide how much business to do with the company and so that they can assess how well the company can service the products that they are interested in purchasing. Major customers are concerned about how much reliance they can place on the company continuing as a major source of supply.

- Then there are the **Suppliers**. Suppliers are interested in knowing how reliable the company is as an outlet for their products and services - again, if the company is a major customer, they will be interested in assessing the likelihood of that situation continuing; the financial statements may provide some of the information to help them make that assessment.

- We must not overlook **Governments and their agencies** as a user of financial statements, even though they can usually get the information they need by other means. They require information for resource allocation purposes, to assist them in the regulation of the activities of enterprises in general, to determine taxation policies, and as the basis for national income and statistics.

- Then there are the **taxation authorities.** In some countries, this is often the primary reason why some companies prepare financial statements. In other countries, such as my own country, Canada, tax reporting is quite separate from financial reporting. Even so, the financial statements often form the basis for arriving at the information that is required by the taxation authorities.

- The final group that I specifically want to mention is **the public**. The general public is especially interested in the activities of those companies that have a significant economic impact for a variety of reasons, for example, the economic contribution that such companies make to the community, the employment opportunities that they provide, whether they are

operating in an environmentally responsible manner, and whether they provide employment opportunities for other companies as a spin off to their particular operations.

It must be emphasized that the categories of users, the needs of users, and the emphasis that will be placed on meeting their respective needs will vary, depending on the social and political system and the legal environment in which the company operates. The focus of financial statements and associated financial information may therefore vary from country to country. In some jurisdictions, the interest in published financial statements of employees and governments, for example, may not be as great as it is in other jurisdictions. Where significant, special purpose financial information will be developed to meet the needs of some of the more specialized user groups.

I would now like to spend a few moments on how financial statements can meet these information needs. It is generally recognized that financial statements cannot meet **all** the needs of **all** users. Accounting standards generally recognize this fact. For example, the Canadian standard on Financial Statement Concepts notes that "It is not practicable to expect financial statements to satisfy the many and varied information needs of **all** external users about an entity". On the other hand, it is also generally recognized that there are many information needs that are common to most, if not all, users. Consequently, although the focus of financial statements may be on the needs of certain user groups (for example, shareholders and creditors), in meeting those needs, the needs of other user groups will usually be satisfied.

What, then, are the needs of users? The Financial Accounting Standards Board in the United States has noted that most users, or potential users, of financial statements are "generally interested in [the company's] ability to generate favorable cash flows because their decisions relate to amounts, timing and uncertainties of expected cash flows". Most users have invested either their money, their goods and services, or their time in the company, and they expect to receive a return on that investment. The following are some of the needs that have been identified:

- First, there is the **assessment of the company's performance**. Users are interested in making such an assessment, not only in terms of how much profit the company has actually generated, but also to see whether the company has lived up to their expectations, and to any expectations that were previously forecast by management. Users may also want to compare the company's performance with that of its competitors, or with companies in other industries.

- Next, there is the **assessment of the quality of management.** Although this cannot be measured simply in financial terms, the financial statements can be helpful in providing indicators of management's ability to maintain and enhance profits, to operate the company efficiently, and to discharge its stewardship function effectively.

- **Estimating future prospects** is another user need that has been identified. Depending on their objectives and interests, users might want to know, for example, trends in profits, trends in dividends, requirements for future capital, and the ability of the company to provide employee benefits (such as pension payments when they retire).

- There is also some interest in **assessing the financial strength and stability** of a company. For example, what are the company's strengths and vulnerabilities, should the economic climate change?

- **Assessing solvency** is yet another interest that has been identified. This is of particular importance in respect to decisions relating to future investments, and in considering whether credit to the company should be extended.

- **Assessing Liquidity** is another use for which information in financial statements may be of some assistance. This again will be of interest when making decisions on extending credit to the company. It will also be of interest in considering the likelihood of changes in dividend or interest payments

- The information can be used **in comparing** various aspects of a company's performance either with the company's own past record, or with that of other companies or groups of companies.

- It can also be used **in making valuation decisions**, in that the information included in the financial statements may be helpful to lenders and shareholders in assessing the value of their holdings or potential holdings in the company.

- A further use is **in assessing whether the company is adaptable.** For example, financial statements may help users assess the company's ability to switch its areas of operations in accordance with possible changes in economic conditions.

- The information disclosed in the financial statements, especially the notes, often provides assurance, or otherwise, that there has been **compliance with laws and regulations.**

- **Assessing contribution to society** is yet another use The published financial statements often provide some indication about the company's contribution to job creation, exports, national income and development of national resources.

A more recent use of financial statements and associated information is in helping users to assess whether the company has been, and is likely to continue to be, **environmentally responsible**. With the importance that is now being given to the environment, this information is of interest not only to the general public, but also to user groups, such as shareholders, in assessing whether sound business practices are being followed by the company.

It would be naive to think that the information provided in financial statements can, by itself, fully meet all the user needs described above. It can, however, play a useful and, in many cases, a significant role in this regard.

In closing, I would like to make a few other observations.

First, it is important that **all** companies whose operations are economically significant be required to make their financial statements publicly available, if the objective of providing full and fair disclosure is to be met. An argument that is frequently given for not disclosing certain information is that such disclosure would put the company at a competitive disadvantage with other companies in the same line of business. This problem is accentuated where some companies are **required** to publish financial statements, whereas others in the same line of business are **exempted** from doing so.

The next observation is that financial statements must be issued on a **timely basis** if the information included therein is to be of any assistance in helping users meet their needs. One of the main criticisms that has been made is that the information in financial statements tends to be stale dated by the time it is published.

In addition, the information provided must be both **relevant and reliable**, if it is to be of assistance to the users of financial statements.

Finally, the information must be **presented in a "user-friendly" manner**. The manner in which the financial statements are presented must enable the users to fully comprehend the financial position and the results of operations of the company, and any other information that the company's management is presenting.

Effective communication is essential. Some rather innovative techniques have been suggested to help communicate the main messages. For example, graphs and bar charts are often used to show changes in sales and profit from year to year; an article in the Journal of Accounting Research has suggested using diagrams of facial expressions to communicate various financial ratios. The mouth portrays the relationship between profit and sales. The nose, ears, eyes and even the shape of the face, have their own messages.

In a somewhat simpler example, Loblaws, a Canadian food chain company, with several supermarkets in various parts of the country, has used a shopping cart diagram to convey some of its messages to the users of its financial statements.

It should be emphasized that such techniques cannot replace the financial statements. They can, however, be used to highlight some of the information that is contained in the financial statements.

Sources:

"Corporate Reporting: Its Future Evolution" Research Study. The Canadian Institute of Chartered Accountants, 1980

Statement of Financial Accounting Concepts No. 1. The Objectives of Financial Reporting. Financial Accounting Standards Board, United States, November 1978.

"Objectives and Concepts underlying Financial Statements" The Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting, United Nations, 1989.

"Financial Statement Concepts". CICA Handbook, Section 1000, The Canadian Institute of Chartered Accountants.

CONCEPTS OF FINANCIAL STATEMENTS

Olaf Hasselager

1. The Objective of Financial Statements

The objectives of accounting naturally depend on the needs of the users.

The structure of the economic system of any national state has great influence on these objectives.

This is so much more evident in nations which are switching from a command economy to a market economy. Before there was only one economic entity, the State. Now there are many economic entities to account for and the emphasis of financial reporting has shifted from a national level to a private, enterprise level.

2. Concepts of Capital Maintenance

The concept of capital maintenance implies that capital is synonymous with the net assets of the enterprise. Accordingly, profit is earned only if the money amount of the net assets at the end of the accounting period exceeds the money amount of the net assets at the beginning of the period.

An inherent problem of financial reporting is that measurement has to be made in monetary units.

The value of money is itself subject to change and the existence of different currencies has to be taken into account.

The concept of physical capital maintenance implies that also factors which are independent of changes in the values of monetary units must be taken into account. This is necessary to overcome the difficult measurement problems of enterprises operating in a hyperinflationary environment.

3. Basic objectives

The basic objective of financial statements for business enterprises is the provision of information on the performance, the financial position, and changes in the financial position of an enterprise.

Information about the performance of the enterprise and in particular its profitability is primarily provided in the income statement (profit and loss account).

Income is defined as the increase in economic benefits during the accounting period in the form of inflows, enhancement of assets or decreases of liabilities which are not related to contributions from equity owners.

Expense is the decrease in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities which are not related to distributions to equity owners.

In certain concepts of capital maintenance revaluations and restatements of assets and liabilities that increase or decrease equity are not included in the income statement, but shown in equity as revaluation reserves.

Information about the financial position is provided by the balance sheet, which shows the economic resources of the enterprise, its financial structure, its liquidity and solvency. It also shows its capacity to adapt to changes in the environment in which it operates.

The assets are the resources controlled by the enterprise as a result of past events and from which future economic benefits are expected.

The liabilities are present obligations arising from past events, the settlement of which is expected to result in an outflow of cash or cash equivalents.

Equity is the residual interest in the assets of the enterprise after deducting all liabilities.

Information about the *changes in the financial position* is provided in the sources and funds statement. It is useful for the assessing of the ability of the enterprise to generate cash and of the needs of the enterprise to utilise the cash flows. The statement may be structured to show the changes in various ways. It may be all financial resources or the working capital, i.e. the difference between current assets and short term debt or liquid assets only.

In many countries fiscal and financial reporting is more or less the same. This creates difficulties, because the objectives of the two types of reporting are different. Accordingly many countries, including Denmark require separate reporting. In Denmark most limited liability companies prepare a financial report with an annex showing the corrections and additions which are necessary for taxation purposes.

In most western countries the publication of external financial reports is only obligatory for limited liability companies and other undertakings which are of such importance that their financial reports are of public interest.

4. The Accounting Assumptions

4.1 The Accrual Concept

Financial statements are prepared on the accrual basis of accounting.

The effects of transactions and other events are recognised when they occur. They are thus reported in the financial statements of the periods to which they relate.

The transactions are not recognised at the time, when cash or cash equivalents are paid.

4.2 The going concern assumption

As a general rule, financial statements assume that the enterprise will continue its operations in a foreseeable future. If the enterprise is intended to be dissolved, another basis of accounting should be used.

5. The Quality of Financial Statements

According to the 4th EEC Directive, financial statements should give a true and fair view of the assets, and liabilities, the financial position and result of a company. In the US financial statements have to give a fair representation.

The IASC Framework sets out four criteria for the quality of financial information.

- understandability
- relevance
- reliability
- comparability

5.1 Understandability

Information should be understandable. However, financial statements are not designed to be understood by the man in the street. A reasonable knowledge of business and economic activities and accounting principles must be assumed.

In a period of transition from a centrally planned economy to a market economy only few people will understand the concepts used in financial statements.

Therefore, complex matters need to be explained. We should bear in mind that financial statements are meant for people without first-hand knowledge of the operations and the situation of the enterprise.

5.2 Relevance

Information must be relevant, for the economic decisions of the users of financial statements.

5.3 Reliability

Information should be reliable and free from material error and bias. This implies a set of principles:

Faithful representation
substance over form
neutrality
prudence
completeness
realisation

On the prudence concept some comments are necessary.

Financial statements cannot avoid uncertainties of many kinds. For example, will doubtful receivables result in payments to the enterprise? How long is the useful life of a fixed asset? How to assess the future of the enterprise in an unstable economic or political environment?

The prudence concept is an unavoidable evil, but by far a lesser evil than inflated accounts.

5.4 Comparability

Financial statements should be comparable between consecutive accounting periods. They should also be comparable between different enterprises.

6. Recognition

Revenue recognition is the main concept for the calculation of net income. Which items should be recognised in the financial statements?

Two criteria should be met:

a) it shall be probable that any future economic benefit associated with the item will flow to or from the enterprise, and

b) the item should have a cost or value that can be measured with reliability.

Reliability was one of the qualitative characteristics mentioned before. At least, a reasonable estimate must be made. If this is not possible, the item should not be recognised in the balance sheet or income statement.

Income is recognised when a increase in future economic benefits can be measured reliably and with a sufficient degree of certainty. There are different opinions as to the degree of certainty needed for recognition. Some countries consider that all income should be realised and the transaction made before any recognition. In other countries increases in assets can be recognised when the gain is realisable.

Expenses are recognised when a decrease in future benefits has occured that can be measured reliably. Costs are matched to revenue.

7. Measurement

Four different measurement bases are mentioned by the IASC Framework. Two of them are in fact are closely related to the capital maintenance concept.

Historical cost fits with the financial concept of capital maintenance while the current cost accounting base fits - at least to a certain extent - with the concept of maintenance of the productive capacity of the enterprise.

Realisable value and present value does not depend on a sales transaction, but open market conditions are necessary for any reliable measurement. This concept of measurement is not admitted in all countries. It may be difficult to imagine whether the market is open and effective enough. In some countries the prudence principle is interpreted in a restrictive manner prohibiting the recognition of gains that are not realised but only realisable.

THE LEGAL INFRASTRUCTURE OF FINANCIAL ACCOUNTING AND REPORTING

Frank Jenkins

The purpose of this article is to highlight three basic elements of the law on financial reporting:

— the requirements for keeping accounting records of the transactions of an enterprise,

— the relationship between the law and accounting standards in respect of the content of financial reports,

— the institutional framework for setting accounting standards.

There are differences in the position of OECD countries in all three of these aspects. These variations stem from the different historical and cultural heritages and from different economic conditions.

Before financial statements can be drawn up, there have to be some records of the transactions of an enterprise from which the financial statements may be prepared. All OECD countries have some minimum requirements in their laws as to the records which an enterprise must maintain to reflect its business activities.

In some countries, such as the UK, the requirements are expressed in terms of the objectives which the accounting records should support without being at all specific as to how they may be achieved. For example, the UK law requires the accounting records to be sufficient to enable the directors to prepare financial statements that give a true and fair view. There are few further requirements as to the form which the records should have to achieve that objective. Nevertheless, thanks to the influence of the accountancy profession, all companies carry out their basic bookkeeping in fairly standardised ways.

The laws of other countries create more detailed and specific requirements in respect of bookkeeping. These requirements reflect the different traditions applying to commercial activity. In some countries, the law deals with the relationships between persons engaged in commercial activities. This fundamental approach will determine whether the requirements in respect of accounting records are applied to all business enterprises or only those with the characteristics of limited liability.

In the UK, the traditional view is that the need for regulation of business activities is associated with limited liability. If the owners of a business enterprise have an unlimited liability for its debts, then the law does not seek to regulate how they conduct their activities or the records they need to keep.

The French approach, for example, is very different in respect of accounting records. The accounting plan covers both the underlying accounting records and the presentation of annual accounts.

This leads into the second issue. In respect of annual financial statements, should all the requirements be expressed in the law? Or should some be left outside the law? Where should the line be drawn?

All the OECD countries have included requirements in their laws regarding the preparation of financial statements in respect of enterprises with limited liability.

At the very minimum, there is a legal requirement for information to be made available to shareholders. However, the relative importance of legal requirements and non-legal standards differs from one country to the other.

About 14 years ago, the OECD conducted a survey among its members on the manner in which accounting requirements are established. This survey identified three main approaches:

— in the first group of countries accounting rules are set by laws and regulations.

— in other countries accounting practice is determined, in addition to laws, by non legal standards set by the accounting profession, sometimes in conjunction with the business community and others with an interest in financial reporting.

— the third approach is of a primarily legal character. Requirements are set after consultations between a public authority and a broad range of groups representing the interests of preparers and users of financial statements and the accouting profession.

There has been some degree of convergence since this survey was conducted. In particular, the boundary has been blurred between the second and the third categories.

Today systems in use in OECD countries are of two kinds:

The first category follows a 'primary law' approach. The second is a 'primary law plus standards'.

Under the 'primary law' approach, the financial reporting requirements for enterprises are contained in laws which have gone through a full parliamentary process. Any changes to the requirements or any increase in reporting requirements are also made through legislative changes.

In this environment, any accounting requirements which may be expressed outside the law would have little practical effect. Compliance with the law would be viewed as all that would be necessary for financial statements to meet their objectives.

The other approach, of 'law plus standards' encompasses a range of systems under which accounting requirements may be set outside the law but with a variety of legal effects.

At one end of the spectrum, there are systems in which accounting requirements are set by a government body and have the full force of law.

In other cases, detailed accounting requirements may be set by a non-governmental body but nevertheless have the force of law. For example, in the Canadian system, accounting standards are issued by the accountancy profession and have the full force of law for to companies regulated at the federal level.

Towards the other end of the spectrum, some systems may be described as self-regulation. Accounting standards may be issued by a non-governmental body and not have any explicit legal backing. For example, standards issued by the Netherlands Council for Annual Reporting are not mandatory. However, considerable importance will be placed upon the standards when a court considers accounting issues. Any company which has not complied with a standard will have to show a good reason for not doing so. Consequently, even though the accounting standards are not part of the law, they have a quasi-legal status.

In the UK, the accounting standard setting process was revised a couple of years ago. Standards are issued by a private sector body. The law does not specifically require standards to be followed. But it does recognise that the standards exist. All large companies are required to state in their annual accounts whether or not they have complied with accounting standards. One of the legal requirements is that annual accounts should give a true and fair view of the state of affairs of the companies and their profit or loss for the year. Accounting standards are an expression of what is true and fair. Consequently, any company which departs from an accounting standard needs to show a good reason which will stand up to scrutiny by courts.

The various approaches taken by OECD countries have their own advantages and disadvantages.

Under the 'primary law' approach accounting requirements are generally limited in scope. There is a high degree of certainty that they are followed when financial statements are drawn up. The disadvantage is that any changes in accounting rules require legislative or regulatory action. Consequently, they are likely to be revised only at long intervals. If these changes do not occur relatively frequently, accounting rules may become out of date because of developments in the commercial and financial environment.

The 'law plus standards' approach is more flexible. Standards may be varied to reflect the changing commercial environment. New developments and new circumstances may be dealt with as they arise. Also, in those countries where the standards are not part of the law, there may be greater freedom in the manner in which they are expressed. They are slightly more removed from the problems of legal interpretation and may deal with the application of principles rather than provide a firm set of rules.

The question is sometimes raised as to whether it is reasonable to leave standard setting in the hands of a private sector body. It is argued that there is no government control over the body and therefore no control over the standards which may be issued.

However, such fears are groundless. Any standard setting body has to obtain the acceptance of the business community if it is to be successful. Consequently, there is a built-in limitation for any unreasonable behaviour. Also, if there is any degree of government recognition of a standard setting body, it will always be open to the government to withdraw that recognition. Neither side would want that to happen and this will lead to a consensus building approach.

This leads us to the third issue, the institutional framework for the setting of accounting standards.

I mentioned earlier that there had been some degree of convergence in standard setting since the OECD conducted its first survey. There is now agreement among OECD countries that accounting standards are too important to be left to accountants alone.

Whether a standard setting body is a government body or a private sector body, there are wider interests represented than just the accountancy profession. If the standards are to be acceptable to the business community, then their representatives ought to be involved in the standard setting process.

The interests which may be represented in standard setting vary from country to country, depending upon each country's traditions. They include :

— business organisations, which may be employers organisations or representatives of particular industrial sectors such as banking or insurance,

— financial analysts who are one of the main groups of users of financial information,

— stock exchanges, which obviously have a particular interest in the annual accounts of listed companies,

— in some countries, employee organisations such as trade unions.

The accountancy profession is also heavily involved, often in two separate capacities. Firstly as preparers of accounts when working within enterprises. Secondly as auditors of the accounts when an independent audit of financial statements is required.

There is some government involvement even in private sector bodies. In the UK for example, two government observers attend the meetings of the standard setting body.

This article presented a broad overview of the legal infrastructures for accounting in OECD countries. It showed that there is no single solution which is appropriate for all circumstances.

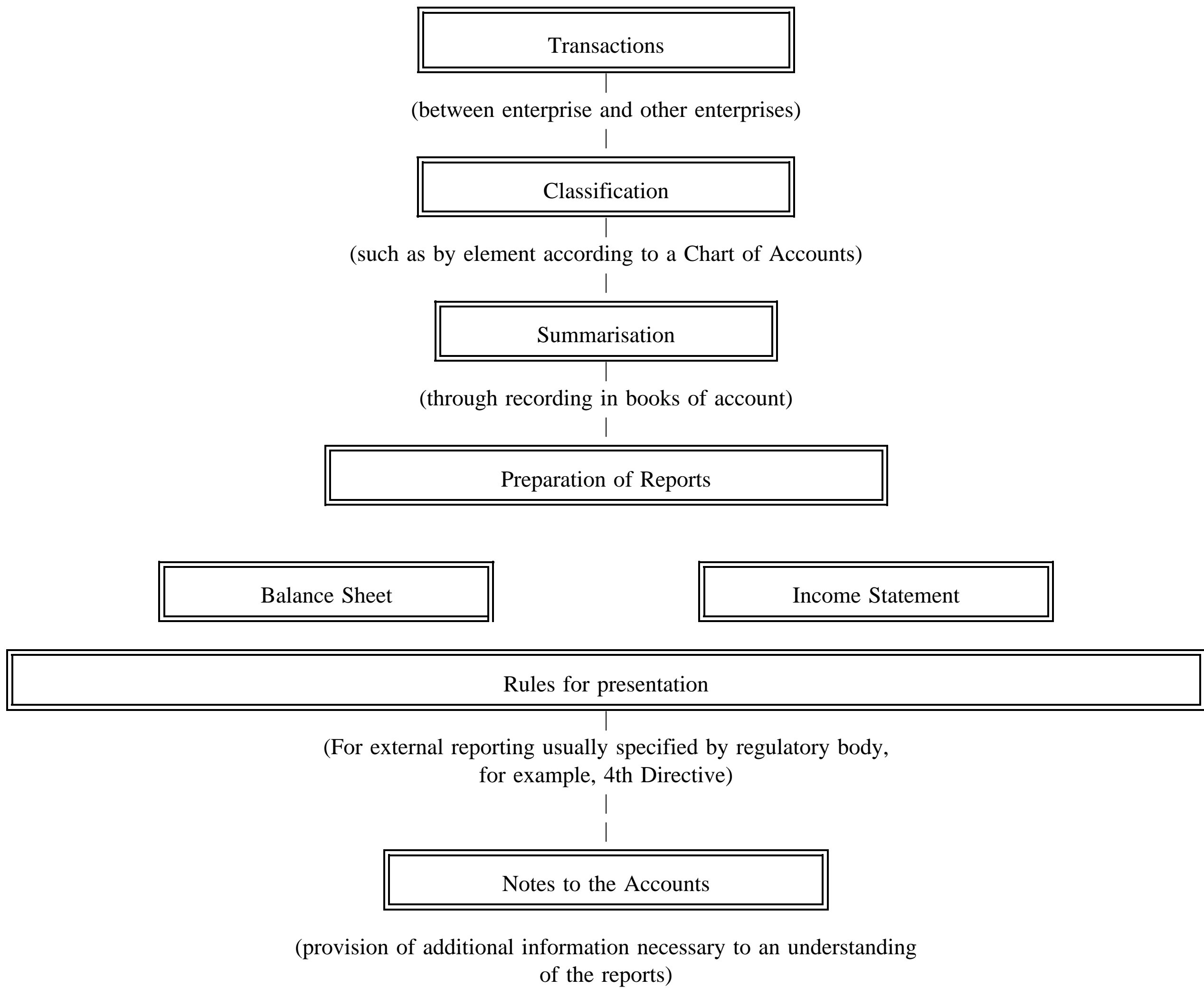
Chapter III

Elements of Financial Statements

ELEMENTS OF FINANCIAL STATEMENTS
PROFIT ALLOCATION AND THE INCOME STATEMENT

Geoffrey J Harris

Accounting may be viewed as a process of collecting, classifying, aggregating and summarising the monetary aspects of transactions entered by an enterprise. Depending on the purposes for which the information is to be used and the type of user (whether for the purpose of reporting externally to shareholders or internally to managers etc.) a variety of different types of accounting reports may be prepared. The type of report to be prepared will influence the rules, practices and methods adopted in the selection of information and the manner in which it is presented. This process may be represented visually as shown in the following chart.



Transactions
(between enterprise and other enterprises)
Classification
(such as by element according to a Chart of Accounts)
Summarisation
(through recording in books of account)
Preparation of Reports
Balance Sheet
Income Statement
Rules for presentation
(For external reporting usually specified by regulatory body, for example, 4th Directive)
Notes to the Accounts
(provision of additional information necessary to an understanding of the reports)

A) Balance Sheet

In its simplest form the accounting equation may be expressed as

$A_o - L_o + OE_o$

where
A = assets
L = Liabilities
OE = Owners' Equity (Capital, Proprietorship)

This expression may be viewed as representing the balance sheet of an enterprise at a particular time, to, say, the beginning of an accounting period. At the end of the period 1, the balance sheet would be expressed as

$A_1 = L_1 + OE_1$

B) Income Statement

The income/profit of an enterprise (and in this context I am using the terms synonymously) could be determined or calculated in two different ways:

i) Comparison of wealth (owners' equity) at two different dates.

If this approach were adopted income would be expressed as:

$Y_1 = OE_1 - OE_o$

Where Y 1 Income/Profit assuming that there had not been any contribution by or distributions to owners during the period.

Now in order to apply this method it is necessary to have:

- a consistent definition of the elements recognised in the calculation

- a consistent basis for measurement (valuation) of the elements and an associated concept of capital and capital maintenance. Note that when measuring income in this way we need to have consistent rules for determining and separating the capital base from its growth (increment) during the period. In conventional accounting the concept of capital is invested money capital and the basis of the measurement is historic cost,

- thus the concept of capital is important since it provides the basis for such a distinction between the return of capital and the return on capital which provides a measure of performance of the enterprise and its management. From this return on capital (i.e. the profit/income earned by the enterprise) dividends can be distributed to owners.

This approach to measuring/determining income is in principle straightforward but lacks content in the sense of providing information which may be considered necessary for users of financial statements (investors, creditors, owners etc). This method is also appropriate if we wish to look at the income earned over the whole life of the enterprise. In this regard it is useful to note that the accounting process is based on the assumption of the continuity of operations of the enterprise (going concern assumption) and that users require information about its activities and performance on a progressive basis during its life.

ii) The analysis of transactions identified as relating to operations (income producing/earning activities).

This is a more complex, but rewarding approach. It is consistent with basic accounting practice and its emphasis is on the recognition, classification and measurement of the monetary attributes of transactions.

Under this approach income is determined as:

$$Y_1 = R_1 - X_1$$

[R = Revenues
X = Expenses in period 1]

It is based on the application of what is referred to as the matching concept. The matching concept reflects:

— the notion of recognising the revenues earned in an accounting period (note that the life of the enterprise is divided into accounting periods usually of a year) and deducting the expired costs (expenses) incurred in earning those revenues;

— expenses incurred in relation to a period may result from the consumption of the services of fixed/long term assets [i.e. process of depreciation/amortisation which gives rise to questions of what is the best basis of allocating the cost of a fixed asset over its estimated useful economic life or the incurrence of other expenses such as wages and salaries.

One misconception to be guarded against is that assets are "good" things to have while expenses are "bad". Many assets, for example, plant and equipment, are nothing more than long term expenses. For example, if an enterprise purchases a computer it is not expected that it will constitute a permanent asset. The computer is a source of services which will be gradually consumed by the enterprise and will eventually need to be replaced if the enterprise remains in business and continues to require those services. The only difference between assets of this nature and expenses such as wages and advertising **is** that the computer services are purchased in advance of their consumption which may take several years (accounting periods) whereas wages are normally recorded as an expense after the services provided by the wage earners have been consumed.

The recognition of revenues attributable to a period may be affected by the way in which uncertainty impacts on the measurement process e.g. realisation concept:

a) a sale transaction on credit is generally recognised in full at the time of sale (twofold/dual effect of transactions in accounts represented by an increase assets (debtors) and increase revenues (sales) even though cash has yet to be received. The uncertainty of collection is recognised in aggregate through making provision/allowance for doubtful debts.

b) In other cases the effect of some events may not be recognised because to do so would result in the recognition of revenue (gains) which were uncertain in nature e.g. increases in the market value of listed/quoted investments, the effect of favourable movements in foreign exchange rates.

Thus the extent to which gains and revenues are recognised in the accounts (and thus the measurement of income) may be substantially affected by the application and interpretation of the prudence concept (as for example occurs in a number of countries which have implemented the 4th Directive). For

example a comparison of United Kingdom and German approaches to the recognition of revenue on long-term construction contracts indicates a different interpretation of the relationship between the prudence and matching concepts.

Returning to the accounting equation which can now be expanded as follows:

$$A_1 = L_1 + OE_0 + Y_1$$

where $Y_1 = R_1 - X_1$

$$A_1 = L_1 + OE_0 + (R_1 - X_1)$$

If we now take account of profit distributions (D) and additional capital contributions (C) the equation may be expressed as:

$$A_1 - L_1 + OE_0 + (R_1 - X_1) - D_1 + C_1$$

C) The Distribution/Allocation of Profits

As noted previously, the profit/income of the enterprise is determined after allowing for the maintenance of financial capital expressed in terms of invested money capital.

This increment in wealth generally places an upper limit on the profits available for distribution to owners (e.g. shareholders, other equity holders). There are however constraints on the ability of management to distribute profits which may arise from:

1. Legal Constraints

In some countries there are detailed rules affecting the extent to which profits may be distributed so as to ensure that the net assets provide sufficient cover for the protection of the interests of creditors. For example, in some countries legislation provides that dividends may only be paid out of profits which are specified.

2. Prudential financial management

i) Since profits are a significant source of financing the continuing development and growth of the enterprise, management faces the problem of maintaining a balance between the appropriate distribution of profit (dividends) to owners and its retention for financing future growth. [Note that rewards to owners generally occur in the form of dividends (usually a cash distribution) and increases in the market price/value of their ownership equity).

ii) The cash distribution decision is a financing decision. Management must manage the flow of cash of the enterprise to be able to pay dividends without constraining the ongoing activities of the enterprise. It is here that the effect of accrual accounting and the difference between profits and cash become more pronounced (e.g. the earning of a profit does not ensure that the enterprise has cash available for distribution) and the importance of the way in which the realisation principle is interpreted. The more relaxed the interpretation of the realisation principle, the greater the scope for differences occurring between the profit and operating cash flows for a period.

D) Notes to Accounts

When reporting information to users of financial statements it is seldom sufficient to provide aggregate summary information in the form of a balance sheet and income statement. As clarified earlier there are a wide group of users of financial statements in a market economy and their legitimate needs for information need to be satisfied. One means of doing so is to provide additional information in the form of notes or attachments which explain and expand on a wide variety of items included in the financial statements and on other transactions and events affecting the financial condition and performance of the enterprise. Such notes may relate to transactions not recognised in the accounts, events affecting the interpretation of the accounts, further explanation and detail and other information deemed relevant for accountability and stewardship purposes, such as directors and executive salaries, which may be considered important because of the separation of ownership and management of the enterprise.

These notes may be quite detailed and extensive showing, for example,

- components of balance sheet items
- maturity schedules in respect of creditors
- additional statements such as those relating to cash flows (accounting methods applied by the enterprise).

They may also be quite simple and straightforward, showing for example the number of employees and the market value of investments.

Why are such notes necessary?

There are two main reasons:

1. Legal requirements.

The legislation in some countries establishes a basic minimum level of disclosure of items necessary to present a true and fair view of the operations and condition of the enterprise.

2. "Good commercial practice."

Enterprises make a number of voluntary disclosures either in response to the expectations of some users of financial statements or as a means of reducing the uncertainty of assessment and interpretation of the financial statements.

Uncertainty is an ever present characteristic in market economies both from the point of view of the firm and the providers of finance. Information is regarded as an economic good, the provision of relevant information tends to reduce uncertainty. For example the providers of loan capital are bearing risks relating to the repayment of loan and the payment of interest. In this regard information may reduce their perception of the risks associated with an enterprise and thus the reward required for taking those risks. In these circumstances an enterprise has an incentive to reduce costs through the provision of information.

Key

A = Assets
B = Liabilities
OE = Owners Equity (Capital/Proprietorship)
R = Revenue
X = Expenses

D = Distribution
C = Capital Contributions/Withdrawals
Y = Income/Profit

Basic Equations

(1) $A_0 = L_0 + OE_0$
(2) $A_1 = L_1 + OE_1$
(3) $Y_1 = OE_1 - OE_0$
(4) $Y_1 = R_1 - X_1$
(5) $A_1 = L_1 + OE_0 + Y_1$
(6) $A_1 = L_1 + OE_0$
(7) $A_1 = L_1 + OE_0 + R_1 - X_1 - D_1 + C_1$
(8) $A_1 = X_1 + D_1 = L_1 + OE_0 + R_1 + C_1$

VALUATION OF ASSETS AND LIABILITIES UNDER THE EC DIRECTIVES

Herbert Biener

1. Valuation rules are important features of the fourth EC Directive. Article 31 states that items must be valued in accordance with general accounting principles that include such basic concepts as going concern, consistency, prudence and accruals, as well as requiring that the components of asset and liability items should be valued separately.

The Directive also states that the opening balance sheet for each year must, apart from exceptional circumstances, correspond to the closing balance sheet for the preceding year to ensure that full information is given so far as the appropriation of profits and treatment of the retained earnings at the preceding year-end is concerned.

2. Article 32 lays down that valuation shall be according to the historical cost convention. Article 33, however, provides that, pending subsequent coordination, Member States may, by way of departure from the historical cost convention, authorise or require in respect of all companies or any classes of companies:

a) valuation by the replacement value method for tangible fixed assets with limited useful economic lives and for stocks;

b) valuation by methods other than that provided for in (a), which are designed to take account of inflation for the items shown in annual accounts including capital and reserves;

c) revaluation of tangible fixed assets and financial fixed assets.

3. Articles 34 to 40 deal with the valuation of formation expenses, fixed assets, research and development, goodwill, current assets and stocks.

4. Considerable weight and emphasis is laid on the general concept of prudence, for example:

a) only profits made at the date of the balance sheet may be included but account is to be taken of all foreseeable liabilities and potential losses, even though they may only have become apparent after the balance sheet date (Article 31(1)(c)(aa) and (bb));

b) account must be taken of all depreciation whether the result of the financial year is a loss or profit (Article 31(1)(c)(cc));

c) the value of fixed assets with limited useful economic lives must be reduced by value adjustments calculated to write off the value of such assets systematically over their lives (Article 35(1)(b));

d) Article 35(1)(c) provides for cases where value adjustments may be made in respect of financial fixed assets so that they are valued at a lower price than historical cost. It makes

such value adjustments mandatory in respect of fixed assets, if it is expected that the reduction in their value will be permanent, irrespective of whether or not they have a limitation on their useful economic lives;

e) Articles 39(1)(b) and 39(1)(c) contain similar provisions in respect of current assets.

5. Allied to the prudence concept is the restriction on profit distribution, for example:

a) revaluation and similar reserves may not be distributed unless realised (Article 33(2)(c));

b) distributable reserves are restricted by the amounts of formation expense and, unless Member states authorise to the contrary, amounts of research and development expenditure that have not yet been fully written off [Article 34(1)(b) and 37(1)].

6. On the other hand, in accordance with the overriding principle that the annual accounts are to show a true and fair view, there are also provisions preventing excessive reduction in amounts, for example:

a) revaluation reserves should be reduced to the extent that the amounts transferred thereto are no longer necessary [Article 33(2)(c)];

b) where value adjustments have been made in respect of financial fixed assets and the reasons for which they were originally made have ceased to apply, these adjustment must be reversed [Article 35(1)(c)(dd)];

c) a similar provision applying to current assets appears in Article 39(1)(d);

d) provisions for liabilities and charges shall not exceed in amount the sums which are necessary (Article 42).

7. In view of the fact that in some countries the accounting treatment is directly affected by fiscal legislation, the valuation rules contain various clauses designed to show the impact of fiscal legislation upon the accounting treatment, for example:

a) the treatment of the revaluation reserve for tax purpose must be explained either in the balance sheet or in the notes to the accounts [Article 33(2)(a)];

b) if fixed assets or current assets are the subject of exceptional value adjustments solely for taxation purposes, the amount of the adjustments and the reason for making them shall be indicated in the notes on the accounts [Articles 35(1)(d) and 39(1)(e)];

c) Article 43(10) requires disclosure of the effect on the results for the year where items were valued at other than historical cost with a view to obtaining tax relief.

VALUATION PRINCIPLES IN EASTERN EUROPE

Jens Roder

The acceptance of valuation principles is very much linked to the acceptance of the fundamental accounting concepts and principles that underlie the preparation and presentation of financial information. Valuation principles have evolved to address the needs of specific users of financial information, namely the potential seller and acquirer of a business entity.

Many thousands of companies in Eastern Europe are preparing for privatisation. Western investors are seeking advice as to the likely value of their target. Eastern European countries have generally governmental requirements for a commercial or market-based valuation of each business, particularly when a foreign investor is involved.

In these new markets the requirement for valuation gives rise to the following questions: What does value mean? Do eastern and western investors have differing measures for perspectives on value? How is value determined in Eastern Europe?

Many businesses have been wholly dependent on the former COMECON markets, some supplying markedly inferior quality products. Indeed, many businesses are financing huge stocks of goods of a quality that cannot be sold in alternative markets, destined for Russia, which will not be dispatched until payment is certain. Therefore they now face an uncertain future.

The businesses with a strong domestic market and/or some established western exports are more attractive and more valuable, as are those that offer key strategic positioning for a wider european market.

Some sectors have suffered from a lack of investment by their sponsoring ministries. Ministries have been selective in their allocation of funds, and it is common to find that certain plants within an industry are operating with modern, sophisticated equipment, while others in the same industry are limping along with antiquated plant more than 25 years old.

Some enterprises, prima facie, have limited value, although this has not prevented Western investors paying significant sums for factories where the only commercial solution is to raze them to the ground and start again with a greenfield site.

Differing Value Perspectives

In Eastern Europe the traditional measure of value applied locally has been asset value, not withstanding the impossibility of placing a true value on assets. In the absence of any real measure of profitability due to subsidies and centrally fixed prices, this is often considered to be the only available yardstick. Other local measures of value include the importance of the business to the economy in terms of revenues from taxation, hard currency earned and the number of citizens employed both directly and indirectly.

However, much has changed over the last two years. Both management and government officials now recognise the concepts of commercial market value and strategic value. A few early mistakes have taught them how to deal with western investors and how to achieve realistic values for the businesses under their control.

Typically, the western investor appraises a potential investment by reference to what the investment will contribute in terms of expertise, patent and product rights as well as the future cash flows which he expects that investment to earn having taken into account the risks attached to achievement of those returns and to any know-how or other contribution in kind which he needs to provide in order to realise those cash flows. This approach is common and is therefore becoming widely accepted, also when valuing business entities in Eastern Europe, particularly where western investors are involved.

Strategic Value

A further relevant value consideration for the western investor is strategic value. Many western companies are operating in saturated markets which are at best static and often declining. The opening up of the former communist countries in Europe is therefore perceived as a tremendous opportunity to expand existing networks and to break into new markets.

There are investors who are seeking a low-cost manufacturing base due to the current low wages paid in these countries of typically around US$ 60 a month. However, this should be considered a short-term advantage - there is no evidence to suggest that wages will remain low indefinitely. The longer-term opportunity rests in the new markets and their unsatisfied demand.

The market for investment is highly competitive and most local businesses are able to organise a "beauty parade" of potential investors. Such competition of itself tends to increase the price but the strategic motives of the potential investors tend to separate the bidders. Often the bids have differed by over 100 per cent due to one or more potential investors perceiving advantages which are perhaps not available to others, such as production synergies.

We have advised many local vendors and inward investors and have observed with interest the different approaches of western investors. Apart from some notable exceptions, UK companies are seen as short-term investors. There is a market for long-term investors only, although some short-term tax benefits and low labour cost benefits can be taken into account. German, Austrian and Scandinavian investors tend to focus on long-term privatisation plans.

Methodology

Some valuers and investors still subscribe to the net assets basis due to a perceived lack of any other usable method. "Market" valuations of assets are carried out, using either local indices or western European indices, often of dubious origin. These valuations should be treated with caution. There is no real market for second-hand plant and machinery in Eastern Europe and there may still be a question mark over the ownership of land. Furthermore, the western concept that assets of a trading company are only relevant to the extent that they are used to generate profits and cash is equally valid in Eastern Europe.

The appropriate methodology for valuing a trading company is some form of capitalisation of the likely future earnings or cash flows that the business is expected to produce.

Critics of this approach state that it is impossible to use discounted cash flow techniques as they require fundamental assumptions to be made about the future of the enterprise and the local economy which, they say, cannot be made in such an uncertain environment. Clearly, such assumptions have to be

made but the application of a net asset based method also requires fundamental and equally uncertain assumptions to be made about the realisation of those assets.

Therefore, there should be no theoretical obstacles to using an approach based on future expectations as this is the prime consideration of the investor. Furthermore, in our experience, the majority of the local business entities in Eastern Europe are perfectly capable of preparing reasonable projections and indeed have often done so before. The fact that these projections then need to be adjusted to reflect western accounting conventions does not necessarily preclude their use.

Such projections are subject to the uncertainty of the future macroeconomic indicators and to the uncertainty of a country moving from a centrally planned to a market economy. The former can be largely eliminated if consistent assumptions regarding future levels of inflation, interest rates and exchange rates are made and if these are used in deriving a discount rate, there is little possibility of arriving at a materially misstated value. Such assumptions can be varied within a given spread to give a range of valuation possibilities.
edit

The risks must be evaluated but the inherent risks in the projections are not that different to those experienced when developing cash flow projections in western countries. The key issue is the correct interpretation and use of the projections, which is where the valuer's skill and experience is of paramount importance. Just as there is no right value for a business, there is similarly no wrong value for it. The value reflects, what two separate independent negotiators agree that it is worth.

Practical problems

It is important to be aware of practical problems when valuing in Eastern Europe. A valuation opinion is only as sound as the underlying information upon which it is based and a thorough review and analysis of the financial statements is generally a first step in the valuation process. Often the financial accounts of an enterprise have not been subject to an "audit" similar in scope to that applicable in western economies. The different accounting policies applied must also be understood and their effect on any valuation quantified as already mentioned. In almost all instances it will be necessary to restate financial information to ensure comparability and address omissions.

In most Eastern European countries, fixed assets are not depreciated over their economic useful lives, stock is often included in the balance sheet at its selling price and provisions are rarely made against obsolete stock and overdue debtors.

Another potential problem is the lack of market information in Eastern Europe. The basis of valuation is comparison: comparison with alternative investment opportunities and with similar recent transactions in the actual market place.

The new capital markets in Eastern Europe are not developed enough to allow for valid conclusions on value to be drawn. Indeed, there is as yet no capital market structure for the public offering of shares.

There are, however, a number of private deals for which details are available. Happily, at the moment, the euphoria of concluding a successful joint venture arrangement or other forms of investment outweighs the desire for confidentiality of information. Therefore many more details of transactions are publicly available than for similar private transactions in the West. Comparison is therefore possible, although it is not always possible to identify the strategic element of the transaction.

In the absence of reliable local market information, the valuer will then move to a market where such information is available and extend the comparison process to evaluate the differences between the two markets. There is no difference with the process by which valuations are generally performed in the

West. There are limited transactions in private companies' shares, so comparisons are drawn with the quoted markets.

For valuation in eastern european countries it is possible to derive a multiple of profits or revenues and required rates of return from western evidence and to adjust for the higher costs of money and the greater local risks. As each of the countries moves closer to a true market economy, this process will become easier and less subjective.

In summary, valuations are carried out in Eastern Europe using generally accepted valuation methodologies used in M & A transactions in western countries. However, many transactions are carried out on an asset valuation basis. In order to arrive at a fair valuation of a business, several valuation bases as well as methods can be used to take into account the uncertainties and weaknesses inherent in each of these methods. We, along with everyone else, accept that there is a greater degree of uncertainty to such valuations than in the West. However, the experience and knowledge of the valuer can overcome these problems which are no more than the risk/reward investment analysis that is required in preparing any valuation. The two key requirements are valuation experience and local knowledge, and therefore it is of vital importance to combine the skills which exist on a local level - knowledge of the future of the market and the economic and legal environment - with the technical knowledge and experience of the valuer.

VALUATION ASPECTS OF PRIVATISATION

Dr Wienand Schruff

Several valuation issues arise in the context of privatisation of state owned enterprises operating in an environment of transition towards a market economy.

A clear distinction should be made between:

— valuation of assets and liabilities, the net asset position,
— valuation of an enterprise as a whole
— fixing the sales price for an enterprise.

The three valuations are related, but identical results are unlikely for the following reasons:

a) In a business environment, the value of an asset is determined by expected future profits rather than the amount of money spent on the purchase of that asset.

b) The actual market value of an asset reflects generally the expectations of its profitability. Therefore, the value of assets which can be used only for production of goods for which there is no need or demand, falls down to zero regardless of the historical cost and the age of that item.

c) The value of an enterprise as a whole is also based on its future profitability it is represented by the discounted value of all future benefits. On the other hand, the enterprise's net asset position, as shown in a balance sheet does not represent the value of the enterprise as a whole, because some of the resources used and liabilities caused by the enterprise may be missing from the balance sheet depending on the accounting principles applied, eg:

— certain identifiable intangible assets (for example, specific know-how),

— non-identifiable intangible assets such as the "goodwill" comprising the benefits from the market position, the relationship with clients or customers, the organisation and management quality,

— contingent liabilities such as, for example, responsibility for environmental damage and commitments for the continued employment of inefficient personnel.

— The sales price of an enterprise to be privatised will differ from the valuation of the business as whole for a number of reasons:

— different bargaining strengths of investors,

— different privatisation procedures such as direct sales, public auctions or public offerings,

— Government may be interested not only in privatisation but also in maintaining employment, balancing the state budget and attracting foreign investment and technology.

The internationally accepted valuation procedure for an enterprise under the assumption of going concern is the discounted cash flow method. The present value of an enterprise is consequently the addition of all the discounted future cash surplus from operations.

If the surplus which is expected from immediate liquidation of the enterprise exceeds the amount of discounted cash flow expected from operations, the value of the enterprise is represented by the liquidation value. This situation often occurs in enterprises with weak earning power.

Valuation under the discounted cash flow method requires reliable data in order to estimate the future earning power. The estimation of earning power is always a difficult task, even for an enterprise operating in a market economy, but is almost impossible, in an economy in transition. Czechoslovakia, for example, the application of this method is limited to cases where foreign investors are involved and the valuation has to be carried out by western experts. In Hungary, the discounted cash flow method is not allowed for privatisation purposes.

Why is the estimation of future income of an enterprise operating in an economy in transition so difficult?

The estimation of future earnings is usually based on detailed business and finance plans over the next five years. The starting point for all forecasts is the present state of affairs, which is influenced by the development of the enterprise in the past two or three years. The past and present results, adjusted by elimination of extraordinary items, provide an indication of the earning power at the date of valuation. The earning power should be determined from the performance of the most recent accounting periods. Detailed analyses of individual products or product areas should be undertaken as a basis for forecasts and projections.

In former centrally planned economies, it is impossible to analyse earning power on the basis of future cash flow surplus. As experience from Eastern Germany shows, information provided by the accounting system which has been applied in the past is not suitable for the estimation of the present earning power. Most of the enterprises in Central and Eastern Europe are facing the collapse of their traditional markets. Thus, forecasts and projections cannot be based on profit or loss figures shown in recent periods. Forecasts of future income are therefore virtually impossible.

Alternative Proposals:

In this context, the valuation of the company's net assets may be helpful. No investor would pay more than the amount which is necessary to rebuild the enterprise entirely. Thus, the net asset value could be used as a basis for negotiations on privatisation.

The determination of the net asset value also raises difficult questions:

Should assets be recorded at historical cost minus depreciation or should they be revalued at replacement cost in accordance with the world market price level?

In my opinion the second alternative seems to be preferable in the case of the Baltic States:

For enterprises transformed into a corporate legal form, the first step of a new accounting system is the establishment of an opening balance sheet.

For this purpose a revaluation of assets and liabilities is necessary in order to achieve a proper basis for accounting in future periods. In the opening balance sheet of a newly privatised enterprise identifiable intangible assets as well as tangible fixed assets, which have not been recorded in the past (brand names and land, for example) should be incorporated. Contingent liabilities for layoffs of employees should be carefully assessed and recorded in the balance sheet.

Valuation of assets and liabilities will have to deal with significant uncertainty for example:

a) Land has usually not been accounted for in centrally planned economies. If enterprises are given the property rights on land, the value of land should be determined on the basis of market prices, considering that a real estate market has already been developed in many Central and Eastern European countries.

   In Eastern Germany all enterprises had to set up an opening balance sheet in Deutsche Mark for July 1, 1991. At that date the Deutsche Mark was introduced as a new currency. Because the absence of markets in Eastern Germany would make the valuation of assets and hence a determination of replacement cost difficult, the approach of the *DM Bilanzgesetz* is to allow the opening balance sheet to be changed up to 31.12.1994 if subsequent information allows values to be with greater certainty.

b) Valuation at replacement cost may be considered unappropriate where plant, machinery and inventories are unlikely to be replaced because of their condition, technology or marketability.

c) Accounts receivable should be valued at their estimated realizable value.

d) Valuation of intangible assets is one of the most difficult tasks. Intangibles are usually valued by using the discounted earnings or discounted marginal revenues attributable to that respective item. However, in many cases no reliable estimation can be made. Therefore, intangibles are often valued at zero, taking into account that if an enterprise shows weak earning power, no benefit may be expected from intangibles such as brand names.

Because of uncertainties in the valuation of the company's future cash flows, and net asset position it is recommended to add a specific clause into the privatisation contract between the government and the investor to provide for reassessment and adjustment of the basic data underlying the sales price. The same should apply to the valuation of assets and liablities for balance sheet purposes so that valuation may be reviewed in the light of further market developments.

Chapter IV

The Accounting Profession

THE ROLE AND ORGANISATION OF THE ACCOUNTANCY PROFESSION

Gisela Nagy

I. Introduction

The Fédération des Experts Comptables Européens (FEE) is the representative organisation for the accountancy profession in Europe. It currently groups together the 35 leading professional bodies in 23 countries, including all 12 Member States of the European Community, and these have a combined membership of approximately 300,000 individuals.

A young organisation, FEE itself was created in October 1986 and commenced operations in Brussels in January 1987. Its origins, however, go back much further, since it took over responsibility for the activities previously carried on separately by U.E.C. (1951) and the Groupe d'Etudes des Experts Comptables de la CEE (1961). FEE's true beginnings therefore predate the creation of the European Community, and show that the accountancy profession was among the first to demonstrate its commitment to the European ideal.

The accountancy profession which FEE represents is a wide and varied one, as are the activities carried on by individual accountants.

The unique and essential contribution made by our profession, emphasises the need to ensure that an adequate accountancy infrastructure in place, if the transition from central planning to a market economy is to be successfully achieved.

II. Characteristics of a Market Economy

Several elements combine to make a market economy:

— The interaction of supply and demand, rather than central planning, to determine the output and price of goods and services.

— Entrepreneurship, or the taking of risks by those who wish to supply goods and services, without being sure what the demand and/or price for those goods and services will be.

— Investment, whereby accumulated capital (savings) are put at the disposal of an entrepreneur to provide him with the resources to supply goods and services.

— Risk and return, whereby those who provide capital require payment for making their capital available, with this payment usually varying in relation to the risk associated with the project being financed.

— Regulation, which is the framework of rules and laws put in place to ensure fair treatment of those involved in the market process.

— Decentralisation of decision making. In a centrally planned economy, all decisions concerning the matching of supply and demand, the fixing of prices, and the level of investment are made centrally, and the state both accepts all risks and benefits from all returns. In a market economy, on the other hand, literally millions of consumers, producers, workers, bankers, investors and regulatory authorities are involved, each with their own interests, rights and objectives which must be taken into account.

A market economy can only work if there is an exchange of information between all the economic agents. Accountancy is concerned with the exchange of financial information, and can therefore be regarded as the language of economics. Accountancy aims to provide information relevant for:

— calculating profit, so as to measure returns on investment,
— measuring economic activity so as to help the making of decisions about setting prices, making investments and taking risks,
— giving a fair picture of an enterprise's performance and financial position to all those with a legitimate interest in the enterprise.

Providing information for internal use within an enterprise is designed to meet the decision making needs of management, and is frequently called management accounting.

Providing information for users outside the enterprise is frequently called financial accounting, and it is designed to meet the needs of users such as shareholders, bankers, suppliers, employees, tax authorities, regulatory agencies, the general public and so forth.

Finally, even in a market economy, the governmental or public sector plays a very major role, and the public sector has its own specific accounting needs. This area of activity is frequently called public sector accountancy.

III. What do Accountants do?

40% of the professionals are involved in providing accountancy services to the public (e.g. private individuals, enterprises, government) either individually or through firms of accountants. Roughly 60% are involved in industry, services, education or government service. This reflects the broad nature of the demand for accountancy and accounting information.

The services provided by individual accountants or firms of accountants are varied, but among the major categories are the following:

Accounting

In order that the many interested parties in a market economy can communicate properly with each other, it is necessary to have at least a common minimum level of uniformity about the way in which accounting information is gathered, processed and reported. Procedures, practices, standards, rules, laws and other requirements have therefore been developed to ensure that accounting information is relevant, understandable and comparable, in order that it can be usefully used for decision-making purposes. When accountants provide accounting services to clients, they provide the benefit of their know-how and expertise about these rules and standards. Assistance and advice are made available to clients regarding the organisation and design of accounting systems, the keeping of accounting records and the preparation of financial statements, whether required by law or for other reasons. The nature of the services can vary from basic bookkeeping for small or unsophisticated clients to detailed advice on the application of accounting principles and standards for sophisticated clients.

Auditing

Under the law in most market economies, many companies are required to have their annual financial statements audited, whereby a properly approved auditor or firm of auditors is required to express an opinion as to whether the financial statements give a true and fair view of the results of the company's activities and of its financial position, and whether they comply with the relevant legal provisions. The purpose of this independent, external audit is to lend credibility to financial information and thereby to enhance the effectiveness of economic decisions made on the basis of it. In addition, many companies and other entities not subject to the statutory audit requirement voluntarily request contractual audits, in view of the benefits that accrue from this service. Finally, there is a growing demand for audit-related services, which involve the issuance of special-purpose reports and opinions or the application of certain defined procedures.

Tax advice

In this area, services can be broadly categorized as relating to tax planning or tax compliance, the former consisting of advice on the application of taxation law and the latter relating to the preparation and presentation of the various returns and declarations required by law, and assistance to clients in their dealings with the relevant authorities.

Management consultancy

Given the broad and comprehensive nature of their education, training and experience, accountants can contribute a considerable body of information and guidance to clients in a wide range of areas. These may include general financial and business advice, the management of financial systems, internal controls, information technology, strategic planning, mergers and acquisitions, marketing, production, personnel, executive search and personal financial planning. There is a very clear trend towards expanding the range of services provided. In many countries, the management consultancy units of accountancy firms are the largest consultancy organizations.

Insolvency

Accountants are either the leading or significant providers of insolvency services in those countries where they are permitted by law to act in this capacity. Their role may thus be that of liquidator, receiver, administrator or a similar role for companies or individuals in financial difficulties or of adviser to other professionals acting in these capacities. Clients may also turn to accountants for advice before financial difficulties reach a critical stage. In many cases, therefore, this area of practice is known as "insolvency and corporate recovery".

Trusteeship and administrative duties

In certain countries, accountants frequently act in a fiduciary capacity for clients, handling investments and similar financial arrangements.

Valuation and civil litigation

Accountants are often asked to contribute their specialist expertise when assets or businesses are being valued, particulary when businesses are being sold as a going concern. Potential investors will offer a price based on an assessment of future returns, taking into account the level of risk, and much of the information they require for decision-making is accounting-based. Similarly, accountants can be called upon by courts and those involved in litigation to express their expert opinions on matters which are uncertain or under dispute.

IV. Regulation of the Accounting Profession

In order that our profession, and the services it provides, remain responsive to the ever-changing needs of the market place and the public interest, it is evident that concerted effort is needed to develop and maintain the highest levels of technical and performance standards, competence and integrity. It is also natural that structures should exist to represent the profession in its dealings with the public authorities, regulators and others, as well as to support individual accountants and firms in the provision of services to their clients and employers.

Areas Requiring Regulation

To meet the requirements mentioned above, regulatory measures are necessary in the following areas:

Technical and performance standards

— Accounting standards
— Auditing standards
— Other performance standards (e.g. for management and public sector accountancy)
— Quality control standards

Competence

— Education
— Training
— Examinations
— Post-qualification education and training

Professional conduct rules

— Independence
— Fees and commissions
— Incompatibilities
— Clients' monies
— Relations with colleagues
— Advertising and solicitation
— Professional indemnity insurance
— Scope of practice
— Form of practice
— Relations with other professions

Enforcement procedures

Responsibility for Regulation

In a democratic, market-economy society, there are several arguments in favour of entrusting all regulatory authority and power to the accountancy profession itself.

The state is a major user of accountancy services, but its needs may not be the same as those of others. Hence, it may not always be in the broader public interest for all regulatory authority to rest with the state. In a civil society, it is accepted that the state should not determine all aspects of economic life, so some autonomy must be granted to those most directly involved.

At a time of privatisation, deregulation and decentralisation, it is held by many that it can be more efficient, effective and economical for governments to delegate responsibilities to the private sector.

Many forms of government regulation are based, directly or indirectly, on legislation, and this can often be inflexible and slow to change. Since accountancy is a discipline which must evolve constantly to remain relevant to a rapidly changing environment, the greater flexibility of private sector self-regulation has advantages.

Finally, if the accountancy profession is itself responsible for the regulatory framework which governs it, accountants will be better motivated to follow both the letter and the spirit of the rules which they themselves have developed, as opposed to externally-imposed requirements.

On the other hand, it must be recognised that many people share the suspicions of George Bernard Shaw, who said that all professions are a conspiracy against the layman. I do not believe this fear to be justified but, for a profession such as ours whose relevance and success depends on the public's trust in us to look after their interest, especially in relation to auditing, we must be prepared to accept such compromises as are necessary to maintain this trust. Some form of external involvement in the regulation of the profession is therefore, on balance, usually in the profession's best interest, if this leads to greater public confidence in the services that are provided.

To avoid the risk of incorrect perceptions of the profession, it is both in the profession's interest and the public interest for the state to intervene, at least to oversee the regulation of the profession to ensure fair play between all the relevant parties involved. This is especially the case where the profession enjoys privileges awarded by the state, such as the audit monopoly in many countries.

A degree of government involvement in the regulation of the profession is also a form of recognition of the importance of accountancy services, and therefore can be seen as increasing the status of both the profession as a whole and individual accountants.

The balance struck between self-regulation and governmental regulation differs from country to country, in response to different national conditions, but a common solution is one whereby the state reserves ultimate responsibility for the regulation of at least some accountancy activities to itself, but then delegates these powers to self-regulatory professional bodies. As long as the profession is seen to be conducting its affairs properly, the government does not intervene.

Common Responsibilities of Government

Given the differences between countries, any attempt to describe a "typical" division of responsibilities between governmental regulation and self-regulation can only be a broad overview or generalisation. Bearing this in mind, the type of responsibilities often handled directly by government include:

— definition of scope of practice
— definition of form of practice
— definition of general rules on professional integrity
— specification of entry requirements for the profession
— protection of the professional title
— accounting and auditing requirements imposed on enterprises

The role of the state can therefore be seen as one of defining the general framework within which accountants operate, and within which the profession enjoys its own self-regulatory powers.

One special case is accounting standard setting. Often this is not handled by government and/or the profession only, but involves representatives of the many preparer and user groups with an interest in financial reporting.

Common Self-Regulatory Responsibilities of the Profession

Subject to the same caveats as mentioned above, among the tasks often handled by the self-regulatory structures of the profession are the following:

— setting of audit and other technical performance standards
— quality control standards and programmes
— administration of education, training and examinations
— development of detailed professional conduct rules
— representation of the profession
— support services for members

Enforcement of professional conduct rules is frequently dealt with by the professional bodies, but very often with the involvement of external representatives to ensure the transparency and apparent fairness of the process, and to provide the necessary reassurance to the wider public.

Differences in Approach

The preceding sections have attempted to identify those areas in which the regulation and structure of the accountancy profession is similar throughout Europe. However, there are several differences of detail.

- of the many services provided by our profession, some countries choose to regulate a large number, whilst others leave those unregulated, allowing freer operation of market forces. Only statutory auditing is regulated in all countries.

— when countries do regulate a particular activity, it is very common for them to do so by restricting the provision of the service in question to those who are appropriately licensed. This is often done by awarding a monopoly to members of particular professions, but this monopoly can be awarded to either our profession or shared between several professions. In some cases it may even be extended to certain non—professionals. An example of this is provided in some countries by tax advice and accounting services.

— as mentioned earlier, the balance between regulation by government and self-regulation varies. The existence of public-law professional bodies, or chambers, in German-speaking countries is a special case in point.

— the concept of the accountancy profession also differs from country to country. The German language does not even have a word for "accountant". In some countries, membership of the profession is regarded as being the same as holding a licence, or functional title, to provide certain regulated services to the public. Once the accountant in question leaves public practice, he must surrender his title and thereby ceases to be regarded as a member of the profession. In other countries, the professional title awarded is more equivalent to an educational title, which the accountant retains throughout his life, no matter what career he

follows. This explains the apparent disparities in the size of the accountancy profession between Germany and the United Kingdom, for example.

— Countries also differ as to the permitted scope of practice of accountants, and the legal forms in which they may practise.

Impact of the Single Market on the Regulation of the Profession

Despite the differences which currently exist between the countries of Europe as regards the regulation and structure of the accountancy profession, greater convergence can be expected in the future. The removal of many differences will come about as a result of the steps being taken to create the Single EC Market, the extension of its rules to the other members of the 19-country European Economic Area, and the impact of other countries following the EC example.

For example, the 1984 Eighth Company Law Directive sought to lay down common standards for the education, training and qualification of statutory auditors, and contained further provisions on auditor independence; the ownership, management and structure of audit firms; and related issues.

The Eighth Directive did bring certain benefits, but in no way did it lead to the creation of a single EC accountancy profession, nor did it deal with many important issues. For example, the directive:

— deals only with statutory auditing, and not with accountancy as a whole. Its coverage is therefore incomplete;

— lays down minimum standards only. Member States are free to require higher standards, and many do;

— does not deal with many aspects of the structure of the profession and the rules which govern the practice of accountancy. Significant differences therefore remain between countries regarding scope of practice, incompatibilities of activities, advertising, fee-setting, etc;

— does not grant accountants practice rights in EC countries outside their home Member State. Whilst a procedure is foreseen whereby Member States may give recognition to qualifications obtained elsewhere, they are under no obligation to do so;

Thus, 27 years after the signing of the Treaty or Rome, a common market for accountancy services had still not been achieved.

Some progress can be expected as a result of the recent directive on the mutual recognition of professional qualifications, which was adopted in December 1988 and was due to come into force in January 1991, although some Member States have yet to comply with their obligations. This will permit an accountant carrying on certain activities in one Member State, and using a professional title to do so, to move to another Member State and have the right to the equivalent title necessary to carry on the same activities in that country.

This is a major step in the direction of a single market in accountancy and is a significant improvement on the Eighth Directive, but it still does not remove all remaining barriers. For example:

— the directive applies only to persons and not to firms, which are the most common practice units in many countries.

— because of differences in the structure of the profession in different countries, the range of activities covered by different professional titles can vary considerably, making it difficult to work out which titles correspond to each other.

— the directive deals with mutual recognition in the context of freedom of establishment; that is, it is designed for accountants moving on a reasonably permanent basis to another country and acquiring the local professional qualification. It does not deal with the cross-border provision of services.

— access to a new title is not automatic. To provide adequate protection to the public, the accountant is required to pass an examination in local law and tax in the host country.

— ethical supervision of migrant accountants is on a host country basis (unlike the case for banks, which involves home country supervision). In addition, a previous arrangement continues under which migrant accountants are bound by the ethical rules of both their home and host countries - and, should there be a conflict, by the more onerous of the two. This can have unusual implications.

Thus, the impact of the mutual recognition directive is not so much to create a single accountancy market, but to recognise the continuing existence of 12 separate national markets, each with its own characteristics, and to facilitate movement between these markets. Given the ultimate objective of a true single market, this solution can only be regarded as a provisional one which, sooner or later, will have to change. Indeed, a case currently before the Court of Justice could require the dropping of the obligation to be established in a country so as to be authorised to act as a statutory auditor there.

Regulation in a Market Economy

A further development which may influence the future direction of the regulation of the accountancy profession is a consequence of the growing understanding that all the professions operate in a market economy. On one hand, this seems obvious, but on the other hand, it has been a widely held view for quite some time that the operation of market forces is incompatible with maintaining and enhancing the high quality of professional services.

This view has now been challenged, not least by a 1985 OECD study on competition policy and the professions. Facilitating the freer operation of market forces has been a major objective of the EC's Single Market programme, and the Commission Directorate General for Competition recently had a study carried out on competition within the accountancy profession.

The growing consensus is that the regulation of all professions, including the accountancy profession, should be done in a way which is not unfairly in restraint of competition, and which is not more burdensome than necessary to achieve and improve the high standards of quality which are needed to protect the public interest.

Areas of regulation where it is sometimes difficult to strike a correct balance include:

— scope of practice limitations
— professional conduct rules
— entry requirements
— forms of practice entity.

One must always ensure that the benefits of new regulations are not outweighed by the costs.

It should also be remembered that market economies are no longer national, but regional and global. Therefore, if the accountancy profession is to serve the public interest by meeting the market's need for high quality services, it must be able to do so regionally and globally.

At the professional level, regional and international organisations such as FEE, IFAC (International Federation of Accountants) and IASC (International Accounting Standards Committee) have been created.

Individual accountants and firms are becoming more international in their practice, with networks and alliances at regional and worldwide level.

Intergovernmental organisations such as the EC, OECD, United Nations, GATT and the Council of Europe deal with many of the issues which arise from the practice of the profession in different jurisdictions. Initiatives have been launched to encourage, facilitate and even require the regional and international mutual recognition and harmonisation of professional standards and qualifications, audit reports and financial statements.

The accountancy profession has developed and prospered, in the public interest, by adapting the range and quality of its services to meet constantly changing market needs. If the public interest is to continue to be served, it is essential not to regulate the accountancy profession in a way which hinders this innovation in the future. Instead, the regulatory framework should support and guide this innovation so as to ensure that the legitimate needs of all interested parties are met in a balanced manner.

The Accounting Profession: Professional Qualification and Control

Eero Prepula

The objective of an audit of financial statements, prepared within a framework of recognised accounting rules, is to enable an auditor to express an opinion on such financial statements. The auditor's opinion helps to establish the credibility of the financial statements. While the auditor is responsible for forming and expressing his opinion on the financial statements, the responsibility for their preparation is that of the management of the company. The audit does not relieve management of its responsibilities. Management's responsibilities include the maintenance of adequate accounting records and internal controls, the selection and application of accounting policies, and the safeguarding of the assets of the entity.

Today the importance of the auditor's role as an independent professional is widely acknowledged. The external audit process is important to the credibility of financial information because of the objectivity that an independent professional introduces into the financial reporting process. Whether financial information is relied on for purposes of distribution of profit, raising capital in domestic or international capital markets, or for fiscal and statistical purposes by governments, the objective scrutiny of an impartial expert is crucial to the integrity of that information. Users of financial information must view outside auditors as competent, impartial overseers of the financial statements.

To qualify as an approved (i.e. certified or chartered or authorised) auditor, a candidate must meet the requirement of competence. Generally in the OECD countries a person may be approved only after:

— having attained university entrance level,
— then completed a course of theoretical instruction,
— undergone practical training and
— passed an examination of professional competence of university level organised or recognised by the state.

The European Community issued its 8th Council Directive in 1984 on the approval of persons responsible for carrying out the statutory audits of accounting documents. When fully implemented by EC Member States and the other Member states of the European Economic Area (EFTA countries, except Switzerland) it will result in a great degree of uniformity regarding auditor qualifications in most OECD Member Countries. The Directive contains a detailed list on those subjects which must be included in the examination of auditor's professional competence. As regards the practical knowledge which must also be tested in the examination, this must be acquired by a minimum of three years' practical training in the auditing of annual accounts, consolidated accounts or similar financial statements. At least two-thirds of such practical training must be completed under an approved auditor.

The Directive does not specify the national authority having the power to grant approval of persons responsible for a statutory audit of accounts. It is therefore for the Member States to choose an administrative authority or a professional association, provided that in the latter case the association is authorised by national law to grant such approval.

The examination of professional competence is intended to guarantee the necessary level on theoretical knowledge of the candidate and the ability to put such knowledge into practice. The auditor

must be competent and independent. This condition has to be satisfied, both upon his appointment and during the course of his mandate. The independence is as well of a moral (independence as a state of mind) as of a financial (no financial interest in the client) nature.

Within generally accepted auditing standards a framework of independence has developed which relies on three essential concepts:

- the prohibition against the auditor's to managerial decisions of the client;
- a framework of rules prohibiting the existence of family relationships with respect to the client;
- the absence of financial interests, direct or indirect, in the client (e.g. absolute prohibition to receive loans from a client).

The 8th Directive prescribes that the authorities of a Member State shall grant approval only to persons of solid reputation. It also requires Member States to prescribe that persons approved for the statutory auditing of accounts shall carry out such audits with professional integrity. The principle of the independence of auditors is expressly laid down by the Directive, but it leaves it to Member States to determine the conditions of this independence and the appropriate sanctions.

More and more, the audit is carried out on behalf of an auditing firm. The 8th Directive allows Member States to also approve firms of auditors where they satisfy a number of conditions. These conditions must ensure that control of the firm remains with qualified professionals and that there is no interference by other people in the execution of the audit.

In addition to adequate criteria covering the qualification of auditors and the development of rules of conduct regarding the independence of auditors, there are other important considerations. Approved auditors and approved auditing firms must examine and report on financial statements in accordance with the re-quirements of legislation, regulations or relevant professional bodies. The auditing standards utilised by auditors in the performance of their examinations of financial statements are also essential to the credibility of the audit process. These standards are comprised of:

- general standards regarding auditor qualifications and due care,
- standards on planning, testing, evidential material documentation and
- reporting standards which set out the minimum content of the auditor's report.

The International Federation of Accountants and most national professional bodies have developed guidance in the area of auditing. But those bodies, like other private-sector bodies, can not necessarily mandate compliance with their pronouncements. They must rely on persuasion and voluntary compliance. Mandatory standards can be set by supervisory bodies (governmental or self-regulation).

Confidentiality is also essential to the credibility of the audit process. The auditor should respect the confidentiality of information acquired in the course of his work. The auditor should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose.

The supervisory bodies may impose sanctions on approved auditors who violate professional rules and guidelines. The possible sanctions consist of:

- remark and/or warning;
- cancellation of the professional licence.

In forming his opinion on the financial statements, the auditor carries out procedures designed to obtain reasonable assurance that the financial statements are properly stated in all material respects.

Because of the test nature and other inherent limitations of an audit, together with the inherent limitations of any system of internal control in the client organisation, there is an unavoidable risk that some material misstatement may remain undiscovered. However, any indication that some fraud or error may have occurred should lead the auditor undertake all reasonable efforts to confirm or dispel his suspicions.

Auditing firms use quality control procedures to ensure that the legal rules and generally accepted auditing standards are complied with. Such systems of quality control include the necessary policies and procedures to provide the auditing firm with reasonable assurance that due care and attention is given in such areas as hiring, professional development, assignments of personnel supervision, independence, consultation, acceptance of clients, and inspection.

In some countries, e.g. in US, Canada and Ireland, there are actual quality control systems required by regulations or professional standards where an outside body monitors and enforces compliance with quality control standards through periodic reviews. On the other hand, such quality reviews by an outsider are so expensive that in most countries there are no statutory provisions concerning quality controls for approved auditors when conducting an audit.

When business enterprises fail, the auditor may be the only remaining party with sufficient financial resources or insurance coverage against which litigants can proceed. The principle of joint and several liability, applicable in many negligence and some fraud actions, aggravates the problem by allowing successful claimants to collect all or part of any damages from any defendant held liable, irrespective of the degree of fault. Under this system of liability auditors often find themselves virtually alone in this respect and are frequently sole defendants in legal actions in which inadequate auditing is alleged. The fact that auditors traditionally practice in partnerships and thereby professional liability extends even to the personal net assets of individual partners has made resolution of the liability problem acute.

In some countries the liability of an approved auditor who has acted negligently is limited by virtue of legislation. In Germany, for example, the prescribed limit is DM 500.000 for one audit. However, the limitation of liability only applies, however to the conduct of statutory audits. With regard to voluntary audits or advice, liability is unlimited by statute, but frequently limited by agreement.

ANNEX I

ACCOUNTING ACT OF THE REPUBLIC OF ESTONIA

The Accounting Act of the Estonian Republic lays down the methods of accounting and the rules of maintaining accounting records for juridical persons of the Estonian Republic.

I. GENERAL PROVISION

Art. 1. The accounting system used in the Republic of Estonia shall correspond to internationally recognized basic principles of accounting in conditions of market economy.

Art. 2. In the Republic of Estonia, accounting records shall be maintained by juridical persons, including:

1) Enterprises registered under the Enterprise Act;

2) Bodies of State and local authority funded from State and local budgets;

3) Other institutions and organisations.

Art. 3. The present Act does not cover private farms and self-employed person, for whom the rules of accounting and maintaining accounting records shall be determined by tax legislation.

Art. 4. Those obliged to maintain accounting records shall proceed from the present Act, from other normative acts of the Republic of Estonia, their statutes, as well as the instructions and recommendations issued by the Accounting Administration set up under the present Act.

Art. 5. Those obliged to maintain accounting records shall lay down in-house rules concerning the recording of transactions, the circulation of accounting documents, the processing of documents, the keeping of ledgers, inventory taking, the preparation and analysing of accounts.

Those obliged to maintain accounting records shall be in possession of a set of national normative acts regulating the maintenance of accounting records as well as relevant instructions, issued by the enterprise (institution, organisation) which shall be complemented when needed.

Art. 6. Heads of enterprises (institutions, organisations) shall be responsible for organising the maintenance of accounting records, and shall bear responsibility for is under the laws of the Republic of Estonia.

To fulfill this obligation, they may choose different ways:

1) Create an accounting department as a part of the structure of the enterprise (institution, organisation), headed by the chief accountant;

2) Sign a contract with an outside certified accounting firm to use its services;

3) Sign a contract with an outside certified accounting expert to use his or her services.

Budget financed Bodies of State and local authority may, according to mutual agreement, transfer their accounting activity either to the accounting department of the respective body of authority or to the regional accounting bureau (centralised accounting department).

Art. 7. Those obliged to maintain accounting records shall apply the double entry principle in their accounting.

Art. 8. When maintaining accounting records, the observance of laws regulating the protection of business secrets and of information concerning enterprises shall be guaranteed. In accounting, the following items shall be regarded as business secrets: information concerning business relations; the costs and profitability of subunits and products of the enterprise; costing and pricing of products; the financial strategy and tactics of the enterprise. Information that is regarded as a business secret may not be demanded from an enterprise in its accounts.

All persons (including auditors) who, in the course of performing their duties, learn business secrets shall be obliged to maintain their confidentiality.

Art. 9. Accounting reports shall be presented in the Estonian language and in Estonian currency.

II. RECORDING OF BUSINESS TRANSACTIONS AND THEIR ENTRY INTO BOOKS OF ACCOUNT

Art. 10. Business transactions shall be entered into chronological and systematic books of account.

Chronological entries shall be contained in a book of business transactions (book of original entry). Books of systematic entries shall include: the general ledger (containing synthetic accounts) and books of analytical entries (subsidiary ledgers, card files, etc.). Chronological and systematic synthetical accounting may be combined into one book (general ledger).

Instead of one book of business transactions (book of original entry) several specialised books may be kept.

Books of accounts may be kept and retained:

1) In handwriting (manually);

2) As a computer printout;

3) In the form of legible microscript;

4) On punched cards, punched tape, on magnetic discs or magnetic tape, etc., which can be reproduced as a computer printout.

The keeping and retention of records referred to in (3) and (4) without computer printout (2) shall be subject to permission by the Accounting Administration.

Art. 11. Entries into books of account shall be based on original documents, certifying business transactions, or documents, containing summary information (summary vouchers).

An original document in accounting shall be a written record confirming the transaction. An original document shall contain the following:

1) Name and number of the document;

2) Date and place of preparing;

3) What the business transaction involved and what it was based on;

4) Numerical data concerning the business transaction (the amount concerned, price and sum total);

5) Signatures of the persons involved in the business transaction who shall be responsible for the accuracy of the information on the original document.

Depending on the nature of the business transaction concerned and the data processing system used, other information may be added.

Documents shall be prepared while the business transaction takes place of if this is not possible, immediately after it has taken place.

Art. 12. Entries into the general ledger shall be based on accounting records, prepared on the basis of original documents or summary vouchers, which contain the date and number of registration of that record in the book of chronological entry, the synthetic asset and liability accounts, as well as the sums involved in the business transaction. The accounting record shall either take the form of a memorial order attached to the document or shall be marked on the document itself. The number of the accounting record shall be indicated in the entries made into the accounts of the general ledger.

Art. 13. Cash receipts and payments shall be recorded no later than the next working day. Other business transactions shall be recorded in accordance with the needs of providing the enterprise with operative information.

Art. 14. Entries on accounting documents and in ledgers may not be erased; nor shall they be corrected without adding a correction entry. In case a correction is made, the data of the correction and the signature of the person making it shall be added.

Financial documents shall contain no corrections.

Incorrect entries in ledgers shall be corrected with using the cross-entry method.

Art. 15. Based on the standard account schedule adopted by the Accounting Administration, persons obliged to maintain accounting records shall prepare account schedule of synthetic accounts for the enterprise (institution, organisation).

Persons obliged to maintain accounting records shall fix for each synthetic account its analytical subdivisions (if possible, also a specific listing).

Art. 16. Accounting documents and ledgers shall be retained in the enterprise (institution, organisation) until the annual account is prepared. Upon this, they shall be submitted to the archives of the enterprise (institution, organisation) where they shall be retained in accordance with the national rules concerning archives.

Account schedules, accounting instructions as well as descriptions and programs of mechanized or automated accounting procedures, bearing a note stating the duration of their use, shall be retained in the enterprise for a period no shorter than five years after the end of the financial year, so that the account schedule and accounting procedures used earlier can be checked upon.

III. ASSETS AND LIABILITIES

Art. 17. The assets of enterprises consist of fixed and current assets. Fixed assets participate in the economic activity for a longer period of time and are depreciated. All other assets are current assets.

Small assets (assets such as instruments, furniture, etc., that are cheap and used for a short period of time) shall be included among the current assets. The upper price limits and period of use of small assets as well as the rules of making inventories of them and the entry of their cost into books shall be fixed by the enterprise.

Art. 18. The fixed and current assets of an enterprise shall be started in accounts at their cost, consisting of the purchasing price, delivery, construction, installation and implementation costs.

On the balance sheet, the fixed and small assets of an enterprise shall be shown at the balance cost (cost and depreciation shown separately), whereas the current assets shall be shown at their cost.

Art. 19. The cost of reconstructed fixed assets shall be increased by the amount of reconstruction costs.

Art. 20. Re-valuations of the property of the enterprise, as well as the recording of the results of re-valuations in the accounting records shall be based on a respective decree by the Estonian government or on the instructions of the Accounting Administration.

Art. 21. Foreign currency dealings shall be shown in Estonian currency according to the exchange rate of Bank of Estonia effective on the day or operation. Change in the exchange rate shall be shown as a profit (loss) of the enterprise.

On the balance sheet, foreign currency shall be evaluated according to the exchange rate of Bank of Estonia effective on the day the balance sheet is drawn up.

Art. 22. The enterprise shall fix internal depreciation rates for all types of fixed assets within the depreciation limits set in the Republic of Estonia for different types of fixed assets. The limits of depreciation rates shall be fixed by the Ministry of Economics of the Republic of Estonia.

Calculation of the depreciation of fixed assets shall be terminated when they are 100 per cent depreciated in the accounting records.

Art. 23. The financial results from the sale of enterprises fixed and current assets shall be shown as the profit (loss) of the enterprise.

Art. 24. When buying an enterprise or part of it, the buyer increases the assets and liabilities of his/her enterprise by the amount shown in the seller's accounting records. If the purchasing price exceeds the seller's recorded value, the difference between them will constitute goodwill. Goodwill shall be recorded by the buyer in a special asset account under that name, being liable for depreciation within 10 years.

Art. 25. If the enterprise introduces changes into the system used for recording property or changes its depreciation rates, it shall indicate the nature of the changes in the annual report for that year and show the resulting differences in terms of money in the balance sheet as well as in the profit and loss statement.

Art. 26. The profit (loss) of the accounting period shall be calculated with respect to all goods (products, services) realized during the accounting period, i.e. those that have been delivered or shipped to the purchasers, irrespective of the time the money is received.

Accounts yet to be received represent a debitory credit, which is to be recorded in respective asset accounts. Upon receipt of money the debitory credit is written off.

Art. 27. Advance payments received as a part of sales operations represent a liability to be shown in the respective liabilities accounts. As a sales contract is fulfilled, the sum of the advance payments is deducted form the sales liabilities account.

Art. 28. A foregone liability is written off according to the decision of the management (general meeting), as a loss incurred by the enterprise or is covered form a special reserve fund.

An overdue asset is transferred into the profits of the enterprise. Relevant explanations shall be presented in appendices to the annual account.

Art. 29. Liabilities (assets) and credits which fall due in more than one year are viewed as long-term liabilities and assets. For each long-term liability and assets, those obliged to maintain accounting records shall prepare a chart of payments (payment received), indicating the sum to be received (paid) according to the dates of maturity, as well as the interest and the sum total. In appendices to the annual account the balance of every long-term liability (asset), as well as the dates they fall due and the interest, shall be shown separately.

Art. 30. For the purpose of calculating the cost price of the production sold, the costs shall be divided in such a way that the cost price of the production sold over a given period includes only the expenses linked with the manufacturing and sales of this production.

Art. 31. Major expenses incurred by the enterprise as a part of technical research, trial runs, marketing, etc., for the forthcoming periods may be indicated as the expenses of forthcoming periods, to be included in the cost price of the production not later than within the coming five years, or covered from special funds of the enterprise.

The foundation expenses of a shareholding company may be capitalised and included in the expenditures within the next five years.

Art. 32. Articles 17-32 of the present Accounting Act shall apply to other institutions and organisations mentioned in point 3 of Article 2.

The property and accounts of budget-financed institutions shall be recorded in accordance with rules fixed by the Ministry of Finance of the Republic of Estonia.

IV. ANNUAL REPORTS

Art. 33. All enterprises shall compile a report for the past financial year, which shall include a balance sheet, profit and loss statement, financial report, as well as any appendices.

Art. 34 A financial year lasts 12 months. As a rule, the financial year coincides with the calendar year. Subject to approval by the Ministry of Finance of the Republic of Estonia, the financial year of an enterprise may last:

1) from May 1 to April 30, or

2) from July 1 to June 30, or

3) from October 1 to September 30.

In the case of starting or closing down an enterprise, the financial year may not exceed 15 months.

Art. 35. All Annual Reports shall be compiled and endorsed within three months following the financial year of the enterprise.

An endorsed copy of the Annual Report shall be presented to the Department of Statistics of the Republic of Estonia within four months following the financial year of the enterprise.

Art. 36. The Annual Report for the past financial year shall be drawn up and endorsed as follows:

1) in the account books of the enterprise, all current operations of the enterprise during the financial year shall be entered, an inventory shall be made of the property and resources of the enterprise; regulating and terminating entries shall be made; the profit (loss) shall be calculated; final balances of the balance account shall be calculated, and reports, charts and appendices shall be drawn up;

2) in the Report, a proposal by the management as to the distribution of the profit for the financial year shall be recorded;

3) if the enterprise has an administrative board, the Report shall contain an assessment of the administrative board of the activity of the management during the past financial year;

4) an auditing check on the Annual Report shall be carried out. The auditor's approval (or rejection) of the Report shall be added to the Report;

5) the Annual Report, complemented with the auditor's evaluation shall be presented to the owners of the enterprise (depending on the type of the enterprise, either to a higher body or to the owner's general meeting) for endorsement.

Art. 37. Appendices to the Annual Report shall contain, at least for the previous two financial years:

1) calculations regarding State taxes and local government taxes;

2) the distribution of the profit;

3) the structure of capital and financial investments;

4) the dates of maturity and structure of long-term loans;

5) the dates of maturity and structure of long-term assets and liabilities;

6) the structure of shares and participation payments;

7) the structure and dynamics of fixed assets and calculated depreciation;

8) the structure and dynamics of special funds;

9) information about after-balance accounts;

10) changes introduced into the enterprise's accounting methods;

11) basic points of the financial analysis of the enterprise, as well as explanatory notes.

Art. 38. In accordance with an enterprise's own rules, monthly and quarterly accounts may also be drawn up.

Art. 39. The profit and loss statement of an enterprise shall be drawn up based on the following scheme:

1) Gross turnover of the realisation.

2) Deductions from the gross turnover (different types specified).

3) Net turnover of realisation (p.1-2).

4) Costs (different types specified).

5) Profit (loss) form realisation (p.3-4).

6) Financial income (different types specified).

7) Financial expenditures (different types specified).

8) Gross profit (loss) (p.5,6-7).

9) Taxes and allocations reducing the amount of taxable profit (different types specified).

10) Sums increasing the amount of taxable profit (different types specified).

11) Amount of profit subject to income tax (p.8-9,10).

12) Income tax of the enterprise.

13) Other taxes and allocations levied on or paid from the profit (different types specified).

14) Net profit (loss) of the enterprise (p.8-13).

Art. 40. The balance sheet of the enterprise shall be drawn up according to the following basic scheme:

Assets

1. Fixed assets and other long-term assets.

    1.1 Fixed assets (different types specified).

    1.2 Other long-term assets (different types specified).

2. Current assets and other short-term assets.

    2.1 Cash (different types specified).

    2.2 Short-term investment (different types specified).

    2.3 Debitory credit (different types specified).

    2.4 Reserves (different types specified).

    2.5 Other short-term assets (different types specified).

Liabilities

1. Equity

    2.1 Restricted equity (different types specified).

    2.2 Unrestricted equity capital (different types specified).

Art. 41. The report of the financial situation of the enterprise shall be drawn up according to the following basic scheme:

1) Sources of working capital in the financial year (different types specified).

2) Use of working capital in the financial year (different types specified).

3) Increase (+) or decrease (-) of the working capital in the financial year (p.1-2).

(4) Change in the amount of working capital according to the balance sheet date (changes in the initial and final balances of the balance sheet entries).

Art. 42. The structural scheme for Annual reports of an enterprise shall be fixed by the accounting Administration.

Art. 43. The schemes for the Annual Reports of other institutions and organisations mentioned in p.3 of Art. 2 of the present Accounting Act shall be fixed by the Accounting Administration.

The Annual Reports of budget-financed institutions shall be drawn up and presented in accordance with the rules fixed by the Ministry of Finance of the Republic of Estonia.

Art. 44. The Annual Reports of an enterprise (institutions, organisation) shall be maintained permanently.

V. ESTONIAN ACCOUNTING COMMITTEE

Art. 45. Accounting work shall be guided by the Estonian Accounting Committee of the Ministry of Finance, which shall issue mandatory accounting instructions as well as recommendations concerning the methods used.

The Estonian Accounting Committee shall endorse a procedure for certifying accounting specialists.

Art. 46. The Estonian Accounting Committee shall have a Chairperson appointed by the Government of the Republic of Estonia for a period of three years. The Chairperson shall appoint members to his board. One of the members shall be a lawyer. The Chairperson of the Administration and its members shall be experts in the field of accounting, either researchers or practitioners.

The Estonian Accounting Committee shall have a legal quorum if the Chairperson or Vice-Chair, as well as three other Members, one of them a lawyer, are present.

Art. 47. The Estonian Accounting Committee shall pass decisions with a simple majority of votes. If the votes are divided equally, the Chairperson shall have the decisive vote.

Art. 48 Being part of the Ministry of Finance of the Republic of Estonia, the Estonian Accounting Committee shall have its own ;independent budget. The work of the Members of the Estonian Accounting Committee, as well as the experts involved, shall be remunerated.

VI. IMPLEMENTATION OF THE ACCOUNTING ACT

Art. 49. In case of non-compliance with the present Act, juridical persons shall be liable to sanctions provided for the legislation of the Republic of Estonia, including a ban on their activity.

Art. 50. Compliance with the present Act shall be enforced by the Ministry of Finance of the Republic of Estonia.

From those obliged to maintain accounting records, the Ministry of Finance has the right to receive the information necessary for the implementation of the present Act.

ANNEX II

ACCOUNTING LAW OF LATVIA
(Draft Translation)

Part 1

General Rules

Paragraph 1

This Law applies to all undertakings, businesses and non-profit organizations which are registered in the Latvian Republics Business Register, irrespective if their form or ownership, to the offices and organizations which are being financed by State or Municipal budgets as well as to social organizations, trade unions, religions organizations, political parties and public foundations.

Paragraph 2

Businesses, Corporations, Government offices or organizations (further referred to as "businesses") should record all business transactions and changes in their assets and liabilities. The accounts should be organized in such way as to enable a third party to follow through afl transactions and to obtain a clear picture of the business at any given time.

The information should be timely, meaningful, true and comparable. Clear borders should be set between profit and loss in each fiscal year. The responsibility for establishing and maintaining the accounting system rests with the manager, or in the case of a sole proprietorship- its owner (further referred to as "manager". The manager is also responsible for the safekeeping of all source documents, either the actual documents or its facsimiles.

Paragraph 3

The manager can organize the accounting:
- by creating an accounting department;
- by contracting out with an outside accounting or other firm to provide for accounting service;

The owner of sole proprietor can keep the accounts by himself.

Paragraph 4

Business information contained in annual statements published or obtainable by the general public, are not regarded as confidential business information. All other accounting data is regarded as confidential and can only be obtained by auditors, by government tax authorities to check the correctness of tax application, as well as other governmental institutions in cases as prescribed by law.

Paragraph 5

All accounting monetary values are expressed in Latvian currency units.

Part 2

Accounting Registers

Paragraph 6

Books of account must be in Latvian language.

If there is a foreign business partner, then other languages can also be applied, providing that it is understood by internal and external auditors.

If any abbreviations, codes or symbols are employed, the meaning of them should be clearly evident.

Paragraph 7

No entries in the books of account are permitted without a source document. A source document contains the following prerequisites: Business name, type of the document, date, the nature of the transaction, quantities and the money amounts, signatures of the officials responsible for the transaction and correctness of information. Adjuncts to certain documents include serial numbers, seal etc.

Entries in the books of account must be made timely, fully, accurately and systematically. No entries are tolerated which deviate from source documents

Corrections or changes in the books are done in such a way that the purpose and the nature of the correction is substantiated and that the original entry is preserved.

Electronic Data Processing is only permitted if the requirements of this Act are fully preserved and print-outs or visual readings can be furnished for third parties.

Paragraph 8

Cash and bank transactions are to be posted daily and balances at the close of each business day be calculated. Businesses with daily cash intake not exceeding the official minimal monthly wage can make weekly cash postings and balances. Businesses using Cash Registers can use the sum total of the tape as basis for the posting. Other business transactions must be recorded in accounts timely, but not later than 20 days after the appropriate month's end, and at the end of the accounting period.

An externally produced source document takes precedence over an internal one. An external document is prepared by parties that deal at arm's length and not by our own business, its proprietor or his family members or other business that they may own. Source documents prepared by the latter are all considered as internal in nature.

Paragraph 9

Businesses whose annual income exceed 1000 minimal monthly wage amounts, have to maintain a double-entry accounting system. AU others can use any of the generally accepted recording systems, providing they satisfy the taxation authorities. The provisions of this paragraph do not apply to offices and organizations financed by state or Municipal budgets, whose bookkeeping and accounting is regulated by the government of the Republic of Latvia.

Paragraph 10

Each business must keep its books of original entry, inventory records and annual Financial Statements complete with notes, organizational programs (Charts of Accounts etc.), systematically arranged for the periods of:

Annual Financial Statements and Notes as well as the Business Ledger - 10 years and subsequent storage at the State Archives.

Inventory Records, books of original entry and source documents - 10 years.

Source documents re payroll, segregated by year and month - 75 years.

All other documents - 5 years.

Data processed electronically must be kept for periods enumerated above. If a business is liquidated, the liquidators and the State Archives Board make a determination as to the preservation of the books and records. The manager of the business is responsible for his business' books and records and their archives.

Part 3

Inventories & Financial Statements

Paragraph 11

A business, at its commencement, has to prepare an opening Balance Sheet, listing and evaluating its assets - land, buildings and equipment, inventories of raw materials and finished goods, as well as cash and bank balances, together with encumbrances such as claims and debts. Such evaluation must be made at the end of each fiscal year.

Inventories are ascertained by physically counting, weighing, etc. pricing and extending. Accounts Receivable and Accounts Payable must be confirmed. Inventory result are entered in registers. The valuation of assets and liabilities is prescribed by Laws and Regulations.

Assets such as Fixed Assets or certain types of production inventories for which perpetual inventory records are being kept and the fluctuations are negligible, can be shown at their book balances. However, every three years they have to be fully accounted for, by physically ascertaining their volumes and values. Similar assets can be lumped and priced at mean average prices.

Paragraph 12

Uniform products can be inventoried at random by applying statistical methods to determine their value; however, the obtained results cannot significantly differ from the results obtained by ordinary method. Fiscal year-end physical inventories are not mandatory if perpetual inventory records can produce accurate types, quantities and values. Fiscal year-end inventories can be taken 3 months before the actual year-end or one months after it and adjusting the actual amts by incoming and outgoing quantities to arrive at the year-end balance.

Paragraph 13

A business at its commencement or closure must present a special opening or closing Balance Sheet showing its assets and liabilities based on reliable data obtained from inventories. The manager of the business or organization is responsible for the accuracy of the Balance Sheet. All terms and conditions pertaining to fiscal year-end Balance Sheet apply mutatis mutiendis to the opening Balance Sheet. For each fiscal year a Report must be rendered consisting of a Balance Sheet, P&L Statements and Notes.

Non-Profit organizations financed from State and Municipal budgets, religions and social organizations must also submit their yearly Reports, showing the amount of funds received and disbursed, along with the purpose for which they were spent. Full contents of the Report and its prescribed form, as well as the details of presentation, submission and publishing are contained in separate Acts and Regulations.

Paragraph 14

The fiscal year should cover 12 months an usually it coincides with a calendar year. The Ministry of Finance of the Latvian Republic can issue a permission for a business to commence and close a balance on a different date, if the by-laws of the company allow. The initial fiscal year for a commercing business, as well as fiscal year for operating business if opening and closing dates have been changed can be shorter or longer, but not exceeding 18 months.

Part 4

Accounting Methodology

Paragraph 15

The Council of Ministers takes decisions concerning key problems in bookkeeping, as well as determines the authority of governmental institutions with the regard to accounting methodology. The supervision of accounting methodology is entrusted to the Board of Accounting Methodology. It is appointed by the Council of Ministers of the Republic of Latvia and its main objectives are:

- to prepare Laws and Regulations which regulate and guide the accounting,
- to evaluate the Laws and Regulations in light of theirfeasibility and appropriateness,
- to organize training programs,
- to charter auditors,
- to evaluate electronic data processing programs and to report on their feasibility in Latvian Republic.

Part 5

Responsibility for transgressions

Paragraph 16

Managers who have tolerated transgressions of this Law or other Acts respecting accounting or Returns, or who have been grossly negligent or malicious in their duties regarding the presentation of the accounting data, or in the failure to submit the required Statements or Returns, are liable for prosecution in accordance with the appropriate Laws of Latvian Republic.

Paragraph 17

Manager is liable for losses sustained through his gross negligence in breaching this Act to the owners of the business, the State (municipality) or third parties, Physical persons or incorporated entities can recover their losses through appropriate civil proceedings.

Law on Financial Statements in Latvia
(Draft Translation)
General Rules.

Terminology used in the law:

A Parent is a corporation whose capital contribution in another corporation, exceeds 50 per cent, or has the majority of votes.

A Subsidiary is a corporations where the Parent's capital contribution exceeds 50 per cent or where the Parent has the majority of votes.

Affiliated company is a company where the corporation's capital contribution is from 25 to 50 per cent with no majority in voting.

A concern is a group of corporations constituted by the Parent and Subsidiaries. If one or more natural persons are the owners of separate companies, they do not from a concern.

Paragraph 1

(1) This Act encompasses all Latvian Republic's registered undertakings irrespective of their structure or ownership. This Act does not govern banks, other credit institutions and insurance companies which are regulated by a Special Act. This Act does not govern farmers and sole proprietorships whose profits do not exceed accounting *Act para 8 (2000 minimal monthly wages). Statistic accounts are regulated by "Law on Statistics".

Paragraph 2

(1) Financial Statements are expressed in Latvian Republic currency and is prepared in Latvian language.

Paragraph 3

(1) Financial period covers 12 months; The first period can be longer or shorter, not exceeding 18 months or longer if change in fiscal year takes place.

(2) Corporations and establishments of one concern - (associated Co) have identical fiscal year-ends.

(3) Financial Statements should contain Balance Sheet & Profit and Loss Statements explanatory notes and report.

Paragraph 4

(1) Financial Statements has to be clear and precise, in accordance with the provisions of this Act.

(2) Financial Statements has to present true and clear picture of the Organization's assets, liabilities and its Financial results.

Paragraph 5

(1) Balance Sheet and Profit and Loss Statements should be prepared in accordance with formats enumerated in paras 10 to 14. Profit and Loss Statement format can be chosen among the paras 11 to 14.

(2) Profit and Loss format, once selected, can only be changed if there is a special need for it, and if it has been used at least for two consecutive years which has to be disclosed in notes attached to Financial Statements.

Paragraph 6

(1) Item in Balance Sheet & Profit and Loss Statements covered in paras 10 to 14 have to be prepared in sequence given in these paras; however it is allowed to separate them or add new ones, if desired.

(2) Items can be combined if they are insignificant and clarity is obtained; however they must be detailed in notes.

Paragraph 7

(1) Each Balance Sheet and Profit and Loss item has to show comparative figures for prior year if applicable. If they are incompatible, they have to be explained in notes.

(2) B/S & P&L items which have no entries this year, are shown only if last year had an entry against it.

Paragraph 8

No balancing between Assets and Liabilities is permitted.

Paragraph 9

(1) If an asset or a liability covers more than one of the items enumerated in the schedule, it should be clarified with a note following the item, or in notes attached.

(2) Corporations own shares (asset) and capital investments in other entities, are shown in specially designated items.

Balance Sheet and Profit and Loss formats

Paragraph 10

Balance Sheet

Assets

Long term investments

I. Immaterial assets

1. Capitalized research & development costs
2. Concessions, patents, licenses, trade-marks etc.

3. Goodwill
4. Advanced payments for non-material assets

II. Fixed assets

1. Land and buildings
2. Equipment and plant
3. Other fixed Assets and inventory
4. Capitalized costs re unfinished fixed assets

III. Long-term financial investments

1. Investments in subsidiaries
2. Loans (long term) to subsidiaries
3. Shares in associated Corps
4. Loans to associated Corps
5. Debentures, long term notes and Shares in other Corps
6. Other loans (long term)
7. Cost of own Shares or ownership Certificates
8. Loans to employees and board

Current Assets

I. Inventories

1. Raw mats, main stock & supplementary materials
2. Semi-finished goods
3. Finished products & goods for sale
4. Unfinished orders
5. Advances re purchases
6. Draught animals and productive cattle

II. Debtors

1. Accounts Receivable - trade
2. Accounts Receivables - Subsidiaries
3. Accounts Receivables - Associated Companies
4. Other accounts receivables
5. Unpaid calls re shares
6. Short-term loans to employees and board
7. Prepaid expenses

III. Bonds, debentures & shares in capital

1. Short-term loans to subsidiaries
2. Cos own shares or ownership Certs
3. Other short-term notes and shares in capital

IV. Cash on Hand and Bank balances

Liabilities
Own Capital

1. Own Shares or Ownership Capital
2. Premium on Shares
3. Long term asset Revaluation Reserve
4. Reserves
   (a) Specified by this Act (B/ Debt)
   (b) Reserve for own shares or capital parts
   (c) Reserves in accordance with Cos by-laws
   (d) Other reserves.

5. Retained Earnings.
   (a) Re. prior year (Loss),
   (b) Current.

Accruals (Reserves).

1. Accrued pension payments (current),
2. Accrued taxes,
3. Accrued (other).

Creditors: (short a long term).

1. Debentures,
2. Loans payable to be converted into shares,
3. Bank loans,
4. Advances from customers,
5. Loans from suppliers and contractors,
6. Creditors secured by special notes,
7. Loans from subsidiaries,
8. Loans from Assoc. Corp.,
9. Unpaid income taxes,
10. Other creditors incl. other taxes + soc. ins. dues, Deferred revenue,
12. Current year's dividends,
13. Prior year dividends unpaid

Paragraph 11

P&L Statement (vert. form according to periodic payment method).
1. Net Sales.
2. Fin. goods & unfin. goods increases or decreases.
3. Our own asset creation costs.
4. Other income.
5.
   (a) Raw mat & other material costs.
   (b) Other sundry costs.
6. Payroll costs.
   (a) Wages a salaries.
   (b) Pensions.
   (c) Payroll taxes.

7. (a) F. Asset depreciation and amortization.
   (b) Material + product losses (extraordinary).

8. Other sundry costs.
9. Revenue from joint ventures.
10. Revenue from dividends, debentures & other long term investment.
11. Other interest income.
12. Losses of long term investments, securities and short term capital participation.
13. Interest expense.
14. Profit (or loss) before extraordinary income (or loss) and taxes.
15. Extraordinary income.
16. Extraordinary expenditures.
17. Extraordinary (or loss) before taxes.
18. Income tax (current year).
19. Other taxes.
20. Current year's net income (loss).

Paragraph 12

P&L (vertical form according to payment method).

1. Net Sales.
2. Cost of production.
3. Gross profit (or loss).
4. Selling expenses.
5. Admin. , expenses.
6. Other revenue.
7. Revenue from joint ventures or capital investments.
8. Revenue from dividends, debentures, long term investments.
9. Other interest income.
10. Losses of long term investments, securities and short term capital participation.
11. Interest expense.
12. Profit (or loss) before extraordinary income(loss) & taxes.
13. Extraordinary income.
14. Extraordinary expenditures.
15. Extraordinary (loss) before taxes.
16. Income tax (current).
17. Other taxes.
18. Current years net income.

Paragraph 13

P&L (in Account form & according to period pay out method).
Payments

1. Fin. and semi finished goods decrease.
2. na
3. Revenue from joint ventures and capital investment.
4. Dividends, debenture income & other long term investment.
5. Other interest income.
6. Profit (or loss) before extraordinary items & taxes.
7. Extraordinary revenue.
8. Loss for the year.

Special provisions regarding Balance Sheet items.

Paragraph 15

Assets employed in the business on long term basis are classified as Fixed Assets. Others are current assets.

Paragraph 16

Every fixed asset on the B/S or in the notes to the B/S has to contain this information:

1. Its purchase price or cost in accordance with prior years B/S.
2. Additions or improvements in the year.
3. Disposal at purchase price or cost (Notes only).
4. Transfers from or to in the year.
5. Revaluation.
6. Total asset value at B/S (incl. 5. above).
7. Depreciation (amortization) in the current year.
8. Depreciation (amortization) prior year adjustments, incl. disposal revaluation adjustments.
9. Total depreciation (and incl. items 7 and 8).

Paragraph 17

(1) Payments before B/S date but percentage to the next year must be shown in Assets as prepaid expenses. Revenues received before B/S date but pertaining to the next or subsequent years are shown in Liabilities as Deferred Revenue.

(2) Payments pertaining to this year, but payable in the next year are accrued expenses and shown as a liability. Revenues pertaining to this year but receivable in the next year are Accrued Revenue and shown as an Asset.

(3) If items in (1) and (2) are material amounts, they must be covered by a note.

Paragraph 18

(1) Only rights and things that are actually paid for are to be shown as "concessions, patents, trade-marks etc. " and also "Goodwill". Goodwill is disclosed only in the act of buying the company or.......... It is the difference between its price and capital (assets less liabilities).

(2) Debts, receivable more than one year after B/S date are to be classified as long term debts and the debtors name be shown separately.

1. na
2. (a) Raw material & other material costs.
   (b) Other costs.

3. Personnel costs.
   (a) Wages.
   (b) Pensions.
   (c) payroll taxes.

4.
(1) Fixed Asset & non-material asset depreciation & amortization.
(2) materials product losses (extraordinary).

5. Other pay outs.
6. Long term finance. investm. debenture & short term venture capital depreciation.
7. Interest expense.
8. Profit before extraordinary items & taxes.
9. Extraordinary expenditures.
10. Income tax current year.
11. Other taxes.
12. Current year's net income.

Income:

1. Net Sales.
2. Fin & semi-fin. goods increase.
3. Own asset creation costs.
4. Other income.
5. Income from joint ventures & capital investments.
6. Income from dividends, debentures and long term investments . . . .
7. Other interest income.
8. Loss before extraord. items & taxes.
9. Extraordinary income.
10. Loss for current year.

Paragraph 14

P&L (a/c form according to pay out method)
Payments(Expense)

1. Manufacturing costs.
2. Selling expenses.
3. Admin. expenses.
4. Long term invent. + short term cap. investment depreciation.
5. Interest expense.
6. Profit before extraordinary items & taxes.
7. Other expenditures.
8. Income tax (current yr).
9. Other taxes.
10. Net profit for the year.

Revenue:

1. Net Sales.
2. Other income from operations.

(3) Liabilities to be classified as: short term payable within one year and long time debts payable after one year. Both are liabilities to creditors. They are also to be shown separately and totals of short and long term debts to be disclosed.

(4) Purchase advances are shown as liabilities. Any advances from or to subsidiary are shown separately in B/S.

Paragraph 19

(1) Reserves are amounts that are created to cover losses, debts or other pay outs which pertain to the current year or previous years and are expected to be met, but the exact time and the amount is unknown.

(2) Reserves cannot exceed reasonable amounts, and they must be noted for each reserve separately.

Paragraph 20

(3) Company is not required to disclose its distribution of profits or discharge of losses in the B/Sheet. The distribution of profits as decided by General meeting of members should be reflected in next years B\S.

Special regulations re. P/L Statement.

Paragraph 21

Net Sales is revenue from the Cos goods or services, less volume and other discounts, VAT, excise and other taxes directly related to Sales.

Paragraph 22

(1) Item "Manufacturing Costs" para 12 ’and 14 are to be related to the Sales Volume.

(2) Items in para 12 and 14 "Manufacturing Costs", "Selling Expenses" and "Administration Costs" also include depreciation and amortization of the assets employed.

(3) Items in para 11 to 14 include dividends, revenue from capital investments, debentures and other long term instruments, interest income, interest expense. Subsidiary income and expense are to be shown separately.

Paragraph 23

(1) Revenue and expenditures not directly related to the nominal functioning of the enterprise, as well as material revenue and expenditures pertaining to another fiscal year are shown as extraordinary revenue and extraordinary expenditures.

(2) The amount and nature of the above revenue and expense are shown as a note to Fin. States, except immaterial amounts.

Paragraph 24

(1) If the competition dictates the Corporations which in the current year do not exceed two of the criteria mentioned in part of this para, are permitted to use P&L using "Gross Revenue" or "Gross Loss" by combining:
paragraph 11 - items 1 to 5;
paragraph 12 - items 1 to 3 and 6;
paragraph 13 - items 1 and 2 in expanse and 1 - 4 in revenue-
paragraph 14 - items 1 and 2 in expanse and 1 - 2 in revenue.

(2) Criteria in (1) above are:

1. B/Sheet total 1,5 million ECU
2. Net Sales 3,5 million ECU
3. Average number of employees in current year - 250.

(3) Balance Sheet total in this para (2) above is the Balance Sheet total as in para 10. Average number of employees is computed by totaling the number of employees at the end of each calendar month and dividing the grand total by the number of the months in the fiscal year.

(4) The advantage in (1) above is lost if the Corp. in its current year has exceeded two of the criteria mentioned in (2) above and this has taken place i-n two consecutive fiscal years. Rules of the Evaluation.

Paragraph 25

(1) Items on the B/Sheet should be presented in accordance with the generally accepted accounting principles:

1. Going concern- it is assumed that the Corp. will continue its operations in future.
2. Consistency- evolution methods cannot be changed from one fiscal year to the other.
3. Conservatism- values should be cautious and:
   (a) Revenues only generated in the fiscal year should be included in the accounts;
   (b) Due regard should be given to any losses or diminishing asset values, which have accrued in the current or prior fiscal years even if they are discovered between the fiscal year- and the date of the publishing of the Financial Statement.
   (c) All depreciation and amortization should be booked, regardless of the Financial results.
4. Proper matching of revenues and expanses in the fiscal period, irrespective of their dates.
5. Assets and Liabilities should be determined separately.
6. Opening B/Sheet of any fiscal period should correspond to the closing B/Sheet of the previous fiscal period.

(2) If, in exceptional cases, there is a deviation from the above mentioned principles, it should be fully and completely explained in the notes, also disclosing the monetary effect on the corps B/Sheet and Revenue and Expense.

Paragraph 26

(1) Fixed assets should be valued at their acquisition or manufacturing costs.

(2) Acquisition cost is the purchase price, plus expenditures incurred until it is serviceable.

(3) Manufacturing cost entails raw and other material directly related to its manufacture. Manufacture overhead pertaining to the asset could also be included in its cost if it relates to the period.

(4) Loan or overdraft interest applicable to the manufacture of the asset must also be included, but it must be disclosed in the notes.

Paragraph 27

Fixed asset costs with limited life are depreciated over their useful life. Land cannot be depreciated.

Paragraph 28

(1) If, for some reason, the value of a long term investment has diminished below the value ascribed in paras 26 and 27, such assets can be valued at the lower values.

(2) Long term financial investments can also be valued at lower values as at the B/Sheet date.

(3) Write-downs mentioned in (1) and (2) above, cease if there is no justification for same.

(4) Write-down amounts in (1) and (2) above and any changes in (3) above are entered in a separate B\S item in Notes.

Paragraph 29

(1) Fixed assets and long term financial investments, values of which are substantially higher than their acquisition or manufacturing costs, or their values on the B/Sheet of the previous accounting period, can be valued at higher values if it is considered that their, higher value will prevail. Depreciation and amortization will be computed on the value booked and shown in the P&L. No such appreciation above laid down cost is allowed on land.

(2) Such appreciation is shown as "Revaluation Reserve" in the equity section of the B/Sheet and its use is permitted only in accordance with conditions (3) and (4) below.

(3) Revaluation Reserve diminishes if the asset is disposed of, not used in the business, or the Reserve created is no longer justified.

(4) Revaluation reserve cannot be distributed as dividends.

(5) "Revaluation Reserve" and its changes have to be explained in notes showing:

1. Revaluation Reserve at the beginning of the year.
2. Increases in Reserve during the year.
3. Deductions mentioned in (3) above, disclosing the nature of same.
4. Reserve amount at the end of the fiscal year.

(6) The use of part (1) of this para has to be explained in the notes, showing appropriate B/Sheet items and the methods employed. B/Sheet and the notes should give a clear picture of each revalued B/Sheet asset and the difference between its value in accordance with 21 to para 28 reevaluations as well as the revaluation effected by point (1) in this paragraph.

Paragraph 30

(1) Current Assets should be valued at their acquisition or manufacturing costs.

(2) Acquisition costs are calculated by adding together the-purchase price and costs directly related to the purchase.

(3) Manufacturing costs are computed by adding the purchase prices of raw materials, semi- finished products and supplies directly related to the product or article produced. Applicable overhead can also be included if it relates to the same accounting period. Selling costs cannot be included i-n manufacturing costs.

Paragraph 31

(1) Inventories are priced and manufacturing costs ascertained by employing average price or FIFO method.

(2) If using the above methods, an aberration from the market value at the B/Sheet date results, the difference for each component should be explained by a note.

Paragraph 32

Current assets at the B/Sheet date are valued at the lower of cost or market prices. Stock can be evaluated on the B\S date at the lower production, purchase or market price. Stock cannot be evaluated at the price exceeding current market price.

Paragraph 33

(1) Securities shown as current assets, which are subject to price fluctuations in a recognized exchange, are valued at their market value on the B/Sheet date, not with standing conditions in para 30. above.

(2) If employed, para 32 and this para (1) stipulations are shown in notes.

Paragraph 34

Corporation's Organization costs and costs associated with the cost capital increase, are shown as Intangible assets but are amortized in the next year.

Paragraph 35

(1) Expenditures in para 10. I sub para 1. to 3. considered as intangible assets, are amortized by straight line method over 5 years.

(2) Such intangible assets have to be substantiated by documentary evidence and they cannot be written off in the year of acquisition.

Paragraph 36

(1) If a loan is payable at an amount higher than the amount received, the difference is shown as an Asset and it should be shown separately in the B/Sheet.

(2) This difference is to be amortized evenly over the term of the loan.

Paragraph 37

(1) Debtors and Creditors balances at the B/Sheet date are shown as evidenced by document sand the entries in the books, and they should be confirmed by contacting the debtors and creditors themselves. In cases of dispute, the balances should be shown as shown by the books. Doubtful accounts Reserve should be created for slow or doubtful payers and its composition should show each debtor separately as well as the amounts involved. If an account is considered as uncollectible, if should be written off by debiting the Reserve or P&L.

(2) Reserves created for special purposes should be shown separately in the Liability Section of B/Sheet.

(3) Own share Capital should be shown separately segregated by its Components.

(4) Long term debts are obligations, whose due dates are longer than the next accounting period. All other debts are classified as current liabilities.

(5) Current liabilities should disclose separately:

1) dividends or distributions to the owners;
2) amounts payable in the current year;
3) unpaid salaries and wages;
4) taxes payable to state or municipal authorities.

Paragraph 38

If the Corporation has sold its own shares or ownership certificates at a price higher than the nominal value, the premium must be shown as a liability captioned "Own Capital" as "Premium on Share emission". If they are sold at a price lower than nominal value, the discount should be shown exactly as above but as a negative figure.

Paragraph 39

Notwithstanding stipulations in para 26. , 28. and 29. Parent corporation shows its investment in Subsidiary capital in an amount which corresponds with the Subsidiary's book entry, with these conditions:

1. This valuation method is to be explained in a note, also mentioning which Subsidiary it refers to. If the subsidiary's income also in the year is material, it should also be disclosed.
2. Parent in its B/Sheet or in a note shows separately the difference between the purchase price of Subsidiary shares and the present value of its investment in it.
3. Parents investment in a Subsidiary fluctuates with the Subs. realized profit or loss and such changes are to be disclosed in its B/Sheet.
4. Schedule of amounts in (3) above is to be included separately in the P&L Statement for each year.
5. Parent's investment diminishes with the amount of Subsidiary dividends paid.

Regulations governing the Notes.

Paragraph 40

The information to be specified in notes could be presented either as notes to the relevant items or as separate items in the B/Sheet and/or P&L Statement.

Paragraph 41

Full information be supplied as to the valuation of the items, as well as the computation details of Fixed Asset depreciation, amortization and write downs of investments and other assets. If computations involve Foreign currency, the exchange rate should also be disclosed.

Paragraph 42

(1) Notes should show afl Subsidiary and Associated Corps names and addresses as well as the amounts of capital invested in each entity. Information from each subsidiary's last audited statement should be finished showing subs . own Capital Structure and P&L results. This information can be omitted if it is immaterial to the requirements of para 4 of this Act.

(2) This information can be omitted if it is considered to be detrimental to the corporation, but it should be so stated in the Notes Subsidiary's Capital and P&L disclosure is not needed if:

1. Its B/Sheet is not published and the Parent's Capital contribution is below 50%, or
2. Subsidiary and its Financial Statement is already included in the Consolidated Concern Statement in accordance with para 56, or the conditions of para 39 apply.

Paragraph 43

If the Corps Share Capital is comprised of more than one class of shares or equity components, they should be segregated on the Fin. Statement and showing separately by Class, number of each class and the nominal value. Corporations with Share Capital should always show their number of shares issued and their nominal value.

Paragraph 44

If a corporation has borrowed funds with a conversion privilege into co's shares, then each such loan should show the amount, conversion rate and the terms and conditions. If the loan is secured by a co's debenture or other instrument bearing interest, then in addition to the above requirements, also the interest rate should be disclosed, for each such loan.

Paragraph 45

(1) Each B/Sheet long term liability should disclose the part payable more than 5 years after the B/Sheet date.

(2) If the co's assets are encumbered by a mortgage or other such security (hypothec), each such asset separately should show its B/Sheet value and the encumbrance. Total encumbrance for all subsidiary assets and for all concern assets should be also shown in notes.

(3) Notes should also disclose the aggregate amounts of such liabilities as pension commitments, trade and debt guarantees, discounted notes and other contingent liabilities not disclosed elsewhere, if they are material amounts. If the corp has important rent or lease agreements, the salient parts should also be mentioned. Commitments to the Parent Co and to the Subsidiaries should be shown as a separate item in the notes.

(4) Loans, mortgages or guarantees issued to Directors or officers of the Corp. or its Parent should be shown separately, together with amounts, interest rate and repayment terms and conditions.

(5) Amounts of loans and mortgages, guarantees or pledges given to shareholders, except Parent Co and Parents shareholders, are tabulated separately, showing amounts repaid. This does not pertain to loans and guarantees to the employees of the Parent or the Subsidiary for the purpose of purchasing the shares of the Corporation.

Paragraph 46

For all land and buildings the property tax assessment must be shown.

Paragraph 47

If the cost center "Unfinished outside orders" contain some if the expected profit at the fiscal year end then this should be disclosed along with the methods used.

Paragraph 48

(1) Net Sales should be segregated by product lines and geographic markets if they are distinct in character and different from normal sales.

(2) This provision is not applicable to corps which submit their Fin. Stats using para 24 (1). Other Corps can also disregard it if it would harm their business interests but it should be so stated in the Notes.

Paragraph 49

(1) Notes should show the total of all taxes paid in the fiscal year.

(2) Notes should also show the effect of taxable extraordinary income (or loss) on the profits (income) tax for the fiscal period.

(3) All reductions or rebates of each tax received during the year must be detailed (for each tax separately), also disclosing the relevant document and authority.

Paragraph 50

(1) Notes should give information re. the average number of *employees* in the fiscal year.Wages and salaries should be presented in a format in para 11 (6) and para 13 (3).

(2) Salaries of all (a)board members, (b)directors and (c)managers should be totaled by these groups, as well as their perquisites, the same refers to payroll taxes. Bonuses should be shown separately.

Paragraph 51

(1) The following information should be supplied regarding co's own shares or equity components:

1. Number of shares or equity components, their total nominal value and the ratio as to the total value of the co's capital.
2. No of shares or equity components sold or redeemed in the fiscal year, their nominal value and the ratio combining both transactions, to the co's capital.
3. Reasons for the purchase of co's own shares or equity components in the fiscal year.

(2) Information in point 1. above should be segregated to show shares and equity components separately as well as to distinguish between ownership and holding as a pledge.

Paragraph 52

If in a fiscal year subsidiary has purchased or sold shares or equity components of the Parent then the Parent has to finish information as to the nominal value of its shares or equity components, the ratio to its total Capital, as well as the purchase or sale prices. (2) Information us point (1) above should be segregated to show separately shares and equity components to distinguish between ownership and holding them as pledge.

Paragraph 53

Yearly changes in Capital, its values as well as its components are to be disclosed.

Paragraph 54

(1) Corporations with B/Sheets not exceeding two of the criteria in (2) below, can omitinformation mentioned in para 44, para 45(l) and (2), para 49(l) and (3) and para 52. However corps long term debt due more than 5 years after the B/Sheet date and the total amount of the mortgages payable have to be disclosed.

(2) Criteria, enumerated in (1)above are:

1. B/Sheet total- 0,15 million E. C. U.
2. Net Revenue- 0,3 million E. C. U.
3. Average employees in the year- 25.

(3) If the corp is a Concern, this para's(l) is not applicable if one of the concern members or the concern itself exceeds two of criteria mentioned in (2) above.

(4) B/Sheet total in (2) above is the sum total of assets enumerated in para 10. Average number of employees is computed by totaling the number of employees at the end of each calendar mouth and dividing the total by the number of months in the fiscal year.

(5) If the criteria mentioned in (2) above are exceeded or cease to exceed, the conditions mentioned in (1) above apply only if this has occurred in two consecutive years.

(6) Notes should disclose the Corps. average number of employees.

(7) Sole or full partnerships proprietor must disclose in notes all of his other assets and liabilities, even if they are unconnected with this enterprise, save and except his personal effects.

Annual Report.

Paragraph 55

(1) Report should include information which is not disclosed in B\S; P & L Statements or Notes, but is relevant in evaluation the Corps assets, liabilities, its Financial condition and last year results, except that, in extreme cases, this could hurt the Corporation.

(2) The Report should include:

1. Any important events since the fiscal year-end;
2. Corps future trends and
3. Research and development activities.

(3) Board of Directors should include either in this Report ar Notes the proposed distribution of profits or a plan to absorb the losses.

(4) Parent's Report should contain information regarding the Concern as a whole, for (1) and (2) above.

(5) In case the Directors consider that the Corps future is uncertain due to Financial difficulties, full details regarding new capital investment or a proposal to Creditors should be finished.

Concern's Statements.

Paragraph 56

Concern's Statement consolidates all the statements of the corporations under its jurisdiction as in lst para.

Paragraph 57

Concern's Statement consist of the B\S, P&L Statements and Notes. It should have the same fiscal year-end as the Parent Corporation.

Paragraph 58

(1) Concern's Statement consists, as prescribed in para 4, of the yearly Financial Statements of the Parent and its subsidiaries.

(2) Concern's Statement should disclose all of its Profit or Loss and the consolidated capital. Interim Profits and Dividends should be eliminated.

(3) Interim profit means Parents mark-up on transactions with a Subsidiary, except if an outsider is also involved or if the article has been written - off by the Subsidiary.

Paragraph 59

If competition dictates, Concern's P&L Statement could be prepared as stated in para 24(l), providing the two criteria mentioned in para 24(2) are not exceeded, but para 24(3) and (4) still prevail.

Paragraph 60

(1) If special conditions in the Concern exist, the Financial Statement of the Concern can take the form of a Concern Report, but this should be disclosed in a Note.

(2) Concern's Report should disclose information regarding internal loans receivable and payable. Further, the Report should show the Parent's Profit or Loss for the year and its Capital. Relevant information for each Subsidiary concerning Parent's investment in it should also be shown, providing it has not been disclosed in the Parent's Fin. Statement as required by para 39. In addition, Concern's Financial results for the year as well as its total Capital must be disclosed.

(3) By computing amounts in the last sentence of (2) above, interim profits and interim dividends must be eliminated. Conditions of para 58(3) still prevail.

Financial Statement presentation and certification.

Paragraph 61

Financial Statement must show:

(1) For a sole proprietor - his first and Surname, and address. For partnerships - the same about full partners - board members. For all other types of corporations- all director's, board members and executive's names and Surnames and addresses, as their Corporate Status, including the members who have left their positions.

(2) Corporation's full name and address. Concern's Statement should also show all Subsidiaries names and addresses. Sub's Statements should show the Parent's name and address and the Parent's Capital Contribution in the Sub.

(3) Fiscal year-end Financial Statement is signed by: -Sole proprietorship - the proprietor, Partnerships and firms with full liability - persons who are fully responsible, Firms with limited liability - the Chairman of the Board, directors and the general manager.

(4) If any of the persons who have to certify the Financial Statement or Report, has a just cause why he cannot do so, or if he has any objections against it, he can do so by an appendage.

Audit and Publishing.

Paragraph 62

(1) All Copra's year-end Financial Statements are subject to an audit. If the Corp. is considered a small business as per 54. para (2) criteria, it is performed by the audit committee. If it exceeds the limits, then the audit is performed by a licensed auditor appointed in accordance with the relevant Acts. Shareholder's meeting cannot approve the year-end Financial Statements without auditor's report.

(2) Concern's Statements and Report are subject to mandatory audit by the auditors.

(3) If any changes in the Corps or Concern's annual Fin. Stat. or Report have been made after it has been audited, then the changes have to be re-audited and such re-audit has to be annotated accordingly.

Paragraph 63

(1) Annual audit has to include the examination of books and records in order to Satisfy auditors that generally accepted accounting principles have been adhered to, and that the applicable laws and by-laws have been followed. For a Concern it must be sure that the figures in the Statement correspond to the various member Corps and the Statement does not reflect a misleading picture of the Concern's economic and fiscal position.

(2) Corps directors and others must submit the annual Fin. Statements and the Report to the auditors as soon as they have been prepared. The Auditor has to have access to all books, records and source documents, as well as assets, and liabilities but especially cash, securities and inventories.

(3) The Auditor is entitled to any information from all Corps directors and others to facilitate his audit, even before he has received the annual statements. Such information he can also demand from afl Subsidiaries and the Parent if he is conducting the audit of a Concern.

(4) No auditor nor his subordinates will reveal the Corps commercial secrets obtained during the audit.

Paragraph 64

(1) An auditor, after he has done an audit, furnishes his Report. In it he has to state that the accounting system, annual report (or Concern report) conforms to the Laws and that he has received all information and explanations.

(2) If, after the completion of the assignment, the auditor has no objections, he renders the following Audit Report: In our opinion, the books, annual report financial statements present fairly, in all material respects, the financial position of.......................... (firm/Concern) as at................ 19.... and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles which have been applied on a basis consistent with that of the preceding year. The firm's (Concern's) report is consistent with firm's (Concern's) financial statements.

(Auditors)

.... signature and date.

Paragraph 65

(1) If the auditor has significant objections or comments, he can quality his report by stating them.

(2) If the Objections are material, the auditor can further qualify his report or even refuse to issue one, but he has to state his reasons for qualifications or refusal in writing.

Paragraph 66

(1) No longer than a month after the approval of the Report and no longer than 4 months after the fiscal year-end, the Firm or Concern has to submit to the State Financial Inspection Board a copy of an audited Fin. Statement and Report, as well as an Auditor's Report, if applicable, and a letter when it was approved by the Shareholders. If the distribution of profits is not evident in the Fin. Statements or Report, a certified copy of the Shareholder's Report showing the distribution must be finished or a plan how to deal with a loss.

(2) Corporations subject to para 54 may not render a Report but have to show their decision of the distribution of profit or how to absorb a loss in their Financial Statement. (3) Corporations subject to (2) above or para 54, must also submit with the annual Fin. Statements a letter signed by the Directors of the Corp. that the conditions of para 54(2) to (5) have been complied with. The auditor has to certify this statement.

(3) Fin. Statements of establishments not subject to para 54 conditions, after their submission at the State Financial Inspection Branch, must be published immediately. Establishments and Concerns who do not meet the criteria in para 24(2), must publish, at their expense, their B\S and P\L Statements in an official newspaper of the Latvian Republic or a publication designated by the State Finance Inspection Board. The annual Fin. Stats and Reports received by L. R. State Fin. Inspection Board must be accessible to the general public.

Paragraph 67

(1) If a Corporation publishes its annual Fin. Stats and Report in its entirety, and, if applicable, also Concern Report, then both of them should be in the same form as they were audited, also together with the Auditor's Report if applicable. If the auditor has qualified his Report or has refused to sign it, this also has to be disclosed, together with underlying reasons. If the proposed profits distribution or loss disposal is not show in the Balance Sheet, then the proposals or decisions must be published.

(2) If the Fin. Stats and other documents are not published in their entirety, it should be clearly stated that this is an abridged Fin. Statement and a complete one is available at the L. R. State Finance Inspection Board. The auditor's Report, if there is one, may not be included in this abridged publication, but it should clearly state whether the Auditor has certified the Report or refused to do so.

Paragraph 68

(1) L. R. State Finance Inspection Board Senior Inspectors can demand any information necessary for the purpose of ascertaining whether this Act, the relevant Profits Tax Acts or the Corporations bylaws have been complied with.

(2) If the directors, managers or any other responsible Corporation officials fail to submit documents pursuant to para 66 and 67(l) stipulations, or does not provide information, as required in (1) above, the Chairman of L. R., State Finance Inspection Board can levy fines either by days or weeks to secure compliance.

The Chairman of L. R.
Supreme Council

The Secretary of L. R.
Supreme Council

ANNEX III

LAW ON THE PRINCIPLES OF ACCOUNTING IN LITHUANIA

CHAPTER 1
GENERAL PROVISIONS

Article 1. Sphere for the Application of the Law on the Principles of Accounting

This Law shall establish the procedure of financial accounting binding upon individual (private) enterprises, general and limited partnerships, stock companies, limited liability companies and agricultural partnerships, state enterprises, state stock enterprises (hereinafter referred to as enterprises) as well as to all types of enterprises, organisational units, and enterprises and organisations financed from the budget.

Other institutions and organisations involved in noncommercial (non-profit) activities shall determine the procedure of rendering accounting independently, incompliance with this Law.

Article 2. Objectives of the Law

The law on the Principles of Accounting shall regulate the general accounting principles of property and ownership, as well as of the results of economic activity and performance of economic subjects (the entities' going concern, the consistency of accounting, and the accrual of revenues and expenses) as indicated in Article 1 thereof. Accounting shall be duly organised as to provide tax assessment agencies, state statistics, owners, creditors and commercial partners with timely and exact information, and to ensure an informational basis for business and commercial transactions.

Article 3. General Need for Management for Accounting

In pursuance of the laws of the republic of Lithuania, International Accounting Standards and the directives of the European Economic Community general methodical management for accounting shall be carried out by the Government of the Republic of Lithuania.

Article 4. System of Accounting

The system of accounting shall be determined by the form of ownership, the type of enterprise, the size of enterprise, and the nature of its activities.

Enterprises shall independently choose the system of a management accounting.

All enterprises and organisations shall conduct accounting in a double entry system, with the exception of those enterprises which are allowed to conduct simplified accounting.

All business and financial transactions shall be confirmed by documents. Business transactions which cannot be confirmed by documents shall be confirmed by documents for other transactions related to the said transactions.

Accounting shall be conducted in the State language (Lithuania). In joint ventures and foreign capital companies functioning in the Republic of Lithuania, accounting shall be conducted in the Lithuanian language and, if necessary, in a foreign language as well.

Article 5. Chart of Accounts

The specimen chart of accounts shall be approved in accordance with the procedure established by the Government of the Republic of Lithuania. Enterprises shall draw up individual charts which shall be approved by the head of an enterprise.

Article 6. Monetary Unit

Accounting shall apply the basic monetary unit of the Republic of Lithuania. In case of transactions in foreign exchange, accounting figures shall be recalculated in accordance with the established exchange rate.

CHAPTER 2
ACCOUNTING SERVICES

Article 7. Management of Accounting

Accounting may be managed:

1) upon the foundation of an independent accounting agency; and
2) using the services of accounting, auditing and consulting enterprises according to agreements.

State enterprises, state stock enterprises, stock companies and limited liability companies shall be obliged to establish either an independent accounting department or an accounting post.

The functions of independent accounting services, accounting, auditing and other consulting agencies shall be regulated by their statutes.

Article 8. Status of Chief Financial Manager (Accountant)

In an enterprise, accounting shall be managed by the chief financial manager (accountant). The chief financial manager shall be appointed and dismissed by the head (board) of the enterprise or by its owner(s).

The chief financial manager (accountant) maintaining accounting in pursuance of the laws and executive acts of the Republic of Lithuania as well as with this Law, must ensure the accuracy of accounting entries and the timely preparation of statements. The chief financier's instructions concerning accounting shall be binding upon all employees of the enterprise.

CHAPTER 3
DOCUMENTS AND REGISTERS OF ACCOUNTING

Article 9. Registration of Economic Transactions

Records of business transactions made in registers of accounting shall be confirmed by documents. They shall be recorded clearly and legibly, either by hand or by technical means.

Enterprises may use standard, special, or free-form primary documents, which have juridical validity.

Article 10. Juridical Validity of Documents

The following requisites shall provide a document with juridical validity:

the name of the enterprise;
the name of the document;

the date of its formation;

the indices of the estimation of economic activity; and

the posts, surnames and signatures of individuals who conducted the economic transaction and who are responsible for its execution and registration in compliance with the established requirements. Documents which do not contain the aforementioned requisites shall not have juridical validity.

Article 11. Signing of Documents and Responsibility

The head of an enterprise shall approve the list and certify specimens of the signatures of individuals authorised to sign source documents. Documents shall be signed personally.

The individuals who draw up and sign the documents shall be responsible for their timely and accurate preparation, the exactness of the information included therein, and their legitimacy.

Article 12. Accounting Registers

Data concerning the accounting period shall be recorded in accounting registers.

Accounting registers may be rendered in a standard or free form. They shall be complied in a chronological, systematic, systematic-chronological or other established manner.

CHAPTER 4
FINANCIAL STATEMENTS

Article 13. Contents and Submission

Annual financial statements of enterprises, with the exception of enterprises which are allowed to submit simplified reports, shall include a balance sheet, income statements, statement of the changes in financial position of the enterprise, as well as notes about the statements.

The forms of financial statements as well as the procedure for their submission and availability to the public shall be established by the Government of the republic of Lithuania. It shall be prohibited to demand the submission of non-established financial statements.

Article 14. Major Requirements

Prior to the drawing up of an annual statement, accounting must cover all business transactions made within the accounting period. Accounting data must be confirmed by stock-taking data related to long-term assets, inventory values, accounts, as well as to financial and other resources.

Article 15. Approval of Financial Reports

Prior to submission to administration bodies, financial statements shall be considered and approved in accordance with the procedure set forth in the by-laws of enterprises.

Prior to submission for approval the financial statement, it may be submitted for auditing.

The head or owner of an enterprise shall be responsible for the submission of an incorrect financial report, even if it has been checked and approved by an auditor.

Enterprises which have the rights of a legal person shall prepare their financial reports on the basis of the data as of December 31, whereas the balance sheet shall be prepared on the basis of the data from the foundation and liquidation date of an enterprise.

CHAPTER 5
EVALUATION OF PROPERTY AND INVENTORY

Article 16. Valuation of Property

In the accounting books of an enterprise, long-term assets shall be evaluated and recorded at the purchase price whereas in the balance sheet they shall be recorded at the value of net fixed assets (the purchase price and depreciation shall be recorded separately).

In the accounting, inventories shall be evaluated at the price of acquisition, and in financial statements - at actual costs. While calculating the actual cost, earlier acquired inventory shall be written off.

Article 17. Stock-Taking

The stock-taking procedure shall be established by the Government of the Republic of Lithuania.

Article 18. Accounting and Evaluation of Expenses and Revenues

In accounting, revenue shall be recognised at the time they were earned, whereas expenses shall be computed at the time they have accumulated, with no consideration to the date of payments.

The procedure for the accounting of revenues and expenses shall be established by the Government of the Republic of Lithuania.

CHAPTER 6

KEEPING OF DOCUMENTS, ACCOUNTING REGISTERS AND FINANCIAL STATEMENTS

Article 19. Rectification of Errors

Errors in documents shall be rectified by crossing out the incorrect text of number in a legible manner and by inserting in the appropriate number or text.

The individuals who make corrections therein shall put their signatures and the date next to the corrected number or text.

It shall be prohibited to make corrections in monetary documents.

Upon approval of the financial statement, its data shall not be subject to rectification. Errors and inaccuracies noted after the approval of a financial statement shall be rectified by drawing up a subsequent financial statement.

Article 20. Procedure for Storage

Prior to the approval of an annual financial statement, documents and accounting registers shall be kept in accordance with the procedure established by the heads of enterprises. Such documents shall be submitted to the archive and kept there in accordance with the Regulations of the State Archive. Annual financial statements shall be kept for an unlimited period.

Article 21. Registration of Lost or Withdrawn Documents

In case of loss (damage) of documents, accounting registers, or financial statements, the employee in charge of their keeping shall write an explanatory note and submit it to the head (owner) of the enterprise. The head (owner) of the enterprise shall adopt an appropriate decision.

The bodies of the law enforcement, finance and control may withdraw documents only in the presence of the head (owner) or accountant of an enterprise. The officials who withdraw the documents shall draw up a report and leave copies of the documents which were withdrawn. In the event that it is impossible to leave copies, all the requisites of a taken document shall be included in the report.

Article 22. Continuity of Accounting

If an enterprise is liquidated, when its property, rights, obligations and responsibilities are transferred to another enterprise, the latter enterprise shall take over the kept documents, accounting registers and financial statements. In the event that there is no legal successor, the body which has adopted the decision to liquidate the enterprise shall establish the procedure for the further keeping of documents, accounting registers and financial statements.

CHAPTER 7
COMMERCIAL SECRECY AND RESPONSIBILITY

Article 23. Commercial Secrecy

Accounting data of an enterprise presenting a commercial secret shall not be open to the public. Employees of an enterprise and other individuals (auditors, inspectors, experts and tax inspectors), as well as law enforcement officials who have learned the commercial secret in the line of duty, must keep it in secret.

Data included in financial statements may not constitute a commercial secret.

Article 24. Responsibility for the Organisation of Accounting

The head (owner) of an enterprise shall be responsible for the organisation of accounting, timely submission of statements, and preservation of documents.

Officials of an enterprise who have violated the provisions of this Law or other regulations for accounting shall be liable under the laws of the Republic of Lithuania.

VYTAUTAS LANDSBERGIS
President
Supreme Council
Republic of Lithuania

Vilnius
18 July 1992
No I-2654

RESOLUTION
ON
THE PROCEDURE OF THE ENACTMENT
OF THE LAW ON THE PRINCIPLES OF ACCOUNTING

The Supreme Council of the Republic of Lithuania resolves:

1. To establish that the Republic of Lithuania Law on the Principles of Accounting enters into force on 1 January 1993.

2. To commission the Government of the Republic of Lithuania to prepare the standard acts concerning the procedure for the enactment of this Law and to establish the terms and order for the preparation of balance sheets statements.

VYTAUTAS LANDSBERGIS
President
Supreme Council
Republic of Lithuania

Vilnius
18 July 192
No I-2654

List of Authors

Herbert Biener
Ministerialrat
Justizministerium
Heinemann Str., 6
D-5300 Bonn 2
Germany

Marcus Bracklo
Price Waterhouse
Corporate Finance Beratung GmbH
Martin Luther Strasse 1
D-1000 Berlin 30
Germany

Professor Toomas Haldma
Tartu University, School of Economics
9 Nooruse Street
Tartu 202400
Estonia

Geoffrey Harris
Shell International Petroleum Co Ltd
4 York Street
London
SE1 7NA
United Kingdom

Olaf Hasselager
Department of Companies Accounts
Danish Commerce and Companies Agency
1 Kampmannsgade
DK-1780 Copenhagen
Denmark

Frank Jenkins
Department of Trade & Industry
Room 512
10-18 Victoria Street
London SW1 ONN
United Kingdom

David Moore
Director
Canadian Institute of Chartered Accountants
277 Wellington Street West
Toronto, Ontario
Canada M5V 3H2

Gisela Nagy
Vice President
Fédération des Experts Comptables Européens (FEE)
Penzingerstrasse 16
A-1140 Wien
Austria

Marie Nigon
Consultant/OECD
Adjunct Professor
University of Paris I (Panthéon Sorbonne)
83 Avenue d'Italie
75013 Paris
France

Eero Prepula
Kihlman Ltd
Kansakoulukuja 1 A
00100 Helsinki
Finland

Jens Roder
Vice President
Fédération des Experts Comptables Européens (FEE)
Lyngbyvej 16-18
P O Box 2709
DK - 2100 Copenhagen
Denmark

Wienand Schruff
KPMG Deutsche Treuhand-Gesellschaft
Louise-Dumont-Str. 25
D-4000 Düsseldorf 1
Germany