

## 2.5. THE FORMATION OF ENTERPRISES' ACCOUNTING POLICIES OF EU COUNTRIES

The task of the national domestic and foreign policies of Ukraine on the modern stage of its development is the entry of our country into the European political, economic and legal space, getting full membership in the European Union and its establishment as a powerful European state. Therefore, accounting, which is an important object in the process of harmonization within the EU, was defined as one of the priority areas of adaptation of national legislation to EU legal framework.

Our state faced the issue of adaptation of Ukrainian legislation to the European one for the first time after signing «Agreement on Partnership and Cooperation between Ukraine and the European Communities and their Member States» on 14<sup>th</sup> June 1994 [4].

In addition, «State Program of adaptation of Ukrainian legislation to the EU legislation» (hereinafter – the Program), which determines the mechanism for obtaining by Ukraine a compliance with the Third Copenhagen and Madrid criteria for membership in the EU, was adopted by signing the same law No. 1629-IV from 18.03 2004 [46]. This Law and other normative acts [34; 40] clearly define priority areas for adaptation of Ukrainian legislation, including the accounting of companies.

Thus, the purpose of adaptation of Ukrainian legislation to the EU legislation is the compliance of the legal system of Ukraine with *acquis communautaire*<sup>2</sup>, taking into account the criteria set by the European Union, with the states intending to join it.

The program specifies that the adaptation of legislation is regarded as the process of bringing the legal framework of Ukraine in accordance with *acquis communautaire*.

Thus, the adaptation of national legislation to European countries is a priority component of the process of Ukraine's integration into the

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<sup>2</sup> *acquis communautaire* (from fr. «heritage of the community») – is the name of the legal system, the legal order of the EU; it is not translated into national languages

EU, which in turn, is defined as a priority area of Ukrainian Foreign policy. «This is a systematic process that includes several successive stages. At each of these stages certain degree of compliance of the legislation of Ukraine with the EU acquis should be achieved» [168].

The legal basis for policy in the field of accounting is defined in the Article 44 (2) (g) «Treaty on the European Union» [51]. For the implementation of the proposed program annually, within the approved plans, the work on implementing methodology of direct use of international accounting standards in domestic practice was launched. This is the main point of adaptation of Ukraine to *acquis communautaire* in accounting.

High quality constructed complete accounting system is an essential condition for the effective functioning of each entity. It involves forming and accepting for the long term separate specific and clearly defined elements of regulation of accounting and reporting, which is the accounting policies.

The term «Accounting policies» first appeared in international practice and officially began its use in 1973 after the adoption of IAS 1 «Disclosure of accounting policies» and IAS 5 «Information that has to be disclosed in the financial statements» [24]. New IAS 1 «Presentation of Financial Statements» [14] was issued on the basis of these standards, and includes requirements for the disclosure of information in accounting policies. IAS 8 «Accounting Policies, Changes in Accounting Estimates and Errors» is also worth noting [23]. The same issues are considered here, as well as conceptual framework to international standards, which defines requirements for the disclosure of accounting information and practical recommendations on the use of standards, contributes to the harmonization of accounting standards and procedures relating to coverage of accounting policies in the financial statements.

In the domestic accounting practice, the possibility of using separate elements of accounting policies by business entities came after the adoption of Regulation on the organization of accounting and reporting in 1993<sup>3</sup>.

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<sup>3</sup> Cabinet of Ministers of Ukraine Resolution of 3 April 1993 Number 250 «Approval of Regulations on organization of accounting and reporting in Ukraine» – it has lost its force nowadays

The term «accounting policies» was introduced into official turnover in Ukraine since 2000 by the Law No. 996-XIV «On Accounting and Financial Reporting in Ukraine» [27]. Thus, according to the Article 1 it was defined as a special term: «Accounting policies is a set of principles, methods and procedures used by the enterprise for the preparation and presentation of financial reporting».

At the same time, the definition «Accounting Policies» we can find in IAS 8. According to the mentioned normative and legal act, «accounting policies is specific principles, bases, conventions, rules and practices applied by business entity in preparing and presenting financial statements reporting» [23].

It should be noted that the Law No. 996-XIV defines the category «Accounting Policies» in singular and in IAS 8 this concept is characterized in plural. This is primarily connected with that fact that the accounting policies established regarding the specific object of accounting is considered a separate accounting policies according to the international rules. And according to the National interpretation of this concept, exactly aggregate of such accounting policies constitutes single accounting policies of entity.

In any case, we believe that it is about «accounting policies, which are, by their nature, very specific code of regulations, preparation and presentation of financial statements, which ensures compliance with a common methodology of displaying business operations of the undertaking for a long period with sticking to basic methodological principles of accounting and reporting» [168].

In the current economic conditions it is necessary to compare these financial statements on an international scale with the growth rate of internationalization of trade and investment. This implies the introduction of common rules for accounting and formation of financial reporting in compliance with national accounting standards.

Modern European countries are «the source of many legal systems, including English, German, French, Scandinavian and more. These systems, along with other political and economic differences, established huge variety of accounting, reducing the quality and comparability of financial reporting indicators of various countries in

the context of globalization and the growth of business investment activity» [91].

Recognizing this, EU Member States were the first countries that made the first steps towards the convergence<sup>4</sup> of accounting and financial reporting.

In addition, in the level of economy at the stage of international integration attention to the issue of unification of accounting was intensified. Today, there are two approaches to solve this problem, namely the harmonization and standardization.

The first step towards the harmonization of the European countries activities was the use of so-called «principle of achieving equal economic conditions» within the European Community.

The solution of this problem consisted in the development and publication of series normative documents, which were called the Directives or laws of EEC. They were dedicated to the unification of information disclosure requirements and accounting. The Directives establish basic provisions for accounting and formation of financial reporting that EU member states integrated into national legislation.

In particular, the most important and significant among them is the Fourth directive (78/660 / EEC) (regarding reporting of societies) No. 78/660 «On the annual accounts of certain types of companies» [31] from 25. 07.1978 and the Seventh directive (83/349 / EEC) EU Directives (on consolidated reporting of societies) 83/349 «On consolidated reporting» [30] from 06.13.1983. The Fourth Directive standardizes rules that must satisfy two basic forms of reporting of any enterprise – balance sheet and balance sheet and statement of earnings (losses) and establishes a flexible approach for preparation of reporting.

The special paragraph of this Directive defines a list of applications that should complement the reporting (information on accounting methods used by the entity in assessing the value of assets in the calculation of depreciation, turnover by major activities and other indicators that have essential importance for objective assessment of the financial condition).

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<sup>4</sup> Convergence can be defined as the approximation of accounting standards of various jurisdictions by identifying common optimal principles and methods by the developers of these standards.

Thus, the Directive 78/660 / EEC [31] contains requirements regarding the content of the annual financial statements, correctness of reflection of the financial condition of any entity, methods of valuation of assets and liabilities of audit and disclosure of reporting. However, indicators of the financial condition of a separate entity in today's economy that is characterized by the construction of complex, distributed systems of companies linked by relations of control and subordination, can not give an idea about the location of this subject on the market, its real condition and prospects.

Therefore, the Seventh Directive 83/349 / EEC [30] provides obligations for such entities to disclose the accounting policies and present consolidated statements regarding related parties, which would ensure the opportunity to have an idea for investors about the financial situation of this economic system (group of companies) as a whole. The main dominants of the Seventh Directive define the relationship between the parent and subsidiary companies, method of preparation of consolidated reporting of transnational corporations, audit verification, procedure for providing transparency of reporting companies, etc.

The adoption of the Seventh Directive was caused by the necessity of unification of issues regarding recognition in accounting and reporting transactions with foreign currencies and methods for bringing performance of balance sheet, reporting on profit (losses) and other forms to the single currency, terms for preparation of reporting, methods for ensuring comparability of data, stability of techniques and methods for consolidation of reports.

As it was noted earlier, the main provisions of the Fourth and Seventh EU Directives «establish detailed principles and rules in many areas of accounting and represent the so-called «minimum requirements for harmonization», under which Member States develop their own additional requirements and introduce, on request, changes in national legislation. At present they have about 40 options at the level of Member States, a lot of them are aimed at reducing the reporting requirements. Since the harmonization of accounting and reporting is based on a legal basis, compliance with the requirements of EU Directives is mandatory for all companies» [168]. Periodically the directives are reviewed, improved and changes are made to them, but they have never been subjected to radical processing since their adoption.

Implementation processes towards harmonization and coordination of accounting standards in the EU through the implementation of the requirements of the Fourth and Seventh Directives into national legislation took place over a long period of time. Table 2.5.1 reflects summarized stages for implementation of EU Directives.

During the first stage the UK and Denmark were the first countries which adopted the requirements of the Fourth EU Directive in 1981, and France and Germany adopted the requirements of the Seventh Directive in 1985.

Austria was the last country in this stage, and adopted a policy of EU requirements on accounting and financial reporting because of its late (in 1995) entry into EU and thus completed the first stage of implementation of the requirements of these directives into national legislation.

The second stage of implementation of the requirements of the Fourth and Seventh Directives into national legislation, as can be seen from Table 1, started with entering new members to the European Union on the 1<sup>st</sup> of May 2004. Accession to the European Union has obliged these countries to conduct changes of national legislation on keeping accounting and preparation of financial reporting in accordance with the requirements of the Fourth and Seventh Directives of the European Union, respectively, these directives have been adopted since 2004.

In 2007, the accession of Bulgaria and Romania to the European Union obliged these countries to accept the requirements of these directives that have been done by them since 2007 [91]. Croatia entered in 2013 as the last. Thus, directives are applied to more than 7 million companies in Europe after the enlargement of the European Union. During 1978–1983 in the development of the Fourth and Seventh Directives accounting harmonization of EU member states has gained significant political and economic importance, creating conditions for the formation of a unified European economic space. Providing complete and accurate idea about the financial condition and results of operations of business entities was the most important consequence for the adoption of EU directives, thus making accounting information more valuable, relevant and useful especially for external users (investors, shareholders, creditors and other business partners).

Table 2.5.1

**Implementation of the Fourth and Seventh Directives  
into national legislation of European countries**

EU countries		Date of entry into the European Union	Date of adoption	
			IV directive	VII directive
The first stage		1981 – 1996		
1	Belgium	1957	1984	1990
2	Italy	1957	1991	1991
3	Luxembourg	1957	1984	1988
4	Netherlands	1957	1983	1989
5	Germany	1957	1985	1985
6	France	1957	1983	1985
7	Great Britain	1973	1981	1989
8	Denmark	1973	1981	1990
9	Ireland	1973	1986	1992
10	Greece	1981	1986	1986
11	Spain	1986	1989	1991
12	Portugal	1986	1989	1991
13	Austria	1995	1996	1996
14	Finland	1995	1995	1995
15	Sweden	1995	1995	1995
The second stage		2004 – 2013		
16	Estonia	2004	since 2004	since 2004
17	Cyprus	2004	since 2004	since 2004
18	Latvia	2004	since 2004	since 2004
19	Lithuania	2004	since 2004	since 2004
20	Malta	2004	since 2004	since 2004
21	Poland	2004	since 2004	since 2004
22	Slovakia	2004	since 2004	since 2004
23	Slovenia	2004	since 2004	since 2004
24	Hungary	2004	since 2004	since 2004
25	Czech Republic	2004	since 2004	since 2004
26	Bulgaria	2007	since 2007	since 2007
27	Romania	2007	since 2007	since 2007
28	Croatia	2013	since 2013	since 2013

However, it should be noted that the realization of common goals, is still accompanied by the presence of national priorities and obstacles of various kinds (e. g. political parties, tax authorities, businesses, etc.). «Implementation of the requirements of EU Directives into the national law of the Member States with different levels of economic and social development, especially the legal and tax systems have different influences on the development of accounting and reporting in each country. In addition, national GAAP<sup>5</sup> in each country was developed over the years considering political, economic and social differences, government decisions, government regulation, taxation and other normative objectives that were taken into account in the development of common principles and rules of national GAAP in various countries» [168].

In countries of continental model of accounting (Austria, Germany, France, etc.) with the introduction of standards of EU Directives requirements for quality, usefulness and value of financial information were legally established which in turn influenced the growth of informativeness of financial reporting and reducing the impact of tax legislation on accounting and financial statements. In countries of the Anglo-American accounting model (UK, Ireland) financial reporting aims to meet information needs of investors and creditors, and accounting is regulated by the authorities that are independent from tax legislation. This led to much smaller changes in national legislation concerning the regulation of accounting and financial reporting formation.

Despite the large number of economic, political and social differences between EU member states, the Fourth and Seventh Directives have led to the harmonization and coordination of the basic elements of accounting and financial reporting in the national legislation of individual countries, thus causing a change in the assessment and recognition of assets, liabilities and capital, requirements for disclosure of information in the financial statements and, consequently, changes in auditing financial information.

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<sup>5</sup> GAAP – is the system of generally accepted accounting principles. Sometimes this abbreviation is interpreted as Generally Accepted Accounting Practices — is common practice of accounting.



In addition to the above, there is the idea of standardization of accounting caused by the expansion of integration processes in the development of the European and world economy. It involves the establishment of common rules and requirements for accounting and application of unified set of standards that regulate accounting event and its reflection in the statements.

Standardization allows making accounting policies, general principles and a system of accounting and reporting global. It is carried out as part of unification of accounting at the mega-level that is carried out by the International Accounting Standards Board (IASB). The approach to standardization of accounting means that there should be a unified set of standards for any accounting situation in any country, and therefore there will be no need to develop national standards.

The interstate level of accounting policies includes principles and rules on accounting, as defined by international standards. These include International Financial Reporting Standards (IFRS), International Accounting Standards (IAS) and Interpretations of the Standing Interpretations Committee (SIC) issued by IASB.

According to the international practice, accounting policies in different countries have their own specific characteristics. For example, in the UK and the Netherlands accounting policies are less structured and are not so detailed and not as formalized as in the US.

On the other hand, the development of economic integration of the European countries contributes to more rapid process of harmonization and unification of accounting. This in turn causes both its structure and in particular accounting policies to be more detailed.

International standards, as it is known, are advisory in their nature, but their content defines basis for the establishment of legal regulation and provision of accounting policies in Ukraine.

IAS 1 «Presentation of Financial Statements» defines a complete set of financial statements, which must include the so-called «statement of financial position at the beginning of the oldest comparative period when an entity applies an accounting policies retrospectively or makes a retrospective recalculation of articles of its financial statements or when it rearranges its articles of financial statements» [22].

The business entity reaches «accurate presenting reporting» through compliance with international standards that are applied.

Fair presentation also requires the following responsibilities from business entity:

a) to choose and apply accounting policies in accordance with IAS 8 [23];

b) to provide information (including accounting policies) so as to provide accurate, comparable, relevant and understandable information to users;

c) in conditions when compliance with the specific requirements in IFRSs is insufficient for providing possibility of different users to understand the impact of certain transactions or other events and conditions on the financial position or performance of the business entity activity, disclose additional information.

It has been stipulated in IAS 1 «Presentation of Financial Statements» [22] that the business entity can not rectify inappropriate accounting policies neither through disclosure of information about applied accounting policies nor additional notes or explanations. Other international standards of financial reporting and accounting contain a number of recommendations regarding individual elements of accounting policies or commercial operations for which accounting policies is applied.

It should be noted that IFRS 1 «The first application of International Financial Reporting Standards» [22] warns the business entity to disclose in the Notes to the financial statements all the points regarding accounting policies. In particular, the principles which the company adheres and the methods used for the implementation of these principles should be disclosed. Such information is essential for determining the financial position of the business entity directing its cash flows, as well as to determine the performance of activity.

IFRS present the requirements and principles that are necessary to take as a basis in the process of formation of accounting policies. «It is about the principles of continuity of the company activity, accrual, consistency, essentiality, sustainability etc. It is necessary to allocate as the main principles constancy or permanence from year to year. Exceptions are cases of changes for improving accounting policies, the

effects of which should be disclosed in the explanatory notes to the annual financial statements» [168].

The procedure for amending the accounting policies is also regulated by European legislation. Thus, in the UK according to standard 17 (SSAP 17) «Accounting for post balance sheet events», all cases of changes after the balance sheet is made are divided into those which are subject to alteration and those that can not be altered. The first are so-called «material (significant)». These, for example, include transactions related to debtors). The second, that can not be altered are reported in the notes to the statements and describe their results and character. These, for example, are nonexistent facts at the balance sheet date, such as fire and so on.

Therefore, changing (improving) of accounting policies that caused material changes should be applied to the items of the current reporting period as adjustments to previously accrued reserves and should cover the amount of income of the current period.

In Germany, changes in accounting policies that affect the current revenue must be legally agreed upon the Commercial Code. In such countries as Belgium, Italy and Spain a different practice is used. In particular, any adjustment should take place through the account «Income and losses» for the last reporting period. It should be noted that the accounting practices of these countries recognizes losses from adjusted events, but not incomes. In France, for example, all changes must also go through the account «Gains and losses» for extraordinary articles. If changes in accounting are caused by the improvement of the accounting system, all adjustments should refer to the account «Reserves». Thus, all the events that can not be adjusted according to the basic principle of «existing enterprises» must be analyzed in detail in a separate document.

Another essential feature of foreign accounting practice is that large business entities prepare two versions of accounting policies. The first is made at the beginning of the year and is purely formal. It serves as a symbol of current national accounting principles that were fulfilled in the company in the last reporting period, and includes the expected changes and clarification of the current year. The second version is

made at the end of the reporting year before reporting. Thus, during the year, an entity may change the selected accounting policies.

Accounting policies are revealed, as it is known, in the Notes to the financial statements. The first of these usually summarizes the accounting methods used in the preparation of reports. In other words, it features the peculiarities of accounting of the company. In the second note the results of changes in accounting policies are reflected, if these policies were changed during the year.

In this regard, the influence of accounting policies on the situation in the company is considered in the explanatory note to the financial statements. For the purpose of internal analysis the so-called «map» of possible options of making profit is made with different approaches to measuring inventories, expenses, depreciation methods, terms of sale, the range of products produced. For financial reporting purposes, these figures should be presented in minimized form.

National accounting adjustment programs of European countries are oriented on IASB standards. Professional accounting organizations, Unions of Chartered Certified Accountants and Auditors of each EU country take their own decisions about the degree of mandatory compliance and implementation of international standards (e. g. full, cancellation or replacement of only certain articles). Special laws, commercial codes or other normative acts on the activities of EU companies reflect the fundamentals of the organization and record keeping on various categories of businesses. Thus the national systems of accounting regulation should be brought into conformity with the Fourth EU Directive. It is known to coordinate various accounting systems and is the basis for the creation of European regional accounting system. Given its requirements, regulation of companies' activities is conducted according to their type and size. Thus, the most common forms of companies in foreign practice are joint-stock company (PLC – Public Limited Company) and private (Ltd. P) limited companies [91]. Therefore, these entities have different reductions in the requirements of publishing statements and the results of audits.

So-called «publication of statements» includes different concepts. All financial statements of the UK, Italy and Spain will be registered in a special body. For example in the UK this special government body is

the Register of Companies. In Italy, auditing expertise and publication of its results are necessary only for listing companies. The financial statements of all companies in Germany are published in the Commercial Register and the statements of large companies are also published in the Federal newspaper. Belgian annual reports are registered by the National Bank of Belgium and listed companies whose shares are publicly traded at the exchange, must also publish their reduced forms of reports in periodicals (newspapers).

In France, in addition to the registration of financial statements for certain specified companies, their publication is stipulated in the Bulletin BALO<sup>6</sup>.

Such differentiated approach in the requirements to publishing reporting and the results of the audit verifications determines differences in levels of freedom of business entities in their choice of accounting methods (Figure 2.5.1).

On the one hand, the system of open reporting has a positive impact. This increases the trust of government bodies and investors. From the other side, sometimes there are situations where publicity of financial reporting of economic unit could trigger its financial collapse. These and other reasons causing differences in the requirements for publicity.

Therefore, it is necessary to agree the requirements of publishing statements with the demand for its confidentiality, according to which the published financial performance should not inflict damage to the interests of the company.

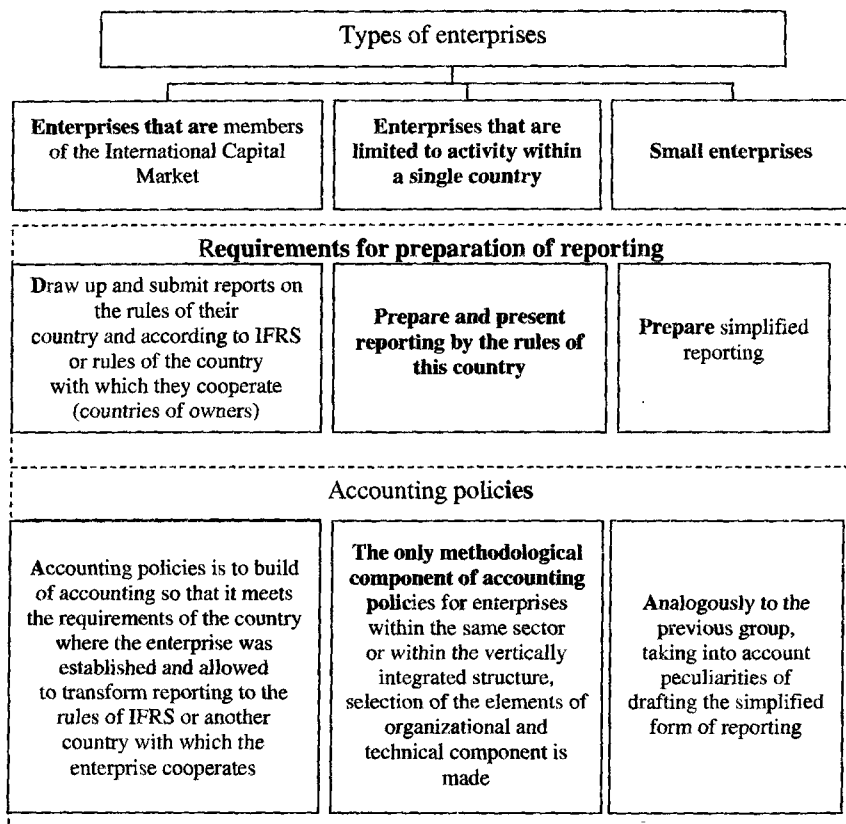
Experience of integration processes of accounting and financial reporting in Europe shows that over the long period (over 40 years) there was a gradual harmonization of the accounting system of EU member countries took place. This is the way to adaptation of national legislation and harmonization of methodologies for accounting and reporting in different countries.

Thus, since the 80's of the XX century, the European Union has developed a number of directives concerning the harmonization of financial reporting in order to reduce the variety of procedures for

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<sup>6</sup> BALO – Bulletin des annonces legates obligatoires

accounting and formation of financial reporting. Further development of harmonization and standardization was observed during the 90's by making decisions on expanding limits of comparability of financial reporting and improvement of application of IAS [168].



**Figure 2.5.1. Separation of approaches of the accounting policies formation of EU member states according to the types of enterprises**

Considering the European integration and public policy of Ukraine concerning compliance with regulatory and legal framework to the European standards, as well as exploring international experience of accounting harmonization in the EU countries, it is necessary, first of all to determine the list of priorities tasks on the approximation of the current existing legislation and future normative and legal base of Ukraine to the EU legislation [3]. And this will act as an important prerequisite for strengthening economic relations between Ukraine and the European Union in the immediate future.

## **2.6. PROBLEMS OF HARMONIZATION OF ACCOUNTING IN UKRAINE WITH INTERNATIONAL AND EUROPEAN REQUIREMENTS**

Ukraine as the European state that aims to become a member of the European community, which was created by countries that joined it bringing all spheres of life to unified norms and standards, should acknowledge these rules. Therefore, there is a task of considering the International Accounting Standards as a tool for harmonization of accounting in different countries and for comparison of international standards with national to study if there is a conceptual unity.

The issue of transition to international standards remains very problematic for Ukraine, so many papers as adherents of this process, and adversaries were devoted to this issue. This issue was investigated by domestic and foreign researchers. However, due to the development of harmonization process and the lack of unanimity in the views of scientists, this issue needs further research. First thing you should determine the differences between the concepts of «unification», «standardization» and «harmonization» (Figure 2.6.1).

Unification is a way for construction of totality to a single system or internal form [131, p. 479]. In determining the differences between harmonization (with increasing similarity conducting of bookkeeping calculation practices in different countries) and standardization (using more stringent and less vague rules), C. Noub [136] added that in the

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*On the 50th anniversary  
of the Ternopil National  
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# **ACCOUNTING IN UKRAINE UNDER IMPLEMENTATION OF THE EUROPEAN LEGISLATION**

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The monograph is devoted to problems of development and improvement of the accounting system in Ukraine in accordance with European legislation and implementation of principles and approaches recommended by the International Financial Reporting Standards. The research provides the theoretical study of improvement of the legal framework and practice of accounting, ways of solution of organizational issues and reasoning for the use of modern accounting methods and advanced information models. The monograph is intended for researchers, practitioners and students, who take economics courses.

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# **Preface**

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The growth of capital mobility, the expansion of interconnections between individual countries, the increase in international trade, the establishment of international and transnational corporations and many other factors contribute to the progressive development of economic relations which are established to date in the global economy and are characterized by the further development of globalization processes. The creation of the global financial information system leads to a change in requirements that are faced by accounting, analysis and audit. One of the main international processes occurring in the world today is the harmonization of national systems of accounting and financial reporting in different countries.

Widespread use of positive international experience in issues of accounting system formation plays very important role. In this context, the study of problems of the implementation of international accounting standards into the national accounting system is sufficiently urgent because it enables to evaluate the real chances of implementing international requirements and the effect of their application in practical area of a specific country.

An important feature of Ukraine joining to the EU is compliance of national goals, principles and norms of policy and legislation with law and order of the EU, which is based on the so-called «common heritage» (acquis communautaire). The particular importance of *acquis communautaire* concept consists in ensuring uniformity of the legal system of the European Union, providing the integrity of the system and obligation of identical application of law in all EU member states. Successful implementation of international accounting experience is

possible only in case of improvement of the business climate in Ukraine, as well as establishing effective and constructive partner relations between institutions that are appointed to control the process of adaptation and implementation of IFRS.

The monograph deals with the problems of development and improvement of the Ukrainian accounting system with European legislation and implementation of principles and approaches recommended by the IFRS.

The monograph was prepared by the academic staff of the Department of Accounting in the Public Sector of Economy and Service Sector under the guidance of Doctor of Economics, Professor, Head of Department Mykhailo Luchko.

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