

# PRACE NAUKOWE

Uniwersytetu Ekonomicznego we Wrocławiu

# RESEARCH PAPERS

of Wrocław University of Economics

Nr 375

## Quantitative Methods in Accounting and Finance

edited by  
Edward Nowak  
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Publishing House of Wrocław University of Economics  
Wrocław 2015

Copy-editing: Elżbieta i Tim Macauley

Layout: Barbara Łopusiewicz

Proof-reading: Barbara Cibis

Typesetting: Agata Wiszniowska

Cover design: Beata Dębska

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Wrocław 2015

**ISSN 1899-3192**

**ISBN 978-83-7695-427-1**

The original version: printed

Printing: EXPOL, P. Rybiński, J. Dąbek, sp.j.  
ul. Brzeska 4, 87-800 Włocławek

## Table of contents

<b>Preface</b> .....	7
<b>Natalia Bielous:</b> A method of estimation of resource component of the economic security system.....	9
<b>Magdalena Chmielowiec-Lewczuk:</b> Insurance Contracts Project for accounting .....	18
<b>Anna Isayeva:</b> The normative legal regulation of accounting for financial investments .....	29
<b>Marcin Klinowski:</b> Management accounting evolution as a result of management by projects.....	37
<b>Mykhailo Kuzub:</b> The implementation and functioning of an internal audit in an agriculture enterprise .....	45
<b>Lesya Leshchiiy:</b> Evaluation of managerial flexibility: the method of real options .....	55
<b>Michal Maliuzenko:</b> Crypto-currency peering as an investment instrument..	63
<b>Ruslan Motoryn:</b> Estimate of financial stocks in the household sector .....	70
<b>Tetiana Motoryna:</b> Methodical approaches for the calculation of indicators of financial flows in the household sector.....	77
<b>Vasil Mukoviz, Inna Komarova:</b> Methodological approach to the evaluation of the investment supporting economic development of agricultural enterprises under conditions of uncertainty of a competitive environment.....	86
<b>Maria Nieplowicz:</b> The use of the Balanced Scorecard in the implementation of the strategy to support the development of sport and recreation in the City of Lublin .....	94
<b>Bartłomiej Nita:</b> Methodological issues of management reporting systems design.....	105
<b>Edward Nowak:</b> The usefulness of information disclosed in company annual activity reports .....	117
<b>Marta Nowak:</b> Psychological aspects of controlling.....	126
<b>Michał Poszwa:</b> Special VAT settlement procedures.....	135
<b>Olga Sharapa, Volodumur Rossokha:</b> An analysis of integration in the agriculture in Ukraine .....	143
<b>Marcin Wierzbiński:</b> The economic optimisation of cogeneration power plants .....	152

## Streszczenia

<b>Natalia Bielous:</b> Ocena składnika zasobowego systemu bezpieczeństwa ekonomicznego przedsiębiorstwa.....	17
<b>Magdalena Chmielowiec-Lewczuk:</b> <i>Projekt Insurance Contracts</i> w rachunkowości ubezpieczeniowej .....	28
<b>Anna Isayeva:</b> Regulacje prawne dotyczące rachunkowości inwestycji finansowych .....	36
<b>Marcin Klinowski:</b> Ewolucja rachunkowości zarządczej jako skutek zarządzania przez projekty.....	44
<b>Mykhailo Kuzub:</b> Implementacja i funkcjonowanie audytu wewnętrznego w gospodarstwie rolnym.....	54
<b>Lesya Leshchiiy:</b> Ewaluacja elastyczności menedżerskiej: metoda opcji realnych.....	62
<b>Michał Maliuzenko:</b> Peering kryptowalutowy jako narzędzie inwestycyjne ..	69
<b>Ruslan Motoryn:</b> Ocena oszczędności gospodarstw domowych .....	76
<b>Tetiana Motoryna:</b> Metodyczne podejście do obliczania wskaźników finansowych w sektorze gospodarstw domowych.....	85
<b>Vasil Mukoviz, Inna Komarova:</b> Metodologiczne podejście do oceny inwestycji wspierających rozwój gospodarstw rolnych w warunkach niepewności i konkurencyjnego otoczenia.....	93
<b>Maria Nieplowicz:</b> Zastosowanie zrównoważonej karty wyników w realizacji strategii wspierania rozwoju sportu i rekreacji w Lublinie .....	103
<b>Bartłomiej Nita:</b> Metodyczne zagadnienia projektowania systemów sprawozdawczości zarządczej .....	116
<b>Edward Nowak:</b> Użyteczność informacji ujawnianych w sprawozdaniu z działalności jednostki.....	125
<b>Marta Nowak:</b> Psychologiczne aspekty controllingu.....	134
<b>Michał Poszwa:</b> Procedury szczególne rozliczania VAT .....	142
<b>Olga Sharapa, Volodumur Rossokha:</b> Analiza konsolidacji sektora rolniczego na Ukrainie .....	151
<b>Marcin Wierzbiński:</b> Ekonomiczna optymalizacja pracy elektrociepłowni ..	162

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# **THE NORMATIVE LEGAL REGULATION OF ACCOUNTING FOR FINANCIAL INVESTMENTS**

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**Summary:** The article presents the main normative legal framework for the regulation of financial investment transactions. The need for and nature of the fundamental laws and regulations which the issuers and accountants must comply with while dealing with financial investments have been considered. The methodological principles of accounting for financial investment according to the requirements of national and international accounting regulations (standards), EU Directives have been analyzed. The aim of the study is to analyze the normative legal regulation of accounting for financial investment.

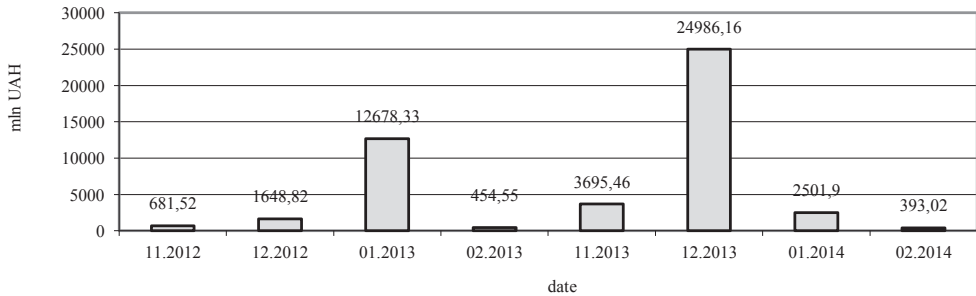
**Keywords:** normative legal framework, accounting for financial investments, IAS, EU directives.

DOI: 10.15611/pn.2015.375.03

## **1. Introduction**

The stock market in Ukraine is forming gradually, with a constantly increasing number of transactions in securities. However, significant political fluctuations in the country led to changes in the stock market. Since the beginning of the political unrest, companies have been trying to improve their financial standing by attracting investors. Shareholders are also trying to safeguard their funds by buying shares, expecting to make a profit. However, during the escalation of the political conflict the situation changed. Starting from January 2014 the volume of registered share issues has plunged. When comparing the November 2013 – February 2014 and November 2012 – February 2013 time periods, we can see an increase in the volume of the registered share issues from November 2013 to February 2014 by 16,113.32 million UAH (Figure 1).

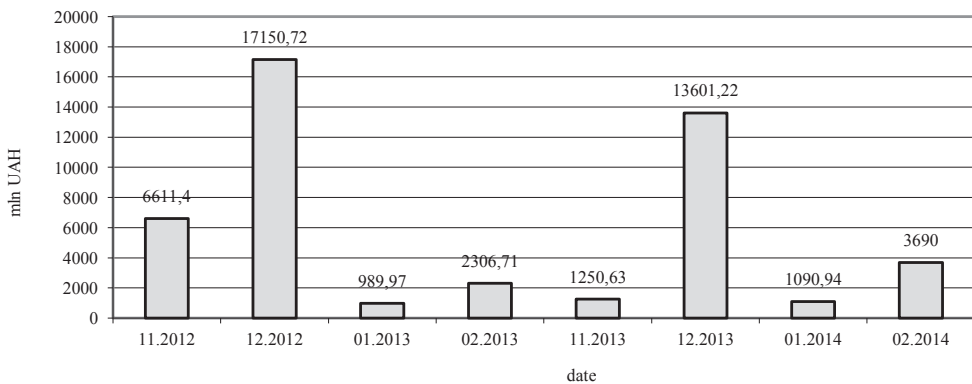
An organization issues bonds mainly when it has stable working capital and a high credit rating in order to reduce the taxable income by the amount of expenses to pay interest on the bonds and in order to raise additional financing without granting managerial rights within the organization. A bondholder is a creditor who receives



**Fig. 1.** Volume of registered share issues in Ukraine

Source: Statistics of the State Commission for Securities and Stock Market of Ukraine, own elaboration.

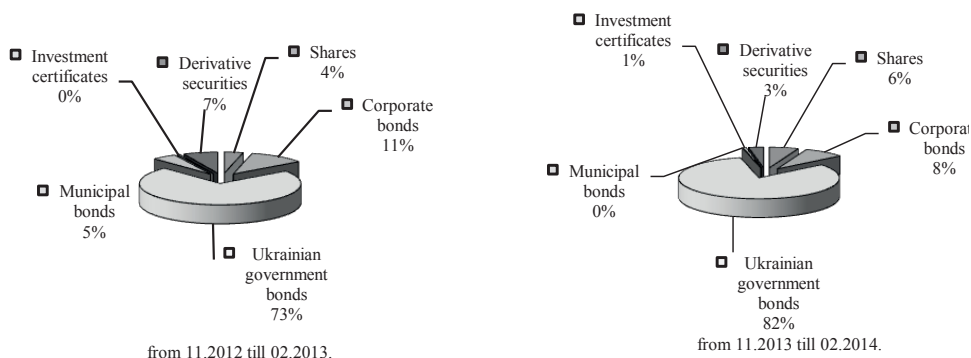
a guaranteed interest regardless of the income or financial standing of the issuer. During a period of political unrest the volume of registered bonds issues constantly fluctuates. However, when comparing November 2013 – February 2014 and November 2012 – February 2013 periods, we can see a decrease in the volume of the registered bonds issues from November 2013 to February 2014 by 7,426.01 million UAH (Figure 2).



**Fig. 2.** Volume of registered bond issues in Ukraine

Source: Statistics of the State Commission for Securities and Stock Market of Ukraine, own elaboration.

In t periods from November 2013 to February 2014 and from November 2012 to February 2013 in the distribution of securities by type, the biggest share belonged to government bonds and the smallest to municipal bonds and investment certificates. In a politically unstable environment the government attempts to attract additional capital into the country by increasing the issuance of government bonds, the share of which increased by 9% (Figure 3).



**Fig. 3.** Distribution of securities by type on the Ukrainian stock exchange

Source: Statistics of the State Commission for Securities and Stock Market of Ukraine, own elaboration.

Significant political and economic changes, together with the fluctuations in the stock market, have had a direct impact on the normative legal regulation of accounting in general and financial investments in particular. Changes in the economy led to changes in the legal framework. Accountants keeping financial investment records should comply both with the normative legal framework regulating the stock market and accounting for financial investments. The unstable political and economic situation in the country and the large number of normative legal documents regulating the stock market and accounting for financial investments, which are constantly being modified, make it difficult for corporate accountants to navigate all the applicable legal requirements and define the fundamental regulatory framework necessary for recognizing financial investment transactions in the financial accounts and in financial reporting.

The legal regulation of the securities market has been studied by O.D. Danilov, H.M. Ivashina, I.V. Kryvoviazuk, V.I. Pavlov, I.I. Pylypenko, O.H. Chumachen'ko. In particular, the general principles of stock market transactions regulation in Ukraine was considered in the works of I.V. Kryvoviazuk, V.I. Pavlov, I.I. Pylypenko. The examined work of the Commission for Securities and Stock Market aimed at improvement of securities market state regulation and investor protection, strengthening of the Ukrainian stock market competitiveness and the development of the State depository system and corporate governance. Classification of the legislative framework governing the circulation of financial investments has been studied by O.D. Danilov, H.M. Ivashina and O.H. Chumachen'ko. Thus, these scholars place in a separate group the normative legal documents that:

- 1) identify the path of professional activities' development on the stock market,
- 2) enable the indirect state regulation of the relations and activities of the stock market participants,
- 3) regulate the methodological principles of the financial and investment policies in Ukraine.

It proposed to group separately specific conceptual acts, state programs defining fundamental ways and methods of stock market regulation; regulations, codes defining the fundamental principles of exercising legal ownership on the stock market; conventions, agreements, treaties between Ukraine and international organizations, financial institutions concerning the operation, development and regulation of the stock market. A partial list of the laws regulating the accounting for financial investments is contained in the works of V.H. Shvets', L.I. Lukianenko, O.V. Nebyltsova, and R.S. Korshykov. Problems exist at the moment with the definitive list and clarity of the fundamental accounting regulatory framework determine the relevance of the chosen research topic.

The objective of this paper is to determine the fundamental normative legal framework that defines the methodological and organizational principles of accounting for financial investments and their recognition in corporate financial statements. The object of the study is the legal and normative documents regulating accounting for financial investments.

## **2. Regulation of financial investment circulation on the securities market**

The fundamental law defining the nature of the securities and their issuance and circulation procedure is the Law of Ukraine on Securities and the Stock Market of 23.02.2006 № 3480-IV. The law provides the definition and classification of securities, the main requirements for the transfer of rights and the fulfillment of obligations ensuing from debt securities, issuance procedure in the public and private securities placement, guidelines on disclosure of information by issuers and professional participants of the stock market. Similar in meaning is the Directive 2001/34/EU on the admission of securities to official stock exchange listings and information to be published on those securities. However, the Directive is more detailed, for example a separate annex is dedicated to several options for a company to submit information for the purpose of admission of securities to the official stock exchange listing.

The applicability of financial sanctions for violations on the securities market are determined by the Law of Ukraine on State Regulation of Securities Market in Ukraine. Moreover, the legal methods of regulating financial investments transactions are stipulated in Chapter 14 Securities, Book 1 of the Civil Code of Ukraine and in Articles 222 and 224 of the Criminal Code of Ukraine. Financial sanctions on legal persons are given in more detail in the Law on State Regulation of Securities Market in Ukraine. However, the Criminal Code additionally stipulates liability for: the falsification of documents submitted for the registration of securities issue, maintaining improperly a register of registered securities holders, the manufacturing, sale or use of counterfeit non-government securities.



The issuance and circulation of securities can be electronic. The electronic circulation of financial investments is regulated by the Law of Ukraine on the National Depository System and Specifics of Electronic Circulation of Securities in Ukraine. The articles of the Law define the legal basis, specifics of electronic circulation and accounting for financial investments in the National Depository System of Ukraine.

### **3. Regulation of taxation of financial investment transactions**

The taxation of financial investment is regulated by the Tax Code of Ukraine. However, there are certain differences between the understanding of the nature and classification of investments in tax accounting and business accounting. The economic nature of definitions is similar, but their form is different. Notably, in business accounting financial investments mean assets are held by a company in order to increase profit (interest, dividends, etc.), to increase capital value or other benefits to the investor. In the Tax Code, financial investments mean business transactions involving the purchase of corporate rights, securities, derivatives, and/or other financial instruments. The difference in the interpretation is related to the different purposes of tax and business accounting. The purpose of tax accounting is to determine the tax base and the purpose of business accounting is to provide users with complete, accurate and unbiased information about financial investments to support their decision-making. Also there are certain differences in the classification of financial investments. In particular, in business accounting for the preparation of a balance sheet, financial investment is divided into long-term and current investment based on the circulation period. In tax accounting, financial invest is usually divided into direct investment, which allows control on the part of the investor, and portfolio investment, which does not give the right to exercise control. The corporate profit tax, which is supposed to decrease each year, is defined by the Tax Code. Thus, from 1<sup>st</sup> April 2011 to 31<sup>st</sup> December 2011 the tax rate was 23%, from 1<sup>st</sup> January 2012 to 31<sup>st</sup> December 2012 it was 21%, from 1<sup>st</sup> January 2013 to 31<sup>st</sup> December 2013 it was 19%, from 1<sup>st</sup> January 2014 it was 18%.

### **4. Regulation of accounting for financial investment and its recognition in financial reporting**

Apart from the aforementioned laws, accounting for financial investment transactions is regulated by the Law of Ukraine on Accounting and Financial Reporting in Ukraine, which defines the legal basis of state regulation of accounting and financial reporting organization and methodology in Ukraine. In particular, the Law defines the purpose, main principles of accounting and reporting, requirements to source documents and accounting registers, fundamental principles of financial reporting and the application of international financial reporting standards.

All financial investment transactions must be recognized in the financial accounts and in accounting registers. Ukrainian legislation provides the Chart of Accounts for assets, capital, liabilities and business transactions of companies and organizations, and the Instruction on its use. In recent years, changes have been made to the Chart of Accounts. In particular, it provides only for synthetic accounts, however, sub-accounts have to be defined by the companies. The Instruction additionally contains a list of sub-accounts. This approach to the Chart of Accounts matches the accounting trends in developed countries, where accountants are given greater autonomy in determining the methods of accounting for financial investment. Guidelines on the use of accounting registers are approved by the Order of the Ministry of Finance of Ukraine № 356 of 29th December 2000.

Financial investment transactions are recognized in the financial reporting that is prepared in compliance with the methodological principles specified in the National accounting regulation (standard) 1 “General requirements for financial reporting”. NAR(S) 1 has been adopted in order to harmonize national accounting standards with international accounting standards. However, there are certain dissimilarities and deficiencies in the adopted standard. In particular, the new NAR(S) does not define the contents of financial reporting items separately, which increases the likelihood of errors at the information itemizing step. There are inconsistencies in recognizing certain accounting items. So, in the Cash Flow Statement, subjects of investment activity include all dividends and interest received from financial investment. In the Profit & Loss Statement, financial activities include financial income from dividends, interest and other income derived from financial investment, excluding income from participation in the capital belonging to operational activities; financial costs, such as interest expenses and other costs associated with the borrowing of capital; profits and losses ensuing from financial activities. Thus, it is useful to resolve the contradictions in financial reporting by transferring dividends, interest and other income derived from financial investment, excluding income from participation in the capital, to subjects of financial activity in the Cash Flow Statement. To achieve greater transparency, it is advisable to allocate in the Profit & Loss Statement separate items for the recognition of the gains and losses ensuing from investment activities.

If the methodological principles of financial investment recognition are considered from the point of view of GAAP, EU Directives and IAS, the requirements as for the content and volume of data required in the reporting differ. So, according to the EU Directives, the main focus is on the need to disclose information regarding receivables, including information on declared but unpaid capital, and short-term investment. EU Directives do not require detailed information about own capital. GAAP instead focuses on the need for detailed information on long-term investment and own capital. The most complete and detailed methodological principles are provided by IAS. IAS focuses both on long-term and short-term financial investment and on the own capital of companies. National AR(S), in terms of reflecting information about financial investment in the reporting in most aspects correspond to IAS, however,

IAS is more detailed. That is why there is a need for further harmonization of the content of AR(S) with IAS.

The fundamental principles of the valuation of financial investment and the requirements for disclosure in the Notes to Financial Statements are stipulated in AR(S) 12 “Financial investment”. The methodological principles of recognition and classification of gains and losses ensuing from financial investment are stipulated in AR(S) 15 “Revenue” and AR(S) 16 “Expenses”, developed based on IAS.

Transactions related to the calculation of earnings per common share are regulated by AR(S) 24 “Earnings per share” [National Accounting Regulations (standards)]. IAS 33 “Earnings per share” has similar contents [International Financial Reporting Standards]. However, IAS 33 additionally contains information on: the recognition and calculation of dividends on preferred shares, the submission and disclosure of information on calculated profit in financial reporting. AR(S) 24 instead contains sample calculations (calculation of earnings per share). However, it is useful to supplement AR(S) 24 with guidelines available in IAS 33.

Issuers of securities separately prepare the “Report on the issue, placement and circulation of securities” (Form № 2-B). The report provides an account of the nominal value of the issued and placed securities, as well as the realizable value of the resold securities. Guidelines for completing the report are provided in the instruction on filling in this form approved by the Order of the State Statistics Committee of Ukraine of 13<sup>th</sup> July 2006 № 318.

## 5. Conclusions

Thus, the normative legal regulation of the stock market, accounting for financial investment is put into force by laws, codes, regulations, government programs, etc. Taking into account the political and economic situation in the country and aiming to increase the transparency of accounting for financial investment, it is necessary to harmonize the legislative framework of Ukraine and the EU. Such harmonization will promote the transparency of the financial investment circulation, the quality of accounting for financial investments and their recognition in reporting. Public trust in financial reporting will grow accordingly, which will encourage investors to perform financial investment transactions.

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## REGULACJE PRAWNE DOTYCZĄCE RACHUNKOWOŚCI INWESTYCJI FINANSOWYCH

**Streszczenie:** W artykule przedstawiono główne ramy regulacyjne i prawne transakcji w zakresie inwestycji finansowych. Przedstawiono potrzebę i charakter podstawowych praw i przepisów, którymi powinni kierować się emitenci i księgowi w trakcie inwestycji finansowych. W artykule została przedstawiona analiza zasad metodologicznych rachunkowości inwestycji zgodnie z wymaganiami przepisów krajowych i międzynarodowych (dyrektyw UE). Celem opracowania jest analiza regulacji prawnej inwestycji finansowych.

**Słowa kluczowe:** ramy prawne i regulacyjne, księgowość inwestycji finansowych, dyrektywy UE.