

# Japan's Assistance Programs for Ukraine —Educational Projects in Business Accounting and Market Economy—

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## Abstract

This paper introduces and discusses lectures in business accounting and market economy for the former Soviet Union as follows:

- an introduction of important accounting concepts
- a brief overview of the differences between accounting practices in the former Soviet Republics and Japanese and international standards.
- the expectations placed on the Japan Centers in providing future assistance in spreading accounting knowledge and practice in the region.

### 1. Japan's Technical Assistance programs for Ukraine and the former Soviet Republics

In the aftermath of the collapse of the Soviet Union in 1991, the former republics made considerable efforts towards an increased social and economic transformation. They embarked on a program of reforms with the purpose of achieving a smooth transition to the system of market economy. As well as other developed countries, the Japanese government played and is still performing an important role of assistance for Ukraine and other former Soviet republics. For instance, Japan has been providing professional training, the purpose of which is to assist in the transfer of Japanese and international experience and know-how in the fields of economic planning, accounting and business administration.<sup>[1]</sup>

### 2. The Role of Japan Centers

The Japan Centers have been established in various regions to provide training to individuals expected to play crucial role in facilitating, conducting or regulating economic activities in the changing market environment. The first centers were initiated at the Moscow International Business

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[1] Цели и задачи Японских центров как базы для подготовки кадров,  
<http://www.jcentersakh.ru/about.html>, 2005/02/28

School (MIRBIS) in the campus of the Russian Economic Academy named after Plekhanov in Moscow and in Khabarovsk in the autumn of 1994.<sup>[2]</sup> Afterward, other Japan Centers were established in Bishkek of the Kyrgyz Republic (May, 1995), at the Far East State University in Vladivostok (April, 1996), at Yuzhno-Sakhalinsk in Sakhalin (September, 1996), at Kiev in Ukraine (January, 1999), in Moscow State University (January, 2001), in Saint Petersburg (March, 2001), and in Nizhni Novgorod (October, 2001).<sup>[3]</sup>

At each of these centers, Japanese experts offer courses in various fields of knowledge for Russian businesspeople and researchers for the purpose of sharing both Japanese and international experience concerning activities and practices in the market economy. The centers also provide Japanese language courses, as well as seminars by local experts and specialists.<sup>[4]</sup>

### **3. From Socialism to Market Economy**

Countries in the former Soviet Union including Ukraine are making significant efforts to promote the system of market economy. For these efforts to bear fruits, it is necessary to establish a sound financial infrastructure. There are three key concepts upon which the financial infrastructure needs to be built: the bank system, the tax system, and the accounting system. It should be emphasized that these three elements do not function independently, but interdependently.<sup>[5]</sup>

As a result of this increased interest, the status of the accounting profession has been raised. For instance, a large and increasing number of students pursue studies in accounting, analysis, and auditing at the Faculty of Economics in Moscow State University. Furthermore, major international auditing firms have founded several branches and offices in Moscow, Kiev, and other big cities of the former Soviet Union. Thus, graduates from such accounting courses have high expectations for a similarly large remuneration received by their peers in Western countries. This is equally true for Ukraine.

### **4. Convergence with the International Accounting Standards**

In cooperation with OECD, CIS countries held a series of international accounting conferences on yearly basis until 1997 (Almaty, Kazakhstan (1995), Moscow (1996), and Kishinev, Moldova (1997)). In the meeting held in Kishinev (1997), there was an unanimous agreement to adopt the

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[ 2 ] "Japan's Assistance Program for Russia", Ministry of Foreign Affairs of Japan, 2000.

[ 3 ] Цели и задачи Японских центров как базы для подготовки кадров,  
<http://www.jcentersakh.ru/about.html>, 2005/02/28

[ 4 ] "Japan's Assistance Program for Russia", Ministry of Foreign Affairs of Japan, 2000.

[ 5 ] Kumiko Saito, "On the adoption of the International Accounting Standards in Russia", Reports and Discussion Papers from SRC Seminars, No. 92, Slavic Research Center, Hokkaido University, 2003 (Japanese edition).

International Accounting Standards. Finally, there was a discussion regarding the adoption of International Accounting Standards in Moscow (1998), during the international symposium organized by the Russian Ministry of Finance and the International Accounting Standards Committee.

As a participant to the international conference in Moscow (1996) and symposium (1998), and judging from these discussions, it became clear to me, that these countries were at different levels of progress towards the full adoption of international standards. The accounting reforms in Uzbekistan Republic were the most rapidly advancing of all CIS countries. For instance, the structure of the income statement had already been altered in 1996 to reflect the western format. However, although its structure was adapted to the western format, it is not possible to reject claims that issues related to content and compliance remain. In the absence of evidence, it is not clear whether the International Accounting Standards are practically and fully adopted in Uzbekistan.

#### **5. Teaching Practices in Ukraine and former Soviet Republics**

Technical assistance programs through TACIS, USAID and the Japanese government (the Ministry of Foreign Affairs, the Ministry of Economy, Trade and Industry, etc.) have been provided over the last decade. There are signs that those programs have been rather quite successful. But, there is a long way before a full-fledged efficient accounting system takes shape in the CIS countries including Ukraine.

Judging from my own experience teaching accounting and finance in various Japan centers, it is extremely important to examine in some detail, the conceptual discrepancies and differences in the practice of accounting across the former Soviet Union and Western countries. For example, there is a very significant difference between the former Soviet Union and the Western countries in relation to the "capital" and "profits" which are two of the most important concepts in accounting. It is important also to highlight the differences between accounting practice in the former Soviet Union and the International Accounting Standards.

Bearing this approach in mind, I would like to take the opportunity provided by this series of lectures which draw also from previous materials presented elsewhere, to cover issues related to the accounting transactions including the bookkeeping cycle and classification of accounts, among others.

##### **5.1. Accounting as a Global Business Language**

In terms of business, accounting should be viewed as a global language, as a means of communication. I would like to argue that although Russian, Ukrainian and Kyrgyz accounting

standards are acceptable at home countries, they still fall short of international standards. While a rich diversity remains something to be celebrated, it is also important to provide financial statements in accordance with these international standards.

Thus, this part of the lecture will be devoted to cover rather theoretical issues in accounting. It will serve the purpose of providing an outline of accounting practices, accounting standards, and accounting postulates, in relation to the former Soviet Republics. It is important to gain a proper understanding of theoretical issues because many theoretical concepts and assumptions underlie the accounting practices and standards. For instance, it is observed that many companies have gone bankrupt in the former Soviet Union over the recent years. But, without the assumption of companies being viable and operating on perpetual basis (i.e. as "a going concern") , it would not be possible in accounting to give a measure of their operating results and financial conditions or establish the financial statements.

## **5.2. Accounting Transactions**

The content of this program on accounting transactions is as follows.

- 5.2.1. The Bookkeeping Cycle
- 5.2.2. The Classification of Accounts
- 5.2.3. Cash and Deposits
- 5.2.4. Merchandising
  - 5.2.4.1. The Periodic Inventory System
  - 5.2.4.2. Costing Merchandise Inventory
- 5.2.5. Long-Term Assets
  - 5.2.5.1. Fixed Assets
  - 5.2.5.2. Depreciation
  - 5.2.5.3. Intangible Assets
- 5.2.6. Notes Receivable/Notes Payable
- 5.2.7. Other Receivables and Debts
- 5.2.8. Securities
- 5.2.9. Operating Expenses
- 5.2.10. Capital

### **5.2.1. The Bookkeeping Cycle**

In the former Soviet republics, the general journal was not used. Instead, the usage of the special journals (журнал - ордeр) was widespread. In Russia and Kyrgyzstan, there are 16

different kinds of special journal, and in Ukraine there are 18 of such. These discrepancies in journals coexist with the use of a ledger that differs significant from the Western concepts. In this ledger, accounting transactions are not recorded in accordance with the chronological order. They were recorded only on aggregate basis as the total sum and balance of each account once a month.

These different approaches are the source of much confusion amid the foreign community. It renders the task of conciliating financial statements with the International Accounting Standards difficult for accountants in the former Soviet Union.

### 5.2.2. The Classification of Accounts

There were three elements of accounts in the former Soviet Union, namely, the 'aktiv', 'passiv', and 'aktivno-passiv' accounts. But in Western countries and Japan, there are rather five classes: assets, liabilities, capital, expenses and revenue.

During the NEP (New Economic Policy) era in the early 1920's following the Russian Revolution of 1917, Galagan, Rudanovskii, Veitsman, Kiparisov and other eminent accounting scholars published some interesting works on the bookkeeping system in the Western style. But this line of thinking, which focused on individual enterprise, was viewed as incompatible with the Soviet collectivism and radical industrialism overseen by Stalin. Consequently, their accounting theory and approach were vehemently opposed and suppressed.<sup>[6]</sup> As a matter of course, this event had a resonance on academic circles.

Whereas professional accountants and university professors in the West regard the classification (the five elements of accounts) as axiomatic and is usually taken as granted, this approach constitutes rather a completely new idea for accountants in the former Soviet Union. Since, this classification is of fundamental importance and a thorough understanding is necessary in order to provide financial statements that meet international criteria.<sup>[7]</sup>

### 5.2.3. Cash and Deposits

Whereas in the Western countries cash includes cash equivalent, but in the former Soviet

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[ 6 ] Kumiko Saito, "A Historical Study on the Soviet Bookkeeping Theories in the Beginning of the 1930's and their Social Backgrounds - in reference to A.M.Galagan's theory -", Year Book of Accounting History Association, No. 8, 1990.

[ 7 ] Based on personal teaching experience, there are signs that the audience gets a better understanding of the accounting system once the five classes of accounts are thoroughly explained.

Union cash equivalent was strictly distinguished from cash. Moreover, transaction of the cash over and short in the former Soviet Union differs from in the Western countries. Concretely explaining, in the former Soviet Union the sum of the cash short was owed to the cashier. On the other hand in the capitalist countries we have been admitting cash short. Taking into account that every company should avoid risks for getting developed, I would like to explain the importance of the cash over and short.

#### **5.2.4. Merchandising**

##### **5.2.4.1. The Periodic Inventory System**

From the accounting perspective, the definition of transaction of merchandising in the former Soviet Union differs from that held across Western countries. The fundamental distinction is that there is no periodic inventory system under the approach based on three accounts: inventory, purchases and COGS (cost of goods sold) . The absence of this concept renders in turn the explanation and understanding of international accounting standards even more difficult. From my experience of lecturing at the Japan centers in Russia, there were difficulties translating the concept of periodic inventory system into Russian. Therefore, "the entry using three accounts" was translated into Russian as (запись на трех счетах) in consultation with Prof. A. D. Sheremet of the Head of the Accounting Department at Moscow State University in 1996.

Under the perpetual inventory system, the cost of each commodity should be confirmed using information provided by the journal. The use of the perpetual inventory system is usually restricted to the accounting of expensive goods: valuables, estates, etc., because it is too costly to adopt for ordinary commodities, for which the periodical inventory system is used instead. It is possible also to conceive a different approach under the periodic inventory system to adapt and account for particular conditions. For instance, an account "sales allowance" can be created in order to avoid improve sales revenues by preventing salespeople from offering excessive discount margins. Without such account of "sales allowance", it may be difficult to know the extent of realized profits.

It may be argued that the transition towards the adoption of the perpetual inventory system may be further complicated by the historical absence of the periodic inventory system in the former Soviet Union. The periodic inventory system is an important concept that underlies all financial statements in the Western accounting system, and as such it deserves a thorough explanation. During the course of these lectures, sufficient time will be allowed to the explanation of these concepts and accounting transactions in Western countries using some

case studies. This will offer also the opportunity to gain deeper understanding of the management system, management strategy and management style of Japanese and Western companies.

#### **5.2.4.2. Evaluation of Goods Inventory Costs**

Three methods of valuation (FIFO, LIFO and simple average), can be possibly used across the former Soviet Union, in order to provide some measure of inventory and assign the business costs to individual items. But, historically, the simple average method had been the most widely used. Notwithstanding the official instructions of the Ministry of Finance of the Russian Federation in July 1994 to use FIFO and LIFO as well, most companies still rely on the simple average method, out of fear that changing the inventory policy would result in higher tax payments. Therefore, it is my hope that during this series of lectures, a better understanding is gained regarding the various practices in calculating inventory and their economic significance.

#### **5.2.5. Long-Term Assets**

##### **5.2.5.1. Fixed Assets**

In the former Soviet Union republics, the revaluation of fixed assets has been so far performed several times, repeatedly. In contrast, it was carried out only once in Japan, just after World War II. Although according to the International Accounting Standards under the normal economic conditions, fixed assets should be valued using the acquisition cost, they are valued alternatively under hyperinflationary conditions. The method of revaluation under inflation in the Russia has differed from that recommended by the International Accounting Standards and this causes confusion among investors and practitioners.

The problem arises when the fixed assets is revaluated without reflecting the revaluated amount in the "capital surplus" of the equity capital as a credit item. Moreover, inconsistencies appear when the fixed assets are deleted without being accompanied by a subtraction of the equivalent amount from the capital surplus.

When analyzing the capital surplus in Russian financial statements, it is not possible to distinguish the revaluation surplus from the premium on capital stock. In addition, it is difficult to distinguish the real fixed asset from the revaluation surplus.

Though the accounting system is actually geared toward reflecting the International Accounting Standards, the financial statements of past years cannot be corrected. The comparability of the financial statements, which is required according to the International Accounting Standards, is thus not being guaranteed. Therefore, the meaning and significance of the "released financial statements" is not as acceptable without caveats.

In order to understand the financial statements correctly, the analysis should not be confined and limited to the contents of such statements as additional information should be extracted from the journals as well. Of course, the access to company information may be limited with respect to general investors. But, this is not true for the government.

As such, it is important to draw attention to the features of the journal system in order to understand the extent of accuracy of information released through the financial statements.

#### **5.2.5.2. Depreciation**

In Ukraine, Russia, Kyrgyzstan among others, the calculation of the amount of depreciation obeyed the following rules.

- The residual value amounting to 10% of the acquisition cost.
- The straight-line method was generally adopted. It is noted that under inflationary conditions, the straight-line method is very advantageous for companies. In contrast, the accelerated method is more favorable for the tax authorities.

Despite the official recognition of the accelerated method, very few companies have adopted it again out of fear of increased tax payments. Given the increased pressure to adopt international standard, these conditions are not expected to remain for much longer.

#### **5.2.5.3. Intangible Assets**

During the Soviet era, there were no intangible assets. But recently, they have come to appear in the financial statements of companies in the former Soviet Republics. It is noted here that together with this development, the depreciation of intangible assets has to be considered as well.

#### **5.2.6. Notes receivable/ Notes payable.**

As the credit among corporations increases in volume, the business transactions using notes are steadily gaining in importance. The former Soviet Republics are faced with the challenges of

increased trading activity based on transactions using notes. The accounting system should be well equipped to deal with such notes-based transactions in order to correctly reflect the financial conditions of companies.

#### **5.2.7. Other Receivables and Debts**

Transactions with other receivables and debts in the former Soviet Republics are different from those observed in Western countries. The balancing figure is not certain, because accounts sometimes have both debit and credit characters. Therefore, there is a potential for confusion among Western professionals regarding the disclosed figures on Other Receivables and Debts. Given the importance of this problem, some explanation will be provided regarding the conventional accounting transactions in Japan and Western countries.

#### **5.2.8. Securities**

In the former Soviet Republics, the stock exchange system is undergoing the development process aimed at facilitating the transition toward the system of market economy. Financial transactions based on securities issuance and trading are very characteristic of the market economy. As such, further explanation will be provided regarding financial securities, which constitute an important item in the classification of accounts.

#### **5.2.9. Operating Expenses**

In the Soviet era, depreciation was not recognized as expenses, but as funds, or reserves. Given this important distinction, the issue of operating expenses under the system of market economy will be also discussed in some detail.

#### **5.2.10. Capital**

For a long period following the collapse of the Soviet Union, the concept of undistributed profits in the former Soviet Union was completely different from that known in Western countries. Indeed, while undistributed profits are conventionally defined as the after-tax profits, the concept in the former Soviet Republics except for Uzbekistan, refers rather to pre-tax profits.

Capital is one of the most important economic and accounting concepts under the system of market economy, because there was no capital per se in socialist countries.

In discussing issues related to equity capital, it is important also to examine and understand

the relationship between shareholders and managers, agency costs and corporate governance.

### **5.3. Closing process and Making the Financial Statements**

Based on the above discussion of accounting transactions, the closing part of this series of lectures will deal with the establishment of financial statements. Attention will be drawn in particular to the issue of whether expenses and the revenue should be deferred or accrued based on accrual-basis accounting. This is one of the most important and crucial parts of the lectures.

## **6. Concluding Remarks**

This series of lectures is concerned with the accounting problems and issues that usually accompany the shift from the Soviet-era accounting practices to the international accounting standards. Judging from the personal experience of teaching accounting in the Japan Centers at various countries of the former Soviet Union, it is clear that refinement of accounting rules and regulations is not enough. Even if the accounting system is perfectly adjusted to reflect international standards, a successful adaptation to the requirements of market economy is not guaranteed without the proper training of accountants and practitioners practice. Though Uzbekistan's accounting system has undergone the most radical transformation in terms of regulation and standard-setting, it is still facing the challenges of implementation.

Given the prevailing conditions, there is a need for and higher expectations placed on Japan to provide further assistance in terms of accounting training for the former Soviet Union.