1. Introduction

The transformation of Estonia’s economic system since the 1990s as a result of transition from a centrally planned economy to a market-led one involved significant legal and institutional changes in the regulation and practice of accounting. In May 2004 Estonia joins the European Union. In view of this, it is necessary to analyze the effectiveness of Estonian accounting policy and, whether and how well the Estonian accounting regulation directions conform to the requirements of the future European accounting framework. In July 2002, the European Commission decided to oblige all EU companies listed on a regulated market to prepare their consolidated accounts in accordance with the International Financial Reporting Standards (IFRS, previously IAS). This requirement will enter into effect, at the latest, from 2005 onwards.

Introducing theoretical developments from the organizational change theory and the phased approach the present paper examines the evolution of the Estonian accounting system and accounting policy within the context of the EU accession and harmonization. The author concentrates on the following three aspects of the Estonian accounting reform: development of the accounting regulations; development of the scope of accounting regulations and development of the degree of independence of the accounting regulatory institution.

The paper is organized as follows. The next section sets a literature framework for the analysis, drawing on the aspects and phases of the Estonian accounting change. Within this section, on the basis of literature analysis, it is also discussed briefly how the organizational change theory and the phased approach can be used to analyze the accounting change of an individual country. In the third section, the author applies the organizational and phased framework to describe how the Estonian accounting regulations and institutional framework have changed in the course of three different stages: introductory, system building, and system improvement stage. The last section contains concluding remarks on the study.

2. Literature framework for the analysis

In Eastern and Central Europe, the study of accounting is a comparatively new research area, which has evolved only during the last decade after the collapse of socialism. The earlier research viewed the post-socialist countries 'as a bloc' with common problems and challenges (Seal et al, 1995: 659). However, as expressed by Roberts et al. (2002: 9), there are no two countries with identical accounting systems. In a similar way, Bailey (1998: 1462) estimates the Central and Eastern European countries as heterogeneous ones, being at different stages of
transformation from command economy. During the last decade a number of papers have been dedicated to the practice and development of accounting in the Eastern and Central European transitional countries. Several publications address the subject of financial accounting and auditing in Poland, the Czech Republic, Romania, Slovakia and other Central and Eastern European countries, including also Estonia. In general, as our analysis revealed, these publications can be broadly divided into three groups. The first set of papers describe the development of a particular country’s accounting system in general terms. In majority, these investigations indicate state-of-the-art-type studies, are mostly descriptive in character and without using any strong theoretical framework. This set contains also little material on accounting developments in Estonia. In The European Accounting Review Bailey et al. (1995) published a paper on the accounting reform in the Baltic states – Estonia, Latvia and Lithuania. This paper includes a description of accounting developments during the first half of the 1990s. There is also a chapter in the European Accounting Guide (1998) about the development of the accounting systems of the Baltic States (see Alver et al., 1998). The second set is dedicated to particular issues which are analyzed on the basis of a certain theoretical framework in the context of an individual country. Among these issues, we can point out true and fair concepts (see Kosmala-MacLullich, 2003; Sucher et al., 1996), organizational aspects of the accounting reform (see Seal et al., 1995), relations and impacts between accounting and taxation (see Jaruga et al., 1996; Holeckova, 1996). The works in the third group of research have a comprehensive and comparative character, analyzing various aspects of accounting development in several transitional countries (see Bailey, 1995; Bailey, 1998; Parker and Nobes, 2002). These sets of investigations on different countries of Eastern Europe provide a framework for analysis and exemplify some of the issues encountered when developing accounting practices, which may be relevant for evaluating the Estonian experience.

Analyzing the accounting system change in the Czech Republic, Seal et al. (1995) use the theories of organization and organizational change as a theoretical framework for their investigation. Proceeding from the studies of Laughlin and Gray (1988) on organization theory, and of Laughlin (1991) on organization change theory, Seal et al. (1995) defined an accounting system as an organization and modeled the Czech accounting change as a second-order change (morphogenesis). The authors of the Czech analysis argued that the theoretical framework of organizational change could also be applied to other post-socialist countries (Seal et al., 1995: 663).

For the transitional countries, Bailey (1998: 1462) suggested application of a phased approach to the accounting reform. It was proceeded with respect to placing the companies’ statutory financial statements in the public domain. In the current paper, the phased approach has been involved in order to periodize and to expand the scope of the Estonian accounting reform. Literature analysis revealed that the phased approach has been used in the Czech Republic (Seal et al., 1995), Poland (Kosmala-MacLullich, 2003; Jaruga and Szychta, 1997), Romania (King et al., 2001) and
Estonia (Haldma, 2003) to a certain extent to divide the accounting reform into periods. In this paper, to analyze the conceptual aspects of the Estonian accounting reform, we are using an integrated theoretical framework of organizational change and the phased approach which are merged into a single theoretical framework.

3. Stages of the integration of the Estonian accounting system into the international framework

To periodize the development of the Estonian accounting system Haldma (2003) distinguished three stages in this process: the introductory (1990-1994), system-building (1995-2002) and system improvement stage (from 2003 onwards). Following, basing on these stages, we concentrate on the development of the accounting regulations, the scope of accounting regulations and the degree of independence of the accounting regulatory institution to analyze the content and depth on the Estonian accounting change.

The first, introductory stage (1990-1994)

The accounting regulation and its scope. Estonia started to aspire towards market economy when it was still a part of the Soviet Union, and much earlier than the other Soviet republics. In July 1990, more than a year before independence was regained in August 1991, the Regulation on Accounting was adopted by the Estonian Government. This event was the first step towards creation of market-economy accounting environment in Estonia. The Regulation on Accounting came into effect from 1 January 1991. As pointed out by Bailey et al. (1995: 688), this event also marked the beginning of the spread of accounting disharmony within the territories comprising the USSR.

The Regulation made accounting an autonomous area of information provision and established minimum requirements to all juridical persons in Estonia (enterprises, entities of state and local authority and other organizations) for the organization, structure and maintenance of the book-keeping (accounting) system. In the contemporary sense, the Regulation was quite modest in content and volume, consisting of only ten pages. But the introduction of subjective elements (depreciation rates, inventory valuation methods, assets valuation methods, etc. decided by companies) into the accounting practice, formation of a particular accounting policy, change from cash-basis accounting to accrual-basis accounting, institution of some (unfortunately, not all of them, but under the particular circumstances this was also understandable) basic accounting principles, such as the realization principles, the matching principle, the historical cost principle appeared to be extremely radical changes in the accounting framework of Estonia. The regulation served as an initiative to link the future development of accounting in Estonia to the EC 4th directive.

Accounting regulatory institution. According to the Regulation, the Estonian Accounting Board (later named as Estonian Accounting Standard Board – EASB), supervised by the Ministry of Finance became the guiding body of accounting in 1991. The main task of the Board was to issue mandatory accounting instructions as
well as recommendations concerning the methods to be applied. Also all further developments in the field of accounting were expected to be initiated and prepared for legislation and implementation by the Board.

In summary, the actions spurred by the accounting regulation in Estonia greatly contributed to and helped create a favourable environment for the adoption of the basic principles of market economy accounting, preparing movement to the second stage of the Estonian accounting reform.

The second, system-building stage (1995-2002)

In August 1991, when Estonia regained independence, the country switched over to a new, market-led economic system, having an accounting system which originated from the period of centrally planned economy. Therefore, despite the positive aspects of the abovementioned Regulation on Accounting, a further set of measures was suggested in order to accelerate development and bring Estonian accounting in line with the international standards and principles. Therefore, the reformers of the accounting systems in Estonia had to tackle the question about what model of accountancy would suit best for the country’s unique developmental needs.

In the middle of the 1990s, the development of the business environment in Estonia was affected by the conceptual changes and improvements in the legal system (particularly in taxation), ownership changes (the most intensive period of privatization was 1993-1995) and increasing FDI inflow.

Therefore, the main problem was: how to build a forward-looking and flexible accounting regulation system, which would enable Estonian accounting integration into the European accounting framework. The traditional continental European approach based on the accounting law would have been too inflexible to reflect the rapid changes in transition circumstances. Moreover, Van Hulle (1993: 390) expressed the idea that the use of the accounting law as a means of standard setting could also be an interesting mechanism against too frequent (and sometimes unnecessary) changes. But this could not be the position for the transition countries (e.g. Estonia), because a stable and effective accounting regulation system, consistent with the general accounting principles was almost non-existent there. Bailey (1998: 1457) had doubts about the transition countries’ ability to implement a large accounting change when there was so much other instability (new political and legal systems; new institutional structures). But there were no other alternatives. The guiding body, the EASB had to take responsibility and conceptualize further developments towards the international accounting principles.

After a comprehensive exploration, internal discussions, careful consideration and some testing in practice, the EASB drafted the Estonian Accounting Law (EAL) which was passed by the Estonian Parliament in June 1994 and came into effect in January 1995. One of the most conceptual issues of the EAL was an attempt to create the facilities for merging the Continental European approach with the Anglo-American approach.
The accounting regulation. Since 1995 the accounting framework and procedures in Estonian companies and institutions have legally been regulated by the following documents:
- Estonian Accounting Law (EAL);
- Estonian Accounting Standards (EAS) issued by the EASB

Such a combination had a number of advantages in the initial period of the accounting reform, speeding it up and enabling the transition process to be flexible. The EAL served as a frame-law, whereas the EASs prescribed more particular issues of financial accounting.

Chapter 1 of the EAL specified the objective of the EAL, which is to create the legal basis 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 EAL internationally accepted accounting and reporting principles are defined as the accounting directives of the European Community and the principles, standards and recommendations developed and approved by the International Accounting Standards Committee (IASC) (*Heaamatupidamistava*, 2000).

Cairns had argued (1997: 309) that the only realistic option open to the EU was to lend its full support to the adoption of the IAS as the mutually acceptable standards of accounting. He agreed (1997: 310) that this approach was controversial within the European accountancy profession at the end of 1980s and only the events of the early 1990s made it more tenable. Hence we can conclude that the EASB, drafting the EAL in 1993-94, was able to envisage the further developments of the European accounting framework, consider them in the EAL and improve the Estonian accounting system accordingly.

Between 1995 and 2000 the EASB issued 16 EASs to improve particular aspects of accounting in Estonia. This set includes standards concerning accounting aspects of the Conceptual Framework of Generally Accepted Accounting Principles; Revenue Recognition under the Revenue Principle; Liquidation and Termination Balance Sheet Preparation; Business Combinations; Balance Sheet Accounts; Income Statement Accounts; Equity Method; Leases; Consolidated Accounts of Credit Institutions; Government Grants; Interim Report Preparation; Earnings Per Share; Segment Reporting; Long-term Construction Contracts; Consolidated Accounts.

One way to put the Estonian accounting regulations, i.e. the EAL and EASs, into the international context is to examine the alignment of the Estonian accounting rules with the IAS. In 2000 and 2001, by the initiative of the biggest international auditing companies, two surveys on national accounting rules were carried out in 53 (2000) and 62 (2001) countries to investigate their alignment with the IAS (GAAP 2000, GAAP 2001). In both surveys Estonia was on the list. Tables 1 and 2 show the position in which the Estonian rules would not allow or would not require compliance with the IAS for end of December 2001 (adapted from GAAP 2001 at [www.ifad.net](http://www.ifad.net)).
Table 1. Accounting areas on which there were International Accounting Standards but not Estonian rules in 2001

<table>
<thead>
<tr>
<th>Accounting areas</th>
<th>Related IAS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provisions in the context of a business combination</td>
<td>IAS 22</td>
</tr>
<tr>
<td>Employee benefit obligations</td>
<td>IAS 19</td>
</tr>
<tr>
<td>Derecognition of financial assets</td>
<td>IAS 39</td>
</tr>
<tr>
<td>Hedge accounting for derivatives</td>
<td>IAS 39</td>
</tr>
<tr>
<td>Certain aspects of the preparation and presentation of cash flow statements</td>
<td>IAS 7</td>
</tr>
<tr>
<td>Rules requiring the disclosure of:</td>
<td></td>
</tr>
<tr>
<td>• statement of changes in equity</td>
<td>IAS 1</td>
</tr>
<tr>
<td>• fair value of financial assets and liabilities</td>
<td>IAS 32</td>
</tr>
<tr>
<td>• fair values of investment properties</td>
<td>IAS 40</td>
</tr>
<tr>
<td>• discontinuing operations</td>
<td>IAS 35</td>
</tr>
</tbody>
</table>


Table 2. Estonian accounting practices that differed from the IAS rules in 2001

<table>
<thead>
<tr>
<th>Accounting areas</th>
<th>Related IAS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Except for certain listed investments, financial assets are not recognized at fair value</td>
<td>IAS 39</td>
</tr>
<tr>
<td>Trading and derivative liabilities are not recognized at fair value</td>
<td>IAS 39</td>
</tr>
<tr>
<td>On acquisition, restatement of net assets to fair value is limited to the difference between cost and book value</td>
<td>IAS 22</td>
</tr>
<tr>
<td>The income tax of dividends are charged to retained earnings and not recognized in the income statement.</td>
<td>IAS 12</td>
</tr>
</tbody>
</table>


As can be seen, from an IAS perspective, there were a number of gaps and differences in the Estonian rules. But on the other hand, our analysis revealed that this number is quite modest by comparison with the other Central and Eastern European and even developed market economy countries (in more particular see Haldma (2003, p. 509). This speaks about (although there can be some speculative aspects) the flexible manner of the Estonian accounting system and the appropriateness of the chosen way of the Estonian accounting reform.

Scope of the accounting regulation. During 1995-2002 different sections of the EAL were continually improved, and its scope was expanded. At the beginning (on the day of enactment of the EAL) the Law related to registered companies, but in the subsequent years it was expanded to sole proprietorships (in September 1995) and public legal juridical persons (institutions) (in June 1996). Central and local government accounting entities were required to comply with the general principles of the EAL (Chapters 1-16) and the main guidelines issued by the Ministry of Finance.
Accounting regulatory institution. According to the EAL (Chapter V), the status of the EASB has improved substantially. Section 38 stipulated that the EASB is an independent governmental unit, established by the Government of Estonia and operating within the administrative jurisdiction of the Ministry of Finance. This status oriented the EASB essentially more towards independence than had been done by the 1991 Regulation on Accounting.

The third, system improvement stage (beginning in 2003)
The conceptual change within the European accounting framework, arranged in July 2002, required revision of the set of the Estonian accounting regulations, which by 2000 had reached a certain level, and to make the corresponding improvements. The initial steps to carry out the third stage were arranged through the new, amended version of the EAL and a new (revised) set of the Estonian Accounting Standards. Both of them came into effect on January 1, 2003. The main characteristic of the new EAL and the new set of EAS is their clear orientation to the International Financial Reporting Standards (IFRS).

The accounting regulation. The new Estonian Accounting Law permits all companies to apply in their consolidated and parent’s financial statements either:

(a) IFRS, or
(b) national accounting standards (Estonian GAAP).

The accounting framework applied to annual and consolidated accounts is company’s free choice and if IFRS is selected, then there is no need to prepare a second set of accounts in accordance with local standards. All listed companies will be required to apply IFRS in their consolidated and separate accounts from 1 January 2005 (most of them do it already). In addition, the new law requires that national accounting standards (Estonian GAAP) should be harmonized with IFRS and cross-referenced to applicable IFRS paragraphs. Any differences in the local standards compared to IFRS must be explained and justified.

The Estonian Accounting Standards Board (EASB) re-wrote most of its standards by the end of 2002 and brought them into accordance with the requirements of the new law and IFRS. The first set of 12 new standards of the EASB (“new Estonian GAAP”) became effective from 1 January 2003. Currently there is a set of 17 following EAS in use: EAS 1 General principles of Preparation of Financial Statements; EAS 2 Presentation of Financial Statements; EAS 3 Financial Instruments; EAS 4 Inventories; EAS 5 Tangible and Intangible Assets; EAS 6 Investment properties; EAS 7 Biological assets; EAS 8 Provisions, Contingent Liabilities and Contingent Assets; EAS 9 Leases; EAS 10 Revenue recognition; EAS 11 Accounting for subsidiaries and associates; EAS 12 Government Grants; EAS 13 Liquidation Balance Sheet; EAS 14 Accounting for non-profit association and foundations; EAS 15 Interim Reporting; EAS 16 Segment Reporting; EAS 17 Earnings Per Share.
The new Estonian GAAP is in fact a simplified summary of IFRS, cross-referenced to corresponding paragraphs in IAS/IFRS standards, and focusing on areas, which are more relevant for the Estonian companies. As the volume of the Estonian GAAP standards is considerably smaller than IFRS (existing 17 Estonian GAAP standards make together about 350 pages), some accounting areas are covered only very briefly or not at all. In areas, which are not covered by the guidelines of Estonian GAAP, the IFRS treatment is recommended, but not mandatory. Table 3 sets out the current position in relation to comparing Estonian accounting standards with IASB Standards.

Table 3. Implementation of IFRS in Estonian Accounting Standards

<table>
<thead>
<tr>
<th>Range of implementation</th>
<th>International Accounting Standards</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fully implemented</td>
<td>IAS 1, 2, 8, 10, 11, 14, 16, 17, 18, 20, 22, 23, 24, 27, 28, 32, 33, 34, 36, 37, 38, 39, 40, 41</td>
</tr>
<tr>
<td>Partially implemented</td>
<td>IAS 12, 21</td>
</tr>
<tr>
<td>Not implemented</td>
<td>IAS 19, 26</td>
</tr>
<tr>
<td>Not relevant at present</td>
<td>IAS 15, 29, 30, 31, 35</td>
</tr>
</tbody>
</table>

Consequently, starting from 2003, there are no significant differences in recognition and measurement policies between IFRS and Estonian GAAP. Differences remain in disclosure (Estonian GAAP requires less disclosure than IFRS) as the Estonian GAAP is primarily meant for small and medium-size entities. As a result of the last years of the Estonian accounting reform, large companies are expected to choose the full IFRS option, while small and medium-size companies may use the revised set of EAS as their accounting framework.

These steps, arranged at the beginning of the third stage of the accounting reform, enabled Estonia to abolish the majority of the limitations listed in Tables 1 and 2. Therefore it can be concluded that the Estonian accounting regulation, including the EAL and the set of accounting standards, is in line with the requirements of the new European accounting harmonization policy.

The development of the accounting regulation scope and institution. The new EAL has also expanded the scope of the EAL, involving also governmental institutions. Thus it can be concluded that the accounting principles of all types of institution are the subjects of the EAL. The new law has significantly enhanced the independence of the EASB. According to the EAL Chapter 5, the EASB is an independent committee whose rules of procedure are approved by the Government of the Republic on the proposal of the Minister of Finance. At the same time, the Ministry of Finance, the Government of the Republic and other government agencies shall interfere with neither the content of the guidelines issued by the Standards Board nor the process of their preparation.
Discussion of the accounting policy change in Estonia

Next all the elements of the Estonian accounting reform will be put together so that the new ‘organization’ can be interpreted and evaluated in accordance with the theoretical framework of the present paper – the organizational change and phased approach.

Before applying the theories of organization and organizational change, we need to define the meaning of ‘organization’ in the context of accounting. Laughlin and Gray (1988) examine an organization through four main elements. According to their definition, an accounting system can be regarded as an organization if it is 1) ordered, 2) purposive, 3) having an existence which is ‘separate from those individuals who operate it’ and 4) being a ‘changing organism interacting with, responding to and influencing its host society’ (Laughlin and Gray, 1988: 19). In this paper, the approach of Seal et al. (1995: 660) is applied, who view an organization as a national system of the activity of accounting. The focus is on overall regulation of accounting rather than on any particular accounting institution. According to the organization theory, particular organizations are assessed for balance and coherence, embracing also meaning and process (Seal et al., 1995: 660). In view of these definitions of organization and the analysis carried out earlier in this section, it can be argued that the Estonian accounting reform in its three stages was both ordered and purposive.

As a starting point for the organizational change, the present author uses the position of Laughlin (1991) who suggests that a change may be classified as being either a morphostasis (first-order) or a morphogenesis (second-order). Smith defined (1982: 318) the former as ‘making things look different while remaining basically the same’ and the latter as a change that ‘penetrates deeply into the “genetic code”’. Laughlin (1991) introduces further subdivisions, classifying change processes into ‘rebuttal’, ‘reorientation’, ‘colonization’ and ‘evolution’. The substantial characteristics of changes are discussed in greater detail by Seal et al. (1995: 662). Although the latter authors point out some potential dangers in employing the theories of organization and organizational change for the purpose of modelling accounting systems (Seal et al., 1995: 663), herein we proceed from their suggestion that these theories can be a useful theoretical framework for analysing the early phases of transition, as was mentioned above.

The main points of change in the Estonian accounting system so far have been the introduction of a number of specialized regulations on accounting (the Regulation on Accounting, the Estonian Accounting Law, the Estonian Accounting Standards) plus the Commercial Code and laws on auditing, taxation, etc. When analyzing the organizational change through the particular stages described earlier in this section, it is appropriate to use the phased approach. It seems that the organizational change and the phased approach are interdependent. We argue that organizational change can be regarded as the initial position for the phased approach, whereas the phased approach, on the contrary, can describe, periodize and justify the development and logic of the organizational change. Proceeding from the issues presented earlier in
the current paper, we can follow the phased development of the Estonian accounting reform (system) in three different directions:
- substantial development of the accounting regulations towards implementation of the IFRS;
- development of the scope of accounting regulations from private business companies to governmental institutions;
- development of the degree of independence of the accounting regulatory institution – the Estonian Accounting Standards Board.

Further we will summarize how the integrated theoretical framework of organizational change theory and phased approach seeks to identify the pathways followed by the Estonian accounting reform. In our judgement, Estonian accounting, in both stages, moving to the first and second stage underwent a second-order change when a conceptual change took place in the national accounting system. According to Seal et al. (1995: 677), the second-order change may be based on a colonization model or an evolutionary model. Laughlin (1991:220) expounds that in ‘colonization’ a small group on the background of an environmental disturbance create a lasting and fundamental change in both the visible and invisible elements in any organization. ‘Evolution’, in contrast, is a more participatory, discursive and consensus-seeking form of change. Analyzing the development of the Estonian accounting system during the first two stages, it seems that the colonization model is more appropriate than the evolutionary model for describing the path of change so far. Viewing the Estonian accounting development during the third stage, a first-order change seems more appropriate than a second-order change, for a conceptual change and orientation towards the IFRS took place during the second stage of accounting reform already.

5. Conclusions

The present study, focussing on the evolution of the Estonian accounting framework and developments in the accounting system in association with improvement of the business environment, revealed the following.

First, the development of the Estonian accounting system can be divided into three different stages - the introductory (1990-1994), system-building (1995-2002) and system improvement stage (from 2003 onwards).

Second, the Estonian accounting regulation, including the Estonian Accounting Law and Estonian Accounting Standards can be estimated as a successful compilation of different international accounting approaches. Such a combination has a number of advantages in the initial period of creating accounting regulation (transitional period) and enables making the transitional process more flexible in manner.

Third, the Estonian accounting regulation is in line with the International Accounting Standards and the requirements of the new European accounting harmonization policy.
Fourth, an integrated theoretical framework, including the theories of organization and organizational change, and the phased approach can be used to analyze the process of the accounting reform in Estonia. This framework could also easily and successfully be applied to the other Central and Eastern European countries.

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Kokkuvõte

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