
Establishment of the International Accounting Standards in Central-Eastern European and Other Developing Countries

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Abstract

This article investigates the developments in the process of introduction of the International Accounting Standards (IAS) mainly in the countries of central-eastern Europe. These countries are now going through a stage of developing basic infrastructure in most of the areas of economic activity and especially in the financial markets. In particular, this article presents the business environment of developing countries and highlights problems arising in the entire financial sector of these countries from establishment of the IAS. Its most important finding is that factors like fluidity of domestic accounting standards, lack of appropriate training of accountants and employees, as well as lack of trust in the economic-political system of the country play a negative role to the IAS introduction process.

Keywords: International Accounting Standards, Developing Countries, Central-Eastern Europe

JEL Classification: M41, M42

1. Introduction

In the effort to provide reliable and comparable accounting information in order to assist investors, creditors and other interested parties, each country has established its own accounting standards. These standards reflect the culture, history and characteristics of accounting problems faced by each country (Choi and Muller, 1992). These standards were either developed by professional organizations or by governments and other regulatory authorities in these countries (Basoglou and Goma).

Accounting standards relate to two different but interdependent sides of a business. The first side relates to providing financial information to executives of the enterprise, and consequently are a procedure internal to the enterprise. The second side relates to the provision of financial information to investors and the supervisory authorities (Whittington, 1997)² (Mertzanis, 2001).

The differences appearing in the accounting standards of various countries was one of the main issues of debate at the 10th World Conference of Accountants in 1972 and led to the creation of the International Accounting Standards Com-

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² See Whittington, 1997.

mittee (better known as IASC)³. Representatives of Australia, Canada, France, Mexico, Holland, the United States of America, West Germany, England and Ireland participated in this committee. The main concern of the committee was the effort to establish a series of accounting standards which would be acceptable to all countries (Kapaya, 2000). During the period 1974-1979 the committee issued 13 International Accounting Standards (IAS), which were not widely implemented due to non-acceptance by the regulatory authorities of the countries participating in the committee. The main reasons for non-acceptance were primarily:

1. The IAS were not absolutely comprehensible,
2. The IAS provided many alternative solutions to accountants to deal with accounting issues, a fact which caused confusion.

Following pressure exerted by the International Organization of Securities Commissions (IOSCO) for the establishment of a comprehensible and mutually acceptable series of accounting standards, the International Accounting Standards Committee reached agreement on the establishment of 40 basic standards in 1999.⁴ (Basoglou and Goma).

1.1. The need for International Accounting Standards

At the beginning of the new millennium, international economic activity is increasing at a rapid rate. Over the last decade as a significant increase in international commerce was recorded, as well as in capital transfers between countries, in international investments, in the number of multinational corporations and the purchase-sale of bonds, shares and securities on stock exchange markets.

International supply of Capital by Companies

*(Sales of securities outside of local markets)
in millions of dollars*

Geographical region	1995	1999
North America	11,307	23,963
Europe	31,526	82,809
Africa - Middle East	1,779	3,174
Asia	12,235	41,219
Latin America	878	721
Total Market	57,725	151,887

Source: Choi, Frost and Meek, *International Accounting, Prentice-Hall, Fourth Edition, 2002, page 2*

³ The first reference to establishing an IASC can be traced back to the 1st World Conference of Accountants held in St. Louis, Missouri in 1904 (Samuel and Piper, 1985, p. 59).

⁴ International Accounting Standards Board: IAS around the world, how IAS are being used. www.iasb.org.uk, 2001.

The table above shows the international supply of capital from companies in countries in five geographical regions for the years 1995 and 1999 respectively. As can be seen in the table, there was an increase in the international supply of capital from \$57,725 million to \$151,887 million which is equivalent to a tripling of this figure in five years only. The volume of activity for Latin America, Africa and the Middle East is low compared to the other three regions, a fact which is justified by the existence of multinational companies in these areas whose management is located in developed countries. As is well-known, multinational corporations are continuously seeking higher profits with the lowest possible cost. In this effort, they examine the possibility of relocating themselves to developing countries. However, in order to take the decision to relocate to such an area, they need reliable and comparable financial data (Basoglou and Goma). The existence of differing accounting standards from country to country renders the task of multinational corporations more difficult. The establishment of International Accounting Standards would solve a significant problem in the difference between standards between countries and would significantly facilitate multinational corporations (Choi, Frost and Meek, 2002).

The establishment of International Accounting Standards would also significantly facilitate institutional and individual international investors.

The establishment of a uniform set of International Accounting Standards would constitute a significant advantage for other interested groups such as multinational corporations providing accounting and consultation services, international inter-governmental organizations such as the United Nations, the European Community, the Organization for Economic Cooperation and Development (OECD) as well as the governments of countries, international stock exchange markets and capital markets. If all countries were in line with the IAS comparable, reliable financial data would be available at global level, a fact which would contribute to reduced learning curve costs for individual accounting standards in each country by interested parties. Moreover, it would no longer be necessary to prepare accounting statements on the basis of both the IAS and domestic accounting standards for companies preparing to list on international exchanges. The possibility of access to global economic databases from countries which use the IAS is another significant advantage from establishing the standards.

Globalization of economies through contemporary changes in international markets renders the harmonization of local accounting standards with International Accounting Standards necessary. In order to achieve transparency and uniformity in the establishment of a framework international accounting system both financial and non-financial data on the performance of enterprises must be examined so as to give rise to a uniform means of presenting financial statements of companies at global level (Voon, 2001).

Globalization, the spread of major multinational corporations and technology have significantly changed the manner of organizing companies, government and society as a whole. These changes led to the creation of a type of organization of human work based on group work, the provision of incentives and the effort to adjust the cost of underemployment (Voon, 2001).

The establishment of the IAS would contribute to identifying strategic alliances between enterprises and the creation of transparency in relations between them. The manner in which developing countries have responded to globalization will significantly affect their rate of growth, their quality of life and the development of their economies during the decades to come. In countries where economic and political institutions are 'relaxed' and flexible, establishment of the IAS will be easier compared to countries where business and political management structures are much stronger. As a result, countries with deeply rooted systems will face greater problems in harmonizing with the International Accounting Standards and will require more time to implement and apply them. In general terms, one can claim that the method of response and the ease of adaptation of the economies of developing countries to the IAS depends to a large extent on the decisiveness and adaptability of the governments of these various countries (Voon, 2001).

2. IAS and Developing Countries

2.1. Introductory Remarks

From 1st January 2005 all enterprises listed on stock exchanges from countries in Europe should prepare consolidated balance sheets based on the International Accounting Standards following a decision taken by the European Union on the 31.12.2001 (Bellas, 2003). In relation to the countries of Central-Eastern Europe, the establishment of IAS can be summarized as follows (East West Management Institute, 2002):

- In the Czech Republic, Estonia, Latvia and Lithuania and Slovakia, preparation of financial statements based on the IAS will only be mandatory for companies listed on the stock exchange.
- In Hungary, companies will have the option to prepare financial statements both in accordance with national legislation and in accordance with the IAS or American Accounting Standards.
- In Poland the country of origin of the Company will determine whether the financial statements will be prepared in accordance with Polish Accounting Standards, IAS or American Accounting Standards.
- In Slovenia enterprises will prepare financial statements based on local accounting standards, which are not yet fully in line with the IAS.

The main tool for harmonizing Company Law is for the European Commission to issue a Directive. The provisions of Directives determine the behaviour of all companies from the moment that they are incorporated into national law. Nonetheless, each Member State is given the opportunity to choose the method and mode of implementing Directives and of modifying the provisions of directives with the aim of achieving their objectives. It is self-evident therefore that the integration of a Directive into national law does not automatically guarantee harmonization of accounting standards since this presupposes identical interpretation of the standards (Mertzanis, 2001).

The category of developing countries also includes countries from the Middle East. It is worth noting that in these countries there are major differences in terms of both wealth and development. For example, countries such as Turkey and Egypt are considered developing economies and have need of influxes of foreign capital, while rich, petrol producing countries such as Saudi Arabia and Kuwait have the necessary capital to make investments abroad.

In general terms, the countries of the Middle East have positively welcomed the establishment of the IAS. The domestic accounting standards of some countries are based on or have many similarities to the IAS even though the use of the IAS may not have been accepted by the country. The IAS are treated differently from country to country; some countries consider them as a simple replacement of domestic accounting standards while others such as Turkey agree to prepare financial statements based on the IAS only for foreign enterprises which intends to list on stock exchanges. Few countries, such as Egypt, Jordan and Kuwait, also require domestic listed countries to prepare financial statements based on the IAS. Iran and Israel are the only countries which have not expressed interest or any intention to establish use of the IAS.

Lastly, the category of developing countries also includes many countries in Asia such as China. In most Asian countries the international accounting standards have already been accepted despite problems in the economies of these countries and the lack of capable, trained professionals within enterprises.

The objective of this article is to present the business environment of developing countries and to highlight problems arising in the entire financial cycle of these countries from establishment of the IAS.

2.2. Description of the business environment in developing countries, development of measures to establish the IAS.

Beginning with Hungary, where there was a liberal socialist system due to the existence of foreign investment and the opportunity for establishment of multinational corporations, the following harmonization measures have been taken for the IAS:

The accounting system of Hungary was examined during the presentation and evaluation of the commercial legislation at a joint meeting in Brussels between 2nd – 5th June 1998. A small difference between the Hungarian accounting legislation and the European Union Directives was observed. More specifically, Hungary achieved full harmonization with the Directive on approval and conduct of annual financial audit of businesses by certified accountants (Directive 84/253/EEC, 8th Directive and Act LV of 1997). At present, the country is taking steps relating to the annual financial statements and consolidated annual statements of account in order to come into line with the corresponding Directives of the European Union (Directives 78/660/EEC, 4th Directive and 83/349/EEC, 7th DIRECTIVE and Act XVIII of 1991 on Accounting).

The measures taken to bring national standards into line with the IAS are as follows (Ministry of Foreign Affairs Hungary):

- In 1992 Act XVIII on accounting entered into effect and its implementation was completed in 1994, which lays down rules for the preparation of annual consolidated financial statements.
- Act LV of 1997 was approved which regulates the establishment of the Institute of Hungarian Accountants and enacted rules and procedures for conducting financial and accounting audits of businesses.
- On 1st January 2001 Act C of 2000 on accounting entered into effect. This act makes it possible to deal with specialized financial issues which are faced by railroad enterprises, the electrical energy market, the natural gas market as well as transport companies on the basis of the laws which govern them, based on general accounting rules. At the same time, legislative decrees were issued which lay down the principles of accounting for dealing with financial issues for certain enterprises subject to special regimes governed by special provisions (insurance companies, banks, and other financial institutions). The aforementioned acts, which took effect in Hungary from 1st January 2001 are completely in line with the 4th and 7th Community Directives on Company Law as well as the International Accounting Standards. The 4th European Directive lays down the form and content of financial statements of companies which must be reported. It is capable of alternative interpretation by each country and permits quite a few differentiations in the implementation of its provisions.

Based on these measures, the economy of Hungary is ready for full harmonization with the IAS from 2005.

All businesses operating in Poland are obliged to follow the Polish Accounting Standards. According to these, all financial statements must be kept in the domestic currency and expressed in the Polish language, a fact which also applies for other developing countries such as Armenia (McGee, 1999). The Polish Accounting Standards were enacted by the Accounting Act of 29th September 1994, which entered into effect on 1st January 1995. Pursuant to this Law, the Polish Accounting Standards are in line with the European Union Directives and to a large extent are also in line with the International Accounting Standards (Poland Ministry of Economy). In November 2000, the Polish parliament approved significant changes to the domestic accounting standards in order to achieve greater compliance with the IAS (MacLulich, 2001). Some of these standards, like those referring to leasing and other long-term contracts, could be applied by businesses before the 1st of January, 2001 (Ernst and Young, 2001).

Just as in Hungary, Poland has established an Institute of Certified Accountants-Auditors which carries out annual financial audits of businesses at least once a year. The auditing of banks, insurance companies, investment firms and all companies listed on the stock exchange is mandatory. For other businesses, an audit must be conducted by certified auditors if two of the following criteria are met during the previous management period (Catalogue of Polish Businesses, 2001):

1. The average number of employees exceeds 50.
2. The total assets of the company during the last financial year were equal to € 2.5 million expressed in the Polish currency.

3. The net sales of the company were equal to € 5 million expressed in the polish currency.

Continuing the description of the business and economic environment in developing countries, we will now proceed to an analysis of the situation in Asian countries.

The most important problem faced by Asian countries is that of poverty. Approximately one billion people live below the poverty line in inhuman conditions, unable to cover even their most basic needs such as housing and food. Consequently, the main objective of these countries is to develop a strong, stable form of economic growth, to implement suitable social policies which permit the participation of all residents in the effort to achieve growth and to establish powerful and reliable institutions in the economy and rules of corporate governance. The reduction of poverty can be achieved by creating new jobs in the private sector, which in turn will develop via international investments (Lintjer, 2002). Therefore, the challenge for Asian countries is the ability to achieve a rapid adaptation to the changing international business environment. This presupposes urgent, radical changes in the entire economic cycle of these countries. Properly organized markets attract larger investments which in turn lead to economic growth. The entry of foreign businesses into these countries and the provision of incentives to them will contribute significantly to this end. As already mentioned, the role of the IAS is equally important in the effort to develop economies.

In China, two separate stock exchange market have been established, one for domestic enterprises and one for foreign enterprises. Companies listed on the first must prepare their financial statements in accordance with domestic accounting standards for domestic investors and in accordance with the IAS for foreign investors and on the second stock exchange market, financial statements are prepared on the basis of the IAS. The establishment of the IAS for all businesses would lead to more reliable financial data and attract large auditing-consulting firms to provide their services to businesses in the country (Eccher and Healy, 2000).

In Russia, a country with strong political and economic structures, there have been significant delays in coming into line with the International Accounting Standards in comparison with other countries in Central-Eastern Europe.

Russia has been faced with major economic problems in its transition from a socialist system to a free market economy. Up until 1985 the main objective of accounting systems in Russia was to protect public property and provide information to state financial programmers. The main role of accountants was to measure and record assets and not to analyze and explain them. Following the political reforms in 1985, the objective of accounting systems in the country became the provision of information for taxation purposes, a fact which also applies in other developing countries such as Poland. Lastly, since 2000, accounting systems in the country have been in transition since they have begun to harmonize with those of Western countries, placing greater emphasis on the growth of domestic enterprises in the context of the international economy (Thunderbird, 2000).

The accounting standards in the country are laid down by state authorities and contained in the Russian Federal Law on accounting and other legislative acts

and decrees (Engineering Center Zodchiy). Despite this, the Russian accounting standards continue to differ significantly from the accounting standards in Western countries (Blums, 1999).

The effort to bring Russian accounting standards into line with those applying in Western countries has not managed to eliminate major problems faced by the Russian business environment. For example, we can mention that five years after the collapse of the banking system, residents of the country remain hesitant about depositing their money in banks, afraid of a new wave of hyperinflation which would wipe out their deposits again. Moreover, loans remain inaccessible to small and medium-sized enterprises. The three basic reasons impeding the growth of the banking system are as follows (Clark, 2001):

1. Lack of trust
2. Lack of investments which provide security
3. Lack of unrestricted competition.

Consequently, the existing banking system is small and fails to achieve its most basic role, which is economic intervention, in other words lending of deposits and assistance with investments in the economy.

In the efforts to reform the banking system, the Russian government has already taken drastic measures and has prepared various studies. The introduction of the IAS is a necessary condition and a significant problem for reforming the system. The IAS require extensive transparency and the disclosure of more financial data about enterprises than the Russian accounting standards. The Russian Central Bank proposed 1st January 2004 as the implementation date for the IAS, one year earlier than a mandatory implementation of the IAS in other European countries. The Prime Minister of the country, Mikhail Kasyanov⁵ gave an order to the Ministry of Finance to present the changes in the accounting system to businesses in January 2003, thus giving them one year to adapt to the needs of the new system. Businesses should review the way in which their accounting books are kept, create new accounts responding to the needs of the IAS, prepare simple consolidated balance sheets, cash flow statements based on new criteria and in general reform the way in which their financial services are organized (Anankina etc., 2002).

Reviewing the entire accounting system of the country and placing emphasis on effective management and administration of businesses will be a significant step towards the entry of foreign multinational corporations into the country, towards foreign investments in Russian enterprises and towards the listing of Russian enterprises on international stock exchanges.

Use of the IAS will contribute to the growth of stock exchanges both in developed and in developing countries, since international investors will have comparable, reliable and comprehensible financial statements of listed companies, making investment in them easier. As is clear, the growth of stock exchanges in developing

⁵ Prime Minister Mikhail Kasyanov promised that the Government and Central Bank of Russia would take a common line in confronting the problem in the banking system. To what extent the reform plans, without the assistance of other factors, will lead to the creation of a robust, reliable banking sector remains unknown.

countries is one of the basic objectives of establishing the IAS. The number of listed companies on stock exchanges in developing countries such as the Middle East is very low in comparison with developed Western countries. The small number of foreign listed enterprises demonstrates the low or even non-existent degree of globalization of these countries. In the context of the efforts to develop international stock exchanges, the International Organization of Securities Commissions is exerting strong pressure on the International Accounting Standards Committee to establish the IAS at international level.

3. Conclusions

From the foregoing analysis it is clear that establishment of the IAS at international level both in developed and in developing countries will significantly contribute to the strong performance of national economies, global capital markets, the global labour market and stock exchange markets.

The degree of adaptability and decisiveness of developing countries in relation to IAS requirements will lead either to rapid or slow establishment thereof. Countries with a strong system of accounting standards already legislated for will face fewer difficulties in their effort to come into line with the IAS in comparison with countries where the domestic accounting standards are fluid, accountants and employees in the economy do not have appropriate training and in general there is a climate of lack of trust in the economic-political system of the country itself. It is worth noting at this point that most developing countries are now just at the stage of developing basic infrastructure for the preparation and support of reliable financial statements. Universities and schools in these countries have recently begun to training modern professionals in the economic sciences. The barrier of language -primarily English- has begun to be eliminated since increasing numbers of professionals have good knowledge of this foreign language. In quite a few countries such as Russia, Hungary, China, Armenia (McGee, 1999) and others, vocational training institutes have been established for employees in enterprises in order for them to be in a position to respond to the more stringent requirements of the modern economy.⁶ Major emphasis has also been placed on creating and training modern managers (Institute of Management Accountants, 2002), application of Management Accounting and the improvement of the credibility of economic control on the financial statements of businesses (International Center of Accounting Reform, 2002). Finally, an effort is made to ensure independence of external auditors through incorporation of a *Code of Ethics* into the Acts by which IAS are legalized (Bychova and Sucher, 2001).

The establishment of the IAS is a global affair and requires the involvement of many agencies in the economic, political and business life of each country. Achieve-

⁶ In relation to the issue of training see the views of Mr. Ray Harris (Senior Executive, Deloitte & Touche) who worked on the International Committee for Chinese Accounting Standards Reform, "China will train 10,000 accountants by 2000, a very small number for the size of the country. Canada for example, which has a population of around 30 million, has 60,000 accountants". (The Financial Post, Toronto, 5th July 1996, p.2.

ment of this objective requires constant, persistent effort and dedication so as to create a truly international capital, labour and securities market. In achieving this target, a primary factor is the auxiliary and consultancy role of the International Accounting Standards Committee (IASC) and the international organizations in assisting developing countries in confronting problems of adaptation which they will come across.

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