REGULATION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS, CHALLENGES AND PROBLEMS FOR SMALL AND MEDIUM AND FOURTH CATEGORY ENTERPRISES IN GEORGIA

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Summary: Georgia has been successfully transitioning and implementing international financial reporting standards for small and medium-sized enterprises, including fourth category enterprises, for several years. The aforementioned issues remain a challenge to the multifaceted work carried out by various agencies, because the main approaches related to ensuring the reliability of financial reporting for small and medium enterprises and among them the fourth category enterprises in Georgia have not yet been established as a final result.

The main goal of the paper is to analyze the financial situation of business entities in the mentioned field in Georgia and to inform the wide circles of interested users about their activities.

The paper analyzes the scope, assumptions, basic principles, concepts, quality characteristics, accounting policy assessment and errors of the financial reporting standard for small and medium-sized enterprises and fourth category enterprises.

Keywords: small and medium enterprise; financial statements; fourth category enterprise; international reporting standard; regulation of financial reporting.

Introduction:

Regarding transition to market relations in Georgia, the private and public sectors gradually separated from each other and led to the necessity to improve financial accounting. After the restoration of independence of Georgia, the accounting standards were gradually introduced, which should be based on the international standards already tested in many countries of Europe and the world. Since 1995, the Law "About Entrepreneurs" has been enacted, according to which the general principles of accounting in the entrepreneurial sphere were determined, thus the first step was taken in the country to move to international standards of accounting. According to the law, which was passed in 1999 "about Regulation of Accounting and Reporting", accounting and reporting in the private sector became
subject to self-regulation, and the law recognized international standards of financial reporting as mandatory. Since 2006, the temporary accounting standards for small enterprises were put into effect, which represented a simplified version of the international standards of financial accounting. In 2009, based on international standards of financial reporting, an international standard of financial reporting for small and medium-sized enterprises were developed. In accordance with the 2014 Association Agreement concluded between Georgia and the European Union, dimensional categories of business entities were defined, the main purpose of which was to promote financial transparency in accordance with the requirements of the European Union directives. The Association Agreement became the basis for the amendments to the Law about "Accounting, Reporting and Auditing" which was implemented on June 24, 2016, in accordance with the requirements of the European Union directives and which significantly led to the harmonization of accounting regulation in accordance with international standards, taking into consideration the specific features of our country. Transition to international standards of financial reporting and implementation for small and medium-sized enterprises and among them for the enterprises of the fourth category, which are related to the requirements of the European legislation.

The following tasks were set:

• What are the problems and challenges faced by small and medium-sized enterprises, including fourth-category enterprises, in the transition to international standards of financial reporting and regulation in Georgia?

• To what extent it is possible to develop a model of financial reporting, according to which it will be possible to evaluate the financial activity of all enterprises with a single and simple method, considering the specific features of the country.

• What prospects are planned for the development and improvement of regulation in the subsequent stages of the transition to international standards of financial reporting? And does it ensure sustainable and efficient development of the country’s economy?

Methodology

The work includes the stages of introduction, development and regulation of international standards of financial reporting for small and medium-sized enterprises in Georgia, including fourth-category enterprises, and compliance with the recognized standards of the European Union, and its compliance with state requirements and directives of European Union for small and medium-sized enterprises in Georgia, including fourth-category enterprises.

Quantitative, qualitative, statistical observation and survey methods are used in the research to determine the existing reality. It is based on the analysis and results of statistical data, received from various governmental and non-governmental organizations, and the results of our research, where the target group represented and participated in the survey were financial managers in different positions employed in various organizations, who have direct contact and are fully or partially involved in financial management in the process of preparing financial statements.

The works of leading Georgian and foreign scientists were used in this paper, as well as information and results of the Public Information Resource of Georgia and
the Accounting, Reporting and Audit Supervision Service, Internet resources. Moreover, verbal interviews with representatives of international organizations were used. The conclusion and recommendations are based on the analysis of the received data about the current situation and international experience.

**Review and discussion:**

The development of small and medium-sized businesses, both at the state and regional levels, especially requires the resolution of regulation by state and market mechanisms and the resolution of organizational issues. If some scientists and experts believe that only the active financial policy of the state can ensure economic balance and overcome the problem of mass unemployment, some scientists and experts believe that this is not the case at all, and the regulatory function of the state in business is due to many reasons. First of all, it is the need to solve such economic tasks that require complex efforts and it is impossible to realize them only through the market mechanism. There really is not solid evidence whether the state intervention in general is negative and hinders business development, or vice versa. It is necessary to say that in all economic systems, the state regulates business and the economy in general, through which the relevant business environment is established and formed.

Promotion and activation of small and medium-sized businesses remain one of the most urgent issues in Georgia today, precisely one of the determinants of the nature of the relationship between the state and business is small and medium-sized enterprises and among them the enterprises of the fourth category, which play a special role in the development of small and medium-sized entrepreneurship. The analysis of the economic indicators of the last ten years reveals that one of the factors causing the economic crisis in Georgia was an inefficient financial accounting system. The current situation created serious barriers to economic activity, and the situation gradually became difficult. Although changes were made periodically to regulate the mentioned issues, this made the existing accounting policy in the country even more difficult in running an existing business, and all such changes significantly worsened the investment environment, as it made it practically impossible for the investor to calculate the acceptable effect as a result of long-term capital investments. The development of international standards of financial reporting and compliance with modern requirements is mostly determined by a well-functioning system of regulation.

International standards of financial reporting have developed qualitative characteristics of financial reporting, which make the information provided in financial reporting useful for users of small and medium-sized enterprises, including enterprises of the fourth category: Perceptibility, Relevance, Materiality, Reliability, Supremacy of content over form, Prudence. Completeness, Comparability and Timeliness.

In 2018, the Accounting, Reporting and Audit Supervision Service of Georgia (SARAS) developed a new, simplified financial reporting standard for enterprises of the fourth category with the support of the Great Britain Management Fund. In 2019, with the support of the World Bank, the project of updating the standard was started. The standard of enterprises of the fourth category is simplified for enterprises of the mentioned size, taking into consideration their small size and limited financial resources.
reporting capabilities. For enterprises of the fourth category, the scope of the financial reporting standard was defined as an enterprise entity whose total assets value does not exceed one million GEL, its income does not exceed two million GEL, and the average number of employees is less than 10 people. This category is assigned when the subject meets at least two criteria. Enterprises of the fourth category prepare financial statements in accordance with the standard intended for this category, if it does not use another standard. The main purpose of preparing financial statements is the transparency and correctness of the company’s financial situation and financial results, processing and providing information to make the right economic decisions, which will be useful for improving the management of companies. Taking into account their simplicity and small size, enterprises of the fourth category are allowed to submit financial statements in a simplified format, which means that, they mainly submit the statement of the financial state and financial results of the enterprise from the components included in the complete package of financial statements. As regards the cash flow statement, its submission is voluntary for the enterprises of the fourth category.

Financial statements prepared in accordance with the standard are based on fair information and such basic assumptions and principles of financial reporting as: accounting on the operating principle, accrual method, prudence and materiality.

The enterprise is obliged to annually submit a complete package of financial statements, which in turn includes:

- financial statement prepared according to the reporting period;
- reporting of income, expenses and retained earnings;
- three explanatory notes (which include financial obligations, guarantees and contingent obligations, if any);
- Enterprises of the fourth category can voluntarily submit cash flow statements.

It is especially noteworthy that the enterprises of the fourth category have the right to use the standard of financial reporting of the enterprises of the fourth category, as well as the international standard of financial reporting and the standard of financial reporting of small and medium-sized enterprises. which is regulated in accordance with the law of Georgia about "accounting, reporting and auditing".

The transition to international accounting standards and implementation for small and medium-sized enterprises, including fourth category enterprises, have been going on successfully for several years in Georgia. Its legal regulation is fundamentally different, and its establishment is related to the requirements of harmonization with European legislation in accordance with the Association Agreement. Despite the passage of a short period of time after the adoption of the new law, practice has shown that certain approaches have come into full compliance, and some still need to be refined.

Mandatory publication of annual financial statements in Georgia for small and medium, as well as the fourth category of entrepreneurial entities from the point of view of financial transparency proves that the changes implemented in Georgia in this regard are gradually harmonizing with the recognized standards of the European Union. International auditing companies were also involved in the mentioned process, which on the one hand provide professional support for all
categories of enterprises and on the other hand publish annual financial statements themselves. "The publication of the mentioned reports is one of the important factors in terms of increasing the transparency of the private sector. By arranging financial accounts in accordance with the international standard, the business entity makes correct and important financial decisions based on numbers for the development of companies and for effectively managing and solving business challenges, which is determined by a wide range of services, high quality and a strong team that creates all the conditions by synthesizing international and local experience" – claims Davit Lomidze, the managing partner of "NEXIA TA", the representative of "Nexia International" brand in Georgia, which is included in the top ten international auditing and consulting companies.

In the process of working on the paper, it is necessary to indicate the important and problematic issues that exist and faced by business entities in the process of implementing international financial reporting standards: the user was not properly aware of the important changes introduced in the international standards of financial reporting for small and medium-sized enterprises, including the enterprise of the fourth category and therefore, the knowledge and awareness of the working specialists fell short of the requirements of the time; For small and medium-sized enterprises, including the fourth category enterprises, some parts of the requirements of international standards of financial reporting turned out to be difficult to understand due to certain inaccuracies, both for business entities and financiers, because there was no practice and practical recommendations for the use of international standards; The low qualification of specialists employed in small and medium-sized enterprises and among them the fourth category enterprises, the absence of skills corresponding to the requirements and the low level of competence were revealed.

In our opinion, certain requirements and approaches should be improved in the reporting legislation. When compiling the financial statements of enterprises of the fourth category, we note that it is not required to divide liabilities into short-term and long-term liabilities. Although this was done for the sake of simplification, in the reporting of the financial condition of the enterprises of the fourth category, the positive side, which brings the division of the information presented for financial analysis into short-term and long-term items, is somewhat lost. Also, the enterprises of the fourth category used the legal right and did not submit cash flow statements, because they saved time and avoided possible mistakes during the initial preparation of cash flow statements, although the degree of financial transparency is somewhat lost with this approach.

Statistical data and results:

Based on the statistical data, it should be noted that in recent years, the transition and implementation of international standards of financial reporting for all categories of enterprises in Georgia took place with different dynamics in different years.

Chart N1 provides disclosure of financial statements for all categories of enterprises, which include small and medium-sized enterprises and among them enterprises of the fourth category.

Publication of financial statements by enterprises in Georgia for the years of 2016-2021:
Based on statistical data, on the one hand, in the first stage, in 2016-2017 years, we are dealing with low indicators of disclosure of financial statements, which was caused by the lack of legal framework and the absence of a mandatory element. Since 2018, due to the changes in the legislative acts, on the basis of which the transition to international standards of financial reporting became mandatory, for publicly interested people and enterprises of 1-2 category, we are dealing with an increase in indicators, the results of 2019 became an exception, which arose from the difficulties of the Covid pandemic. And in 2020-2021 years, with a significant increase, due to the fact that the disclosure of financial statements for 2020 has become mandatory specifically for the enterprises of the fourth category.

Chart N2 details the disclosure of financial statements for all categories of enterprises, including small and medium-sized enterprises and the fourth category of enterprises, according to the results of 2020.

It should be noted that the significant increase in results comes at the expense of small and medium-sized enterprises, including enterprises of the fourth category, and makes up almost 83% of the total published figure. It was also revealed that small and medium-sized enterprises published a much smaller number of financial statements than enterprises of the fourth category.

The same trend continues in 2021 as well, where the results of small and medium-sized enterprises, including enterprises of the fourth category, make up 87% of the overall picture. Which is clearly shown on chart N3.
Conclusion:

One of the important hindering factors in Georgia was the inefficient financial accounting system, which led to the need to move to and implement international financial accounting standards for small and medium-sized enterprises, including the fourth category enterprises, which was carried out step by step in compliance with European legislation. International experience confirms that establishing a proper financial reporting system in any country is a difficult and long process. In this regard, Georgia is no exception, where the search for the perfect direction of financial accounting and audit regulation and the creation of a legal base focused on sustainable development is still ongoing.

Further refinement of the theoretical-methodological foundations of international standards of financial reporting, its further development and perfection will bring such positive results as: timely detection and solution of financial problems in the economic sphere; effective management of existing risks and challenges; establishment of transparency of financial reporting; strengthening the stability and safety of the production process; Increasing employment and raising the professional level of financial personnel in various positions.

Practice and our research have shown that the basic requirements and approaches of financial reporting harmonized with international standards in Georgia for small and medium-sized enterprises and among them for enterprises of the fourth category represent the demand and necessity of the economic system and the society employed in this field. Although some approaches have come into full compliance, practice has revealed some problems and challenges that require further refinement and improvement.

References: