



## THE COMPARISON OF THE ACCOUNTING LEGISLATION OF THE REPUBLIC OF LATVIA WITH THE INTERNATIONAL REQUIREMENTS CONCERNING THE COMPONENTS OF THE ANNUAL REPORTS DEVELOPED BY COMMERCIAL COMPANIES

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**Abstract.** The annual report is a significant document of commercial companies and according to Latvian Republic “Annual Accounts Law”: “the annual accounts shall provide a true and fair view of the assets and liabilities, financial position, profit or loss and cash flow of the company” (Supreme Council, 1992 with amendment). Annual report is used by external users (investors, creditors, customers, competitors, governmental institutions etc.) and by owners of companies, administration and employees. Annual report components, its structure, form, and other requirements are regulated by legislation acts of each country and by international normative documents. Unfortunately these requirements are frequently different. In nowadays globalization circumstances when international cooperation is widely spread it is important for commercial companies annual reports to be comparable and understandable.

The aim of the article is to research and compare requirements of the Latvian Republic commercial company annual reports contents with European Union normative regulations as well as international accounting standards and offer suggestions for LR commercial company annual reports components.

In the paper there are applied the methods of general scientific research in economics: economic analysis and synthesis, logically-constructive, qualitative methods including the methods of the analysis of normative acts. The theoretical and methodological grounds of the article are the normative acts regulating accounting, works produced both by Latvian and foreign scientists as well as the Internet sources.

The author describes and analyses Latvian Republic commercial companies annual report components and compares LR “Annual Accounts Law” and international legislation requirements, which determine annual report content, there are assessed common trends and differences, claimed problems and there are also offered some suggestions for performing LR commercial companies annual reports.

**Key words:** *annual report, financial report, accounting legislation requirements*

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## Introduction

An annual report developed by commercial companies provides information on the financial standing, profit or loss, cash flow, as well as any other information that is relevant to its users to make a variety of important decisions. The composition and the drawing up requirements of an annual report are set in the Latvian Republic (LR) regulatory framework. An annual report consists of individual statements, and during the last twenty years the composition of an annual report of the LR commercial companies has changed several times. The preparation of an annual reports is a labour consuming process, so it is necessary to examine the composition of an annual report, to investigate, what are the international trends in the components of corporate annual reports and find answers to the following question: what LR companies and what statements shall be included into an annual report in order to provide the necessary information about the company, but at the same time to avoid creating an additional administrative burden?

The author principally explores the composition of an annual report only of those commercial companies, which are bound by the LR “Annual Accounts Law”. To the extent it is necessary to research the topic, the author reviews also the requirements for the composition of annual reports of those companies, which shall draw up consolidated annual reports, credit institutions, insurance companies, investment and other companies, which shall comply with the legislative acts regulating their activities.

The aim of the article is to research and compare requirements of the Latvian Republic commercial company annual reports contents with European Union normative regulations as well as international accounting standards and offer suggestions for LR commercial company annual reports components.

In the paper there are applied the methods of general scientific research in economics: economic analysis and synthesis, logically-constructive, qualitative methods including the methods of the analysis of normative acts. The theoretical and methodological grounds of the article are the normative acts regulating accounting, works produced both by Latvian and foreign scientists as well as the Internet sources.

The article consists of 3 parts:

1. The components of annual reports of the LR commercial companies and the development of their application,
2. The International framework for the components of annual reports and its assessment,
3. The proposals for the amendments to the LR regulatory framework concerning the components of annual reports of the commercial companies.

To finalize the article there are provided conclusions, proposals and recommendations, including proposals for significant amendments to the regulatory framework concerning the LR commercial companies.

## Research results and discussion

### 1. The components of annual reports of the LR commercial companies and the development of their application

Law of the Latvian Republic “Annual Accounts Law” definite that “the annual accounts, as a unified whole, shall consist of a financial report and the report of the company management regarding the development of the company during the accounting year” for one’s part “the financial report is a unified whole, which consists of a balance sheet, a profit or loss account, a cash flow statement, a statement of changes in equity and an annex” (Supreme Council, 1992 with amendment). As it is currently defined in



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the LR “Annual Accounts Law”, an annual report includes six reports altogether and the Law “refers to the companies, cooperative societies incorporated in Latvia, economic interest groups registered in Latvia, the European co-operative societies and European commercial companies as well as individual companies, farmers and fishing companies, whose turnover (revenue) from business transactions during the previous year exceeds 200 000 lats” (Supreme Council, 1992 with amendment).

In 1992 there was passed the Law “On Enterprises Annual Accounts”, which title was changed on October 19, 2006 and on November 22, 2006, the presently known title the “Annual Accounts Law” entered into force. The composition of the annual report specified in this law has undergone several changes since Latvia regained its independence. In the law “On Enterprises Annual Accounts” in the first version, which came into force on January 1, 1993, it was stated that “the annual report as a single package consisting of a balance sheet, profit and loss, attachment, and the report” (Supreme Council, 1992 with amendment) – which meant – four statements.

While researching the history of application of components of annual report in Latvia, the author concludes that the balance sheet as a statement to submit had been already defined in the article 678 of the Russian Empire Trading Regulations (Свод законов Российской империи, 1913), which had to be applied by companies also in Latvia even before there was established the independent Republic of Latvia. After the establishment of the LR in 1918 there were passed several normative acts that provided for the balance sheet and other reports to be drawn and submitted (Millere I., 2011). In 1937, the LR Cabinet of Ministers passed the Law “On Joint-Stock and Share companies”, which provided for the following to be included into the annual report:

- balance sheet;
- profit and loss account;
- review of turnovers by the General ledger accounts;
- a written report by the Board on the past year and the current standing of the company (Cabinet of Ministers, 1937).

Comparing the composition of annual report set in the “Law on Joint-Stock and Share Companies” of 1937 with the first passed since the regaining of independence edition of the “Annual Accounts Law” of 1992, the author believes that the composition of annual report prescribed in 1992 was similar to the annual report composition established by the 1937 Act.

The new accounts, which previously were not included into the annual report in LR, were: the statement of cash flow, which for the first time in Latvia was established by the Regulation No.292 “Amendments to the Law “On Enterprises Annual Accounts” of the Cabinet of Ministers, on July 30, 1996, which entered into force on August 7, 1996 (Cabinet of Ministers, 1996). In other countries, the cash flow statement in the application appeared also relatively recently – the first application was set in 1985 in Canada, then in the United States – in 1987, in 1988 in France and in the United Kingdom – in 1991 (Stolowy H., Lebas M., 2006).

The a statement of changes in equity as a compulsory part of the financial statements and hence of the annual report was set on December 16, 1999 by the passed by the Parliament “Amendments to the Law “On Enterprises Annual Accounts”. The author points out that similar information had to be submitted also during the first independence of the Republic of Latvia until 1940 – basic, reserves and other capital (Millere I., 2011).

Table 1 shows the annual report content set by the “Annual Accounts Law”, as well as the date, when the specified in the table component of the annual report came into force. Table 1 also shows the potential reliefs concerning the composition of the annual report, which allows not to submit some report.



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Table 1

## The annual report content in the “Annual Accounts Law”, the applicable reliefs referable thereto and the effective date of the regulations\*

The effective date of the regulations	Annual Report Content	The Reliefs Relating to the Annual Report Components
From 01.01.1993. (Supreme Council, 14.10.1992.)	Article 4, Paragraph 1: “The annual accounts, as a unified whole, shall consist of a balance sheet, a profit and loss account, an annex and the report”.	Article 66, Paragraph 2: “The companies to which the provisions of Article 54 of this Law are applicable to not have to send a report”.
From 07.08.1996. (Cabinet Regulations No.292 30.07.1996.)	Article 4, Paragraph 1: “The annual accounts, as a unified whole, shall consist of a balance sheet, a profit and loss account, <u>a cash flow statement</u> , an annex and the report”.	
From 19.01.2000. (Amendments to law “On Enterprises Annual Accounts” 16.12.1999.)	Article 4, Paragraph 1: “The annual accounts, as a unified whole, shall consist of a balance sheet, a profit <u>or loss account</u> , <u>the statement of changes in equity</u> , a cash flow statement and an annex, as well as the <u>report of the company management</u> regarding the development of the company during the accounting year”.	
From 20.04.2001. (Amendments to law “On Enterprises Annual Accounts” 22.03.2001.)	Article 4, Paragraph 1: “The annual accounts, as a unified whole, shall consist of <u>a financial report</u> and the report of the management regarding the development of the company during the accounting year.” Terminology used in this law: <u>“The financial report is a unified whole, which consists of a balance sheet, a profit or loss account, a cash flow statement, a statement of changes in equity and an annex”.</u>	
From 01.01.2010. (Amendments to law “Annual Accounts Law” 01.12.2009.)		Article 54, Paragraph 1: “Companies, which on the balance sheet date do not exceed two of the criteria referred to in Paragraph two of this Article, are permitted not to prepare a cash flow statement and a statement of changes in equity”.
From 01.01.2013. (Amendments to law “Annual Accounts Law” 29.11.2012.)		Article 54, Paragraph 1: “Companies, which on the balance sheet date do not exceed two of the criteria referred to in Paragraph two of this Article, are permitted not to prepare <u>the report of the management</u> , a cash flow statement and a statement of changes in equity”. Article 54 <sup>1</sup> Paragraph 1: <u>“Companies, which on the balance sheet date do not exceed two of the criteria referred to in Paragraph two of this Article, in addition to the reliefs which are mentioned in Paragraph one of this Law Article 54 are permitted:</u> 1) <u>to prepare an abridged balance sheet,</u> 2) <u>not to prepare an annex”.</u>

\* the major changes in the composition of the annual report, which entered into force on the date specified in the table, are underlined



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As it can be seen from Table 1, in the Article 66 of already the first edition of the “Annual Accounts Law” of 1992, there were included reliefs in respect on the composition of the annual report: “the companies covered by the Article 54 of this Law, can omit sending the report” (Supreme Council, 1992). In its turn in the Article 54 of the Law stated: “the companies, which on the date the balance sheet is drawn do not exceed two criteria of those specified in the second part of the present article ...” (Supreme Council, 1992). It means that, if companies did not exceed two of the criteria set out in Article 54 of the Law, then the annual report consisted only of the balance sheet, profit and loss statement and an annex – a total of three reports, but as it has been already mentioned – since 1996 the composition of the annual report was supplemented with the cash flow statement, but since 2000 – with the statement of changes in equity that companies also had to draw. It should be noted that in the following years, the criteria of the Article 54 were repeatedly changed in various versions of the Law, and if companies wanted to apply the reliefs, they had to meet the existing criteria.

From January 1, 2010, the “Annual Accounts Law” allows not to make a cash flow statement and a statement of changes in equity, if the company does not exceed two of the criteria set out in the Article 54, which in 2010 and 2013 are as follows:

- Balance sheet total – 250 000 Ls,
- Net turnover – 500 000 Ls,
- Average number of employees during the year of account – 25.

The “Annual Accounts Law” stated that if a company does not exceed two of the above criteria for two consecutive years, they may omit the drawing of the cash flow statement and statement of changes in equity, while preparing the report for 2009 (Saeima, 2009).

On November 29, 2012 there were adopted and entered into force on January 1, 2013 substantial amendments to the “Annual Accounts Law”, which provide also for other reliefs for the composition of the annual report. In the new version of the “Annual Accounts Law” there was adjusted the Article 54 and now it includes all the reports that companies using the reliefs may omit drawing: “the companies, which on the balance sheet date do not exceed two of the criteria specified in the second part of the present article, may refrain from drawing up the management report, cash flow statement and statement of changes in equity” (Saeima, 2012). Into the “Annual Accounts Law” additionally there is included the Article 54<sup>1</sup>, which provides for that companies which on the balance sheet date do not exceed two of the criteria specified in the second part of the present article (balance sheet total – 35 000 lats, net turnover – 70 000 lats and the average number of employees during the year – 5) in addition to the relieves listed in the Article 54 of this Law may:

- 1) to prepare an abridged balance;
- 2) not to prepare an annex (Saeima, 2012).

So the companies covered by the criteria of the Article 54<sup>1</sup>, which are basically the criteria to apply micro-enterprise tax, must include into the annual report only the bridged balance sheet and profit or loss statement.

Summarizing the previously studied, the author concludes that for the LR companies covered by the “Annual Accounts Law”, the composition of the annual report in periods is as follows:

01.01.1993 – 06.08.1996 – four statements: balance sheet, profit and loss statement, an annex and the report,

07.08.1996 – 18.01.2000 – five statements: balance sheet, profit and loss statement, cash flow statement, an annex and the report,

19.01.2000 – present time – six statements: balance sheet, profit or loss statement, cash flow statement, statement of changes in equity, an annex and the management report.

Throughout the period of effect of the “Annual Accounts Law” – from 1993 to early 2013, the companies, which were able to apply the some reliefs did not have to submit the management report, but since 2010 – also the cash flow statement and statement of changes in equity. Since 2013, the companies



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which meet the criteria of the Article 54<sup>1</sup> may additionally omit submitting the annex. While summarizing the gathered information, the author points out that the companies applying the reliefs set in the “Annual Accounts Law” had as a minimum annual report the below listed statements within the specified period:

01.01.1993 – 06.08.1996 – three statements: balance sheet, profit and loss statement and an annex;

07.08.1996 – 18.01.2000 – four statements: balance sheet, profit and loss statement, cash flow statement and an annex;

19.01.2000 – 31.12.2009 – five statements: balance sheet, profit or loss statement, cash flow statement, statement of changes in equity and an annex;

01.01.2010. – the present moment – three statements: balance sheet, profit or loss statement and an annex;

Since the 01.01.2013 – the companies, subject to the criteria of the Article 54<sup>1</sup> – two statements: an abridged balance sheet and profit or loss statement.

Further the author will explore the international requirements that determine the composition of the annual report, as well as the application of the requirements for the LR.

## 2. The International framework for the components of annual reports and its assessment

The composition of the annual report and particularly the financial statement is determined by international organizations such as the International Accounting Standards Board, which issues the International Financial Reporting Standards, the European Parliament and the Council, which adopt regulations and directives.

The International Accounting Standard Board is the independent standard-setting body of the International Federation of Accountants Foundation. Its members (currently 15 full-time members) are responsible for the development and publication of International Financial Reporting Standards (IFRS) (IFRS Foundation, 2012). International Accounting Standard (IAS) No 1 “Presentation of Financial Statements” determine: “a complete set of financial statements comprises:

- (a) a statement of financial position as at the end of the period;
- (b) a statement of profit and loss and other comprehensive income for the period;
- (c) a statement of changes in equity for the period;
- (d) a statement of cash flows for the period;
- (e) notes, comprising a summary of significant accounting policies and other explanatory information; and
- (f) a statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements, or when it reclassifies items in its financial statements.” (IASB, 2012).

In 2010, the International Accounting Standard Board issued a “practice statement” on the subject of “Management Commentary”. A practice statement is guidance rather than being a mandatory standard. (Nobes C., Parker R., 2012).

Summarizing the IFRS requirements pertaining to the annual report, the author points out that into the financial statement there shall be included the five statements listed in the above paragraphs a) to e) and, where appropriate, “a statement of financial position as at the beginning” as well as in the annual report there must be included a management report.

The companies shall apply the IFRS in accordance with legislative requirements. Further the author studies, which companies in the LR shall apply the IFRS.

In 2002 The European Parliament and the Council issued “Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the Application of International Accounting Standards”. Article 4 of this Regulation provides: “for each financial year starting on or after 1 January 2005, companies governed by the law of a Member State shall prepare their consolidated accounts in



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conformity with the international accounting standards ... if, at their balance sheet date, their securities are admitted to trading on a regulated market of any Member State” (European Parliament and the Council, 2002). This above mentioned Regulation should be used by every EU member country, including LR.

In Latvia IFRS can be used by companies which prepared consolidated accounts, but whose securities are not admitted to trading on a regulated market. Section 16 of the “Law On Consolidated Annual Accounts” provide: “on the basis of Article 5 of Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards, a parent company of a group of companies may prepare consolidated annual accounts in accordance with international accounting standards.” (Saeima, 2006).

A reference to the application of the IFRS in the LR is also included in the Article 56, Part 2 of the “Financial Instruments Market Law”, which provides for: “if a corporation, which transferable securities are listed on a regulated market shall prepare a consolidated annual report, the consolidated financial statements shall be drawn in accordance with the Regulation (EC) No. 1606/2002 of the European Parliament and Council, dated July 19, 2002 on the application of the international accounting standards, but the financial statements – according to the legislative act requirements of the Member State of origin” and the Part 3 provides for: “if transferable securities of a commercial company are included into the official list in the Republic of Latvia, it draws its financial statements in accordance with the international accounting standards approved by the European Commission and the international financial reporting standards, as published in the official publication of the “Official Journal of the European Union.” It should be noted that in the Article 56 of the “Financial Instrument Market Law” the composition of the report is interpreted differently than in the IFRS: “The annual report consists of:

- 1) the audited financial statements;
- 2) the management report;
- 3) statement of management’s responsibility;
- 4) the statement of corporate governance, if the commercial company draws his statement as a separate part of the annual report.” (Saeima, 2003).

In the “Financial Instruments Market Law” there are neither presented in details, what actually stands for the “audited financial statements”.

Beside the above requirements in the LR the IFRS must be applied by banks, brokerage firms and investment authorities, as provided for by the “Law on Credit Institutions”, the “Financial Instruments Market Law” and the “Investment Companies Act”, the “Regulations on developing the annual report and the consolidated annual report for Banks, brokerage firms and investment management companies” issued by the Financial and Capital Market Commission, where in the clause 4 the composition of the financial statement (Financial and Capital Market Commission, 2006) is set out in analogy to the estimated in the 1st IAS.

To sum up the above reviewed provisions of the EU Regulation, LR laws and other legislative acts, the author concludes that the annual report in accordance with the IFRS requirements, including therein the financial statements set in the 1st IAS shall be drawn up:

- by the companies that prepare consolidated reports, if on the balance sheet date the securities are listed on a regulated market of any Member State,
- by banks, brokerage firms and investment authorities, but parent companies may prepare the consolidated annual reports in accordance with the IFRS.

The “Annual Accounts Law” doesn’t provide for the application of the IFRS, but the requirements of this law are binding for all limited liability companies (LLC), as well as other law subjects. In compliance with the data of the LR Commercial Register in January 2013, there are more than 133.5 thousand of only Ltd. and they are almost 90% of all the active merchants registered in the LR Commercial Register (total of 149.5 thousand). (Register of Enterprises, 2013). Taking into account the previously written, the author



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believes that the UK professors Nobes, C. and Parker, R. in their book “Comparative International Accounting”, falsely claim that, “the three Baltic states ... require IFRS for all financial statements, perhaps because they are small economies lacking their own well-development national rules” (Nobes C., Parker R., 2012).

The “Annual Accounts Law” is prepared in accordance with the directives of the European Council and Parliament – including in particular the requirements of the Fourth Council Directive pertaining to the annual reports of certain types of companies, so the author will explore the requirements of this Directive on the composition of the annual reports and compare them with those set in the “Annual Accounts Law”.

In the Article 2 of the Fourth Council Directive, which was adopted on July 25, 1978, it was stated that: “the annual accounts shall comprise the balance sheet, the profit and loss account and the notes on the accounts. These documents shall constitute a composite whole”, but the Article 46 of the Directive stated that in the report there should be included also in the report. In the Directive it was also stated that Member States may allow the companies to draw up abridged balance sheets (Article 11), and notes (Article 44) (Council of the European Communities, 1978).

In 2012 the European Parliament and the Council of the European Union issued Directive 2012/6/EU of the European Parliament and of the Council of 14 March 2012 Amending Council Directive 78/660/EEC on the Annual Accounts of Certain Types of Companies as Regards Micro-entities. “The European Council underlined that reducing administrative burdens is important for boosting Europe’s economy and Accounting has been identified as one of the key areas in which administrative burdens for companies within the Union may be reduced” (European Parliament and the Council of the European Union, 2012). For that reason Directive 2012/6/EU contains facilitations for contents of the micro-entities annual report. Directive 2012/6/EU determines a new sub-group of micro-enterprises, so-called “micro-entities”. These are companies which on their balance sheet dates do not exceed the limits of two of the three following criteria:

- a) balance sheet total: EUR 350 000;
- b) net turnover: EUR 700 000;
- c) average number of employees during the financial year: 10 (European Parliament and the Council of the European Union, 2012).

If the company on the balance sheet dates of the current and previous year does not exceed two of the following criteria, as provided for in the Directive 2012/6/EU, then it can apply the reliefs pertaining to the composition of the annual report and include therein only an abridged balance sheet and profit and loss statement. Since January 2013, these and other provisions of the Directive 2012/6/EU have been included in the “Annual Accounts Law”, and the “micro-enterprise” criteria set out in the Article 54<sup>1</sup> of this law, however, are several times smaller than the required by the Directive, namely: the net amount of turnover and the balance sheet total is 7 times smaller, but the number of employees – two times smaller. It means that the LR “Annual Accounts Law” projects to apply for relief under the Directive to a significantly smaller number of companies, but the fact remains that, as the Ministry of Finance points out, the reliefs of the Article 54<sup>1</sup> may be applied by more than 58 thousand, or approximately 73% of the subjects of the “Annual Accounts Law” (Ministry of Finance, 2012). However, the provisions of the Article 54 of the “Annual Accounts Law” allowing not to include a management report, cash flow statement and statement of changes in equity into the annual report “refers to more than 73 thousand, or about 93% of all the entities, who shall prepare an annual report in accordance with the requirements of the “Annual Accounts Law”. Therefore, now the obligation to prepare a full annual report and audit it at a certified auditor shall be performed by only 7% of the subjects of the “Annual Accounts Law” (Ministry of Finance, 2012). Here the author wishes to draw attention to the differences in the data on the subjects of the “Annual Accounts Law”. In compliance with the data of the LR Commercial Register in January 2013 there are registered and are active more than 133.5 thousand Ltd., in its turn, while performing the calculations on the basis of the data presented in the “Initial Impact Assessment Report (Summary) of the





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Draft Law “Amendments to the Annual Accounts Law” of the Ministry of Finance it is possible to estimate, that the total number of the subjects of the “Annual Accounts Law” (they are: limited liability companies, joint stock companies, cooperative societies and individual businesses, farms and fish farms) is only 80 thousand. It can be concluded from the above that the Ministry of Finance does not include into the number of law subjects due to inexplicable reasons, about 50 thousand Ltd., as well as other companies, which are required to conform to the requirements of this Law. Do these companies not prepare their annual reports? This issue should be clarified and resolved by the national institutions.

Comparing the requirements of the above-mentioned Fourth Council Directive in respect to the composition of the annual report with the set by the “Annual Accounts Law”, the author concludes that in addition to the requirements of the Directive the LR law included another two statements: from 1996 – the cash flow statement and from 2000 – the statement of changes in equity, which greatly increased the administrative burden of the companies, as only since 2010 the companies, which could apply for reliefs were allowed to omit the submitting of these statements. So for eleven years all the subjects of the Law, regardless of their size, were required to draw up and submit these two statements, the inclusion of which into the financial statements projects the IFRS. The author also wishes to note that the preparation of the cash flow statement requires special additional knowledge and drawing of this statement is considerably time-consuming.

To summarize the above studied, the question arises, why there is necessary the “Annual Accounts Law” in such version, if only 7% of the subjects of the Law, as it is indicated by the Ministry of Finance, without applying the reliefs shall comply with requirements of this Law (Ministry of Finance, 2012).

In the following part of the article the author suggests possible solutions for the future regulatory framework on the composition of annual reports of the LR commercial companies.

### **3. The proposals for the amendments to the LR regulatory framework concerning the components of annual reports of the commercial companies**

To be able to recommend what should be the optimal regulatory framework defining the composition of the annual report, first of all the author would like to point out that in fact the Latvian accounting corresponds the accounting traditions of the continental Europe. Historically, in the world there were formed two major accounting traditions: Anglo-Saxon and continental European accounting tradition. The United States, the United Kingdom, Australia, Canada, New Zealand and other countries where there was the common law system observed in accounting the Anglo-Saxon accounting tradition. The Common law system was established in England and adopted rules aiming at providing an answer to some specific case, not to establish the further guiding rules. This effect resulted in adoption of the Commercial laws, which traditionally did not include detailed regulatory provisions (Nobes C. and Parker R., 2012). It contributed to the development of the accounting profession and professional organizations, consequently the professional organizations worked out and adopted the rules and standards which were voluntarily applied in accounting by society. A different practice is in the countries that follow the continental European accounting traditions that occurred much earlier than the Anglo-Saxon accounting tradition. It was based on the Roman law, which in the 6th century was compiled by Justinian, and which became the doctrine (Nobes C. and Parker R. 2012). The continental European accounting system was based on the French Commercial Code, as adopted in 1673 and known as the Code Savary. This Code and the Commercial Code of 1807 of Napoleon was taken over by other countries – notably Belgium, Spain, Germany and Italy, and in the continental Europe there developed a tradition that all the accounting activities have been defined in the legislation (Walton P., Aerts W., 2006). As it has been studied and found in the monograph by I. Millere “The Accounting Development in Latvia” the accounting development within the Latvian territory in previous centuries was established by the German, Swedish, Danish and other national requirements. Before founding the LR the accounting requirements in Latvia



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were imposed by the legislative acts of the Tsarist Russia, which also continued to affect the LR accounting framework after the foundation of the LR in 1918. While establishing the LR accounting framework to 1940 there were used as the basis as the legislative acts of the former Tsarist Russia, so particularly the German Commercial Code (*Handelsgesetzbuch*). During the socialist period, until the restoration of the independence of the LR, the accounting in Latvia was regulated by the detailed regulatory framework of the USSR (Millere I., 2011).

The author believes that the Latvian accounting systems, historical development and belonging to the continental European accounting tradition shall certainly be taken into account, when developing and adopting the LR accounting regulatory framework, which unfortunately, was not always previously observed. It is testified by the repeated attempt to apply the national accounting standards, which essentially failed. In the development and adoption of the Latvian Accounting Standards (LAS), for many years there was invested much work, but as the result in 2011, again in accordance with the “Annual Accounts Law” there were passed the CM Regulations No. 488 “The Regulations on the Application of the Annual Accounts Law” and the CM Regulations No. 481 “The Regulations on the content and the development order of the cash flow statement and statement of changes in equity,” which contain the requirements of the LAS and thus the developed and adopted standards were no longer relevant. It should be noted that, unlike other Anglo-Saxon countries, the application of standards in Latvia was not voluntary, but established by the regulations of the Cabinet of Ministers. It could be concluded that by means of immature regulatory framework in the LR following the regaining of independence there was an attempt to implement the Anglo-Saxon accounting tradition, but the result was again the adopted regulatory framework that complied with the continental European accounting traditions. The author also points out that neither the existing laws, nor the binding regulations of the Cabinet of Ministers include all the accounting and reporting requirements, but at the same time provide for the additional administrative burdens on businesses, for instance, as on the subject of the composition of the annual report, as it was previously explained.

The author positively evaluates the amendments of 2012 to the “Annual Accounts Law”, which have reduced the number of components of the annual report, however, the regulatory framework pertaining thereto is irrelevant. As it is recognized by the Ministry of Finance currently in Latvia in compliance with the EU view, the criteria of small business would be met by more than 99% of the Latvian companies (Ministry of Finance, 2012), but the composition of the annual report estimated in the “Annual Accounts Law” corresponds the IFRS, including the cash flow statement and statement of changes in equity, which should not be drawn by small, and even more micro-enterprises. For the corporate accounting and report drawing and submission, applying the least administrative burden, to provide the necessary outcome in the LR economics, there shall be taken into account the Latvian accounting traditions and developed the sustainable accounting concept, which would also include the requirements to draw the annual report.

On the subject of the composition and the framework of corporate annual report, the author recommends the Ministry of Finance to develop and implement the national policies on accounting issues, considering the following possible solution:

- the IFRS should be applied: by the companies that prepare consolidated reports, if on the balance sheet date their securities are admitted to trading on a regulated market of any Member State, as required by the EU regulations, banks, brokerage firms and investment authorities, as it is required by the LR normative acts. There could also be established requirements for the LR parent companies to prepare consolidated annual reports only in accordance with the IFRS. In the law regulating the activities of some companies it should be specified that the company’s annual report shall be drawn up in accordance with the IFRS, but in the regulatory framework it is not necessary to include the composition of the annual report and other requirements on preparing, as those are covered by the EU Regulations;



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- to develop and adopt a separate law for companies that are not micro-enterprises and which annual reports shall not be drawn up in accordance with the IFRS. It could be the corrected edition of the “Annual Accounts Law”. This law shall provide for the composition of the annual report for the subjects of this law in compliance with the one set in the Fourth Council Directive, including therein four statements: the balance sheet, profit or loss statement, annex and the management report;
- to develop and adopt a separate regulatory framework for micro-enterprises to draw up their annual reports. The annual reports of micro-enterprises can include only a balance sheet and profit or loss statement, in abridged form, to provide information about the financial standing of the companies as well as the profit of the accounting that is taken into account when calculating the corporate income tax. The framework should also include the bookkeeping requirements, the criteria to recognize and evaluate the items, term definitions and the requirements on the scheme and drawing up of statements.

### Conclusions, proposals, recommendations

The author of the article has studied the LR regulatory framework requirements for the composition of the corporate annual reports, as well as described the requirements of the Fourth Council Directive and the IFRS that determine the composition of the annual report. The author has compared those with the requirements set in the “Annual Accounts Law” and other legislative acts, and consequently the author draws the following conclusions and recommendations:

- the composition of the annual report in the LR “Annual Accounts Law”, which name from the moment it was adopted in 1992 by November 22, 2006 was the law “On Enterprises Annual Accounts”, underwent several changes and increased from four in 1992 to six statements in 2000 and include: balance sheet, profit and loss statement, cash flow statement, statement of changes in equity, the annex and the management report. The above composition of the annual report is provided for in the IFRS, but the “Annual Accounts Law” does not determine the application of the IFRS;
- the EC Regulation No.1606/2002 on the application of the international accounting standards states that the IFRS shall be applied by the companies that prepare consolidated annual reports and the securities of which are admitted to trading on a regulated market of any Member State. Beside the above companies, according to the LR regulatory framework, the annual reports in accordance with the IFRS must be prepared by banks, brokerage firms and investment authorities, while corporate parent companies can prepare consolidated annual reports in accordance with the IFRS;
- the Fourth Council Directive pertaining to the annual reports of certain types of companies, provides for the four statements to be included into the annual report: the balance sheet, profit and loss statement, notes and report, still the LR “Annual Accounts Law” in addition to the set by the Directive since 1996 has included the cash flow statement and since 2000 – the statement of changes in equity, which greatly increased the administrative burden;
- while applying the reliefs provided for by the Article 54 of the “Annual Accounts Law”, which companies may be exploit since January 1, 2010, into the annual report there must be included three statements: balance sheet, profit or loss statement and annex. These reliefs could be applied in 2012 by more than 73 thousand, or approximately 93% of all the subjects of the law. So the task of drawing up a full annual report shall be executed by only 7% of the subjects of the “Annual Accounts Law”;
- the LR “Annual Accounts Law” provides for a significantly smaller number of companies to apply for the reliefs set in the Directive 2012/6/EU for the composition of the annual reports of micro-



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enterprises, including therein only an abridged balance sheet and profit or loss statement. Although by law the amount of the net turnover and balance sheet total is 7 times smaller, but the number of employees - two times smaller than in the provisions of the Directive, still, these reliefs set in the Article 54<sup>1</sup> of the Law could be applied by more than 58 thousand, or approximately 73% of all the subjects of the “Annual Accounts Law”;

- the Latvian accounting meets the continental European accounting tradition and it must be taken into account, when developing and adopting the LR accounting regulatory framework;
- in order to determine the optimal composition of the annual report and adopt an appropriate regulatory framework, the Ministry of Finance could evaluate the proposals:
  - to develop and adopt a separate regulatory framework for the preparation of annual reports by micro-enterprises, stating that the annual report of micro-enterprises shall contain an abridged balance sheet and profit or loss statement;
  - to develop and adopt a separate law for companies that are not micro-enterprises and which annual reports shall not be drawn up in accordance with the IFRS. In the annual reports of these companies, in compliance with the requirements of the Fourth Council Directive, there shall be included four reports: the balance sheet, profit or loss statement, the annex and the management report;
  - in addition to the set in the LR regulations, to provide for the IFRS to be applied by all the parent companies, while preparing the consolidated annual reports.

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