
Importance of the Application of International Accounting Standards in Kosovo Businesses

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The adoption of International Accounting Standards (IAS) is an example of accounting standardization among countries with different institutional frameworks and enforcement rules. IAS, though, create a common language for defining, interpreting and publication of financial statements in the whole world. Furthermore, their aim is “to provide a standardized and coherent sight of the companies to the shareholders and investors”. After the war in Kosovo has been a positive move towards the development of accounting. Accounting system based on IAS cannot be avoided by Kosovo as part of the European and international transactions.

However, financial reporting situation of businesses in Kosovo continues to be unsatisfactory. Implementation of accounting requirements among businesses remains a challenge and there was little improvement in recent years. The Kosovo Financial Reporting Council (KCFR) as a regulatory body that sets accounting standards has neither the human nor the technical capacity to meet its responsibilities.

The purpose of this paper is to provide a clearer picture on the financial reporting environment in Kosovo, the challenges facing Kosovo in terms of financial reporting and the importance of adopting International Accounting Standards in Kosovo businesses.

Keywords: *International Accounting Standards, Kosovo Accounting Standards, Financial Reporting, Kosovo Financial Reporting Council.*

Review of the literature on the effects of adopting IAS's in business

Although the primary objective of IAS's is presenting a fair picture of the businesses through the financial statements, they have broader impact on business activity. Karamanou and Nishiotis¹ found that the adoption of IAS, because of the higher disclosure required, is associated with viewing the firm as entity with high value. Wilson emphasizes the improved market communication of the firm which has adopted IAS, because every disclosure should be further explained by the management². Some articles found that greater disclosure under IAS decreases the cost of capital. For instance, Easley and O'Hara state that firms that applied IAS have the opportunity to impinge on their cost of capital, through the IAS selection and the adopted policies of corporate disclosure. Furthermore, Gebhardt et al confirmed that firms with accurate information provided on IAS basis, "enjoy a lower implied cost of capital".

Although the adoption of IAS's has broad impact, the core influence on a business is in its financial statements. Some articles have examined the effects of adopting IAS on financial statements, particularly on some accounting measures and financial ratios. For that purpose, for instance, Hung and Subramanyan have used a sample of 80 firms in Germany that have adopted IAS for the first time and found some significant results. Specifically, they found that the total assets and the book value of equity are considerably higher under IAS and that the latter plays more significant, while the former less significant "valuation role under IAS". Finally, they

¹ Easley, D. and O'Hara, M. (2004) Information and the Cost of Capital. Cited in: Karamanou, I. and Nishiotis, G. (2005) The Valuation of Firm Voluntary Adoption of International Accounting Standards. Working Paper, University of Cyprus, p.1- 34.

² Wilson, A. (2001). IAS: the challenge for management. Cited in: Rudhede, P. And Wahlberg, J. (2003) Implementation of IAS in SKF. Unpublished MSc, dissertation, Graduate Business School – Göteborg, [on line].

have concluded that "IAS emphasizes fair values and balance sheet valuation"³.

Impact of IAS's in accounting system development and applicability in Kosovo

After the war in Kosovo has been a positive move towards the development of accounting. Accounting system based on IAS's cannot avoid nor Kosovo as part of the European and international transactions. Kosovo Central Authority for the issuance of the Kosovo Accounting Standards (KAS) is Kosovo Financial Reporting Council (KCFR). So far this council has issued 19 KAS which are in harmony with IAS⁴. IAS's find wide application in the Republic of Kosovo, because they have contributed to the improvement and harmonization of financial reporting worldwide.

Local and International Standards of Accounting are used in the following ways:

- a) As national requirements, often as a national process;
- b) As a basis for all or some national requirements;
- c) As an international benchmark of comparison for those countries that develop their requirements;
- d) From the regulatory authorities for local and foreign companies;
- e) From companies themselves.

All companies that have an annual turnover of over 50,000 euros in the preparation of financial statements should apply IAS's.

IAS's and Financial Reporting in Kosovo

Based on Article 3 of the Law No.04/L -014 on "Accounting, Financial Reporting and Audit" Business Organizations prepare financial statements as follows:

- a) Business Organizations shall prepare general purpose financial statements in accordance with this law;
- b) Business Organizations, which conduct their activities by social or public means, shall prepare general purpose financial statements in accordance with this law;

³ Marjan Petreski, The Impact of International Accounting Standards on Firms.

⁴ Kontabiliteti Financiar, prof.dr Rrustem Asllanaj, (Prishtinë, 2010), faqe 35 dhe 36.

- c) Pursuant to Article 5. of this law, Business Organizations, while preparing general purpose financial statements, shall apply the accounting standards, regulations and administrative instructions issued by KFRC;
- d) Notwithstanding paragraph 3. of this Article, Business Organizations may prepare financial statements fully in compliance with IFRS and inform KCFR⁵.

Implementation of IAS's in Kosovo

For the application of these accounting standards in the Republic of Kosovo are a number of rules as:

- a) Large business organization in Kosovo in accordance to Article 4 of this law should apply IAS/IFRS as well as interpretations, recommendations and necessary guidance issued by International Accounting Standard Board which shall be approved by KCRF;
- b) All business organization in accordance with Article 4 paragraph 1. sub-paragraph 1.1. and 1.2. and 1.3. registered as limited liability companies or shareholder companies shall prepare financial statements in accordance with International Standards for Financial Reporting, International Accounting Standard Board which shall be approved by KCRF;
- c) Consolidated financial statements of business organization in accordance with paragraph 1. Of this Article shall be in accordance with Directive 78/660/EEC of EU and IFRS;
- d) The financial statements referred to Article 4 paragraph 1 sub-paragraph 1.1. of this Law shall be audited by statutory audit firms that are licensed to carry out statutory audits by the competent authorities as defined in this law;
- e) The financial statements referred to Article 4 paragraph 1. sub-paragraph 1.2. of this Law shall be audited by statutory audit firms or Auditors that are licensed to carry out statutory audits by the competent authorities as defined in this law;
- f) All statutory audits in Kosovo, which include all audits required under this law, and external independent audits of other business or

⁵ Law No.04/L -014 On Accounting, Financial Reporting and Audit, page 3.

not-for-profit, socially owned or publicly owned enterprises or other entities as mandated by other applicable laws in Kosovo shall be carried out in accordance with the International Standards of Auditing (ISAs), and related interpretations, guidance and pronouncements of the IAASB, and by Auditors that are approved to carry out statutory audits by the competent authorities as defined in this law;

- g) The competent authority for the transposition of International Standards of Auditing and related interpretations, guidance and pronouncements of the IAASB shall be the KFRC.

The findings of the Report on the Observance of Standards and Codes (ROSC) 2012

This report (ROSK 2012) is an update of the 2006 Report on the Observance of Standards and Codes (ROSC) on Accounting and Auditing in the Republic of Kosovo. The main objective of the 2006 ROSC was to assist the then-existing Kosovo Provisional Institutions of Self-Government in strengthening Accounting and Auditing practices, in order to support sustained economic growth and improve the competitiveness of local enterprises.

ROSK 2012 has found that although consistent support for reforms has been provided by the World Bank, the European Commission and USAID since 2006, the landscape for corporate financial reporting has not changed dramatically since the last ROSC.

On the compliance side, the most significant change since 2006 is the improvement within the banking supervisor. Enforcement of accounting requirements among non-banking entities remains a challenge and there has been little improvement since 2006. The financial reporting regulator, the Kosovo Board for Standards on Financial Reporting (KBSFR), which was never fully functional, was replaced by the Kosovo Financial Reporting Council (KFRC) in 2011. No significant change, however, was made to the operating model of the regulator and, unless this is addressed, there is a distinct possibility that KFRC will follow in the footsteps of KBSFR. To discharge all these responsibilities, the KFRC must have an extensive technical expertise at its disposal. Currently, the KFRC does not possess such expertise. Still need to take steps towards the establishment of a quality

assurance system in accordance with the Statutory Audit Directive in EU. Without a functioning standard-setter and regulator, the Kosovo financial reporting regime has not been able to play any role in attracting inflows of foreign direct investment⁶.

The Law on Financial Reporting requires that the KFRC issue accounting standards that comply with IFRS. As was the case in 2006 with the KBSFR, the current structure and resources of the KFRC are inadequate to enable it to fully discharge this mandate. The KFRC is the standard setter and regulator for non-financial sectors. The wording of the Law on Financial Reporting does not mention Kosovo Accounting Standards (KAS) in Article 5 (applicable accounting standards), although Article 14 makes KFRC responsible for the development of KAS. In March 2012, the KFRC issued an administrative instruction clarifying that KAS are applicable for 2012 to all companies; IFRS should be applied in future periods, starting January 1, 2013. As well, the Law on Financial Reporting mandates that the KFRC collect and publish the financial statements of those business organizations that are required to make public their financial statements. Currently, KFRC has neither the human nor the technical capacity to discharge this additional responsibility.

Two sets of accounting standards have been in effect in Kosovo since 2001: (i) the Kosovo Accounting Standards (a selection of modified "2001 IAS"), or "KAS," and (ii) IFRS. KAS have never been updated. The review of KAS was conducted in 2006 as part of the first Accounting and Auditing ROSC. As was to be expected, it identified significant differences between KAS and IFRS already at that time.

Conclusions

Several conclusions can be drawn from the arguments provided above. The first and most directly effect of the application of IAS's is on financial statements. Each company can significantly influenced by certain standards and these effects should be taken into consideration. Business organizations in Kosovo should advance in the preparation of financial statements in accordance with IAS's. Over financial reporting, business organizations must

⁶ Report on the Observance of Standards and Codes (ROSC) on Accounting and Auditing in the Republic of Kosovo, June 2012.

disclose all elements of financial statements, in order to be complete, accurate and reliable.

But, as mentioned above, the adoption of IAS's except direct consequences has also indirect consequences on firms. In this line of thinking, their effects on management and decision making process could be considered as important, than their impact on the cost of capital, on the availability of relevant and crucial information, on the management's accountability etc.

To sum up, the effects of adopting IAS on firms are multiple, positive and noteworthy. The very adopting process is accompanied with many obstacles, but then, IAS complied accounting supplies more reliable picture for the business, and therefore contributes for a higher value of the firm.

The above elements are some of the conclusions that were identified in the study of this topic on importance of application of international accounting standards in Kosovo businesses.

I consider it necessary to give some recommendations for future related to the areas that should be oriented in order to influence on the elimination of barriers on the regular financial reporting. Therefore, i think that the focus should be:

- a) Developing a strategy to improve the financial reporting infrastructure in Kosovo;
- b) Taken initial steps towards establishing a sustainable system of quality assurance for the functioning of legal auditing;
- c) Developing a transparent financial reporting that helps foreign investment;
- d) Creating a strategy to improve the performance, functionality and capacity of KCFR;
- e) The organization of continuing professional education for business during the year, presenting and interpreting any changes of IAS's and KAS's on financial reporting.

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