

FINANSIAL REPORTING AND AUDITING IN THE CONTEXT OF ASSURANCE OF INFORMATION TRANSPARENSY OF THE ACTIVITY OF ECONOMIC ENTITIES OF UKRAINE

აუდიტი და ფინანსური ანგარიშგება სავაჭრო-საინფორმაციო გამჭვირვალობის უზრუნველყოფის კონტექსტში უკრაინის ეკონომიკური სუბიექტების საქმიანობაში

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Abstract

The purpose of the study is to disclose the interdependence of the processes of forming and publication of the financial reporting and audit quality as interdependent elements of ensuring the information transparency of the activity of economic entities of Ukraine. Such shortcomings of Ukrainian system of information disclosure that is publication of annual financial statements in scope which is not satisfy the requirements of laws and regular acts, unconfornity between the scope of published financial statements and auditors' obligation, discrepancy between managerial staff obligations and auditors' obligation have been analyzed, the ways of its solutions have been proposed. The results of investigation show that the increasing of audit quality will be promoted by the improvement of organization of enterprise's accounting, internal control and management what have to be provided by the elaboration of the obligatory regulations concerning assessing the observance going-concern principle, observance of laws and regulation which are influenced the enterprise's activity, organization of internal control and fraud's preventing system. The components of guarantying information transparency of enterprise's tax relations in the system of financial reporting have been investigated. The format of disclosure the information about qualitative status of taxation in the annotations to the financial reporting taking into account the demands of Ukrainian Tax Code as regards to the process of tax administration has been proposed.

Key words: financial reporting, information transparency, tax relations, auditing, auditor's report

ანოტაცია

სტატიის მიზანს წარმოადგენს უკრაინის ეკონომიკური სუბიექტების საქმიანობის ფინანსური ანგარიშგების ფორმირებისა და გასაჯაროების, ასევე აუდიტის ხარისხის, როგორც ურთიერთდაკავშირებული პროცესების, ურთიერთკავშირების გამოვლენა. გაანალიზებულია უკრაინაში ინფორმაციის გახსნილობის სისტემის ისეთი უარყოფითი მხარეები, როგორებიცაა წლიური ფინანსური ანგარიშგების გასაჯაროება იმ მოცულობით, რომელიც არ შეესაბამება ნორმატიული და საკანონმდებლო დოკუმენტების მოთხოვნებს, გასაჯაროებული ფინანსური ანგარიშგების შინაარსისა და აუდიტორის ვალდებულებების შეუთანხმებლობა, მართვის პერსონალის და აუდიტორის მოვალეობების შეუსაბამობა. შემოთავაზებულია აღნიშნული პრობლემების გადაჭრის გზები.

კვლევის შედეგები გვიჩვენებენ, რომ აუდიტის ხარისხის ამაღლებას ხელს უწყობსადრიცხვის ორგანიზაციის, შიდა კონტროლისა და საწარმოში მენეჯმენტის გაუმჯობესება, რაც თავის მხრივ

შეიძლება უზრუნველყოფილი იქნას შიდა მარეგულირებელი დოკუმენტაციის შემუშავებით, რომელიც შეეხება საწარმოს საწმიანობის უწყვეტობის პრინციპის დაცვას, ნორმატიული და საკანონმდებლო დოკუმენტების დაცვას, რომლებიც თავის მხრივ მოქმედებენ საწარმოს საქმიანობაზე, შიდა კონტროლის სისტემის ორგანიზაციაზე და თაღლითობის აღმოფხვრაზე.

შემოთავაზებულია ინფორმაციის გახსნილობის ფორმატები ხარისხიანი დაბეგერის მდგომარეობაზე ფინანსურ ანგარიშგებაში, უკრაინის საგადასახადო კოდექსის შესაბამისად საგადასახადო ადმინისტრირების პროცესის ნაწილში.

საკვანძო სიტყვები: ფინანსური ანგალიშგება, საინფორმაციო გამჭვირვალობა, საგადასახადო ურთიერთობები, აუდიტი, აუდიტორული ანგარიში.

In the conditions of the development of market relations, many decisions of the legislative and executive authorities and businesses are inaccurate and false due to the lack of reliable and complete information. For the same reason many macro- and microeconomic models which are recommended by the experts for the Ukrainian economy in general and for specific economic entities in particular, do not work. Information transparency involves many aspects but the main two aspects are effective operating information infrastructure of the market and a tried and tested mechanism of information disclosure by the participants in this market.

According to Directive 2006/43/EU [1] audit is a key element in ensuring the reliability in the chain of financial reporting which is of considerable public interest. At the same time financial reporting is an integral part of the audit concept, since it accumulates the interests of various entities: users of financial reporting who need reliable and complete information on the activities of an economic entity; management that should provide the preparation of reports based on the principles and procedures required by legislative and regulatory documents in accounting; auditors who will express their opinion about the reliability of reporting which is designed for users of financial information.

Theory of auditing is based on some assumptions (or postulates) elaborated by such academics as Mautz and Sharaf (1961), Lee (1986; 1993), Flint (1988) [2-5]. One of assumptions (postulates) states: "Standards of accountability, for example of conduct, performance, achievement and quality of information, can be set for those who are accountable; actual conduct, performance, achievement, quality and so on can be measured and compared with these standards by reference to known criteria; and the process of measurement and comparison requires skill and the exercise of judgment". This postulate emphasizes the significant importance of legislation concerning financial reporting in theory and practice of audit, as for an auditor to judge the fairness of financial reporting (as "true and fair" or "presented fairly"), he/she must have certain standard or sample for work. In this case R. Adams noted that the more accurately the legal requirements to provide financial reporting are stated, the easier for an auditor to perform a review. If the formulation of the requirements is vague then there will be a

greater likelihood of conflict between a client and an auditor [6, p. 231]. The consequence of this situation can be not only the conflict between the auditor and the client, but also a significant decrease of the informational value of the financial reporting as well as auditing report as a result of the auditing.

The problems of compiling financial reporting and methodological approaches to its preparation are constantly in the spotlight of the national and foreign scientists but there is a lack of an integrated approach in the research of the quality of financial reporting and audit as the interrelated elements of information transparency and information security in society.

Some studies in this area are carried out by rating agencies. For example, in 2009 the rating agency Standard & Poor's together with the analytical company "Financial Initiatives Agency" with the support of US-AID project "Capital Markets Development" carried out the analysis of information transparency of the Ukrainian banks [7]. Now such researches are carried out by Ukrainian Credit Rating Agency. The analysis was based on the principle of complete and timely disclosure of all essential information for investors and other stakeholders (analysts, clients, etc.). The research methodology included the analysis of publicly available information contained in the three main sources: annual reports of banks, official web-sites of the banks and the reporting provided to the regulatory authorities. The study showed that the annual reports of the banks were primarily a part of their image than a real tool of communication with stakeholders, and the degree of information assurance of this source was 17.5%, which is the worst indicator among the three main sources of information. The reason of this result was the absence of the tradition of using annual reports in communicating with investors. But the study of the indicator of accessibility and informative value of the audit reports according to the results of verification of annual financial statements (which is obligatory for all banks) was not carried out, although it is generally accepted that the audit should increase the value of information, provide it with greater credibility and, accordingly, reduce informational risk [8, p. 26-31; 9, p.17-18]. Similar studies for other entities which are subjects to mandatory audit are virtually absent, but according to the authors the results would have been even

worse.

Analyzing the quality of financial reporting of public joint stock companies, information and availability of the results of audits we may single out several problems: (1) there were no requirements for mandatory disclosure of the audit report for a long time; (2) financial reporting is published incompletely and that mainly concerns a limited amount of notes that does not comply with regulatory requirements; (3) there is a discrepancy between the amount of the released financial reporting and objectives which are put forward to the auditors; between responsibilities of management personnel in the regulations of Ukraine and the objectives of the auditors in accordance with international auditing standards.

Article 9 of “The responsibilities of economic entities under audit” of the Law of Ukraine “On Auditing” [10] notes that “the financial reporting of an economic entity under the law is the subject to mandatory audit and should be released in accordance with the laws of Ukraine”, but there is not a word on the publication of the report itself. There were no such requirements in the Law of Ukraine “On Accounting and Financial Reporting in Ukraine” [11]. Only in May 2011 the amendments were made which provided mandatory disclosure by individual entities their financial reporting “with the auditor’s report” (item 4, article 14 of “Submission and disclosure of financial reporting”).

One of the problematic issues in this respect is the notes to the financial reporting. The necessity of the notes is the result of one of the fundamental principles underlying the western and national accounting that is the principle of complete disclosure, according to which the financial reporting must contain all information about actual and potential consequences of business transactions and events that may affect the decisions made based on it. The information to be disclosed, is provided directly in the financial reporting or notes thereto, therefore notes to the reports are equal and valuable components of financial reporting and not a secondary document.

Annual financial reports of public corporations mostly only fragmentally (some would say accidentally) include issues as required for coverage in the notes under specific regulations (standards) of accounting and certain provisions of the order of accounting policy. The rest of their content is repetition of the provisions of accounting standards that are mandatory and which have no variation (alternatives). Almost all companies voluntarily do not disclose optional information. In general, the way in which these additional notes are presented by businesses do not have the necessary informational content and may not be accessible to users for more information about the company.

Let us consider the issue of disclosure of information about the company as the subject of tax relations, as indisputable is the fact that an important aspect of assessing the financial situation of the company should be

the assessment of its tax potential and the state of budget payments.

The Ukrainian government approved standard form №5 “Notes to the annual financial reporting” [12], but there is no separate section on the disclosure of the additional information about the relationship of a company on the performance of its duties as a taxpayer. The regulations (standards) of accounting 10 “Receivables” [13] and 11 “Liabilities” [14] also contain no additional requirements for information disclosure which certainly limits the information content and completeness of the financial reporting.

It is reasonable to include a separate section “Characteristics of performance of the duties as a taxpayer and following the rights,” in the notes to the annual financial reporting in which there can be highlighted three tables: Table 1 “Qualitative characteristics of taxation at a company”; Table 2 “Characteristics of accrued and paid taxes (fees and charges), financial sanctions in the financial year”; Table 3 “The results of verification of the state of payments with the budget with the authority of the State Tax Service.”

A reference list of generalized groups of indicators which can be used to fill the first table should be formed with the requirements of the Tax Code of Ukraine [15]. Accordingly, they should provide the following information: characteristics of a company as a taxpayer; the content and structure of commitments of payments to the budget and state trust funds for taxes, fees and charges; the content and structure of receivables for payments to the budget; tax advising; checks of the regulatory authorities; tax notices – the decisions; administrative appeal procedures and judicial processes regarding tax matters; tax requirements; tax pledge; the administrative seizure of property; installment and deferred cash commitments or tax debt; hopeless tax debt. For example, in relation to such specific situation, as an administrative seizure of property, it is important to provide the following disclosures: the fact of receipt of decision of the seizure of property and inventory of the property; the property which has the imposed administrative detention including that which is imposed on full or conditional administrative detention; the fact of appeal by a company the decision of the head of state fiscal authorities to seize property in administrative or judicial proceedings; the fact and the grounds for termination of administrative seizure of the property of a taxpayer.

Analyzing the regulations of International Standards on Auditing (ISA) [16] we can identify many issues that the auditor should check and as the basic approach we propose review (assessment, testing) of the process used by management for assessment. In the international auditing standards published in 2010 the focus was moved to the variability of the conceptual basis of financial reporting in various countries that affects the decisions and actions of the auditor (for example, when

considering laws and regulations, when assessing compliance with the principle of continuity of activity, when checking accounting estimates and transactions with related parties etc.). Most standards provide mandatory review of management's actions but it is underlined that the lack of mandatory implementation of certain procedures does not relieve the auditor of the need to study specific issues. The standards do not offer clear methods of study of such issues and present only generalized arguments.

According to ISA 550 "Related parties" when the applied conceptual basis of financial reporting establishes minimal requirements for related parties or does not establish them at all, the auditor has to understand the relationships and transactions between an economic entity and the related parties to conclude whether the financial reporting, with the influence of the relationships and transactions, is such that ensures a fair presentation or the one that is not misleading (Item 4).

These issues were considered by the National Commission for Regulation of Financial Services of Ukraine at the beginning of 2010. The information letter [17] states that the majority of submitted financial statements of market participants of non-banking financial services in 2008 were submitted incompletely and mainly it concerns the structure of the notes. But the reports of independent auditors have no warning notices concerning the completeness of information disclosure in the financial reporting. It is also underlined that during the statutory audit of the financial reporting in accordance with ISA 540 "Auditing accounting estimates", an auditor must also pay attention of the user to the excessively risky and inappropriate accounting policy of the management of the audited entity; for example, there is too "optimistic" estimate of the assets. The remarks made by the commission were sensible; however, the situation during 2010-2015 was not significantly changed.

Much attention is paid to queries of management personnel while obtaining the audit evidence in order to get certain information and explanation from him/her. In this case, auditors face the problem of lack of specific mechanism of studying the issue at enterprises, and in the worst case it is misunderstanding of what auditors want to get from them. Analyzing the list of queries which an auditor should make during the audit of financial reporting, we can divide them into two groups: the first group is for further audit procedures and the second group is to identify questionable information or the information for a more detailed study.

The list of queries of the first group includes the need to provide the following information:

1) management's evaluation of risks that the financial reporting may contain considerable misstatements due to fraud including the nature, amount and frequency of such assessments and processes used by management to identify and respond to risks of fraud; the

format of informing senior management on the processes identification and responses to the risks of fraud; informing workers about their views on business practices and ethical behaviour;

2) other legal and regulation acts that could have a significant impact on the activities of the economic entity, the policy and procedures regarding the entity's compliance with laws and regulations including the accepted assessment and registration of lawsuits for identification;

3) identification of the related parties of the entity, the relationship between the entity and the related parties, transactions made by the entity with the related parties during a certain period and the type and purpose of the transactions;

4) management establishes policies and procedures in order to understand internal controls (if any) for identification, recording and disclosure of the relationships and transactions with related parties in accordance with the applied financial reporting framework, authorization and approval of significant transactions and arrangements with the related parties, including those that go beyond the normal activities;

5) management's assessment of the entity's capability to carry on operations on a continuous basis or the basis which presupposes the assumption of a continuous activity.

The given information that the auditor should receive; only a list of legislative and regulatory framework that affects the activities of the entity, and the list of the related parties and transactions with them are endorsed into the requirements of accounting and control that were accepted by most businesses. All other policies, procedures and assessments are not mandatory for development and application. Consequently, there is a mismatch between ISA and the requirements of normative regulations concerning management's responsibilities.

Moreover, taking into account the requirements of other International Standards on Auditing concerning an auditor's actions we may conclude that they take for granted the existence of relevant procedures in companies approved by management that go beyond the normative requirements for the regulations of the order of accounting policy that exists in Ukraine. In particular, it is applied, for example, in the procedures for assessing compliance with the principle of continuous activity. In most cases an auditor is recommended not to perform an independent assessment but to evaluate actions and procedures of management, which undoubtedly highlights the importance of a broad interpretation of the essence and content of the accounting policy, the importance of other organizational documents, particularly in creating an effective system of internal control.

Therefore, the international auditing standards consider management's responsibility widely and accept

presence of many regulatory documents that regulate certain issues of organization and methods of accounting at the company. Solving these problems requires improvement of the organization of accounting, internal control and management in the company and assumes mandatory development of rules, including: assessment of compliance with the principle of continuous activity; compliance with other laws and regulations that affect the activity of an economic entity; organization of internal control and prevention of fraud. Depending on the complexity of the entity's structure and the scope of its activities there can be chosen one of two options for the formation of such provisions: to include them in the general documents concerning organization of accounting in the company (orders or regulations on accounting and accounting policy) or to develop separate orders or regulations. The second option for the entities of public interest is more appropriate.

In conclusion, it should be emphasized that the national system of information disclosure makes it impossible to fully meet the needs of members of market relations due to many reasons. One of them is the problem associated with the preparation and publication of financial reporting of such entities and conducting the audit. One of the main reasons for insufficient use of the audit potential in Ukraine is the absence of real need in the financial reporting which is caused by scarce experience, lack of culture of its use and misunderstanding of its necessity.

The objective of financial reporting is to provide information transparency of an economic entity, and the purpose of audit is to express an opinion on the financial statement which became public. Thus, these two elements are interconnected, but the priority in this system belongs to financial reporting, not to the audit which should only confirm the degree of reliability of the "information transparency" of the entity.

Unfortunately, the national system of information disclosure does not allow meeting the needs of the members of market relations due to many reasons. One of them is the problem associated with the preparation and publication of financial statements of the entities and conduct of the audit. Financial reporting has not yet become the exact element as it is worldwide. The problems are closely linked with such an institution as audit.

The reasons for this are vary. Firstly, businesses are not aware or do not recognize even if it is "deep in their mind" to understand that information disclosure in principle should do better for their business. Secondly, the situation is a fault of the public administration authorities including the National Commission on Securities and Stock Market and the National Commission for Regulation of Financial Services that do not require from their "reporting" entities the information which is fully consistent with the Law of Ukraine "On accounting and financial reporting" and provisions (standards)

of accounting. But in this case it is necessary to raise the issue of the adequacy of the audit results of the financial statements as financial statements prepared in that form do not deserve a positive conclusion. In this case if there is a positive conclusion then it should have an explanatory paragraph, which should underline that some mandatory information is not disclosed in the financial reporting completely.

In addition, there is a lack of coordination between International Standards on Auditing and the national requirements of normative regulations concerning management's responsibilities. Taking into account the requirements of other international standards on auditing concerning an auditor's actions we can conclude that they take for granted the existence of appropriate procedures in companies approved by management that go beyond the requirements of regulations on the provisions of the order of accounting policy that exists in Ukraine. In particular, this applies procedures for assessing compliance with the principle of continuous activity. In most cases the auditor is recommended not to perform an independent assessment but to evaluate the activity and procedures of the management. That certainly highlights the importance of a broad interpretation of the essence and content of the accounting policy. Thus, international standards on auditing consider management responsibility widely and suggest the existence of many regulatory documents that regulate various issues of methodology and accounting at the company that requires improvement of the organization of accounting. It is necessary to fix the expression of management's points of view in the annual financial statement concerning the principle of continuous activity, so that the auditors have the so-called "starting point".

The content of financial reporting in regards of information disclosure about the place of a business in a complex system of tax relations does not fully meet the information needs of its users, its qualitative characteristics and principles of preparation. The model of a normative regulation of accounting, used in Ukraine, clearly establishes the formats of all components of the financial reporting and the list of items. That is why basic information about the quality characteristics of tax relations of a company should appear in the notes to financial reporting as additional one and take into account the requirements of materiality. The above-mentioned proposals will increase the level of information completeness of financial reporting and will help its users to make a validated assessment of the financial condition and fiscal capability of a particular company.

To solving the problems that were considered in the study we need to improve the organization of accounting, internal control and management of the company, which outlines the prospects for further research: development of provisions concerning the assessment of compliance with the principle of continuous activity;

compliance with other laws and regulations that affect the activity of the entity; the organization of internal control and the prevention of fraud and so on.

The issues that were considered in the present study prove the complexity and diversity of the problem of information transparency of the entities of public interest. But it is necessary to improve the quality

of financial reporting as well as the auditor's report so that such measures are not seen as "simple ceremony" in the apt expression of the famous scientist in the sphere of auditing R. Adams [65, p.94].

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