Harmonization and regulation of international standards of financial reporting with the recognized standards of the European Union for enterprises of small and medium and fourth category in Georgia

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Abstract.
Transition and implementation of international standards of financial reporting for small and medium-sized enterprises, including the fourth category enterprises, have been running successfully in Georgia for several years, however, the problem is that despite the versatile and voluminous work carried out by various governmental and non-governmental agencies, the mentioned issues remain open to this day. The main tasks related to increasing the reliability of financial reporting and ensuring transparency, the main approaches to financial reporting harmonized with international standards, for small and medium-sized enterprises, including the fourth category enterprises, have not yet been established in the form of a final result. The main goal of the paper is to study and analyze the financial situation and activities of small and medium-sized enterprises in Georgia, including those of the fourth category, to provide information about their activities to a wide circle of interested users, who do not have the opportunity and authority to request relevant and specific financial information from the enterprises in their field of interest that will help them to make specific economic decisions. The scope of the financial reporting standard for small and medium-sized enterprises and enterprises of the fourth category is analyzed, as well as the basic principles, concepts, qualitative characteristics, evaluation of...
accounting policies and errors through which the acceptability and usefulness of the said financial statements are made to interested users. The financial statements also show the accountability of the top management, also management of small and medium-sized enterprises and enterprises of the fourth category for the management of small and medium-sized enterprises and enterprises of the fourth category, on effective and efficient use of financial, material and personnel resources which aew entrusted to it.

**Keywords:**
- financial statements
- small and medium enterprise
- fourth category enterprise
- international reporting standard
- regulation of financial reporting
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Introduction:

International standards of financial reporting represent the international global language of business relations, which makes the reporting of each company understandable and comparable with the reporting of any other company in the world. 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: How effective is the transition to international financial reporting standards in Georgia for small and medium-sized enterprises and among them the enterprises of the fourth category, and what are the results? Is it possible to develop a universal model of financial reporting, according to which it will be possible to evaluate financial activity with a single and simple method, and what opportunities exist in the direction of development and perfection of regulation in the subsequent stages of the transition to international financial reporting standards?

**Methodology**

The scientific paper discusses the stages of introduction and regulation of international financial reporting standards for small and medium-sized enterprises in Georgia, its compliance with state requirements and harmonization with EU directives.

The paper uses the works of leading Georgian and foreign scientists, information and results of the Public Information Resource of Georgia and the Accounting, Reporting and Audit Supervision Service, Internet resources. The research uses quantitative, qualitative and survey methods to determine the reality and is based on statistical data and results, data received from various governmental and non-governmental organizations and the results of our research, where the target group and participating in the survey were financial managers in different positions employed in various organizations, who have direct have contact and are fully or partially involved in the process of preparing financial statements. The conclusion and recommendations are based on the analysis of the received data on the current situation and international experience.

**Review and discussion:**

The history, experience and current state of small and medium businesses, as well as business in general, are extremely relevant and clearly testify that this most important area of the economy in the conditions of market relations cannot function successfully without active regulation and support from the state. 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. Establishing such a system
in any country is a difficult and long process. In this regard, Georgia is no exception, where since the restoration of Georgia's independence, the search for the direction of perfection of financial accounting and audit regulation and the creation of a legislative base focused on sustainable development, have been ongoing. [1]

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 - the information presented in the financial statements should be as understandable as possible, as for those subjects who have relevant knowledge of business, economic activities and accounting, as well. However, perceptibility cannot be the reason that financial statements do not reflect information suitable for making economic decisions, which may be difficult to understand by some users. Relevance - the information presented in the financial statements should be consistent with the needs of users for making economic decisions. Information then has the property of relevance if it affects certain economic decisions of consumers. Materiality - if the information is material, therefore relevant, and if its omission or distortion would affect the economic decisions made by the user. Materiality depends on the misrepresentation, the magnitude and nature of the error, which must be considered in the light of the relevant particular circumstances. Reliability - information is reliable if it does not contain substantial error, is not biased and fairly represents the needs for making economic decisions within reasonable expectations. Financial reporting is biased and unreliable if the information is presented in such a way that it is intended to influence on the decisions of users to achieve specific results. Supremacy of content over form - the reliability of financial statements is enhanced by operations and other events reflected in financial statements based on their content, and not only in accordance with their legal form. Prudence - Uncertainties inherent in many events and situations should be reflected in financial statements according to their nature and magnitude. Prudence
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involves exercising some level of caution in the face of uncertainties necessary to make accounting estimates. Prudence does not mean that bias is allowed. Completeness - the information presented in the financial statements must be complete, taking into considerations of materiality and the costs necessary to prepare the information. Omitting information may reduce its reliability and comparability. Comparability - users of financial statements should be able to compare the financial statements of an enterprise from different years in order to determine trends in the financial condition of the enterprise and the results of its activities. In addition, through financial statements, users should be able to compare and evaluate the financial position of different enterprises, their performance and cash flow. Thus, the financial results of similar operations and other events and conditions should be evaluated and reflected using the same method throughout the enterprise and in a particular enterprise over the years, as well as by methods compatible with other similar enterprises. Along with this, it is necessary that the users are informed about the accounting policy used for the preparation of financial statements, the changes made in it and the consequences caused by these changes. Timeliness for financial information to be relevant, it must influence the economic decisions of consumers. Timeliness means that information should be available to users in a time frame suitable for making decisions. If information is unduly delayed, it may lose its relevance. Management may need to strike a balance between the timeliness of financial statements and the reliability of the information. Providing users with the necessary information for making economic decisions is considered the main criterion for the optimal ratio between the relevance and reliability of information.

[3]

The Accounting, Reporting and Audit Supervision Service of Georgia, with the support of the Great Britain Management Fund, has developed a new, simplified standard of financial reporting for enterprises of the fourth category. 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 reporting

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capabilities. For enterprises of the fourth category, the standard of financial reporting is assigned when the entity meets at least two criteria provided by law. [5]

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. [4]

It should be noted that the enterprises of the fourth category have the right to use the financial reporting standard of the fourth category enterprises, as well as the international financial reporting standard and the financial reporting standard of small and medium-sized enterprises, which is regulated in accordance with the law of Georgia on "accounting, reporting and auditing". [3]

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 important and problematic issues that exist and faced by business entities in the process of introducing international financial reporting standards were highlighted:

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.

During the meeting, it was revealed that certain requirements and approaches need to be improved in the legal acts of reporting. 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 to be submitted 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 errors in the initial preparation of cash flow statements, although the degree of financial transparency is somewhat lost with this approach.

**Statistical data and results:**

The transition and implementation of international financial reporting standards for all categories of enterprises in Georgia took place in different years with different dynamics, as evidenced by statistical data.

Publication of financial statements by enterprises in Georgia for the years of 2016-2022:

![Chart N1: Accounting, Reporting and Audit Supervision Service of the Ministry of Finance of Georgia www. saras.gov.ge [1]](chart)

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 2020-2022, with a significant increase, due to the fact that from 2020, the disclosure of financial statements became mandatory for 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 2021.

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 80% of the full published indicators. 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 2022 as well, where the results of small and medium-sized enterprises, including enterprises of the fourth category, make up 77% of the overall picture. Which is clearly seen on chart N3.
Research and results:

Since there are some differences of opinion regarding this question, we conducted a study. The target group, who participated in the survey were accountants and financial managers in different positions employed in different organizations, who have direct contact and have to be fully or partially involved in the process of preparing financial statements. (up to 450 people). Three questions were asked in the survey: 1 - What position do you hold in the organization? 2 - Was it necessary to introduce, implement and use international standards of financial reporting? 3 - Are there enough resources today to prepare financial statements in accordance with international standards? The obtained results were distributed as follows:

1 - The position you hold in the organization?

Diagram N1

Chart N3
"Reporting portal of Georgia" https://reportal.ge/ [3]
2-Was it necessary to introduce, implement and use international financial reporting standards?

![Diagram N2]

3-Are there enough resources today to prepare financial statements in accordance with international standards?

![Diagram N3]

The majority of people participating in the survey, 61%, who have direct contact and have to be fully or partially involved in the process of preparing financial statements, respond positively that it was necessary to introduce and use international standards of financial reporting, although we did not specifically ask a question regarding the problems in the process of introducing international standards in the survey, the majority of the interviewees themselves noted that the mentioned process was associated with certain difficulties. As for the answer to the question whether there are enough resources today to prepare financial statements in
In accordance with international standards, the vast majority of people participating in the survey, 89%, answer in the negative. This once again confirms that the introduction, implementation and use of international standards of financial reporting is a demand and necessity of the society employed in this field.

**Conclusion:**

Among the causes of the unstable economic situation in Georgia, one of the important hindering factors was the inefficient financial accounting system, which led to the need to transition to international financial accounting standards and introduce them for small and medium-sized enterprises, including the fourth category enterprises, which was carried out gradually. 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. International experience clearly confirms that the development of international standards of financial reporting and compliance with modern requirements are mostly determined by a well-functioning system of regulation. Establishing such a 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 are still ongoing.

Our research and practical experience have shown that in Georgia, the basic requirements and approaches of financial reporting harmonized with international standards for small and medium-sized enterprises, including the fourth category enterprises, 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:**

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