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DISTORTIONS AND ERRORS IN THE FINANCIAL STATEMENTS: CLASSIFICATION, DETECTION AND WARNINGS

Summary

The necessity to provide reliable financial statements to users is enshrined in the legislation of Ukraine. Thus, the financial statements should be formed according to the rules that are enshrined in regulations of both domestic and international law. The reporting is considered reliable if the information in such should not contain errors and distortions that could affect the decisions of users of reporting.

The quality of the submitted financial statements, its reliability and compliance with all requirements and, accordingly, the effectiveness and appropriateness of management decisions made on its basis are directly affected by the presence or absence of errors in the financial statements, their timely and complete correction. This emphasizes the urgency of improving the characteristics of the classification of errors, which depends on the choice of a particular algorithm for their correction.

The purpose of the article is to investigate the classification of errors in financial statements to predict all possible types and supplement it with new classification features.

The research is based on a systematic approach to the classification of errors in financial statements and the prediction of all possible types. The authors used methods of analysis and synthesis, grouping and detailing, induction and deduction and analogy. Abstract-logical method - for the implementation of theoretical generalizations and conclusions about the nature of errors in the financial statements to supplement them with new classification features.

Analysis of the opinions of scientists on the motives of distortions and errors in accounting and reporting has clarified that the latter can be very diverse, which is quite difficult to assess. We have expanded and supplemented the classification features of distortions in financial statements.

The proposed classification will determine the place and period of occurrence of the destructive factor in the documentation, accounting records and identify those responsible for carrying out specific facts of economic activity, reflected in the financial statements.

In further research, it is advisable to focus on the need to apply the basic principles and procedures of International Standards on Auditing in connection with the fact that the process of transition to IFA in our country is coming to an end.

Keywords: financial statements, distortions, errors, classification of errors, unintentional distortions, intentional errors, material and non-material errors.

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ВИКРИВЛЕННЯ І ПОМИЛКИ У ФІНАНСОВІЙ ЗВІТНОСТІ: КЛАСИФІКАЦІЯ, ВИЯВЛЕННЯ ТА ПОПЕРЕДЖЕННЯ

Анотація

Актуальність. **Постановка проблеми.** Необхідність надання достовірної фінансової звітності користувачам закріплена законодавством України. Тобто, фінансова звітність повинна бути сформована за правилами, які закріплені в нормативно-правових

актах як вітчизняного, так і міжнародного законодавства. Достовірною вважається така звітність, інформація в якій не повинна містити помилок та перекручень, які здатні вплинути на рішення користувачів звітності.

На якість поданої фінансової звітності, її достовірність і відповідність усім висунутим до неї вимогам та, відповідно, на ефективність і доцільність прийнятих на її основі управлінських рішень безпосередньо впливає наявність або відсутність помилок у фінансових звітах, своєчасне та повне їх виправлення. Це підкреслює актуальність питання щодо вдосконалення ознак класифікації помилок, від якої залежить вибір того чи іншого алгоритму їх виправлення.

Метою статті є дослідити класифікацію помилок у фінансовій звітності для передбачення усіх можливих їх видів та доповнити її новими класифікаційними ознаками. **Методологія.** Наукове дослідження ґрунтується на системному підході до класифікації помилок у фінансовій звітності та передбачення усіх можливих їх видів. Автори використовували методи аналізу та синтезу, групування та деталізації, індукції і дедукції, аналогії. Абстрактно-логічний метод – для здійснення теоретичних узагальнень та висновків про сутність помилок у фінансовій звітності, доповнення їх новими класифікаційними ознаками.

Результати. У статті розширено та доповнено класифікаційні ознаки викривлень фінансової звітності. Аналіз думок науковців про мотиви викривлень і помилок у бухгалтерському обліку та звітності дозволив уточнити, що останні можуть бути дуже різноманітними й оцінити їх досить складно.

Практичне значення. Запропонована класифікація дозволить визначити місце і період виникнення деструктивного фактору в документації, облікових регістрах і виявити відповідальних за проведення конкретних фактів господарської діяльності, відображених у фінансовій звітності.

Перспективи подальших досліджень. Надалі доцільно зосередитись на необхідності застосування основних принципів і процедур Міжнародних стандартів аудиту у зв'язку з тим, що процес переходу до МСФЗ в нашій державі завершується.

Ключові слова: фінансова звітність, викривлення, помилки, класифікація помилок, ненавмисні та навмисні помилки, суттєві та несуттєві помилки.

Кількість джерел: 9, кількість таблиць: 1.

Problem statement in general. The desire of many local companies to enter international investment markets is increasingly contributing to the formation of financial reporting as a tool for decision-making by business owners, and as a basis for analysis by external users, including investors.

The necessity to provide reliable financial statements to users is enshrined in the Law of Ukraine "On Accounting and Financial

Reporting in Ukraine" and National Accounting Regulation (Standard) (NAR(S)) 1 "General requirements for financial reporting". Thus, the financial statements should be formed according to the rules that are enshrined in regulations of both domestic and international law. The reporting is considered reliable if the information in such should not contain errors and distortions that could affect the decisions of users of reporting [1].

The quality of the submitted financial statements, its reliability and compliance with all requirements and, accordingly, the effectiveness and appropriateness of management decisions made on its basis are directly affected by the presence or absence of errors in the financial statements, their timely and complete correction. This emphasizes the urgency of improving the characteristics of the classification of errors, which depends on the choice of a particular algorithm for their correction.

Analysis of recent research and publications. Problems of the process of correcting errors in financial statements, the ambiguity of their definition and classification have been the subject of research in the works of well-known domestic and foreign economists, including S. Golov, S. Bychkova, A. Bryzgalin, A. Kuzminsky, M. Kuzhelny, M. Tarasova, B. Usach, O. Petryk, R. Khomyak, V. Shvets, and others. However, without diminishing the value of scientific papers and their theoretical and practical orientation, it should be noted the need for a comprehensive study of all types of distortions and errors in order to timely find, identify and select the necessary method of correcting errors in financial statements. The quality of the financial statements depends on the probability of possible accounting and reporting errors, so a comparison of the standards governing misstatements and errors in the financial statements identified in accordance with IAS 8 and NAR(S) 6 is relevant. In this regard, we will turn to foreign sources and conduct a comparative analysis of IAS 8 "Accounting Policies, Changes in Accounting Estimates and Errors" (IAS 8) and NAR(S) 6 "Correction

of Errors and Changes in Financial Statements”, and see also ISA N° 240 “Auditor's Responsibility for Fraud in Auditing Financial Statements” (ISA 240) [2, 7]. One of the reasons that can lead to an error in reporting is fraud. However, the very definition of “fraud” and “bad faith” doesn’t account in IAS 8 and in NAR(S) 6. Note that the source of distortions in financial statements in both standards is only an error. Also, if inaccuracies or omissions in the reflection of the facts of economic activity in the accounting and (or) in the financial statements of the enterprise, revealed as a result of obtaining new information that was not available at the time of reflection (non-reflection) of such facts, then those are not classified as errors [2].

Formulation of the goals of the article. The purpose of this article is to investigate the classification of errors in financial statements to predict all possible types and supplement it with new classification features.

Presenting the main material. When analyzing financial statements prepared with errors, the signs of distortions and errors should be qualified. A revise of the economic literature, the works of famous scientists, as well as author's research provide an opportunity to identify the following groups for which the classification of types of errors and distortions of financial statements is possible (table 1).

In accordance with the selected classification feature by the degree of the impact on the reliability of financial statements, the identified distortions may be significant and insignificant.

International Accounting Standard 8 “Accounting Policies, Changes in Accounting Estimates and Errors” § 41 presents the concepts of material and non-material errors that lead to incorrect calculation of financial results [7]. The omission or distortion of articles is considered significant if they can, individually or in combination, affect the economic decisions of users made on the basis of financial statements. Significance depends on the size and nature of the omission or distortion which are assessed in the particular circumstances. The size or nature of the article, or a combination of both, can be a determining factor.

Classification of distortions in financial statements

Classification	Types of errors
1. By the degree of influence on the reliability (significance)	a) significant - quantitative (values) - quality (character) b) insignificant
2. By the nature of origin (by intent)	a) unintentional (involuntary) b) intentional
3. By the impact on accounting	a) errors that affect only accounting; b) errors that affect only tax accounting; c) errors that affect accounting and tax accounting
4. By the way of reflecting the facts of economic activity in accounting	a) incomplete accounting b) unfounded accounts (errors in the reliability of the facts of economic activity) c) errors in periodization d) errors of assessment, underestimation or misinterpretation of facts e) errors in documentation f) incorrect (or insufficient) display of information in the forms of financial statements and notes to it g) errors in correspondence h) errors in the presentation
5. By the consequences	a) local b) transit
6. By the frequency of occurrence	a) typical b) unique

Source: Developed by the authors based on [3, 5, 8, 9].

Thus, minor distortions are those whose omission does not affect the financial statements in a way that could mislead users and lead to incorrect decisions based on the data of these statements.

Classification feature based on nature of the distortions distinguishes unintentional and intentional distortions.

According to Bychkova S., errors that occur due to inattention, incompetence and negligence of performers or caused by imperfections of current legislation in the field of accounting, are unintentional distortions. With the constant improvement of the legislative and regulatory framework and the constant obsolescence of methodological materials that describe the procedure for accounting, the probability of errors increases significantly [3, p. 55].

Unintentional distortions should be divided into technical and accounting ones. In addition, it was found that technical errors occur in such cases as:

- the process of calculating the number of taxes when applying the wrong rate;
- drawing up and calculating tax payments;
- inequality of final reporting indicators;
- unclear entries in primary documents;
- transferring primary accounting data to the accounting registers of current accounting and consolidated reporting;
- of incorrect filling of the declaration lines under the condition of full and correct reflection of the operations performed by the enterprise in the accounting registers;
- deviations due to carelessness, negligence, fatigue, errors in accounts or accounting data;
- incorrect transfers of account balances, etc.

In our opinion, it is necessary to supplement this list of types of distortions with incorrect classification, for example, when compiling financial statements, temporary and permanent differences are incorrectly classified.

Therefore, it is also advisable to include errors made during the transformation of reporting to the group of technical errors, as the transformation process consists of several stages and is often carried out without special software (only with Excel). A difficult moment is the reclassification of assets and liabilities, incomes and expenses. It is highly probable that any assets or expenses may be excluded when they are classified in accordance with domestic IAS or, conversely, not included in the group where they should be in accordance with IAS.

In order to reduce the number of errors in the transformation, it is necessary to minimize the impact of the human factor. To do this, IAS specialists develop tables with control checks of information and clearly prescribe the method of the transformation for each area of work. In our opinion, the best way to minimize the risk of errors in the transformation of reporting is to use special computer programs.

We came to the conclusion that technical errors affect only the design of business transactions, and accounting errors (content errors

and procedural errors) mostly consist of incorrect descriptions of economic information in accounting and reporting.

Intentional errors may be the result of the enterprise's statutory activities, part of which are accounting, tax policies and others that affect the content and form of financial statements. At the moment, there are motives that encourage the conduct of accounting policies that distort the state and position of the property of the enterprise and the results of its activities.

As a result of the study, all intentional errors are divided into two categories: those that do not contradict the law and those that contradict the law. Tax evasion is the central point around which legal and illegal business activities are concentrated. There are many ways not to pay taxes, they are both illegal and semi-legal – and they use the shortcomings of the law. Nonpayment of taxes is a mass phenomenon today, the public is quite loyal to it, despite the obvious damage to the country's economy.

However, misstatements in the financial statements may be the result of both errors and bad faith, as the error differs from the latter by the lack of intent underlying the action that led to the misstatement of the financial statements. Error – is an unintentional misrepresentation in the financial statements, including non-disclosure of any numerical indicator or non-disclosure of any information. The key word in the definition of "error" is "unintentional". Therefore, in the author's opinion, the two concepts should not be combined as the main source of distortion of financial statements.

The main factor that determines the difference between "error" and "violation" is what underlies the discrepancy - unintentional or intentional cause. However, intent is often difficult to determine, especially when it comes to the application of accounting indicators or accounting principles. For example, an unreasonable accounting measure may be the result of an unintentional error, or it may be an intentional attempt to enter erroneous information in the financial

statements. Since the error differs from the bad faith by the lack of intent that led to the distortion of the financial statements, we will distinguish between unintentional misrepresentation as a result of an error and intentional misrepresentation as a result of bad faith.

In addition to the concept of "error", IAS 8 defines "accounting". The assessment involves a professional judgment based on the latest information available. It is possible that in connection with the receipt of new information or experience, the assessment will have to be revised, which will not be related to previous periods and is not a correction of the error [7].

R. Khomyak identifies errors by the impact on accounting. According to this criterion, there are:

a) errors that affect only accounting. For example, account correspondence was incorrect, and therefore entries were made in other registers than required;

b) errors that affect only tax accounting. For example, error that were made during the compilation of the register of tax invoices;

c) errors that affect accounting and tax accounting. For example, incorrectly determined initial cost of inventory causes inaccuracy of accounting, as well as incorrect determination of income tax [9, p. 789].

In accordance with table 1 there are other types of distortions that affect the reliability of financial statements.

In our opinion, the incomplete accounting of the facts of economic activity of the enterprise often occurs due to poor knowledge of accounting rules, which in turn leads to data distortion. A typical error of this type is to not reflect the accounting of fines received from the debtor; to not display the received promissory notes issued in the name of the enterprise.

This type of distortion is associated with errors in documenting the facts of economic activity. For example, complete or partial lack of accounting for certain financial and economic transactions of the

enterprise, due to lack of information about these transactions or negligence of employees of the accounting department.

Errors in periodization occur due to incorrect recognition of the facts of economic activity in the reporting periods due to late receipt of documents from contractors, violation of the schedule of documents within the enterprise, which leads to distortion of the financial results of the enterprise and changes in tax base.

We have identified two types of distortions in the detection of errors in periodization - late or early closing of accounts (before the reporting date), resulting in the facts of economic activity, which should be reflected in the next period, included in the accounts of the reporting period.

After the detection of falsified reporting, the data of examinations of individual enterprises revealed that errors in assessing the facts of economic activity by incorrect choice of valuation of assets and liabilities of the enterprise approved in the accounting policy may lead to overstatement or understatement of the balance sheet currency. This will change the economic indicators that reflect the activities of the firm. An example is the preparation of reports without taking into account the cost of work in progress, the revaluation of fixed assets that was carried out incorrectly, a debt due which has long come and the probability of its recovery is very small, no write-off of deficiencies, etc.

Financial statements may be distorted due to incorrect or inaccurate presentation of data in the reporting forms, as well as in the notes due to manipulation of account balances.

Distortion of reporting can also occur through an incorrect relationship between the accounts, which reflects the information about the accounts, not designated for this purpose by the Chart of Accounts of the enterprise. This is possible in case of non-compliance with the requirements, accounting rules and other regulations. In this case, errors may be methodological in nature, the cause of which is a change in regulations.

A number of scientists (O. Lyshylenko, A. Kuz'menko, V. Bilous'ko) divide errors into local and transit. Accounting errors can be local when incorrect entries lead to distortion of information only in the document or register where they occurred, and at the same time do not affect the further systematization of information in other accounting registers. Transits errors are such made in one accounting register, which lead to chain changes in other accounting registers, as well as the reporting of the enterprise [5, 6, 8].

Scientist I. Zholner identifies another classification feature of distortions - depending on the frequency of an error in accounting and reporting, highlighting the typical and anomalous groups of distortions [4, p. 236].

Typical distortions are those that are caused by an invariable cause that causes errors. These errors may be internal in nature, for example, it may be the application of incorrect calculation of a particular type of business transactions, which is implemented in an automated accounting system. There are also errors typical for a group of enterprises, for example, it may be a violation of the principles of accruals in the reflection of costs, which cover several reporting periods.

Abnormal are those errors that do not occur systematically or occur in rare circumstances. Such errors can be considered in the narrow and broad sense of the word: in a single enterprise and in groups of enterprises. They are manifested in the accounting of the enterprise, usually when working with rare for the enterprise business transactions.

The classification of distortions in the financial statements, knowingly or unknowingly, obscuring the true and fair view of the entity's financial and property condition can be continued. The reasons that led to the distortion of financial statements can be very different, which are difficult to assess.

In this regard, it should be noted that our selected classification features contribute to the disclosure of the order of preparation of distorted financial statements. In addition, the classification of types of

distortions and errors can be used to determine the amount of material damage and the place of its occurrence.

Conclusions and prospects for further research in this direction. Analysis of the opinions of scientists on the motives of distortions and errors in accounting and reporting has clarified that the latter can be very diverse, which is quite difficult to assess. We have expanded and supplemented the classification features of distortions in financial statements. The proposed classification will determine the place and period of occurrence of the destructive factor in the documentation, accounting records and identify those responsible for carrying out specific facts of economic activity, reflected in the financial statements.

In further research, it is advisable to focus on the need to apply the basic principles and procedures of International Standards on Auditing in connection with the fact that the process of transition to IFA in our country is coming to an end. However, there is no definition of "fraud" in the standard (IAS 8). The concept is disclosed in ISA 240 "Auditor's Responsibility for Reviewing Fraud and Errors in the Audit of Financial Statements". Therefore, in the future, it will also be appropriate to consider the concepts of "error" and "distortion" from the standpoint of ISA № 240, formerly called "Fraud and Error" (ISA 240 "Fraud and Error"), which gives a clear definition of "error" and "distortion" in the financial statements and indicates their differences.

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