

ACCOUNTING REFORM IN UKRAINE

Robert W. McGee*, Galina G. Preobragenskaya**

Abstract

This paper summarizes the results of interviews conducted at accounting firms and educational institutions in Kiev and Odessa during the summer of 2004, supplemented by later correspondence via the internet. Topics discussed include the adoption and implementation of International Financial Reporting Standards (IFRS), education for accounting practitioners, recent changes in accounting education in Ukrainian universities, accounting certification and taxation. Expertise in IFRS is in short supply in Ukraine. However, demand for knowledge of IFRS is also lacking, which provides little incentive for local Ukrainian accounting firms to develop expertise in this area. As a result, the top international accounting firms, mostly the Big-4, have captured most of the market for this expertise. Nearly all of the largest companies in Ukraine retain the services of one of the Big-4 and it is primarily the large companies that can see any use for IFRS, since it is mostly the largest enterprises that are going to the international capital market in search of capital. International investors demand to see financial statements that are prepared using either IFRS or U.S. GAAP as a condition of providing investment capital and the Big-4 accounting firms are best prepared to provide guidance and expertise in this area. Much of the IFRS training of practicing accountants is done by the Big-4 accounting firms. They have developed extensive course materials over the years and have a competitive advantage in this area. However, the training they provide is mostly limited to their employees and their clients, which means that accountants who do not work for either a Big-4 firm or one of their clients do not have ready access to IFRS training. Ukrainian universities have started to incorporate IFRS into their accounting curriculums. The problem is that they cannot always find good learning materials. Some of the most prestigious universities in Ukraine still do not have a course devoted just to IFRS. IFRS is inserted into their course on foreign accounting. Ukrainian financial statements that are certified by accountants who possess only a Ukrainian certification do not have much credibility in international capital markets. One reason for this lack of credibility is the perception that the average Ukrainian accountant does not meet international standards when it comes to knowledge of IFRS and International Standards on Auditing (ISA). Another reason is because the accounting certification system is viewed as corrupt. There are rumors that Ukrainian accounting certification can be bought.

This problem is being overcome in two different ways. Several internationally recognized accounting certification exams are now being offered in Ukraine. Any Ukrainian accountant who can pass these exams earns instant credibility. The problem is that these exams are given only in English, which greatly limits the number of Ukrainian accountants who can take and pass the exams. This language barrier is being overcome by a group of accounting associations in several former Soviet republics, which began offering a high quality certification program in the Russian language. This certification started with a pilot program in Central Asia and has recently spread to Ukraine, Russia and Moldova. As this program spreads, the credibility of Ukrainian accountants who can pass these certification exams will be greatly enhanced.

Keywords: audit, credibility, IFRS

* *Andreas School of Business, Barry University.* ** *School of International Business, Omsk State University*

Introduction

Much of the information gathered for this paper was obtained by conducting interviews with accounting practitioners and educators in Kiev and Odessa during the summer of 2004. This study replicates an earlier study by McGee and Preobragenskaya (2005) of accounting reform in Russia. Similar questions

were asked to similar segments of the accounting community. The main difference between this study and the earlier McGee and Preobragenskaya study is that the questions for the present study were asked of accounting practitioners and educators in Ukraine rather than Russia.

The following firms and institutions were interviewed:

All About Accounting (newspaper, Kiev)
www.vobu.com.ua

Ukraine Accounting Reform Project (Kiev)
www.capcipa.biz/

Deloitte & Touche (Kiev) www.deloitte.com.ua

Ernst & Young (Kiev) www.ey.com/ukraine

KPMG (Kiev) www.kpmg.com.ua

Auditorckoe Agentstvo Margo (Ukrainian
accounting and audit firm, Odessa)

Odessa State Economic University (Odessa)
www.oseu.odessa.ua

Odessa National I.I. Mechnikov University
(Odessa) www.odnu.edu.ua

KIMI (Kyiv Investment Management Institute)
(Kiev) www.kimi.edu

Adoption and Implementation of International Financial Reporting Standards

Ukraine started to adopt national accounting standards along the lines of International Accounting Standards (IAS) in 1999. IAS was translated into Ukrainian in that year but some explanations were deleted, which caused some problems. There is not much literature in the Ukrainian language that explains how to use the standards. This lack of Ukrainian language materials does not cause much of a problem in the Eastern part of Ukraine, since the main language there is Russian and there are some Russian language materials available, although the quality of those materials has been criticized. But lack of Ukrainian language materials is somewhat more of a problem in the western part of Ukraine, where the Ukrainian language is more prevalent. Although all Ukrainians can understand Russian, some of them prefer to use Ukrainian.

The conversion process has been somewhat successful although the degree of success could not be agreed upon by the interviewees. According to one account by a local practitioner who was knowledgeable about IFRS, the Ukrainian national standards are now about 80 percent like IFRS and the tax rules are in about 98 percent compliance with IFRS. But an accounting professor stated that the national standards and IFRS are far apart, citing inventory as just one example. Many Ukrainian enterprises load all overhead costs into the cost of inventory for financial reporting purposes, even selling and administrative costs. It could not be determined whether this practice is in keeping with national accounting standards but it is apparently common in practice. This treatment of inventory may be widespread among former centrally planned economies. At least one study has found the same technique to be prevalent in Bosnia (Pekmez and McGee 2004).

Ukrainian standards require companies to maintain a specific chart of accounts, a requirement that does not exist in the developed market economies. In a market economy, companies are free

to construct their own chart of accounts, based on what makes the most sense for the particular company.

The IFRS on hyperinflation accounting standards is not applied retroactively in Ukraine. It is not used in practice. Expenses are classified by function in Ukraine. Some transactions, such as foreign currency translation, are recorded gross in Ukraine. Ukraine does not have a standard on government grants. Ukraine's financial instrument standard is not as detailed as the IFRS standard. Ukraine's standard on financial statement disclosure is not as detailed as the IFRS standard. Ukraine's standard on deferred taxes is similar to the IFRS standard. However, it is difficult to calculate the amount of the deferred tax and many companies simply don't do it.

The lack of educated people is slowing down the accounting reform process. There is a lack of educated young people and many of the older generation are not sufficiently familiar with IFRS, or even with national standards. Five years after the start of accounting reform nothing has changed. Accounting graduates still do not know national standards, according to one journalist. Only a few hours of lectures are devoted to IFRS at the universities.

The need for capital drives the market. Internal sources of capital are exhausted. There is no public equity in Ukraine. Private equity exists. Ukrainian companies often do not go to the debt market for capital because it is too expensive. However, those companies that have IFRS financial statements are able to obtain capital at lower interest rates than companies that have only Ukrainian financial statements. There is a need to rationalize business and clean up the financial statements to obtain equity capital, which is the cheapest source of capital.

There are some regulatory and political impediments to rationalizing businesses. For example, a chain of 25 supermarkets might be set up as 23 different businesses for political reasons. The local governments want them to set up separate businesses so they can tax them and give them permits. Such a structure is inefficient and too complicated. No one wants to invest in such a business.

Having poor financial statements is not necessarily an insurmountable obstacle to raising capital. Banks prefer to know their clients well. If the client has repaid loans in the past there is a tendency to lend money again. Knowing a client well is more important than IFRS financial statements. Adequate collateral is also an important criterion that bankers consider.

The political process is intertwined with business in Ukraine. Members of Parliament often have business interests and those interests are usually placed ahead of those of the country.

The conversion to IFRS is an ongoing process. National Ukrainian standards include some topics

that are not addressed in IFRS and IFRS addresses some topics that Ukrainian national standards do not address. However, most Ukrainian accountants do not follow the national financial reporting rules. They follow the tax rules instead. Many Ukrainian accountants do not see a need for financial statements.

However, in some cases Ukrainian financial reporting standards are not much different from IFRS. Some clients that use Ukrainian standards do not require any adjustments at all to comply with IFRS, according to one interviewee.

Most Ukrainian clients choose Ukrainian standards that are as close to the tax rules as possible. Ukrainian standards are broad. It is possible to choose from several choices. Ukrainian financial reporting standards are rules-based, like U.S. GAAP, whereas IFRS are principles based. Thus, whenever a Ukrainian accountant seeks an answer to an accounting question, he or she looks for a rule that covers the situation rather than thinking about which accounting principle might apply.

About 700 Ukrainian enterprises have converted their books from national standards to IFRS, with the assistance of USAID. Professor Goloff developed a methodology for converting Ukrainian statements into international statements. He also wrote several books on the subject. He became famous and respected by the practitioner community as a result.

All of the top 25 banks prepare financial statements using IFRS. Commercial businesses have less likelihood of having IFRS financial statements. Companies owning about 40 percent of the total assets in Ukraine have IFRS statements.

All listed companies must present their financial statements in IFRS format to the National Security Commission. By the end of 2005 it is expected that all companies will be required to use only IFRS, although no one knows for sure whether they will have to prepare two sets of statements or just one. Companies that want to raise capital in the U.S. market will also prepare financial statements using U.S. GAAP. Many companies that have to prepare financial statements for statistical purposes feel that they do not serve any other purpose. Some companies use accounting information for management decision making purposes but the practice is not as widespread as it is in the developed market economies. Companies are not penalized much for making mistakes on their financial statements. Penalties are more severe for making mistakes on their tax statements.

Minority shareholders do not have access to financial information. Most people don't know how to read financial statements. Majority shareholders have access to insider information. There is a very low level of corporate governance in Ukraine. There is no one or no organized group to push for minority shareholder rights.

Ukraine is lagging behind Russia in the area of corporate governance. Ukrainian companies are just

starting to have their internal auditors report to management. Audit committees are practically nonexistent. The stock market is practically nonexistent. As of June 2004, not a single Ukrainian company had had an initial public offering (IPO). The majority of funding comes from private sources. Conversations are one-to-one. When such financing is readily available, there is not much need for corporate governance.

Ukraine has adopted International Standards on Auditing (ISA) as of 2004. It decided not to have separate national auditing standards, so ISA have become the national standards. There is thus no need to reform national standards or do comparison studies to determine how closely the national standards correspond to ISA. Another interesting feature of adopting ISA is that whenever the ISA are amended or new standards are issued, Ukraine adopts them automatically. There is no need to introduce them as new legislation. That is not the case with IFRS, which must be introduced in the legislature, debated, etc. before passage and implementation.

There is a shortage of accountants in Ukraine who are experts on International Financial Reporting Standards (IFRS). However, the shortage is not noticed by a large segment of the Ukrainian accounting community because there is also a lack of demand for knowledge of IFRS. Demand for IFRS expertise comes mostly from the large enterprises, which need financial statements prepared in accordance with IFRS or U.S. GAAP in order to attract foreign investment capital. Small and medium size enterprises usually do not obtain their investment capital in the international capital market, so there is not as much demand for IFRS prepared financial statements among the small and medium size enterprises. As a result of this lack of demand except at the top level, the Big-4 accounting firms have captured a major market share of the audit and accounting work for the largest corporations in Ukraine. The Big-4 firms are practically the only firms that have the needed expertise, and they are practically the only firms that international investors will trust for audit opinions. Thus, the Big-4 has a monopoly among large Ukrainian enterprises.

This near monopoly has had a positive effect on Big-4 firms' growth rates. Ukraine's economy grew by 10 percent in 2003. One of the Big-4 accounting firms reported that its growth in Ukraine in 2003 was 20 percent. Another Big-4 firm stated that it grew by more than 30 percent and that growth would have been even higher if the firm had not been more selective in determining which clients to accept and which to reject. The Big-4 rejects potential clients based on their reputation and integrity. The third Big-4 firm said that it almost doubled clients and staff during the previous year.

Practice development consists mostly of just picking up the telephone when it rings, although the Big-4 firms also hold seminars and breakfast

meetings to attract potential clients. One firm reported that it is very difficult to find good employees. This lack of good employees is the main obstacle to growth. The number of people the firms can train is also limited. And many of their employees leave the Big-4 to work for large enterprises after they are trained. The large enterprises offer experienced Big-4 accountants two or three times the salary that the Big-4 is willing to pay.

Some practitioners expressed the view that it is difficult to find experienced accountants and that it is difficult for recent accounting graduates to find jobs. However, some of the university administrators interviewed said that it is not as difficult for accounting graduates to find jobs as it is for graduates in other fields. Faculty and administrators at the two universities interviewed as part of this study were uniformly of the opinion that their graduates did not have a hard time finding accounting jobs. However, the two universities chosen for interviews were both above average in terms of perceived quality, so perhaps the success of their graduates in finding accounting positions is not representative of the country as a whole.

All of the Big-4 firms have offices in Kiev, the capital, and none of them have offices in other Ukrainian cities, although they do have clients in other cities. Odessa, another large Ukrainian city, has only one international firm, and it is not one of the Big-4. Thus, there still is a place for local Ukrainian firms, although the Big-4 seems to have a controlling market share of the largest enterprises, many of which are headquartered in Kiev.

The accounting practitioner community also does not see much need to be familiar with IFRS. When subscribers to *All About Accounting*, a large accounting newspaper in Ukraine, call the newspaper to ask accounting questions, they almost never ask financial reporting questions. Practically the only questions they have revolve around tax accounting. Even the tax officials do not require IFRS financial statements as part of their audits.

Where there is no demand, there will be no supply. Thus, the shortage of IFRS trained experts does not appear to be a problem for a major segment of the Ukrainian accounting community. However, that perception may change soon, since many Ukrainian enterprises will be required to prepare financial statements that comply with IFRS as of the end of 2005.

Accounting is not held in high regard by business owners because they do not see the value of accounting information, according to some interviewees. This perception will likely change as an increasing number of companies are required to issue financial statements and as an increasing number of Ukrainian accountants pass the various certification exams that are discussed below. Some interviewees indicated that accounting is considered a prestigious job. So there seems to be a divergence

of opinion about the need for accounting information and the status of the profession within Ukraine.

One might say the same about Russia. Enthoven et al (1998) report that a survey of secondary school students ranked accounting 91st out of 92 occupations on the list of potential occupations in terms of prestige. However, that survey was taken early in the transition process. Accounting has since risen in terms of prestige as demand for accounting services has increased rapidly, due to the shift from a centrally planned economy to a market economy.

Public companies, insurance companies and banks are required to have an annual audit. Other companies are not required to have any audit and many enterprise owners and managers do not see the need for an audit in the absence of a legal requirement. This perception will change only slowly.

The concept of transparency is new in Ukraine, as it was in Russia (Preobragenskaya and McGee 2004). Not all Ukrainian accountants and enterprise managers have become accustomed to the idea that their main audience is shareholders, bankers and other providers of capital. Many of them retain the old Soviet mindset that their main audience is the tax authorities (government).

The accounting culture in Ukraine is deeply imbedded, especially among the older practitioners. This old Soviet mentality continues to cause problems. Accountants are accustomed to working with documents. Accruals are difficult for them to understand. Accruals do not require documents, which presents a problem because making entries where there are no documents goes against their mindset. Failure to make accruals is a common mistake for many companies. These mistakes are usually uncovered during the course of an audit. However, things have improved in recent years. The situation is getting better.

Revenue recognition is another problem for Ukrainian accountants. They prefer to get documents and to record revenue only when they have the documents. They prefer to use the cash method to recognize revenue rather than the accrual method.

There is also a problem with substance versus form. If a lease agreement says that it is an operating lease, the company will treat it as an operating lease even though it might be a financing lease in substance. The question about the substantive nature of the lease is never asked. Enterprise accountants go with whatever the lease language says.

Most contracts Ukrainian enterprises have with the Big-4 accounting firms are for just one year. Having contracts of such short duration limits the accounting firm's ability to do pre-audit work during the summer.

Companies also change auditors more frequently in Ukraine than in developed market economies. However, that is not a cause for concern because companies raise most of their capital through debt markets rather than equity markets.

Education of Accounting Practitioners

Accounting practitioners have to keep current with developments in the areas of accounting, auditing and taxation to maintain their certification. Although local Ukrainian accounting firms provide some training, much of the IFRS training is provided by the Big-4 accounting firms. The reason for this preponderance of IFRS training is quite simple. It is mostly the Big-4 firms that have the expertise to conduct such training. They have excellent training materials, which have developed and evolved over several decades of trial and error and use.

However, the training the Big-4 provides is not readily available to the local Ukrainian accounting community. Much of the training is limited to employees of the Big-4 and their clients. Furthermore, most of the training materials, for their employees at least, are available only in the English language. That does not present a problem because the Big-4 only hires individuals who are fluent in English. In cases where course materials are used to train clients, some translation is done, but these materials generally are not made available to non-clients.

There are some exceptions. For example, some of the Big-4 firms use training as a practice development tool. They hold some seminars and breakfast training sessions for potential clients. The training materials they distribute at these sessions are used not only for training but also to introduce potential clients to the quality of the training they offer, training that could be available to their employees if they became clients.

The Big-4 firms provide ACCA, CPA and CFA training to their employees. One of the firms interviewed said it uses the Becker CPA Review materials. In the past it flew its staff to Moscow for training because there were no local training providers, but that situation has changed.

There is a 40-hour annual continuing professional education (CPE) requirement. Accounting training in the Ukrainian language "is a disgrace, a complete joke," according to one interviewee who has taken both Ukrainian CPE and English language CPE courses offered by one of the Big-4. This interviewee also mentioned that the professors who teach the Ukrainian language CPE courses do not know what they are talking about.

Accounting Education in Ukrainian Universities

Many new accounting departments have been started since the breakup of the Soviet Union. Accounting was not such a popular subject before the breakup and many universities did not offer accounting programs. The growth of accounting departments in universities is the result of the increase in demand for accountants in the private sector. It is now fair to

say that most Ukrainian universities have accounting departments.

The number of accounting journals has also increased in recent years and they are very popular. They tend to be practitioner oriented rather than scholarly, in the American sense of that term. Stated differently, the gap between practitioner journals and scholarly journals in Ukraine is not nearly as wide as is the case in the United States.

Ukrainian universities have started to incorporate IFRS and ISA into their accounting curriculums. However, they face several problems in this regard. One problem is the lack of good course materials. Local language materials were not available in the early stages of the transformation from central planning to a market economy. However, this problem is being alleviated in two ways. Initially, accounting course materials were provided by translating books from English into Ukrainian and Russian. However, some of those translations were mediocre. The translation problem can be overcome by having local professors write texts in the local languages. Such texts did not exist in the early stage of the transformation but such texts are now becoming more common. Some texts are available in both Russian and Ukrainian.

Some of the texts have become out of date, due to the rapid changes in Ukrainian national accounting standards and the adoption of IFRS. The universities deal with this problem by assigning readings from accounting journals and newspapers as supplementary material.

One complaint some practitioners have about accounting education in Ukrainian universities is that the lectures are too theoretical and not sufficiently practical. This problem is prevalent where the professor giving the lecture does not have any practical experience. This problem is being partially overcome by hiring professors who are practitioners and by allowing full-time professors to engage in accounting work outside of the university.

The practitioners interviewed in Odessa perceived the professors to be up to date as far as course material and content were concerned. The professors and administrators interviewed at two of the top accounting departments in Ukraine also said that professors are up to date with recent developments in accounting. However, some of the practitioners interviewed in Kiev did not hold this opinion, at least when it came to lectures delivered as part of continuing education courses.

Some of the most prestigious universities in Ukraine still do not have a course devoted just to IFRS. IFRS is inserted into the course on foreign accounting.

Sixty or seventy universities in Ukraine participate in the accounting Olympics each year. These Olympics consist of conferences where students present their papers. Sometimes there are competitions between teams in the third year. These events are highly competitive and serve to create

friendships between students and improve their view of accounting. Such competitions serve to make the material less dry and boring and make it come to life.

The prestige of accounting has increased in recent years, according to the university professors and administrators interviewed, because enterprises need tax specialists and people who can create and interpret accounting information. Directors are starting to recognize the importance of accounting.

This enhanced prestige is having an effect on students and the way they study and view themselves. Students now read extra articles that are not required reading and discuss them. Most students are enthusiastic about their studies, which is a relatively recent phenomenon.

Every university has its own approach toward accounting education. However, there are only so many ways to reform the accounting curriculum or to teach accounting, so there are many common features.

Odessa State Economic University is a case in point. It now offers a four-year bachelor's degree in accounting and a fifth-year master's degree. The State gave them the option of offering either a fifth-year specialist degree or a master's degree, so they chose the master's degree for prestige purposes. Almost everyone who completes the bachelor's degree goes on for the master's. It also has a one year specialist designation for people who have already completed a bachelor's degree in another field. In contrast, many universities in Russia now offer a four-year bachelor's degree, a fifth-year specialist degree and a sixth-year master's degree (Preobragenskaya and McGee, 2005).

The accounting curriculum has undergone major changes in recent years because of the changes in national accounting standards and the adoption of IFRS. Before, the university used to offer just a course in the theory of accounting and some specialized accounting courses, such as agricultural accounting. They now offer a fuller range of courses, including financial accounting, financial reporting, management accounting, accounting for international enterprises and accounting for foreign countries. Starting in the 2004-2005 academic year they will offer a course in tax accounting and reporting. Formerly, the tax course was offered as part of the financial accounting course but it will now be a separate course. There is no special course in IFRS. However, there are courses about international companies. The university also now offers electives. Under the former Soviet system, there were no electives. All students in accounting had to take the same exact courses throughout their program.

There is a special course in the fourth year that requires students to work with accounting documents for three weeks. The documents replicate the documents that exist in a real accounting department, from original invoices through the various stages of the accounting process. The documents are posted to ledgers, with the end result being the preparation of

financial statements. Students must work in all areas of accounting.

In the fifth year students receive practical training. They work with real documents from real companies. Each student works in a certain area, with some of the documents. The end result is the production of financial statements. The work involves more documents and more transactions than was the case in the fourth year. Students also make tax declarations based on their work.

The curriculum is as follows:

1st year - general subjects

2nd year- basic accounting

3rd and 4th year - other accounting – all the main accounting subjects.

5th year - advanced financial accounting and analysis.

Students also write a diploma project in the fifth year after they have received practical training in real companies. They do their diploma project after getting experience. They must defend their diploma project like a thesis.

The delivery format is a combination of lectures, seminars and case studies. Students also study using computer software and there are special courses in computer software. All examinations are written and usually take the form of practical exercises. Some exams require students to produce financial statements. This practice differs from that used during the Soviet era, when some exams were oral.

The language of the lectures are delivered in depends on the students. At the start of the semester each professor asks the class whether they would prefer the lectures to be in Ukrainian or Russian. The lectures are delivered in whichever of the two languages the majority of the class prefers. Such an option may seem strange, or at least interesting, to an American audience, since American professors never give such options. But apparently this option is not so unusual in Ukraine. Some Swedish universities have a similar option, except that in the case of Swedish universities the professor asks the students whether they would prefer the lectures to be in Swedish or English.

The accounting faculty does not specialize to the extent of accounting faculties in other countries. Most of the accounting professors at Odessa State Economic University can teach any of the accounting courses. They do not teach just financial accounting or just managerial accounting or just auditing. One benefit of this approach is that they are forced to keep current on developments in all areas of accounting. The drawback is that they have to spend more time preparing their lectures. Also, they cannot become specialists, although that is probably not necessary at the undergraduate level.

The university does not have difficulty finding people to teach. Accounting professors earn about \$200 a month, which is considered adequate. They also qualify for better pensions – 90 percent of salary – compared to about \$32 a month for the majority of

the population. Some people become professors for the prestige. It is also possible to do consulting and many professors have businesses or consulting practices outside of the university.

About 45-50 percent of their students receive full tuition scholarships, which means that their education is free. Scholarships are awarded on the basis of merit. Students not receiving scholarships have to pay tuition of 3600 greven per year, which is about \$700. Such an amount may seem small to people from developed economies, but to many Ukrainians it is a large amount.

Students do not have difficulty finding jobs after graduation because most of them already have jobs. The fact that the university is prestigious also helps them in the job search. Salaries for new graduates are about \$100 a month. Experienced accountants can earn up to \$800 per month.

Odessa National I.I. Mechnikov University also has a strong accounting program. Some members of the faculty there are trying to spread the idea that accounting can be used as a tool for decision making, an idea that most managers and even many teachers still do not understand.

In the two years prior to the interviews, the university instituted some major changes to its accounting and business curriculum. New courses were offered for the first time. This change was motivated by the appearance of new kinds of enterprises. Courses like financial management, insurance, the stock market and management accounting were taught for the first time. However, there is no special course in IFRS. This topic is incorporated into their course on accounting in foreign countries.

Tax accounting is another new subject. All enterprises are now required to compute taxes, so the university offers a tax course to meet market demand. The emphasis is on the ability to solve tax problems.

The professors and administrators interviewed at Odessa National I.I. Mechnikov University confirmed some of the statements made by practitioners and the professors and administrators at Odessa State Economic University. They also agreed that the prestige of the accounting profession has increased because businesses are starting to realize how important accounting information is for them. Managers are starting to recognize how much value a good accountant can add to their business.

Many of their students also work in the field of accounting during the course of their studies, which gives them an opportunity to earn income while gaining practical experience. Their students do not have difficulty finding jobs after graduation because of the practical experience they have gained and also because Odessa National I.I. Mechnikov University is one of the more prestigious universities in Ukraine. Their students participate in the accounting Olympics and often score well. At the beginning of the semester professors ask their students whether

they would like to have the lectures delivered in Russian or Ukrainian.

Odessa National I.I. Mechnikov University offers three levels of accounting credentials – the four-year bachelor's degree, the fifth year specialist designation and the sixth year master's degree. Practically all of their students study for five years and earn the specialist designation.

Many of the accounting texts they use in their classes were written by Prof. Butenyetz Franz Franchevich, a Ukrainian professor. Thus, there is no need to deal with books that were translated from English, eliminating the problems that invariably result from mediocre translations. His books filled the gap that was created when the Soviet Union collapsed but before the new accounting system took hold. The professors like his books, but they supplement his books with newspaper and journal articles when preparing their lectures. Professors who write textbooks also often incorporate material from articles into their text books. Many books have been translated from English into the local languages, which enables students and professors to have access to the accounting literature of other countries.

Accounting Certification

Financial statements that are certified by accountants possessing only a Ukrainian certification do not have any credibility in international capital markets and do not have much credibility even within Ukraine. That is because of the widespread impression that audit opinions can be sold. The interviews seemed to confirm this perception. In fact, the interviews revealed that even accounting certification can be sold in Ukraine, which is similar to the situation in Russia (McGee and Preobragenskaya, 2005) and perhaps other former Soviet republics.

Ukrainian certification is not highly regarded for other reasons as well. The exam is thought to be much less rigorous than the various international exams like the ACCA (Association of Chartered Certified Accountants) and American CPA and the Ukrainian exams do not test on IFRS to the extent that the ACCA does. However, the national Ukrainian certification exams are somewhat ACCA based. The national exams contain some topics that are also tested in the ACCA exams.

The national certification system has three levels, introductory, intermediate and advanced. However, only the first two levels were ever developed. Students were supposed to receive a certificate after completion of the exams for each level. After all the exams at all three levels were passed, candidates were supposed to be able to exchange their certificates for one diploma. However, the third level exams were never developed and the process stopped because no books were translated and because Ukrainian accountants do not use the level three topics in their work. The

topics tested in the first two exams are used in practice but the level three material is not yet used in practice because the Ukrainian economy is not yet sufficiently developed to use advanced accounting concepts.

The lack of a credible Ukrainian accounting certification is being overcome in several ways. For Ukrainians who have a strong knowledge of English, it is possible to take either the ACCA exams or the American CPA exam. The ACCA is an old and reputable provider of accounting certification. It has been in existence since 1904 and has certificate holders in 160 countries. It has well over 300,000 candidates and is truly international in terms of recognition. It offers three levels of certification consisting of a total of 14 exams. It tests on IFRS and International Standards on Auditing (ISA). It is possible to take the exam in many countries and on all continents. The main problem with the ACCA exams is that they are offered only in the English language, which precludes the vast majority of otherwise potential exam candidates from taking the exams.

The ACCA exams are very popular among the subset of Ukrainian accountants who have a good command of the English language. The majority of the ACCA exam candidates work for or want to work for international firms. Those who can pass the ACCA exams have good job prospects.

The Certified Management Accountant (CMA) exam is another possibility for Ukrainian accountants who want to earn an internationally recognized certification. However, this certification is not very popular in Ukraine, mostly because of a lack of understanding about what management accounting is. Another reason for the relative lack of demand is because the Institute of Management Accountants (IMA), the organization that organizes this exam, has not marketed the exam to any great extent in Ukraine (McGee, Preobragenskaya and Tyler, 2004).

Another way for Ukrainian accountants to gain an internationally recognized accounting certification is to take the American CPA exam. Passing the CPA exam gives instant credibility. However, there are several drawbacks to the American CPA exam. For one, it is offered only in English, which precludes the vast majority of potential candidates from taking the exam. Another problem with the American CPA is that exam candidates must travel to the USA to take the exam.

The travel requirement greatly increases the cost of taking the exam, but that is not the only difficulty. It is not always easy for Ukrainians to obtain a visa and some potential candidates cannot obtain permission to enter the United States. Also, only a few American jurisdictions will permit Ukrainians to take the exam in their state. Although the exam is theoretically open to individuals of any nationality, many states require 150 semester hours of university education, consisting of a certain minimum number of hours in accounting. Many graduates of Ukrainian

universities cannot meet this requirement. Alaska is a popular state because it requires just one year experience with an audit firm. However, CPA exam candidates do not have to go to Alaska to take the exam. Since the exam is now on computer, they can take the exam in any state.

The American CPA exam is not completely relevant to the Ukrainian situation. Part of the CPA exam tests on US tax and business law, which Ukrainians must learn on their own, since no such courses are available in Ukraine. Thus, there are a number of obstacles to be overcome for Ukrainians who want to earn the American CPA designation. The ACCA exams also test on British tax and business law, but the ACCA allows candidates to take alternate exams in these subjects if the local testing authority can convince the ACCA that the local tax and business law exams are the equivalent of the comparable ACCA exams.

Until recently, there was no internationally recognized accounting certification exam that was offered in a language other than English that Ukrainian accountants could understand, thus limiting their opportunities to earn a credible certification credential. However, that situation is changing.

In 2001, a group of accounting associations in several former Soviet republics, with the assistance of the United States Agency for International Development (USAID), gave a regionally recognized accounting certification exam in the Russian language for the first time. The content of the exam is similar in many ways to the ACCA and American CPA exams.

In 2002 an examination network was formed to supervise, manage and spread the exam. This association now consists of 14 accounting associations from 8 countries. Certificates are issued by the ICCAA. Individuals must be a member of one of the 14 sponsoring associations to keep their certificates. The exams are processed mostly by Accels, the same organization that offers the TOEFL and CMA exams. The exams are graded in Tashkent, Uzbekistan, although this may change after the headquarters moves to Moscow. The Center for Business Skills Development (CBSD) processes the exams in Moscow. Surveys have found that people are satisfied with the quality of the exams. The exams have also proven to be very popular. About 2400 people were trained within 12 months of the start of the program in all countries. As of mid-2004 there were 6500 people in the database for all countries.

Certification is at two levels and consists of a total of seven exams. There is also an experience requirement. The lower level is called Certified Accounting Practitioner (CAP) and consists of three exams, Financial Accounting 1, Management Accounting 1 and Tax & Law. Level two, called Certified International Public Accountant (CIPA) consists of four additional exams, Financial

Accounting 2, Management Accounting 2, Financial Management and Auditing.

The CAP and CIPA exams started as a pilot program in the five Central Asian republics – Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan, with plans to expand the program into other former Soviet republics after the exams had been offered a few times in Central Asia. The original headquarters was in Almaty, Kazakhstan. The certification programs have since spread to Ukraine, Russia and Moldova. The headquarters for the exam programs moved to Moscow in mid-2004. Thus, it is now possible for Ukrainian accountants who cannot speak English to earn an internationally recognized and highly regarded accounting certification. As this program spreads, the credibility of Ukrainian accountants who can pass these certification exams will be greatly enhanced.

Although the exams are well received, there have been some minor problems or complaints. The study materials provide examples using American companies. Some students would like those examples to be replaced with local company examples. Russians, Ukrainians and other former Soviets are not accustomed to standardized exams, so there is a bit of culture shock. Candidates in Russia want the exam to test on Russian audit standards rather than international auditing standards. Testing on International Standards on Auditing (ISA) is not a problem in Ukraine, however, because Ukraine adopted ISA. There are no separate Ukrainian auditing standards.

All exam preparation courses are offered through the private sector and are a good source of income for trainers and training providers. Trainers earn between \$100 and \$500 per course, which compares favorably to the \$200 a month they earn as university professors. USAID is not involved in the training aspect of the certification program although it does provide other kinds of support. For example, it trains the trainers and gives free books to students. It has also given a small cash award to the training providers for each student who passes an exam.

The courses vary in length but the recommended length is a total of 60 hours, consisting of 15 sessions of 4 hours each. However, some exam preparation course providers cram the 60 hours into a few days of 10 hours each.

USAID also facilitates the training effort by providing lists of potential trainers to exam preparation course providers. But USAID does more than merely providing a list of possible trainers. It also publishes a list of pass rates for each class, which makes it possible for training providers to determine which trainers had the most success in past training courses. Presumably, this puts pressure on trainers to do a good job so that they can attain a high pass rate for their students and get hired to teach future training courses. USAID also gives each trainer a letter stating the pass rate achieved for each of the courses they teach. These letters serve as a

marketing tool, which they present to the private exam preparation companies when they apply for teaching positions.

However, evaluating the pass rates of trainers as not as easy as might first appear. The main problem with straight pass rate comparisons is that different courses have different degrees of difficulty. The CAP exams are easier to pass because of the nature of the questions and the availability of good preparation materials. The CIPA exams are more difficult and the training materials are not of the same quality. Thus, one cannot automatically conclude that a trainer with a lower pass rate for CIPA exam prep courses is necessarily a worse instructor than someone who has attained higher pass rates for a CAP exam.

These certifications are already being recognized in the marketplace. Some employers will hire only those individuals who have either passed all or some of the certification exams. The Central Bank of Kazakhstan requires internal auditors to have the CAP. The Central Bank of Ukraine requires their internal auditors to pass Financial Accounting 1 and Management Accounting 1 or pass the ACCA or CPA. Azov Steel Company requires all their accountants to have the CAP designation. Some employers will reimburse their employees for the cost of taking the exams. Some employers will increase the pay of employees who pass the exams. The largest bearing company in Ukraine gives employees a 25 percent raise when they pass all parts of the CAP. Prior to the June 2004 exams there were 871 CAP holders and one CIPA in Ukraine.

Most of this employer recognition to date has occurred in Central Asia, since the reputation of these exams is better known there. However, as the exams spread to Ukraine and other former Soviet republics, it is expected that the marketplace will start to recognize the value of these certifications in other countries as well. It is expected that some certificate holders might do business in Poland and Romania, since these two countries provide access to the European Union. Thus, CAP and CIPA holders might start permeating the EU in the near future.

During the course of the interviews it was learned that the CAP and CIPA exams were not generally well known in Ukraine. The individuals interviewed at the Big-4 firms either were not aware that these exams existed or had only heard about their existence but were not aware of any details. This lack of familiarity is to be expected, given the fact that the exams are relatively new even for Central Asia, and are even newer in Ukraine. At the time the interviews were conducted, only a few Ukrainian accountants had taken the CAP and CIPA exams.

However, the CAP and CIPA exams are not totally unknown, especially among the local Ukrainian accounting and audit firms. Furthermore, the CAP and CIPA exams are known not only by the firms in Kiev, the capital, but also in other Ukrainian

cities. The one local firm that was interviewed in Odessa proudly stated that all of its accountants had passed all of the CAP exams. The first individual to earn the CIPA in Ukraine was the director of that Odessa-based firm.

The CAP exams are given quarterly, or at least that was the case until recently. CAP exams will no longer be offered in September starting in 2005 because of low turnout for previous September exams. The reason for the low September turnout is because it is too soon after summer vacation (Kenney 2004). So starting with the 2005 exams, the CAP exams will be offered three times a year, in March, July and November.

The CIPA exams are offered twice a year, in July and November. The exams are given over a three-day period. The financial accounting exams are five hours in length. The other exams are four hours long.

From the tenor of the comments made by interviewees at the Big-4, the interviewers got the impression that it would be a long time before the CAP and CIPA exams would be viewed as the qualitative equivalents of the ACCA and American CPA exams. One reason for this discounting of the CAP and CIPA is undoubtedly because of their newness. Another reason for discounting their quality, or even their credibility, is the fact that they are not in English. The partners at the Big-4 accounting firms in Ukraine are mostly from English speaking countries such as the USA, England and Australia. They are involved in the hiring process. They are more familiar with the ACCA and American CPA exams and they naturally place more trust in the quality of exams they are familiar with than with new exams that they are unfamiliar with. The fact that the CAP and CIPA exams are not in English also casts a shadow on their quality because of the perception that exam candidates do not have access to the same quality of exam preparation materials as do their ACCA and CPA exam counterparts.

There may be some truth to this perception, although the difference in the quality of study materials can be expected to narrow with the passage of time. Many of the study materials used to prepare candidates for the CAP and CIPA exams are Russian translations of English language texts. The Kieso intermediate accounting text is used for the Financial Accounting 2 course, supplemented by additional materials on IFRS, since the Kieso book gives U.S. GAAP examples. The Drury and Horngren books are used for Management Accounting 2. A more complete list of study materials is provided in the appendix. With the passage of time, local authors will publish Russian language materials to prepare candidates for the exams, which will do away with the problem of mediocre translations.

Another source of study material is the exams themselves. Two sample exams for each course are posted on the www.cipa.org.ua/eng/downloads/

website, which makes it possible for exam candidates to see in advance what to expect on the exams. The ACCA also makes its prior exams available to candidates, but the AICPA, the organization that makes the CPA exam, no longer makes its exams available.

There may be some future reciprocity between the CAP and CIPA exams and the ACCA and CPA. The ACCA has indicated that it will grant some exemptions for the ACCA exams if the organization offering the CAP and CIPA can provide evidence that its exams are the equivalent of the corresponding ACCA exams. The State of Michigan may exempt CIPA holders from the experience requirement.

Perceptions on the part of the Big-4 partners may also change as the partners from English speaking countries admit local Ukrainians to their partnerships. At present there are very few Ukrainian partners at the Big-4 firms in Ukraine. The main reason for this lack of local partners is that it takes about 10 years to train someone for partnership and not many Ukrainians have that much experience working for one of the Big-4.

As more Ukrainians achieve partnership in the Big-4, the perception of the CAP and CIPA exams may become enhanced. However, it is unlikely that the CAP and CIPA will attain strict equivalence with the ACCA and CPA in the foreseeable future. The Big-4 will likely continue to require their employees to be fluent in English, and these employees will likely continue to favor taking the ACCA and, to a lesser extent the CPA, rather than the CAP and CIPA exams, although some Ukrainian accountants may take the CAP and CIPA in addition to one of the English language exams.

However, the lack of perceived equivalency of the CAP and CIPA to the ACCA and CPA exams does not mean that the CAP and CIPA will never attain credibility or value in the marketplace. Since the vast majority of Ukrainian accountants cannot speak English well enough to pass the English language certification exams, the only game in town, so to speak, will be the CAP and CIPA exams. Because these exams test on IFRS and ISA, knowledge of these subjects will be able to spread rapidly throughout Ukraine and the other former Soviet republics, which will greatly enhance financial reporting in Ukraine. As the number of Ukrainian CAP and CIPA holders reaches some critical mass, the credibility of these certifications will be greatly enhanced. It is not necessary for the CAP and CIPA to gain equivalency with the ACCA and CPA exams to have a major and positive impact on the quality of financial reporting in Ukraine.

Curiously, some of the major resistance to the CAP and CIPA exams is coming from within the Ukrainian accounting profession. The old guard is resisting change. The younger generation of accountants, on the other hand, is welcoming the change that the introduction of the CAP and CIPA will provide. The president of the national

accounting association in Ukraine issued a letter to the regional accounting executives instructing them not to send anyone to the June 2004 CAP and CIPA exams. They ignored this command from on high. About 1,800 individuals took those exams. The regional accounting associations ignore the national association. The accounting association president, who never took an exam but who is well connected to the Finance Ministry, was so embarrassed that there was speculation he may have to resign.

Sustainability of the examination program is a concern. USAID has been subsidizing the program since its inception. However, it plans to end the subsidy and turn everything over to the ICCAA in 2005. There is a great deal of demand for these certification exams, so there is a fair probability that the program will be able to sustain itself without USAID involvement. However, financing the program is seen as a problem.

Because of the low level of income in the region, USAID hesitated to charge exam fees that were sufficient to cover all costs of the program. In fact, it did not charge any exam fees in the early stages of the program and even gave away books and other exam materials for free. These subsidies will end in 2005 and some way to meet costs will have to be found if the program is to be sustainable.

Each exam costs between \$28 and \$35 to prepare. It costs another \$7 per exam to grade. There are also some fixed costs involved, such as the cost of providing a trainer to teach each course. Students are currently charged \$7 to take each exam. The break even point is estimated to be \$30, so some way will have to be found to either bring down the cost or increase the fees charged to students. Tables 1 and 2 show the CAP and CIPA exam statistics for the June 2004 exams in Ukraine.

Table 1. June 2004 CAP Exam Statistics. Ukraine

	FA-1	T&L	MA-1	Total CAP
# participants	283	232	271	786
# passed	149	158	112	419
Pass Rate	52.7%	68.1%	41.3%	53.3%

Source: Kenney; Mino

Table 2. June 2004 CIPA Exam Statistics. Ukraine

	FA-2	MA-2	Audit	Fin	Total CIPA
# participants	183	150	137	143	613
# passed	9	31	24	19	83
Pass Rate	4.9%	20.7%	17.5%	13.3%	13.5%

Source: Kenney; Mino

As can be seen, the number of participants for the CAP exams is much higher than for the CIPA exams. That is because candidates must first pass the CAP exams before proceeding to the CIPA exams. The pass rates for the CAP exams are also much higher than the CIPA pass rates. There are two reasons for the lower CIPA pass rates. For one, the nature of the material is more difficult. The other reason is because the exam preparation courses for the CIPA exams were not as strong. In some cases,

CIPA candidates had to study on their own without the benefit of preparation classes (Kenney 2004).

Table 3 shows the statistics for the September 2004 CAP exam in Ukraine. The level of participation for the September 2004 exams is much lower than for the June exams because the September exams were offered too close to the summer vacation. The CIPA exams are offered just twice per year, in June and November. Thus, CIPA exam statistics are not given for the September 2004 exam.

Table 3. September 2004 CAP Exam Statistics. Ukraine

	FA-1	T&L	MA-1	Total CAP
# participants	95	103	122	320
# passed	47	55	57	159
Pass Rate	60.3%	63.2%	58.8%	60.7%

Source: Kenney

The results for the November 2004 CAP and CIPA exams were not available by the deadline for submitting this paper. However, statistics on the

number of exam participants were available. The following tables summarize the turnout statistics for the November CAP and CIPA exams in Ukraine.

Table 4. Turnout Statistics. CAP Exams in Ukraine. November 2004

City	Financial Accounting 1	Managerial Accounting 1	Tax & Law	Totals
Dnepropetrovsk	95 (21.7%)	34 (10.7%)	40 (13.6%)	169 (16.1%)
Donetsk	48 (11.0%)	42 (13.2%)	39 (13.2%)	129 (12.3%)
Ivano-Frankovsk	38 (8.7%)	18 (5.7%)	26 (8.8%)	82 (7.8%)
Kharkov	58 (13.2%)	58 (18.2%)	47 (16.0%)	163 (15.5%)
Khmel'nitsky	16 (3.6%)	14 (4.4%)	14 (4.8%)	44 (4.2%)
Kiev	156 (35.6%)	117 (36.8%)	109 (37.1%)	382 (36.4%)
Odessa	27 (6.2%)	35 (11.0%)	19 (6.5%)	81 (7.7%)
Total	438 (100.0%)	318 (100.0%)	294 (100.0%)	1050 (100.0%)

Source: Kenney

Table 4 shows that a total of 438 individuals took the Financial Accounting 1 exam in Ukraine and that the largest number of exam takers (156) was in Kiev. More than 35 percent of the total exam takers for this exam were in Kiev, which is a significant number, and also a revealing number. While it could be expected that Kiev would be the largest exam center, what is also significant about this statistic is that nearly two-thirds of all exam takers took the exam in a city other than Kiev. This statistic reveals that the regions outside of Kiev are not accounting wastelands. A different conclusion might be reached if one were to look at other information. For example, all of the Big-4 accounting firms have offices only in Kiev and the

ACCA exams are offered only in Kiev. If one were to consider only this information, the conclusion might easily be drawn that Kiev is the only city in Ukraine where IFRS knowledge exists. But the CAP and CIPA exams are offered in 7 Ukrainian cities and most exam takers took the exam in a city other than Kiev. Thus, the accounting profession in Kiev does not have a monopoly on accounting expertise. Knowledge of IFRS and ISA are spreading to the regions outside of Kiev, a fact that would not be readily apparent if one were to confine the analysis to looking only at the locations of the Big-4 accounting firms and ACCA exam centers.

Table 5 shows the turnout statistics for the CIPA exams in Ukraine.

Table 5. Turnout Statistics. CIPA Exams in Ukraine. November 2004

City	Financial Accounting 2	Managerial Accounting 2	Audit	Finance	Totals
Dnepropetrovsk	52 (37.4%)	45 (36.6%)	21 (16.9%)	33 (31.1%)	151 (30.7%)
Donetsk	17 (12.2%)	9 (7.3%)	12 (9.7%)	12 (11.3%)	50 (10.2%)
Ivano-Frankovsk	0	6 (4.9%)	14 (11.3%)	3 (2.8%)	23 (4.7%)
Kharkov	0	25 (20.3%)	11 (8.9%)	11 (10.4%)	47 (9.6%)
Khmel'nitsky	0	6 (4.9%)	3 (2.4%)	2 (1.9%)	11 (2.2%)
Kiev	70 (50.4%)	29 (23.6%)	40 (32.2%)	27 (25.5%)	166 (33.7%)
Odessa	0	3 (2.4%)	23 (18.6%)	18 (17.0%)	44 (8.9%)
Total	139 (100.0%)	123 (100.0%)	124 (100.0%)	106 (100.0%)	492 (100.0%)

Source: Kenney

Table 5 shows that Kiev again tended to dominate in terms of exam takers. However, Dnepropetrovsk actually had more exam takers for the Managerial Accounting 2 and Finance exams than did Kiev. Another fact that Table 5 reveals is that the number of CIPA exam takers was much lower than the number of CAP exam takers. The probable reason for this lower turnout is because candidates must first pass the CAP exams before they can sit for the CIPA exams. The CAP exams serve as a screening process.

Finance Certification

The Kyiv Investment Management Institute (KIMI) is the official training center for the Ukrainian Society of Financial Analysts. It is the only exam site in Ukraine for the CFA exam. The CFA exam is given twice a year internationally but only once a

year, in June, in Ukraine. KIMI proctors the exam but does not prepare students to pass it. The Association of Certified International Investment Analysts (CIIA) does the training. The CIIA is in about 70 countries. Exams are offered in 9 languages, including Russian. About 100 people took the CFA exam in Ukraine in June 2004. There is also a certification in Financial Risk Management (FRM) but there is not much demand for this certification at the moment. KIMI is trying to establish national finance qualifications in addition to the international qualifications. There are four levels in finance and financial analysis, all offered in Russian. The exams are devised by KIMI specialists.

KIMI offers several programs to prepare students for the various accounting and finance certification programs and also offers the MBA as a branch of the Kiev Business School. There are two versions of the MBA program. The National

Advantage MBA is taught in Russian. There is also an MBA taught in English under arrangement with Stanford University, some universities in Holland and some local experts, who provide the training.

KIMI also offers a five-year program that covers the topics that are on the CFA exam. CIAA modules are also integrated into the curriculum. Students who already have a five-year degree can earn a second degree in two years. KIMI is also developing educational modules for the CAP and CIPA exams. Three CAP modules were incorporated into their first degree program as of September 2004.

Taxation

The accounting system in Ukraine is driven by the tax rules. Ukrainian tax officials are not concerned with financial accounting rules, whether Ukrainian or international. The same situation exists in Russia (McGee and Preobragenskaya, 2005).

Although accounting firms in Ukraine can develop a tax practice, and while there are tax clients to be had, many Ukrainian enterprises prefer to pay the tax authorities directly rather than some accounting firm to make sure they won't have any tax problems. From the interviews it was unclear whether these payments to tax officials were for consulting or bribes but the perception was that it was a little bit of both.

Ukrainian national financial reporting standards are very flexible, according to some interviewees. Where there are options, Ukrainian firms almost always choose the option that is close to, or identical to the tax rules. Of course, some firms do not follow the national standards at all. There is a tendency to use the tax rules for financial reporting. This tendency causes some problems at times. For example, the tax rule allows companies to deduct the cost of inventory when they pay for it, even if they have not yet received it. That is because the tax rules often follow a cash basis approach rather than the accrual basis. The present tax system has been evolving since about 1993. The most rapid changes have taken place since 2001. The tax law is now 60-70 percent understandable, according to one interviewee. The tax law is basic and subject to interpretation. The law as applied is different from the law as written. There is no precedent and tax court cases are not published. One must find out about them informally.

Corporate Tax

The present corporate tax rate is 25 percent. It was 30 percent in 2003. It was reduced to enhance incentives for foreign investors. The starting point for computing taxable income is financial statement income, followed by many adjustments. Large companies make these adjustments. Small companies prefer to keep two sets of books, one for tax and one for financial reporting.

There are some nondeductible expenses, such as advertising and publications. Although advertising costs are not deductible or amortizable, companies can deduct the cost of hiring an advertising agency. Thus, rather than incur the cost of advertising themselves, they hire an advertising agency to do it for them, which enables them to deduct the cost.

There are no advance rulings. If the tax authorities give a company a written statement that something is deductible this year, the company cannot use that document next year to justify the same deduction. Other companies also cannot use it. There is no precedent. Losses can now be carried forward indefinitely. Under the former rule there was a five-year maximum. There was a feeling that the law needs to be more transparent and more sophisticated, especially in the areas of transfer pricing and thin capitalization. It was also thought that the law needs to be applied more consistently.

Personal Income Tax

The rate used to be progressive with a top rate of 40 percent. Ukraine now has a flat rate of 13 percent. There is an exception for individuals who are temporarily in Ukraine (26%). Interest is excluded from tax. Dividends and royalties are taxed at 13 percent. Capital gains are taxed as ordinary income (13%) with no adjustment for inflation. The tax rate is expected to increase to 15 percent in 2006. A person is a tax resident if in Ukraine for 183 days. If so, he is subject to worldwide taxation. It is not clear how income from other countries is taxed.

More people are now paying taxes. Tax officials are not looking into where unreported income came from in prior years, which amounts to a sort of unofficial tax amnesty.

VAT

The Value Added Tax (VAT) rate is now 20 percent but will be reduced to 18% and perhaps later to 15%. The rate is 0% for export services and medicines. There is no exemption for food.

The Ukrainian VAT is based on the EU 6th Directive. It has been referred to as the black sheep of taxes in Ukraine, the bad tax among the good taxes. The law is badly applied and poorly administered, according to one of the tax specialists interviewed. Ukraine has a huge amount of VAT tax refunds due to taxpayers, about \$10 billion collected between 2000 and 2004, but the government does not like to pay refunds, so the refunds have not been made. The IMF gave the government the funds needed to pay the refunds, yet the refunds have not been paid, which is causing the IMF to be very upset.

There is a scheme to convert VAT refunds into government bonds as a means of payment over five years. This has created a secondary market in VAT bonds, which sell at a 30% discount. The bonds are being sold to financial institutions.

The VAT rules place a tremendous burden on banks, which need to have separate VAT accounts set up. The banks are liable for those accounts. The banks have, in effect, become tax collectors for the state. There is a big debate over this issue. Various proposals have been made and later taken off the table. Several laws have been introduced. It was the opinion of at least one tax specialist that these new laws, if enacted, will impose a huge burden without solving the problem. The VAT is expected to be a big problem for the next few years, at least. One problem that will not be solved in the near future is the place of supply rules. These rules are not clearly defined. The VAT law appears to be stagnant. It is not getting worse but it is not getting better either.

Tax Evasion and Tax Planning

Some individuals and companies pay a bribe for the tax officials to lose their file, with the result that they don't have to pay taxes. Some people build a relationship with the tax authorities. They negotiate taxes, an approach that would be unheard of in most developed countries, but a practice that is fairly common in many developing countries.

As taxpayers become familiar with the tax law they can do tax planning, which is a new concept. There is a special rule for entrepreneurs. They can pay a flat tax of \$200 a month regardless of income. Some individuals try to qualify as entrepreneurs rather than employees so that they can pay the \$200 per month. This technique is being used less frequently now that there is a 13% flat tax. Tax evasion in customs is still widespread. Tax evasion is common in other areas as well. Punishment for evasion depends on the region. There is a 100% maximum penalty. However, taxpayers can pay a 5% penalty if they resubmit their tax return and pay the tax due. The tax specialist who mentioned this point said he could not think of anyone who went to jail for tax evasion. Cases are generally settled out of court. The fairness of the court depends on the judge, the size of the case and how hard the taxpayer is willing to push. Sometimes making a contribution to the judge helps. There is a general feeling that the judge will rule in favor of the government.

Sometimes bribes are paid in the form of advertising. A company pays a large advertising fee but receives little or nothing in return.

Social Security

Payments to private pension funds are not yet deductible, but payments to the state pension fund are deductible. The employer contribution to the state fund is 35-37% of the first 2600 gribnas per month [5.3 gribnas to the dollar]. The employee portion is 3%. It is now possible to make contributions to a private pension fund. However, there are no regulations on how to register a private pension fund. Once regulations are written, it is

thought that pension funds will emerge. The age to qualify for a pension is 55 for women and 60 for men. People can continue to receive a pension if they work beyond pensionable age. The amount of their pension is not enough to live on, about 160 gb per month, or \$30. People cannot hold investments in a foreign country without approval of the Ukrainian National Bank. They cannot invest in foreign pension funds.

Other Tax Topics

It is difficult to guess how the tax authorities will interpret the law because the law is unclear and the law, as applied, is often different from the law as written. Tax forms are easy to understand but there are too many of them. The corporate income tax is collected quarterly. The VAT is collected either quarterly or monthly. Individuals submit their tax returns on April 1. Corporate tax audits are regular, every year or two. The government must give 10 days notice. Audits are of specific items. The general director and the chief accountant can be personally liable for taxes. As a result, some companies don't take all legitimate deductions. Companies pay higher taxes so that corporate officials can avoid personal liability. Whether this practice constitutes a breach of fiduciary duty is an open question. Losses in four consecutive quarters lead to an automatic audit. Companies that have no tax liability are encouraged to pay taxes anyway to get the auditor off the hook with his boss. Auditors are under pressure to collect taxes. Auditors exert extra pressure to squeeze taxes out of people before elections to pay for election campaigns. The World Bank is helping to fund tax modernization. The level of tax education leaves something to be desired. Officials know the basics but not the more technical items. The World Bank is offering training to tax officials. The transfer pricing rules are often applied incorrectly to transactions involving unrelated parties within Ukraine (transfer pricing rules should apply only to related parties). Foreign companies are not taking advantage of the transfer pricing rules and the Ukraine's relatively low tax rates. The Big-4 accounting firms have given advice about pending tax legislation but their advice is usually ignored. They want to receive drafts of pending legislation so that they can provide comments and suggestions, a practice that is common in the developed market economies, but absent in Ukraine. This situation is starting to change, but the practice of providing drafts is still far from a regular practice. Parliament does not ask for feedback. It is an alien concept for them. Members of Parliament do not have that mindset. Also, there is no comment period for pending legislation, since providing comment periods is also an alien concept in Ukraine. The corporate tax system is moving toward an accrual basis but it is not there yet. Inventory is deducted as purchased, with adjustments

for the beginning and ending balances. But some companies do not make these adjustments.

There are several book/tax differences that the tax authorities do not know how to deal with. In the case of inventory, for example, adjustments have to be made between weighted average and FIFO but the tax officials do not know what adjustment must be made. They accept whatever adjustments the companies make. The currency exchange rules are different for book and tax purposes. The tax authorities accept whatever adjustments companies make because they do not understand the rules. Tax officials accept taxpayer calculations.

There is no estate tax in Ukraine. Inheritances are considered income and are taxed as such. An inheritance to the spouse is exempt from tax.

Concluding Comments

The accounting reform process in Ukraine is like the reform process in Russia in many ways. Both countries got off to a slow start and both experienced problems translating accounting materials into the local language. Both countries experienced some difficulty implementing the new accounting into their university curriculum. Neither country has an internationally recognized accounting certification. Many practitioners in both countries do not have much knowledge of IFRS and many do not think that such knowledge is required. In both countries, the demand for IFRS financial statements comes mostly from the international investment community, which often requires IFRS prepared financial statements as a condition of investment. Both countries have a low level of corporate governance (McGee and Preobragenskaya, 2004). However, there are also some differences between the Russian approach and the Ukrainian approach. Whereas in Russia much of the accounting change started at the top, from the government, accounting change in Ukraine started at the grass roots, from the private sector accounting profession, at least to a certain extent. That is true of accounting certification, at least. The driver of professional accounting development in Ukraine was the private sector accounting profession. Russia, on the other hand, does not have an effective developed private sector accounting body at the national level. Russia's accounting profession consists of a plethora of poorly organized and largely ineffective local accounting organizations, the leaders of which often use their position to further their own interests rather than that of the accounting profession. That is not to say that some leaders of the various Ukrainian accounting organizations do not also use their position to further their personal interests. But the situation in Russia seems to be more obvious, since there is a near total absence of public interest present in the Russian accounting organizations.

Another difference is that Ukrainian tax authorities do not require the submission of financial statements, whereas Russian tax officials do.

However, the Russian tax officials require financial statements mostly for statistical purposes. Financial statement numbers are not used in either country to determine tax liability.

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23. Preobragenskaya, Galina G. and Robert W. McGee (2005). Recent Developments in Accounting Education in Russia. In Ilan Alon and John McIntyre, editors, Business Education in Developing Countries: Asia, Europe, Latin America, Middle East and Africa, M.E. Sharpe.
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25. Ukraine Accounting Reform Project

Appendix

Exam Materials for the CAP and CIPA Exams

The following study materials are available in the Russian language and are used to prepare candidates for the CAP and CIPA exams.

Financial Accounting 1

Needles, Anderson and Caldwell, Accounting Principles 4th edition [main text]

Golov, S.F., International Accounting Standards 2001, Kiev, FPBA Ukraine

Welch, Glen., Daniel G. Short. Elementary Accounting, Kiev, Asnovi, 1999

Golov, S.F., Kostuchenko, V.M. Accounting and International Standards: Implementation and Comments, Kiev, Libra, 2001

R. Anthony, G. Reese, Accounting, Situation and Examples, Moscow, Finance and Statistics, 1998.

Management Accounting 1

Hornngren, C.T., Foster, G. Accounting: A Managerial Emphasis, 6th edition. [main text]

Nikolai O.E., Shuskova, T.V. Management Accounting, 2nd ed., Moscow, Editorial URSS, 2001.

Suvchuk, V.P. Financial Management of Enterprises: Practical Cases and Analysis of Real Business Situations, Kiev, Maximum, 2001.

Golov, S.F. Management Accounting, Kiev, Libra, 2003.

Needles, Anderson and Caldwell, Accounting Principles 4th edition, Moscow 1997.

Tax and Law

36 tax items and 133 law documents and 49 other recommendations items listed as sources

Financial Accounting 2

Kieso, Weygandt and Warfield, Intermediate Accounting. [main]

Golov, S.F. International Accounting Standards 2001, Kiev, FPBA Ukraine

Welch, Glen, Daniel G. Short. Elementary Accounting, Kiev, Asnovi, 1999

R. Anthony, G. Reese, Accounting, Situation and Examples, Moscow, Finance and Statistics, 1998.

Needles, Anderson and Caldwell, Accounting Principles 4th edition, Moscow 1997

Golov, S.F., Kostuchenko, V.M. Accounting and International Standards: Implementation and Comments, Kiev, Libra, 2001

Management Accounting 2

Drury, Management and Cost Accounting, 5th edition [main text]

Hornngren, C.T., Foster, G. Cost Accounting: A Managerial Emphasis, 6th edition. Sokolov, editor.

Nikolai O.E., Shuskova, T.V. Management Accounting, 2nd ed., Moscow, Editorial URSS, 2001.

Suvchuk, V.P. Financial Management of Enterprises: Practical Cases and Analysis of Real Business Situations, Kiev, Maximum, 2001.

Golov, S.F. Management Accounting, Kiev, Libra, 2003.

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Finance

VanHorne, G.K., Vahovich, G.M. Elementary Financial Management, 11th edition [main]

Suvchuk, V.P. Financial Management of Enterprises: Practical Cases and Analysis of Real Business Situations, Kiev, Maximum, 2001.

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Carana Corporation/USAID, RPC, Financial Management, Moscow 1989.

Carlin, T.P., Makmin, A.R. Financial Statement Analysis on the Basis of GAAP, Moscow Infra 1998.

Lukasevich, Analysis of Financial Operations, Moscow: Financi 1998.

Brigham, U. Gapenski, L. Financial Management 2 parts, St. Petersburg, Economical School 1997.

Bertstein, L.A. Financial Statement Analysis, Moscow: Finance and Statistics 1996.

Audit

Arens, Loebbecke, G.K. Auditing, 5th edition [main]

Campbell, D. Fogarty, T.G. Execution of Auditing Opinion, 5th edition [main]

International Auditing Standards and Professional Ethics Code, 2001 Kiev, Auditing Chamber of Ukraine, 2003.