

Implementation of IFRSs and IFRS for SMEs: the case of Estonia

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Abstract: This paper gives an overview of prior writings published by Estonian researchers that have analyzed the development of Estonian accounting legislation and financial reporting and potentially contributes to the understanding of Estonian international financial reporting standards' implementation issues. The authors have analyzed the history of Estonian accounting legislation from 1990 until 2013 and have divided the integration of Estonian accounting system to the framework of IFRSs into two stages: 1) implementation of IFRSs, and 2) implementation of the IFRS for SMEs. The paper also analyzes the possible changes the new European Union Accounting Directive will bring to the Estonian accounting framework. As a methodological technique literature review and document analysis are used, including bachelor and master thesis and papers written by the Estonian researchers. In conclusion, it may be said that the implementation of IFRSs and IFRS for SMEs in the form of the Estonian good accounting practice (EGAP) has been smooth and successful in Estonia.

Keywords: Estonia, implementation of IFRS, implementation of IFRS for SMEs, new EU Accounting Directive

JEL codes: M41

1. Introduction

In the context of accounting, Estonia is one of the least-known countries in Europe. There is very little information about accounting in Estonia until the beginning of the 20th century. This is quite apparent considering that there is little accounting-related academic literature in the Estonian language available even at the local level. The list of the authors who have published articles about Estonian financial accounting issues in international accounting journals include Bailey and Alver

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(1995), Alver and Alver (1998, 2009), Haldma (2003, 2006) and Bailey (1998, 2001).

Estonian accounting regulations have only a relatively brief history compared to those of some other European countries. After the collapse of the USSR (Soviet Union) Estonian economic system was transformed from a centrally planned economy into a market-based economy, which involved significant legal and institutional changes in regulations. This gave rise to the development of new accounting environment that Estonia decided to build upon IFRSs. At that time this step was considered to be progressive, as IFRSs were not in the forefront of the European accounting harmonization in the 1970s and 1980s. Van Hulle argued that the particularities of the EU member states were not sufficiently reflected in IFRSs. This was the main reason why these standards were hardly applied at all by the companies in the Community (Van Hulle, 1992: 169).

According to Albu and Albu (2012: 341) the post-IFRS experience of emerging economies has been diverse. Some adjustments have reportedly been relatively successful, but the others less, because of their non-compliance with the standards, or they have even ended in failure. Therefore, this paper attempts to address how globalization and international financial reporting standards have affected the development of the Estonian good accounting practice (the Estonian GAP or EGAP). The paper potentially contributes to the evidence of accounting reforms in emerging economies, its progresses and obstacles. This analysis is important in order to understand the pressures affecting the development of financial reporting system in emerging countries, such as Estonia, and take into account the possible influences when developing new accounting legislation in the future. Therefore, the main objectives of this paper are to regroup significant findings about IFRSs application in Estonia in order to facilitate the understanding of IFRSs implementation issues and to make the results of prior research published in the Estonian language more visible.

To reach the aims of the paper the authors give an overview of the papers published earlier in Estonia, which have analyzed the development of Estonian accounting legislation and its financial reporting framework. The discussion part is presented in two sub-sections. The authors have analyzed the history of Estonian accounting legislation from 1990 to 2013, and have divided the integration of the Estonian financial accounting and reporting system with the international framework into two stages: 1) implementation of IFRSs, and 2) implementation of IFRS for SMEs. The paper also analyzes the implications of the new EU Accounting Directive for Estonian legislation and the reactions of the Estonian government, accounting bodies and other interested parties to the possible changes it will bring to the accounting framework. The consequences of the implementation of IFRSs (costs and benefits, level of compliance, transparency, value relevance etc.) are analyzed to the extent that is allowed by the limited quantitative and qualitative empirical research performed.

Literature review and document analysis have been applied as a methodological technique in all sub-sections. For collecting examples and reactions to the changes in Estonian accounting regulation, bachelor and master thesis and papers written by Estonian researchers have been used.

2. Accounting developments

The collapse of centrally planned economies in the late 1980s and early 1990s dramatically changed the accounting environment in the former socialist countries, including Estonia. The country's economic system was transformed from a centrally planned to a market-based economy, which involved significant legal and institutional changes in regulations, especially the accounting regulations, and which gave rise to the development of new accounting environment. The old bookkeeping system with detailed rules serving the primary task of controlling that the national economic plans were fulfilled was replaced by an accounting system with the primary task of preparing financial reports to the market, but also to give information to management for decision making.

After declaring the restoration of the independence in 1990 it became possible to initiate the accounting reform and implement the accounting system characteristic of the developed market oriented countries. The first step on that way was taken in 1990, when Estonia remained, albeit reluctantly, a constituent republic of the USSR. On July 6, 1990 the National Government adopted the Regulation of Accounting, which came into force on January 1, 1991. The fact deserves special attention because it was the first measure adopted in any of the constituent republics of the USSR to signify the departure from the path of the Soviet accounting evolution. As pointed out by Alver *et al.* (1998), this event marked the beginning of the spread of accounting disharmony within the territories comprising the USSR. It was really an "accounting step" on the transition from command economy to market economy. Although, legally the measure was a regulation, not statute (i.e. not approved by a legislative assembly but adopted by the executive action of the government), comparable to a fundamental or a basic accounting law. Paradoxically, in some sense, as pointed out by Bailey (1995), the Estonian Regulation on Accounting, adopted prior to the restoration of independence in 1991, was more considered a measure and wider in scope than the legislation introduced subsequently in Latvia and Lithuania. Due to lack of local accounting sophistication, there was some inability to distinguish between the suitable and unsuitable aspects of accounting procedures and practices transferred. Therefore, advice from Canadian and Swedish Estonians appeared to be of great support in designing local accounting legislations. It is worth notice that during the period of preparation of the new Accounting Act in 1993–1994 three out of the seven members of the Estonian Accounting Board had international working experience.

In 1991, the Estonian Accounting Board (renamed later as the Estonian Accounting Standards Board – the EASB) took on the responsibility for the development of accounting in Estonia. The main tasks of the Board were declared to issue mandatory accounting guidelines and to make recommendations concerning the methods which were to come into force. All the developments of accounting were expected to be initiated and prepared for legislation and implementation by the Board. At that time the EASB was an independent governmental unit, established by the government of Estonia, which operated within the administrative jurisdiction of the Ministry of Finance as defined in the paragraph 32 (1) of the Estonian Accounting Act (the EAA). The Board had to arrange accounting guidelines related to the EAA.

The first step towards the formation of auditing environment in Estonia was made by the Estonian Regulation on Auditing in 1990 (the Estonian Auditing Act was enforced in 1999). During the following years, 1992–1995, all the “Big Six” audit firms started to operate in Estonia. In 1994, the first set of auditing guidelines was enacted in Estonia. These steps made an essential contribution and helped create a favorable environment for the preparation and enforcement of the EAA. The main problem was how to build up a forward-looking and flexible accounting regulation system, which would enable to overtake and integrate it into the European accounting framework. The traditional system, which based on the accounting law, would have been too inflexible to reflect the rapid changes in transition circumstances. Although Van Hulle (1992) expressed an idea that the use of the law as a means of standard setting could also be an interesting mechanism against too frequent (and sometimes unnecessary) changes. However, this was not the case for transition countries because of their lack of stable and effective accounting regulation system.

The Estonian Regulation on Accounting was in effect until 1995. This document introduced a number of new accounting concepts and principles, new terms and a new set of annual financial statements (including the balance sheet, income statement and the statement of changes in the financial position and notes). The main characteristic of that period is that it was a mix of past (some elements of the former Soviet accounting system remained in force), present (real usage of new methods, principles and financial statements) and future (usage of many new terms of market economy that actually were not represented in the Estonian economy yet).

2.1 Implementation of IFRSs in Estonia

A substantial and complex step of the accounting reform in Estonia was related to the first EAA, which came into effect on January 1, 1995. Chapter 1 of the EAA specified the objective of the EAA, which was to create the legal bases and establish general requirements for organizing accounting and reporting in the

Republic of Estonia based on internationally accepted accounting principles. In paragraph 3 of the EAA internationally accepted accounting and reporting principles were defined as the Accounting Directives of the European Community and the principles, standards and recommendations developed and approved by International Accounting Standards Committee (the IASC – later renamed as the International Accounting Standards Board). The annual financial statements included the balance sheet, income statement and notes. The statement of cash flows was a compulsory part of notes (EASB homepage).

Estonia was the first nation in Europe to align national GAAP with international accounting standards by law. According to J. Alver and L. Alver (2009), the EAA of 1995 stated that the EGAP is based on the standards, interpretations and guidelines promulgated by the IASC. The true and fair view was declared the most important reporting principle, but still the EAA did not contain a detailed set of rules and could best be characterized as constituting legal framework. For example, statement of changes in equity and statement of cash flows were not compulsory parts of the annual report and the latter was recommended to be disclosed in the notes. Also, the EAA did not include any accounting principles, for example, how to recognize inventory initially or how to measure the cost subsequently (FIFO, weighted average cost method). The legal framework was general and applied to all legal entities and physical persons registered as businesses in Estonia.

The EGAP was declared to be based on internationally recognized principles, which were established by the EAA and the Accounting Standards Board Guidelines (ASBGs). In some sense, this concept was a unique combination of Anglo-American approach and Continental (European) approach. According to Haldma (2003), the Accounting Act in the Estonian accounting regulation represents the European approach and the EGAP Anglo-American approach. Such combination had a number of advantages, especially in the first period of the development of accounting regulation (transition period), and enabled flexible transition process. The analysis of accounting regulations in the Eastern and Central European countries revealed that besides Estonia only Slovenia has introduced the aforementioned double set accounting regulation. In the second half of the 1990s this approach was implemented in several countries with market economy – for example in Germany, Norway, Sweden (Haldma, 2003).

From 1995 to 2000 the EASB issued 16 guidelines to improve particular aspects of accounting in Estonia, including accounting principles, preparation of financial statements, revenue recognition etc. The only problem was that the guidelines were not obligatory. They were only recommendations, and in case of a contradiction with the EAA, the requirements of the EAA had to be followed.

The first EAA was in force from 1995 to 2002 and was amended several times. Unfortunately, these changes were mostly cosmetic (Alver & Alver, 2009). The

EAA had considered the valid international accounting requirements, as well as the majority of the requirements of the 4th Directive of EU. In November 1995, the Government of Estonia submitted an official application to join the EU. As the Government of Estonia had expressed Estonia's desire to become a member of the EU, the EASB merged the requirements of the European Directives with the IASC's conceptual framework and treatments by carefully choosing the alternatives in the Directives that resulted in convergence.

The accounting reform continued by the implementation of a new version of the EAA and a new set of guidelines. Both of them came into effect on January 1, 2003. According to the EAA, all companies can choose between two accounting frameworks: to apply IFRSs as issued by the IASB in London and endorsed by EC in Brussels or to apply ASBGs as issued by the EASB in Tallinn. The framework selected must be applied to both, consolidated and parent's stand-alone accounts. If IFRSs are selected, there is no need to prepare the EGAP based financial statements.

The goal of the EAA was declared to create a legal basis and establish general requirements for organizing accounting and financial reporting pursuant to internationally recognized principles. The accounting principles in the new guidelines of the EGAP were fully harmonized with IFRSs (in very rare cases simplified methods were allowed) but required less disclosure than IFRSs. In areas, which were not covered by the guidelines, the IFRSs treatment was recommended, (Deloitte, 2003). Large companies were expected to choose the full IFRS option, whereas small and medium-size companies were likely to use revised EGAP as their accounting framework. Presumably, the profit and equity of year 2003 were substantially the same under IFRSs and the EGAP, but EGAP based financial statements were less informative than IFRSs based financial statements (Deloitte, 2003). Instead of the former two basic statements (the balance sheet and the income statement), the new annual report included four statements: the balance sheet, the income statement, the cash flow statement and the statement of changes in owner's equity. The new Accounting Act brought the Estonian accounting legislation closer to IFRSs and contributed to a better organization of the economic environment. The financial reports by business entities became more informative and enabled different interest groups to have a better overview about the reporting company's financial position, assets and liabilities (Tikk, 2010). The new Accounting Act also modified the status of the EASB, which became an independent commission.

In 2003 about 95% of the companies used the EGAP, including SMEs and larger companies, where the EGAP financial statements met the needs of users. About 5% of companies used IFRSs. These companies included listed companies, other public interest entities (e.g. significant state-owned entities) and companies required to do so by the shareholders, foreign investors or creditors (Vilu, 2004).

On May 1, 2004 the Republic of Estonia joined the EU. In 2004 the financial reporting in the EU was regulated by the Fourth Council Directive 78/660/EEC (in force since July 25, 1978), which treated the preparation of annual financial statements of certain types of companies, and the Seventh Directive 83/349/EEC (in force since June 13, 1983), which defined the preparation of consolidated statements. The above-mentioned Directives were incorporated to the EAA when joining the EU. Since the Fourth and Seventh Directive were not based on IFRSs, there were differences between the Estonian guidelines and the EU legislation in 2004. However, there was no need to make amendments to the EGAP, because according to the regulation accepted by the European Parliament and European Council in 2002 (1606/2002), all EU listed companies were required to prepare their consolidated statements in accordance with IFRSs. This requirement entered into effect in 2005 and represented a preliminary peak in the internationalization process of financial accounting in Europe.

On December 1, 2005 several changes to the EAA were introduced. With the updated EAA, the necessity of providing the users of financial statements with adequate information was emphasized. Besides, the EAA required more information in the management report, such as the description of the main fields of activity as well as products and services and also the main financial ratios. The guidelines which were oriented to IFRSs already required this kind of information to be disclosed in the notes of the annual report.

The amendments to the EAA that came into force in 2008 required that an annual report should disclose the entity's main field of activity pursuant to the Classification of Business Activities used in Estonia. According to the explanatory memorandum, such amendment provides for quick identification and processing of registers maintained by the court. The EASB and the Estonian Board of Auditors considered the change in the context of an annual report inappropriate and suggested that such information should be collected outside the annual report. As a result, such information was published after the notes and annexes of the annual report (Loot, 2008). In 2009, several changes were introduced to the EAA. The main change worth noting was the development of uniform financial reporting taxonomy, which was directly related to the action plan for e-filing of annual reports. Firstly, the taxonomy of the annual report to meet the EGAP was developed (Loot, 2009). The taxonomy was introduced in 2010. As the electronic submission of annual reports is not widespread throughout the world, the authors think that it can be seen as an independent project of Estonia, which could be regarded as exceptional in the world. In 2010 the EAA was amended again, being influenced by the changes made to the Auditing Act, which was updated pursuant to the requirements of International Standards on Auditing. To draw a parallel here, to conform to the requirements of international legislation other Estonian laws besides the EAA have also been influenced by international standards and organizations. In 2011, the amendments made to the EAA resulted from Estonia's

accession to the Eurozone and the replacement of national currency *Estonian kroon* with euro. The functional currency changed from *kroon* to euro as well.

The changes in the Estonian accounting framework from 1990 until 2012 have been summarized in the Table 1.

Table 1. Development of Estonian accounting regulation

Date and name of regulation	Purpose of regulation	Scope of the regulation
Regulation of accounting in 1990, applied from January 1, 1991	To bring about the organization of accounting in the conditions of a market economy	Introduction a number of new accounting concepts and principals, new terms, and a new set of annual statements (balance sheet, income statements, statement of changes in financial position and notes)
EAA in 1994, applied from January 1, 1995	To create the legal basis and establish general requirements for organizing accounting and reporting based on internationally accepted accounting principles	The EAA did not contain a detailed set of rules, it was a legal framework. The EAA was supplemented by a number of methodological recommendations. Between 1995 and 2000 the EASB issued 16 ASBGs to improve particular aspects
New amended EAA in 2002, applied from January 1, 2003	To create the legal basis and establish general requirements for organizing accounting and reporting based on internationally accepted accounting principles	The expanded scope of the EAA was introduced. The accounting principles of all types of institutions (including governmental and consolidated financial statements). The EASB has issued 18 ASBGs

Source: www.easb.ee

In September 2013 the IFRS Foundation (IFRSF) added Estonia as a new jurisdiction profile on the use of IFRSs. The IFRSF's jurisdictional profile summarizes the legal accounting framework in Estonia effective until December 31, 2012 (IASB, 2013).

Overview prepared by Ernst and Young in respect of the legal accounting environment in Estonia states that by 2012, there were no significant differences between the EGAP and IFRSs, except for: 1) annual reports prepared in accordance with IFRSs were more detailed, because those standards required considerably more to be disclosed; 2) unlike IFRSs, the EGAP did not allow using the revaluation method for fixed assets; 3) IFRSs did not allow entities to choose whether they should capitalize loan interests, but the EGAP did allow it (to capitalize or record in the income statement); 4) unlike IFRSs, the EGAP described the transactions (business combinations) under common control (Ernst & Young, 2012).

Bachelor's and master's theses compiled in Estonia have reviewed different aspects of financial statements of Estonian companies, but a comprehensive analysis of the level of convergence of the EGAP with IFRSs is not available. The existing analysis rather compares the compliance of financial statements with the EGAP or compares the quality of financial statements audited by Big 4 and non-Big 4 companies.

Raigla (2007) studied the information disclosed in the notes of financial statements. Her sample consisted of 20 non-audited financial statements. Raigla wanted to show that the non-audited financial statements contain more errors and deficiencies than audited financial statements. The investigation revealed that the sampled annual reports did not use cross-references, the numerical values of notes and financial statements differed, the terminology used was insufficient, information disclosed was often inadequate or even wrong. The work by Raigla is supported by Villems (2008), an authorized public accountant, who also investigated the most common errors in annual reports. According to Villems, the annual financial statements commonly do not include detailed notes for income statement and statement of cash flows.

One research conducted in Estonia showed that there are considerable differences also between the audit quality of Big 4 and non-Big 4 companies. Kannistu (2008) studied annual reports of 15 companies, from which 8 were audited by Big 4 firms and 7 by non-Big 4 firms. According to Kannistu, substantive errors, included recognition of business transactions appeared only in those annual reports, which were audited by non-Big 4 companies. Errors in disclosure appeared in annual reports audited by Big 4 as well as in those audited by non-Big 4 firms. Furthermore, there were more errors in the annual reports audited by non-Big 4 companies. The most common mistake was the insufficient description of the accounting principles in the notes of financial statements and the non-disclosure of information for individually significant financial objects and transactions.

Prants (2013: 37) evaluated the quality of notes to financial statements. The financial statements of ten small businesses were analyzed concerning the information compliance with the requirements and in regard to figures, references and sequence of the notes. To see how the quality of the notes has changed in the course of years and how the electronic reporting requirement has affected the quality of the notes, financial reports that were compiled for the years 2007–2011 were analyzed. The results showed that the electronic reporting requirement had both negative and positive effects on reporting quality. Due to the fact that the electronic reporting form gives the reports a consistent presentation, the reports have become more understandable. A negative effect of the electronic reporting requirement has been the rise of problems with references and exclusion of important information that is required by the EAA. The electronic form probably

gives the compiler an impression that he has submitted enough information even though that is not really the case.

When looking at the costs and benefits of the EGAP, a survey conducted by the Estonian auditing company BDO Eesti AS in 2011 showed that after Estonia started using the electronic e-filing system for compiling annual reports, the average time spent on composing of the financial statements decreased approximately 25% (BDO Eesti AS, 2011: 49).

A study conducted by Bonson and Escobar (2006: 313) showed that when it comes to disclosing information voluntarily in the Internet, Estonian companies are in the front rank in Eastern Europe. From 266 companies investigated (from which 5 were located in Estonia), the study showed that Estonian companies offer relatively complete information including balance sheet of the current and prior year, half-year reports, audit reports etc.

To conclude, until 2012 the majority of Estonian enterprises prepared their annual financial statements according to the EGAP, which copied the accounting principles of the “big” IFRS, except the listed entities that had to follow the “big” IFRS, as required by the EU legislation.

In 2011 several changes were introduced to the guidelines that came effective on January 1, 2013. The new guidelines follow mainly the IFRS for SMEs, although there are some differences between the EGAP and the IFRS for SMEs. As Estonia was among the first countries adopting the IFRS for SMEs in Europe, the reasons for converting from “big” IFRS to “small” IFRS are described in more detail in the following section.

2.2 Implementation of the IFRS for SMEs in Estonia

The need to establish appropriate accounting standards for SMEs has created many debates around the world, but currently consensus has not been achieved on the recommended solutions as the views of interested parties (IASB, EU) vary significantly.

In 2004 the IASB’s proposed the IFRS for SMEs opened an international effervescent debate among academics and practitioners. After that many researchers have tried to collect pertinent evidence for pro and contra arguments and to investigate whether the proposed IFRS for SMEs is likely to meet the needs of the users of financial reports of SME (Tiron-Tudor & Muțiu, 2008).

This was also done in the European Union, where the biggest obstacle was the existence of 28 different accounting systems, which have to be harmonized. For more than thirty years the European Union has been very active in the field of

financial reporting. Its aim has been to “harmonize” the financial statements of enterprises, i.e. to reduce the differences between the member states in this area so that the remaining differences do not constitute an impediment to the EU’s efficient operation. The European Commission is aware that the smallest firms face the greatest costs in complying with regulations and it is, therefore essential to free up micro-enterprises to allow them to pursue their business goals without unnecessary regulation (European Commission, 2011c).

When examining the various policy options available to replace the old Accounting Directives, the Commission considered adopting the IFRS for SMEs at EU level. At the end of 2009, the European Commission started a public consultation on the IFRS for SMEs. The Commission Services decided to seek the opinion of the European Union stakeholders on this Standard. Supporters of the widespread use of the IFRS for SMEs in the EU argued that the Standard was best suited for large and medium-sized companies, for international groups and subsidiaries of companies reporting under full IFRS as well as for companies active internationally, listed on non-regulated markets, seeking foreign financing or “non-publicly accountable” (as defined in the IFRS for SMEs). Those opposed to the IFRS for SMEs highlighted its complexity for SMEs, especially with regard to the smallest companies. Rather than reducing administrative burden, they argued that the Standard would increase it, and also increase the cost of preparation and the audit of individual company financial statements. The requirements for extensive disclosure were also seen as potentially creating a competitive disadvantage *vis-à-vis* companies that follow less stringent rules. Opponents also questioned the actual benefits that the Standard could bring to the companies which operate only locally and have a limited number of shareholders. The countries which opposed the use of the IFRS for SMEs included Germany, France, Italy, Belgium, Finland etc. (European Commission, 2010). The countries which thought that the IFRS for SMEs were suitable for widespread use within the EU included Estonia, United Kingdom, Czech Republic, Denmark, Netherlands, Poland, Cyprus etc. (European Commission, 2010).

This provoked many discussions on what the EGAP should look like in the future. After the release of the IFRS for SMEs by the IASB in July 2009, Estonia started to move towards the application of the respective standard, as it was assumed that the EU would also adopt this. Initially, the plan was to adopt the IFRS for SMEs as the third alternative accounting framework besides the EGAP and IFRSs for Estonian companies on how they could compile their annual financial statements (Nõmper, 2010: 20). Further goal was to stop drafting the ASBGs and just leave the IFRS and the IFRS for SMEs (Luiga & Luigelaht-Teder, 2011: 16). It was believed that unification of the financial accounting rules would help to decrease the administrative burden of Estonian companies. Enterprises with foreign investors or owners already drafted two sets of financial statements – one according to the local (i.e. Estonian) accounting rules and the other one according to their parent company’s / group’s accounting rules. Although, in practice it would

have been possible to use internationally accepted IFRSs, it was not an attractive option in real life as the disclosure requirements of IFRS were too comprehensive. (Nömper, 2010: 20)

Still, replacing the EGAP with the IFRS for SMEs also raised some concerns, as some of the areas in the IFRS for SMEs were less dealt with than in the EGAP. For example, the accounting for investment property and leases were reflected in the IFRS for SMEs in less detail than in the EGAP. Furthermore, in case of business combinations, entities under common control were allowed to use adjusted purchase method, which was not permitted under the IFRS for SMEs. On the contrary, the EGAP did not disclose accounting principles for joint ventures, share based payments and employee benefits that, however, are not very common in Estonian accounting practice either (Nömper, 2010: 22).

In 2010, the EU had still not approved the use of the IFRS for SMEs, because according to the European Commission, the IFRS for SMEs was not suitable to be used for micro-enterprises and it was not in line with the Fourth and Seventh Directive of the EU. In October 2011 the European Commission decided not to endorse the IFRS for SMEs to the European Union legislation, as the IFRS for SMEs was assessed to be incompatible with the European Accounting Directives. The European Commission rejected the option to adopt the IFRS for SMEs at EU level as the Commission deemed that the IFRS for SMEs did not meet the objective of reducing the administrative burden (European Commission, 2013).

Nevertheless, Estonia continued to adopt the IFRS for SMEs. What it actually meant was changing the EGAP in a way that it would be in line with the requirements of the IFRS for SMEs, because formally the EU would not have allowed Estonia to adopt the IFRS for SMEs as a third standard alongside the EGAP and IFRSs. Therefore, the EASB continued to draft the new version of ASBGs that were approved on December 30, 2011 and came effective on the financial year starting from 1st of January 2013, although earlier adoption starting from 1st of January 2012 had been allowed. The EASB justified adopting a new set of rules with the fact that by 2011 “big” IFRS (the basis of ASBGs at that time) had continuously evolved and had a volume of more than 3,000 pages. With that, IFRSs had been designed especially for companies under the public interest, such as listed companies, banks and other large corporations; for smaller businesses IFRSs often tended to be too complicated. The release of the IFRS for SMEs by the IASB had set out the question of whether to try to continue to keep ASBGs in line with the guidelines of the “big” IFRS principles (which would have meant their increasingly complex writing), or to change the framework and instead bring them in line with the IFRS for SMEs. As ASBGs were especially designed for the same target audience as the IFRS for SMEs, the EASB decided in favor of the second option, and the new ASBGs therefore followed the IFRS for SMEs (EASB homepage).

It should be mentioned that Estonia did not adopt the IFRS for SMEs 100%, but took into account the comment letters sent by different interested parties when drafting the new ASBGs. Therefore, the differences between the two sets of standards still exist. Companies that want to keep their accounting methods fully compatible with the IFRS for SMEs are able to do so due to the availability of alternatives. Additionally, the disclosure requirements of ASBGs vary somewhat with the disclosure requirements of the IFRS for SMEs.

The recent changes in Estonian accounting regulation are summarized in Table 2.

Table 2. Changes in Estonian accounting regulation in 2011, effective from January 1, 2013

Aim of the regulation	Developments in accounting issues	Scope of the regulation	Status of EASB
To change the accounting framework and bring the ASBGs in line with the IFRS for SMEs. Estonia did not adopt the IFRS for SMEs 100%.	Companies that want to keep their accounting methods fully compatible with the IFRS for SMEs are able to do so due to the availability of alternatives. Disclosure requirements of the ASBGs vary somewhat with the disclosure requirements of the IFRS for SMEs.	No changes compared to the previous regulation. Accounting entities are the Republic of Estonia as a legal person in public law, local governments, all legal persons in private or public law registered in Estonia, sole proprietors, and branches of foreign companies registered in Estonia.	No changes compared to previous regulation. The Ministry of Finance, the Government of the Republic and other government authorities shall not interfere with the content of the guidelines issued by the Standards Board or with the process of preparation thereof.

Source: www.easb.ee

Peetre (2012: 66–67) has analyzed the impact of changes in the EGAP on entities' profits. Bringing of the EGAP in line with the IFRS for SMEs together with the changes in some accounting methods has an impact on corporate profits, balance sheet structure and hence the financial ratios found on the basis of financial statements. The impact of the changes in the EGAP on the profit and financial ratios differs among companies and can be either positive or negative. Widespread belief that changes have only negative impact on profit is not true. Changes in the EGAP affect particularly those entities that have, for example, goodwill in balance sheet, capitalized borrowing costs, investment property in the balance sheet. The change in the EGAP will also have an effect on financial ratios of companies. On the basis of the sample exercise, the EGAP changes had negative impact on ROE and ROA. There was positive influence on debt to equity ratio and no impact on current ratio. The analysis conducted by Peetre is supported by Vilu (2012: 20) who states that the new EGAP will follow simpler accounting principles but consequently, simpler accounting principles will have negative impact on entities' profits and equities.

An overview prepared by PricewaterhouseCoopers summarizes the legal accounting framework of Estonia in 2014. The listed companies and financial institutions are required and other companies are allowed to prepare financial statements in accordance with IFRSs as adopted by the EU. The EGAP effective from 2013 is based on the IFRS for SMEs with limited differences with regard to accounting policies as well as disclosure requirements. Differences in accounting policies arise mainly due to the fact that in some areas the EGAP allows a choice of accounting policy. Except for differences from limited reasons, net profit and equity are usually the same, regardless of whether the financial statements are prepared in accordance with the IFRS for SMEs or the EGAP. In the areas not specifically covered by the EGAP, the treatment in the IFRS for SMEs is recommended, but not mandatory (PricewaterhouseCoopers, 2014: 40).

2014 is actually the first year, when the annual reports were prepared according to the new ASBGs are presented to the Commercial Register, as not so many companies have used the opportunity of early adoption. Because according to the Estonian law, annual reports have to be submitted to the Commercial Register six months after the end of the financial year, most of the companies submit their annual reports by June 30, 2014. Only after that one can make a more comprehensive analysis of the annual financial statements prepared using ASBGs based on “big” IFRS and annual reports prepared using ASBGs based on the IFRS for SMEs and decide whether any differences exist in the disclosure or other areas between the two sets of standards.

2.3 Implementation of new accounting Directive in Estonia

After rejecting the IFRS for SMEs, European Commission proposed a new Directive to replace and modernize the existing Accounting Directives 78/660/EEC and 83/349/EEC, which stated: “The proposal should simplify the accounting requirements for small companies and improve the clarity and comparability of companies’ financial statements within the Union. These policy choices will reduce the amount of information available to users of small and medium-sized company financial statements, including information, which is publicly available” (European Commission, 2011b).

The proposal for a new Accounting Directive did not contain any new policy proposals regarding micro-entities as these were assessed separately. This project was finalized on March 14, 2012, when the European Parliament and the Council adopted a change in Directive 78/660/EEC. The new provisions had the potential to reduce significantly the administrative burden for those companies not exceeding the limits of two of the following criteria (European Parliament, 2012):

- a balance sheet total of EUR 350 000;
- a net turnover of EUR 700 000, and
- an average of ten employees during the financial year.

On June 26, 2013 the European Parliament and the Council also adopted a new Accounting Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending the 4th and 7th Directives (European Parliament, 2013). Estonia voted against the Directive and submitted an explanatory statement for the disagreement.

The adoption of new Directives also affected Estonia. The statistical profile of Estonian companies based on the quantitative criteria set by the new Accounting Directive is included in Table 3.

Table 3. Distribution of Estonian companies based on the quantitative criteria defined in Directive 2013/34/EU in 2012

Variable	Nano ¹	Micro	Small	Medium	Large	Total
Number of companies	9,230	101,664	3,757	406	71	115,128
Number of employees	4,405	147,535	102,942	54,206	99,056	408,144
Net turnover (bn EUR)	0.13	9	12	10	14	45
Balance sheet total (bn EUR)	0.85	15	11	8	15	50
Proportion:						
Number of companies	8.02%	88.31%	3.26%	0.35%	0.06%	100%
Number of employees	1.08%	36.15%	25.22%	13.28%	24.27%	100%
Net turnover	0.29%	20.28%	26.23%	22.15%	31.06%	100%
Balance sheet total	0.17%	32.64%	21.29%	16.10%	29.80%	100%

Source: Kontseptsioonidokument: 15

According to Table 3, in 2012 110,894 entities (96.3% of total number of companies) had less than 10 employees. Therefore, one can argue that the Estonian micro-entities may be interested in adopting the new regulation in Estonia as well.

The adoption of the new Directive provoked many discussions and reactions in Estonia about the possible future and changes in the Estonian accounting legislation. These reactions were especially strong, as Estonia had just adopted new accounting guidelines following the IFRS for SMEs and the public was not ready for another change.

The Estonian government believes that the failure to consider the proposals made by the Estonia's representatives during the procedure of compiling the new Accounting Directive has resulted in policy choices damaging Estonia's interests. In September 2013, the Estonian government submitted a claim to the European Court of Justice for the annulment of some provisions in the accounting Directive 2013/34/EU. The Directive's original objectives were to reduce administrative burdens for smaller businesses and to increase the comparability of financial reporting. In the opinion of the Estonian government, either of these objectives could not be achieved and the transposition of the Directive would affect the transparency of economic space and competitiveness of enterprises.

According to the Estonian Minister of Finance Jürgen Ligi Estonia has created a convenient e-reporting system, which has greatly facilitated presenting data by companies. The Directive is in conflict with itself and thus, in our case, forces additional reporting requirements by companies to both banks and the state. Foremost, Estonia wants to challenge the Directive's disproportionate limitation so that the additional notes to the financial statements of small businesses submitted through e-filing system of Commercial Register can only be required for tax collection purposes. Since 1 January 2010, all companies, foundations and non-profit organizations have presented their financial statements through special e-filing system. All stakeholders in private and public sectors can use the data reported in the system. Restrictive requirements of the Directive would mean that this international award-winning system should be changed and many state agencies and private companies should contact directly other companies for more detailed information, as data once available in annual reports presented through e-filing system would vanish. The Estonian Bureau of Statistics would not have pre-filled data based on information collected through annual financial statements that help companies save time.

For example, complicated annual statistical report EKOMAR was pre-filled based on the data of annual financial statements on average of 80% of cases, and 20% of data had to be added by the respondents thereto. Thus, the Directive would result, in contrast to its objectives, in the relocation and rise of the administrative burden for both, the companies and the state. In addition, Estonia challenges the provision of the Directive according to which the state may waive the substantive comparability of annual reports. Specifically, member states may establish a rule, which does not require financial statements to reflect the substance of the transactions, but the form. Until such provision is valid, the objective of the Directive will not be achieved – the simplification of cross-border business in the member states through comparable annual reports (Ministry of Finance of the Republic of Estonia, 2013).

Although Estonia has challenged the EU that new Accounting Directive is not suitable for Estonia, the chairman of the EASB Ago Vilu (2013) estimates that it is possible to find national solutions to the Directive's "bottlenecks" that will keep the big picture of the current accounting situation, without the need to sue the EU. When prosecuting against the new Directive one must consider the cost of the lawsuit including the cost of political capital and time. Instead, one should consider alternative options that would equalize the change from the current detailed reporting to the reporting where reporting by micro and small enterprises is not reduced so drastically. For example, one could continue with current format of state e-filing environment, but mark the parts of financial statements required by the Directive with an asterisk, but nonetheless maintain the way information has been asked so far. Vilu also brought out the possibility that auditors may require additional information. For example, it is possible to agree between auditors that to

receive an unqualified opinion, a company has to disclose more than it is required by the Accounting Directive, because the latter does not provide enough information. If the government should require such an agreement, it is also likely that the auditors are willing to provide it. These two measures would be sufficient to keep the current situation in accounting without the need to impose other measures, for example, through amendment of tax laws (Vilu, 2013).

Dontševski (2013: 14) has analyzed the probable implications of the new Directive for the Estonian accounting legislation and day-to-day work of accountants. According to him, changes are expected to occur in Commercial Register electronic e-filing system in 2016 where annual statements will be drafted and this probably means that comparative financial statements will have to be revised as well. The work of an accountant will become more “automated”, as the workload becomes smaller. However, companies that are trying to involve additional investments from third parties, creditors or financial institutions, have to be prepared to provide additional information in a manner required by the third party.

Kajasalu (2014) has conducted a more thorough analysis of the implications of the new Directive for the Estonian accounting legislation. The aim of her work was to find out the conflicts between the new Directive and the EGAP. According to her estimates, the following provisions in the Estonian legislation require coordination with the Accounting Directive (Kajasalu, 2014: 83):

- to create a legal basis for the terms “micro”, “small”, “medium” and “large” undertaking;
- to create a legal basis for the terms “small”, “medium” and “large” group,
- to introduce new “bottom-up” approach and impose rules according to the size of a company;
- to improve the content of the prudence concept;
- to harmonize the balance sheet layout;
- to harmonize the income statement (profit and loss account) layouts;
- to exempt small groups from the requirement to prepare consolidated financial statements;
- terminology as a whole may need to be updated.

Kesksaar (2013: 71–72) explored the requirements for SMEs’ financial statements in the EU and based on that made recommendations how to improve the accounting framework for Estonian SMEs. According to her recommendations, the following provisions in the Estonian legislation should be made:

- to categorize the micro, small and medium-sized entities for accounting, financial reporting and audit purposes;
- to shorten micro and small entities’ annual report submission date from six months to four months;
- to exempt micro and small entities (if audit and review is not mandatory) from statements of changes in owner’s equity;

- to exempt micro and small entities (if audit and review is not mandatory) from management's report.

Kesksaar believes that aforementioned changes would reduce the administrative burden for small entities and harmonize the EGAP better with European SMEs' financial reporting. The authors of this paper believe that many of the recommendations made by Kesksaar are in line with the ones proposed in the new Accounting Directive.

Currently, it takes some time until the Directive becomes effective and therefore some can see the changes in the accounting policy in 2016, unless Estonia does not plan to align its accounting legislation to the Directive before the deadline as it has happened many times before. By litigating against European Commission, Estonia may win one more year before we are forced to adopt the new Accounting Directive. People involved believe that Estonia will lose the court case and thus the "negative scenario" should already be taken into account when preparing for changing legislation affected by the new Directive. This means significant changes in the EAA in 2014–2015 to achieve the cohesiveness with the new Directive. Still the opportunity to choose between the EGAP and IFRSs probably remains as the EU has approved IFRSs. Therefore, the adoption of a new Directive will not affect the companies, which already prepare their annual financial statements according to IFRSs.

3. Conclusions

The implementation of IFRSs in the form of the EGAP has been smooth and successful in Estonia. This is due to the fact that transformation from a centrally planned to a market-based economy involved significant legal and institutional changes in regulations, especially the accounting regulations, and gave rise to the development of a new accounting environment. Since enterprises were aware of the changing situation and the need to create accounting framework suitable for Estonia, there was no public resistance to the new Accounting Act or the EASB guidelines that followed the principles of IAS/IFRSs. As companies were given two options – either to draft their financial statements according to the EASB guidelines (that was the simplified version of IFRSs) or IFRSs themselves – the adoption of IFRSs was not imposed on companies. When it became obligatory in 2005 for the listed entities to prepare their annual financial statements using only IFRSs, it also did not affect many enterprises, as only eight entities were listed on the main list of Tallinn Stock Exchange, and seven were on the secondary list at that time. The authors believe that a complete convergence with IFRSs (as adopted by EU) have been achieved by those companies who have chosen to prepare their annual financial statements using the respective standards.

The adoption of the IFRS for SMEs in Estonia also went quite smoothly and did not create many reactions among interested parties. The main reason was that the IFRS for SMEs followed the main principles of “big” IFRS that was already the basis for the ASBG’s almost two decades ago. A few discrepancies between the IFRS for SMEs and “big” IFRS (for example amortization of goodwill) did not affect many companies in Estonia and thus did not create negative feedback or resistance by them. Even if it affected any entities in Estonia, these companies transferred from preparing their annual financial statements using the EGAP to IFRSs just for the reason not to amortize goodwill. Since the EGAP already followed the principles of IFRSs, companies did not consider the adoption of IFRSs to keep the goodwill in their books that complex or time-consuming. Other companies had just accepted the Estonian version of IFRS for SMEs as it was, because it was very similar to ASBGs effective until 31 December 2012 and it still gave alternatives in some areas of accounting principles, where IFRS for SMEs did not. Therefore, the authors estimate that the possible convergence level of the EGAP with the IFRS for SMEs is approximately 95%, but further empirical research in this area is necessary.

Taking into account how accounting legislation in Estonia has historically been changed (due to the political changes or direct influence by the EU), one should consider whether the changes have really been justified and meet the needs of financial statement users. Although research has been carried out at the EU level among SMEs and their financial statement users (European Commission Study on Accounting Requirements for SMEs, 2011), this actually has not involved any of the Estonian companies or stakeholders. In addition, bearing in mind the effect of the new Accounting Directive to micro- and small entities that constitute 98% of the Estonian companies, one should ask from them and their financial statement users whether the changes in the Accounting Directive are acceptable for them, or would they perhaps continue to provide information in e-filing system as it has been asked so far. This will be the authors’ research task in the near future.

In the light of the recent events (Estonia aligning its accounting guidelines with the IFRS for SMEs on the one hand, and the EU banning the IFRS for SMEs and creating simplified rules for micro-enterprises on the other) it is hard to tell what will happen to the Estonian accounting framework in future. The authors believe that the change in the Accounting Directive will affect the companies’ future financial statements in the way, which is hard to predict now, but will definitely deserve further research.

Acknowledgement

This paper has been financially supported by ESTONIAN-SWISS COOPERATION PROGRAMME.

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¹ Nano company is a term created by the Estonian Ministry of Finance. Nano company has only one shareholder, its balance sheet total is less than 60,000 EUR and liabilities do not comprise more than 50% of total balance sheet.