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The transition to IFRS: The Russian experience

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Abstract

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This thesis is devoted to reforming of the accounting system in Russia and its transition to international standards of financial reporting.

The theoretical part of the project talks about international standards and their essence, conditions that led to appearance of international standards, their main principles, main requirements of international standards to reporting and accounting information.

The main part of the project is devoted to the comparative analysis of Russian and international standards. The analysis base is normative documents which define the order of financial accounting in Russia and international standards of financial reporting. This part talks about distinctive features of accounting systems, main differences in the way some assets, liabilities and operations are recognized and shown and differences in the order report indexes are formed.

The third part concerns the methods of transformation of financial reports in accordance with IFRS.

In the fourth part are briefly mentioned factors that prevent Russia from transition to international standards of financial reporting.
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**Introduction**

The accounting system, which existed in the Soviet Union with its centrally planned economy, was determined by the nature of public ownership and by needs of state management of the economy. The main user of the information given by accounting was the state, namely field ministries and authorities, planning, statistic and financial bodies. The system of state financial control was working on the tasks to determine deviations from provided models of economic activities of enterprises.

When the Soviet Union came apart in the beginning of 90s, process of transition to market economy started in the country. Russia started to develop international economic ties. First enterprises with joint and nonresidential form of property appeared.

Changes of economic relations predetermined the necessity to reform the accounting. Now in the conditions of forming market economy it was not only state bodies who were interested to get clear and true reports about financial situation in the enterprises. These interested users of the reports were shareholders of enterprises and corporations, crediting banks and investment funds, material suppliers, insurance companies, etc. Many of them, mainly foreign investors, thought that the accounting in Russia did not meet international standards and accounting reports of Russian companies did not show their real property and financial situation and were not clear and reliable in general.

The pressure of international monetary-bank organizations was one of the reasons for Russia to start using international accounting standards and to reeducate accountants and auditors. Beside this there can be defined other reasons:

First, in the situation of higher risks in Russia, recognition of international standards of financial reports is a very important step in getting investments. It is generally known that capital, especially foreign one, requires transparent financial information about activity of company and reports of management for investors. Transition to international methods would ease relations with foreign investors and help to increase the number of joint projects.

Second, international practice shows that reports made according to IFRS are noted for their high information value and usefulness. From the very beginning the Standards were developed on the base of requirements of particular users. When
Choosing this or that method, the main criterion is how useful the information is for making economic decisions.

Third, usage of international standards allows reducing time and resources used for development of new national rules of accounting reports. These standards secure quite long experience of accounting reports in the situation of market economy. They are formed as a result of work and research of many accountants-researchers, representatives of different schools. Standards take into account requirements and work with reports of many entrepreneurs, bank and other financial structures, financial analysts and trade unions (Shedrov, 1998).

Transition to use of IFRS in Russia is done in the context of Program of accounting reforming in accordance with international standards, which was confirmed by the Order of the Government on March 6, 1998. It is supposed that transition to international standards will be phased and will take few years. By this time much work was already done in this area – 21 standards on accounting were confirmed, Institute of professional accountants and International Center of accounting system reforming were founded, some legislation acts in this area were taken, first translation of IFRS into Russian was made. Russian credit companies started to prepare financial reports according to IFRS since January 1, 2004. Now many Russian companies try to do their financial reports in accordance with IFRS to get access to international capital market and to get objective appraisal of their business. But still it is evident that it is long way until transition to IFRS is complete.

Thus, at present point, reforming of the Russian accounting and report system is one of the most important tasks and it is an integrated component of wide range of economic changes. The main goal of the essay is to analyze material on this topic. The work consists of four chapters. The first chapter is devoted to international standards of financial reporting and their essence. The second chapter will speak about main differences between Russian and international standards of accounting. The third chapter concerns ways to transform financial reports in accordance with IFRS. In the fourth chapter are briefly mentioned factors that prevent Russia from transition to international standards of financial reporting.

In the course of writing this essay special literature was used. It was literature on international standards of accounting and problems of transition of Russia to IFRS. Special attention was paid to normative base of the accounting in Russia (Regulations
on accounting, Concepts of development of accounting and reports in the Russian Federation for medium-term period). The theoretical part of the essay is based on textbooks (by N.L. Marenkov, T.N. Veselova, J.A. Babaev, A.M. Petrov), various books on IFRS and periodicals. Some information was found on the internet, on the official site of IFRS, official site of Ministry of Finance in Russia and on other sites.
1 Main aspects of international standards of accounting

1.1 Preconditions for development of international standards

It took several centuries for the accounting system to develop. There are some countries which played quite important role in the development of accounting. For example, in the 14-15th centuries some Italian cities-states were leading in this area and they spread the so called Italian method of double accounting, at first in Europe and then in the whole world.

Starting from 19th century development of theory and practice of accounting was under great influence of Great Britain, especially England and Scotland where modern accounting was formed. Active development of share capital lead to the point when accounting reports in these countries became the main source of information for investors and creditors (Epstein, 2008).

At the same time the character of accounting of the countries of continental Europe, Russia and Japan was affected by factors like orientation of business to big bank capital and correspondence with requirements of fiscal authorities. Investments in these countries were obtained with the direct participation of banks, that is why financial reports of the companies were meant for banks at first and not for participants of equity market. State authorities also had great influence on the order of drawing up of accounts in these countries.

Process of unification of accounting is directly connected with fundamental changes in the world economics in the 20th century. Development of international business, strengthening of the role of transnational corporations required some uniformity or at least predictability and understandability of taxation principles used in this or that country, principles of formation and calculation of profit, possibilities to invest earned money, etc. The problem of accounting standardization got international nature and lead to development of some standards, not only in separate countries, but also on the international level (Shedrov, 1998). Thus, we can define three levels of standardization of rules of financial accounting:

1. National
2. Regional
3. International
National standards of financial accounting work in one country as a rule. But some national standards got worldwide meaning. For example, American standards, US GAAP, left their national borders as American fund market takes more than 50% of world capital market.

In some countries regional standards are used. They are based on the political agreement of countries – members of a union. For example, requirements of some European instructions have obligatory nature and are included into national legislation of countries – members of the European Union. The main idea of regional standards is like that: Every country may have its own model of accounting management and standard system which regulates it. But it is necessary that these standards do not contradict similar standards of other countries – members of a union, i.e. they are in harmony with each other. Regional standards work also in Africa, Southern America and Pacific countries.

International Financial Reporting Standards (IFRS) are generally accepted rules on recognition, estimation and disclosure of financial business to make financial reports by companies in all countries of the world. The main idea of this approach is that there should be unified set of standards applied in any situation and in any country.

International standards are developed by highly professional international organizations. At present the following organizations are working on standardization problems:

- International Accounting Standards Board (IASB),
- Intergovernmental Working Group of experts on international accounting standards and reports in United Nations Organization,
- European Committee,
- Securities and Exchange Commission of the USA, (SEC)
- Financial Accounting Standards Board (FASB).

As for Russia, there are few organizations providing significant influence on the development of accounting in accordance with the principles of IFRS. One of these organizations is the Institute of Professional accountants of Russia, founded in 1997. It is non-state structure joined by professional accountants and auditors. The institute carries out attestation of accountants and gives out certificates to professional
accountants. In November 2001 the Institute of Professional accountants of the Russian Federation became a member of the International Federation of Accountants, where every country can get only one full membership.

1.2 General principles of international standards

International standards represent code of compromise and quite general variants of accounting. It is possible to say with all certainty that in the whole world there is no single country which would follow these standards completely. Besides it is not possible to do so, as every country has its traditions in accounting area and there is no reason to break them for the sake of standardization. That is why fundamental base of transition to international standards must be an acknowledgement of general principles of preparing and making reports.

All main norms and principles, realized in international standards of accounting and reports, are described in details in the Framework (Kieso, 2008). We can define some basic points, knowledge and understanding of which can be helpful in reforming the normative base of accounting:

- Objectives and qualitative characteristics of financial statements.
- Measurement of elements.
- Elements of financial statements, their interconnection.

1.2.1 Objectives and qualitative characteristics of financial statements

The central objective of financial statements is providing information about the entity that is useful in making economic decisions. For that the financial reports are to meet some requirements which can be symbolically divided into two interconnected groups:

1. Requirements for reports.
2. Requirements for accounting information.

Attribute characteristics of the reports are:

- **Understandability.** The information must be easy to be understood by users.
- **Comparability.** Information in the reports must be comparable with the reports for previous periods and reports of other companies.
Relevance. Information must be significant to be useful. The relevance of the information means that it can influence economic decisions of the users, help them in estimation of past, present and future events. Every significant item must be presented in the accounting separately. Irrelevant sums must be included into bigger parts of similar meaning.

Attribute characteristics of the accounting information:

- **Reliability.** Information can be considered reliable only if it does not include any significant mistakes or distortions and is unbiased.
- **Faithful representation.** Information must show the operations truly.
- **Substance over form.** Information should take into account economic essence of the operations, not their legal form.
- **Neutrality.** Information is not to be aimed for interests of specific groups of users.
- **Prudence.** It is a very important requirement which consists of conservative estimation of assets and liabilities. Assets and profit should not be overestimated, obligations and liabilities should not be underestimated, i.e. assets are shown with the lowest possible estimation and obligations are shown with the highest possible estimation. In other words, it is potential loss that is taken into account, not potential profit.
- **Completeness.** Reports should show all facts of economic activity which are considered significant by users for reported period.

### 1.2.2 Measurement of elements

All elements must be measured, i.e. their monetary cost is to be defined. International standards suggest different variants of estimation of assets and obligations of the enterprise:

- **Historical cost.** For assets it is the price they were bought for. For the obligations it is a sum received in exchange for obligation. Historical cost is expressed in the factual prices at the moment of the deal.
- **Current cost.** For assets it is means that are to be paid to get similar assets at present moment. For the obligations it is sum that is to be paid to pay off the obligation at present.

- **Realizable or settlement value.** For assets it is a sum of money that can be received as a result of their selling. For the obligations it is a price to pay them off in regular conditions of enterprise work.

- **Present value.** For assets it is present value (capitalized value) of future net cash inflow in the regular conditions of enterprise work. For the obligations it is present value (capitalized value) of future cash outflow when the obligations are paid off in the regular conditions of enterprise work.

Two more variants of estimation can be used. It is market value, i.e. sum which can be received as a result of selling assets on the market, and it is fair value, i.e. value by which assets can be exchanged between parts that are informed and want to do this in near future. Until recently these two estimations were very often in use. Now, in situation of crisis, it became evident that using them was not very prudent.

### 1.2.3 Elements of financial statements, their interconnection

Financial reports inform users about the way operations and events influence the financial state of enterprise. The operations and events are grouped into classes according to their characteristics. There are several sections in financial statements:

- **Assets** – means or resources controlled by enterprise and they are results of former events and source for future economic profit. Assets are shown in balance in case there is a possibility of future economic profit and price of assets can be surely measured. When defining asset right of ownership for it is not principal.

- **Liabilities** – it is debt existing for the reporting date which appeared as a result of former periods and its paying off will lead to enterprise resources outflow. Liabilities are shown in balance only when there is a possibility of future outflow of resources presenting economic profit in case this obligation is paid off and the size of it can be surely measured.

- **Equity** – the residual interest in the entity's assets after deducting its liabilities.
• *Income* – increases in economic benefits during the reported period in the form of inflows or enhancements of assets or decreases of liabilities. The result of it is increases in equity, other than those relating to contributions from equity participants. Revenue and gains arise as a result of principal and minor activity of enterprise.

• *Expenses* – reduction of economic profit which is presented in decrease or loss of assets price or increase of obligations which lead to decrease of owned capital.

Thus, the main principles of making financial reports by international standards were discussed in this chapter. But as it was said above, no country uses IFRS in full, like national standards. Often, accounting systems have essential differences. Let’s see how norms and principles described above are used in Russian legislation and regulations of financial accounting.
2. Comparative analysis of Russian and International Financial Reporting Standards

2.1 Russian standards of financial accounting

The main document that defines the order of accounting method in Russia is Federal Law “About financial accounting” dated November 21, 1996 #129-ФЗ.

According to the law one of the main tasks of financial accounting is to form complete and reliable information about the activity of the company and its property status, as this kind of information is necessary for internal users of accounting reports – managers and owners of company property, and for external users – investors, creditors, buyers, tax and financial institutions and other interested parties.

The law provides for development and confirmation of regulations (national standards) of financial accounting by special state authorities. These regulations define the rules, principles and methods according to which the companies may lead their activities and the way the accounting records are prepared. The Regulations of financial accounting are adapted to the norms defined in the instructions of the European Union and International Standards of Financial Reporting and as a matter of fact are a kind of adaptation of IFRS to Russian situation. Development of the Regulations is a very important step in the evolution of Russian financial accounting.

With the purpose to adapt Russian standards to international analogues some new components were included in the Regulations of financial accounting. These components increase the “transparency” and information value of reports (for example: information about borrowed funds, accounts receivable and payable with gradation on deadlines, more detailed information about long-term and short-term financial investments).

There is a regulation about accounting policy defined by the law. It has to pay attention to the fact that the term “accounting policy” appeared by the direct influence of IAS 1 “Presentation of Financial Statements”. The main propositions of this principle (taking into account Russian character and definite economic situation) are shown in the Regulation of financial accounting “Accounting policy of a company” (ПБУ 1/94).

Development of the idea of accounting policy, changes of accounting reports, application of Statement of Cash Flow, openness of reports – all this and many other things lead to the point where modern Russian accounting system almost does not
differ from the system defined by international standards. All Russian companies, just like any Western companies, prepare Statement of Financial Position, Statement of Income, and Statement of Cash Flow. It is hard to find any differences between Russian and international practice regarding the defined goal of accounting reports. In both cases the goal is to give reliable and true information about the work of the company, the information which will help interested parties to make management decisions.

However, in spite of all these activities, the data of the reports made by Russian rules differ from financial information prepared according to IAS.

### 2.2 Distinctive features of systems of financial accounting

The main reason of differences between Russian and International standards of accounting is a different understanding of some basic elements of the way accounting is done and it is connected with difference in the final goals of financial information use and defined historically. Financial reports prepared according to IFRS are used by investors and other companies and financial institutions. Financial reports prepared according to the Russian system of accounting were used by the bodies of state government and statistics. As these groups of users had different interests and different needs for information, the principles of making financial reports were developing in different directions (Chaja, 2007).

The main differences (see Table 1) concern the addressee of the reports, the explanation of authenticity, interpretation of assets, application of charge methods, and priority of contents over the form.

<table>
<thead>
<tr>
<th>Distinctions</th>
<th>IFRS</th>
<th>Russian practice</th>
</tr>
</thead>
<tbody>
<tr>
<td>Users group whose interests prevail</td>
<td>Investors</td>
<td>Regulating bodies</td>
</tr>
<tr>
<td>Authenticity of reports</td>
<td>Unbiased and truthful reflection of real situation in the company</td>
<td>Correspondence to rules and normative acts</td>
</tr>
<tr>
<td>Interpretation of assets</td>
<td>The object is controlled by the company as a result of</td>
<td>The object belongs to the company by right of</td>
</tr>
<tr>
<td>Distinction</td>
<td>Description</td>
<td>Explanation</td>
</tr>
<tr>
<td>------------------------------------------------</td>
<td>-----------------------------------------------------------------------------</td>
<td>-------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Accrual basis of accounting</td>
<td>Declaration of all expenses and revenues in the period</td>
<td>Declaration of expenses and profits in the period that are confirmed by primary/source documents</td>
</tr>
<tr>
<td>Prudence</td>
<td>Readiness to record expenses and liabilities rather than possible profits and assets</td>
<td>Is mentioned but in many cases is not followed, as there is no realization mechanism</td>
</tr>
<tr>
<td>Substance over form</td>
<td>Activities are evaluated by their contents and terms of work, and not only by their legal form</td>
<td>Is mentioned but in many cases not followed, as there is no realization mechanism. Most of accounting operations are based on primary/source documents which meet special requirements</td>
</tr>
<tr>
<td>Completeness</td>
<td>Financial reports must include all components that are important for evaluation and decision of users. Significance means qualitative characteristic most of all</td>
<td>Is mentioned but is not followed in practice. The importance is defined through quantitative value</td>
</tr>
<tr>
<td>Possibility of professional estimation when reports are being made</td>
<td>Is supposed when solving many questions</td>
<td>Is not allowed</td>
</tr>
</tbody>
</table>

Specific demonstration of the above mentioned distinctions is:

- Differences in the order of evaluation, recognition and record of definite types of assets, liabilities and operations in the reports.
Different order of formation of reported components about property, intangible assets, tenancy contracts, etc.

2.3 Differences in the order of evaluation, recognition and record of definite assets, liabilities and operations

According to IFRS, events are to be presented by their essence and economic reality and not only by their legal form because the nature of transaction does not always correspond to the evident results of the established form. Demand of priority of contents over form can be found in the Russian normative documents (article 7 of ПБУ 1/98), but in practice this principle is almost never realized.

The reason for this is the requirement of the Law about financial accounting to show operations only on the ground of source documents, it means that an accountant can not do anything if he does not have the whole set of documents (Samojlov, 2004). Thus, in case when there are no proper documents, the operation will not be mentioned in the reports even if it was performed.

As a result, when one principle is not followed it leads to domino effect: accrual basis of accounting and demand of prudence are not realized, accountants can not provide professional estimation, etc. But let's see it in more details:

Accrual basis of accounting. IAS 1 reads: The company shall prepare financial reports (with the exception of report about cash flow) using the accrual basis of accounting. It means that an accountant records facts of activity which have financial effects on the company during the reporting period when they take place. And it does not matter when the company received or paid the money on it. In Russian practice because documents from partners can often appear with delay, in most cases the performed operations are shown in the reports during the period when documents are received (Suharev, 2007). For example, many Russian companies record interest expense on loans not at the end of reporting period, but when the bank sends the statement. In this case it leads to overstating of taxable profit.

Recognition of assets. According to IFRS elements of reports are accepted only if they meet criteria of recognition, it means the object is controlled by company as a result of former events and includes a future economic benefits and the element has a price or the price can be estimated surely. In Russian accounting system recognition of assets is done in most cases on the basis of source documents prepared according to unitized forms. For example, it is considered that to declare property in
the company’s balance statement there should be the right of property for them. This comment is based on the letters of Ministry of Finances of Russia where it is defined that the right of property is an immediate sign of recognition. In reality among all signs of assets recognition in ПБУ 6/01 “Reporting of property, plant, and equipment” there is not a word about the right of property. But most of Russian companies recognize assets as their property only after they are registered (Suharev, 2007).

*Lack of possibility to use professional estimation made by an accountant*, for example to define possible recognition of profit or loss. As a result there are essential distinctions in the estimation of assets and liabilities of the company in Russian and international reports. The same concerns the recognition of expenses. According to IFRS expenses can be recognized on the ground of professional estimation made by an accountant of decrease of economic profit. Russian rules say that “expenses are recognized in the accounting if the following conditions are met: expenses are done by special agreement, requirement of the law and normative acts, customs of business circulation” (ПБУ 10/99), i.e. the expenses are to be confirmed by the documents.

*Prudence*. According to IFRS when accepting reporting information it is necessary to be cautious when estimating assets and liabilities, i.e. assets and profit may not be overestimated and obligations and liabilities may not be underestimated. That means that assets are to be shown by their lowest possible value and the obligations are to be shown by their highest possible value.

In Russia this principle is mentioned but in most cases it is not followed as there is no realization mechanism. Clear evidence of it is estimation of accounts receivable. According to Russian standards the company has the right, but is not obliged to, to keep reserves on doubtful debts. As a result, the companies having problems with accounts receivable do not make reserves and they report to all independent users big sums of accounts receivable which will never be received in real life (Suharev, 2007).

The same happens when estimating bills payable. In accordance with Russian standards fines, penalty fees and forfeits are shown in reports only when the company is defined as a debtor by the court. As a result before the court decision the accounting department does not recognize penalty provisions, the level of debts does not correspond to conservative estimation which is really important for report users (Samojlov, 2004).
2.4 Distinctions in the order of formation of reported components

2.4.1 Statement of Financial Position

International standards do not provide any standardized form of this statement and they only define some obligatory points. In Russia the form of the statement of financial position is defined by law, by order of the Ministry of Finances.

There are some differences in the statement points according to Russian standards and their international analogues. Thus, when reporting on main funds, the main *differences are in the depreciation*.

By international standards the company has to check premises of depreciation regularly (method, useful period, residual value). If there were changes affecting the benefits gained from the object, depreciation shall be calculated on basis of new terms for next periods.

In the Russian accounting system review of the premises of depreciation is not provided but neither forbidden. Nothing is said about it. So, following the principle – not forbidden means allowed – Russian companies can review premises of depreciation, just like in IFRS, but usually they do not change them, because it would result in a decrease of property tax and tax inspection would consider it as a tax evasion. Thus, in most cases companies follow the opposite principle – not allowed means forbidden. Until present most Russian companies continue using depreciation norms established for taxation purposes (Suharev, 2007). In practice it means that completely worn out equipment will be depreciated for more than one year and the users will see in the reports a considerable sum of main funds which shows big potential of the company and which is also used to estimate its financial stability.

Orientation of accounting reports towards the requirements of tax authorities has an effect on such aspect as *impairment of main funds*. In IAS 36 (Impairment of Assets) possible signs of impairment shall be shown and companies shall check their presence on every reporting date. In case at least one sign is present, it is necessary to evaluate refundable price of an asset to find the loss because of impairment.

In the practice of Russian accounting impairment is not recognized, but it is not prohibited either. That is why companies may use it, but they do not, being afraid that if they devaluate their assets, they will break generally accepted principle and cause disapproval of tax authorities.
As a result of contradiction of definitions, there are some differences in the way information on intangible assets is shown. By Russian rules (ПБУ 14/2000) intangible assets should be used during long period, i.e. their useful period shall be longer than 12 months. IFRS does not specify any time periods for intangible assets, so they have more flexible approach.

The second difference lies in the fact that if intangible assets shall be accepted in the Russian system special documents are needed which verify the existence of the assets and exclusive right of the company for the results of intellectual work (patents, certificates, other guard documents, agreement of transference (acquirement) of patent, trade mark, etc). In IAS 38 there is no requirement about legal rights, because the main criteria is the possibility to control future economic benefits from usage of non-material assets, and company can control these benefits by other method than as a result of legally registered right.

By Russian standards (ПБУ 14/2000) intangible assets also include expenses spent for foundation of the company. According to IAS 38 establishment expenses are not considered as intangible assets as they are not directly connected with receiving benefits from them. In spite of the fact that these expenses are done with a purpose to get future economic profit, the probability to get profit at the moment of foundation of the company is zero, as the company may turn to be unprofitable.

One more thing about intangible assets is to be mentioned. In Russian accounting system intangible assets may include self-made reputation, price of self-developed software, know-how, exclusive right for trade mark, i.e. assets produced by the company itself. According to IFRS self-made assets can not be recognized as intangible assets, as expenses for them can not be defined from the expenses for development of the company in general.

Another important question is to show expenses for research and experimental works. In the Russian system these expenses can be capitalized in case of positive results. But as positive results do not mean the ability to use or to sell the results of research or development (and this is one of the conditions set by IFRS for capitalizing research and experimental work) we have to accept significant difference in qualification of these objects in the Russian system from the requirements of IFRS.

When showing inventories in the statements according to international standards, the estimation is done by the smaller of two values: prime costs and net
realizable value. This method of estimation is not provided by ПБУ 5/01 “Accounting of inventories”. This standard orders to count inventories by factual prime costs. And at the end of reporting period the inventories are reestimated. The inventories which have become obsolete or have lost their initial quality are shown in the statement of financial position at the end of reporting period with deduction of special reserve for decrease of cost of tangible property. Reserve for decrease of cost of tangible property is shown as expenses among the financial results of company, i.e. the difference between current market price and factual prime cost of inventories, if the last one is higher of current market price.

*Investments* can be short and long term. Current investments are easy to convert and they are timed for not more than one year. Long term investments are investments timed for more than one year. The Russian system of accounting requires that current and long term investments are presented in the statement of financial position by the acquisition price. Contrary to it, international standards allow to consider long term investments according to their nature: amortized cost, fair value or by the lowest among two values – amortized cost and market price.

### 2.4.2 Statement of Income

Most of the differences in a statement of income are caused by differences in the terms of accounting of operations regarding there are not enough documents in accordance with the Russian system of accounting. As it was stated above, international standards order to follow the principle of correspondence according to which expenses are shown in the period of expected profit, and in the Russian system expenses are shown according to special requirements for documents preparation are met. The most common example of lack of correspondence is that many Russian companies accept sale not by date of shipping but by the date of invoice which can be prepared 2-3 weeks after the shipping date.

The differences are also in the way the expenses are presented. By IFRS the company may choose one of two variants to present expenses in the statement of income:

- Classification of expenses by nature.
- Classification of expenses by function.
In the Russian system only classification of expenses by function is used.

According to IFRS, if company prepares statement of income using classification of expenses by function (more used in practice), the company must also provide additional information on the nature of the expenses, including depreciation and amortization and staff costs (salaries and wages). But in the Russian system these expenses are shown in the Attachment to the Statement of Financial Position.

Another difference is in the structure of cost of goods sold. By the Russian system of accounting commercial and general expenses (amortization of management building, expenses for management staff, etc.) can be included into cost of goods sold if it is provided by accounting policy. However, by IFRS these expenses are not considered as directly connected with acquisition of goods and production, so they are not included into cost of goods sold (included in operating expenses).

Exchange accounting causes much of theoretical and practical interest. In the Russian economy exchange plays much bigger role than on international level. Blossom of exchange was during the period of economic instability in 1995-1998 and it was connected with limited liquidity of enterprises and growth of non-payments. And even though after the crisis of 1998 all indexes of non-monetary economics are decreasing, still the share of exchange in the profit of Russian companies is significant (Guriev, 2001).

According to IFRS, if goods or services are exchanged for goods or services corresponding or similar by price that kind of deal is not considered as sale. In cases when different goods are exchanged, for example trucks are changed for foodstuff; the earning is estimated by fair price of received goods or services, adjusted to the sum of transferred cash or its equivalent. In the Russian system of accounting exchange operations are always considered as selling.

2.4.3 Statement of Cash Flow

The Statement of Cash Flow according to IFRS and to its Russian analogue is very much alike, but still there are some significant differences.

According to IAS 7 statement of cash flow shows not only changes in cash but also in money equivalents. Money equivalents include short term and highly liquid investments which can easily be turned into definite sum of money with insignificant risk of price instability. In Russian practice there is no term of money equivalent. The rules for making Statements of Cash Flow tell about cash accountable in the company
cash office and cash kept on operating accounts, currency and special accounts. Short term deposits in banks are included into the list of short term financial investments.

There are some differences in the way the information is prepared. As opposed to international standards which provide the ability to choose between direct and indirect methods of showing cash flow of the current activities, Russian rules allow only the direct method.

There are differences in classification of operations too and they are shown in the Table 2.

**Table 2. Differences in classification of operations**

<table>
<thead>
<tr>
<th>Cash flow</th>
<th>IFRS</th>
<th>Russian practice</th>
</tr>
</thead>
<tbody>
<tr>
<td>Money received from owners (shareholders) as investments</td>
<td>Financial</td>
<td>Operational</td>
</tr>
<tr>
<td>Paid dividends per share</td>
<td>Financial</td>
<td>Investment</td>
</tr>
<tr>
<td>Money received from owners (shareholders) for special use</td>
<td>Financial</td>
<td>Investment</td>
</tr>
<tr>
<td>Receiving and repayment of long term credits and loans (including bonded debts) of special purpose and payment of interests</td>
<td>Financial</td>
<td>Investment</td>
</tr>
<tr>
<td>Receiving and repayment of short term credits and loans (including bonded debts) of special purpose and payment of interests</td>
<td>Financial</td>
<td>Financial</td>
</tr>
<tr>
<td>Receiving and repayment of short term credits and loans (including bonded debts) without special purpose</td>
<td>Financial</td>
<td>Operational</td>
</tr>
</tbody>
</table>

The above mentioned facts are enough to see the level of differences and their consequences for estimation of financial position of the company. As the requirements of tax and statistic authorities for reports made according to national standards are still in force, it is quite hard to transform data of Russian accounting into the international format. But it does not mean that it is impossible. Many Russian companies have changed to report’s preparation according to IFRS. In the next chapter there will be a discussion about how to correct differences between Russian and international accounting.
3. Ways to transform financial reports in accordance with IFRS

There are two main ways to prepare reports by internationals standards (Aksijatov, 2006):

- Transformation of data of Russian accounting in accordance with IFRS.
- Parallel bookkeeping of accounting records by Russian and international standards.

Transformation means “transference” of Russian financial reporting into international one by correcting separate indexes (which were received different from IFRS). Usually when this method is used the companies bear less material expenses and time losses. This method is often used as a temporary measure when transferring to parallel bookkeeping of accounting records by international standards.

Phases and contents of transformation depend a lot on the qualification of the performer who should know national and international standards and has analytical abilities. At the end of his work, requirements of all applied international standards have to be followed and the result has to be in accordance to the framework of financial reporting made by IFRS.

Tentatively it is possible to define few phases that the company will have to go through when transforming financial reporting in to accordance with IFRS (Moderov, 2008):

1. Information collection.
2. Accumulation of differences between Russian standards of financial reporting used by the company and requirements of corresponding IFRS using professional opinions and estimations, especially on use of principle of priority of economic essence of the deal over its legal contents.
3. Calculations of corresponding articles to include into reports by IFRS and mechanical execution of transformation corrections by double recording.
When the process of transformation is finished, the company gets detailed structured information about the nature of activity by Russian standards and by IFRS, the company will be more informed about its financial accounting on the base of these data and is able to transfer to parallel bookkeeping of accounting records.

The drawback of this method, besides possible mistakes (inaccuracy can be 10-50%), is the fact that information prepared in accordance with international standards can be received only at the end of period.

Parallel bookkeeping of records (another name is method of double record bookkeeping) is a next step after transformation. All main differences between Russian and international standards go to separate records and are shown in the base by the Russian system and in the base by IFRS, i.e. “parallelism” of reporting (accounting) is defined by the necessity to set the operation once into computer system and then this system will transfer this operation automatically to the data base of Russian system and to the data base of IFRS. Keeping parallel records means using powerful computer systems which is why this method requires a lot of expenses. The high price and gradual contradiction of data of Russian and western methods of accounting are the drawbacks of this method.

The choice of way to prepare financial reports by IFRS depends on supposed expenses and the purpose to use international standards in the company. The wider company management is going to use the information prepared according to IFRS (for example, for purposes of management accounting and budgeting) the more often company chooses the parallel method (Trubakova, 2009).
4. Factors that block the transition to international standards

At present transition of Russia to IFRS is connected with definite difficulties which require immediate solution. For example, at the labor market there are very few IFRS specialists. That is the reason for that not many Russian companies prepare financial reports independently, in most cases they address to special consulting and auditing firms (Taimazov, 2008).

Financial problems play important role too. The most significant expenses when preparing financial reporting by IFRS are expenses spent on hiring and teaching staff and for consulting and auditing services. Salary required by specialists who know IFRS and have special certificates confirming their knowledge is much higher than salary of other financial specialists. Some experience suggests that this lack of correspondence is present for some time during transition to international standards, but in the future the situation will be more stable (Trubakova, 2009).

Attention of accounting to the requirements of tax authorities is also one of the main obstacles on the way of transition (Chaja, 2007). Very often the company’s management fears that as a result of transition to IFRS and to very transparent financial reporting they will not have any reserves left to optimize the taxation. It is necessary to separate business accounting and tax reporting. The companies should prepare tax reporting on the base of tax laws and for the purpose of taxation only, and business accounting is to be done only in the interests of the company. Then there will be no dualism in reporting and it will be possible to perform profound and comprehensive analysis of the work of the company.

Financial reporting performed in accordance with requirements of international standards still does not have any official status. And as a result, regardless of the fact that companies may prepare reporting by IFRS, they still have to prepare reports by Russian standards.

Accepted Russian national standards of financial accounting are statutory acts but not standards approved by professional union of accountants, like it is recognized in international practice. It is still too early to say if unions of accountants or other interested groups of people, including users of accounting reports, are able to develop methodical normative base independently and that state authorities would let them have this right.
Constant update of IFRS is another problem in some way. On the one hand it is necessary to adapt new terms of IFRS into Russian legal terminology and to do it in time. On the other hand to avoid obsolescence of domestic standards, Ministry of Finances would have to follow all current projects and innovations of IASB in the process of its development.

As a conclusion it is necessary to note insufficient use of new accounting standards in practice. The principles and approaches most Russian companies use in their accounting policy are in most cases based on already established patterns – we do it this way because everyone does it like that. And as a result in many cases even distinct requirements of ПБУ which coincide with IFRS are not followed (Suharev, 2007).
Conclusion

Summarizing advantages of IFRS, it is possible to say that for financial analysts and investors they are possibilities to understand and compare, transparency and reliability; for companies it means less expenses when attracting capital; for national standard developers this means exchange of experience, base for national standards, more trust to national standards and decrease of expenses for their development.

The Russian accounting system is changing gradually, according to the requirements of international standards and in accordance with the speed of economic changes. Russian reporting is becoming more understandable and transparent for foreign investors. However, on the base of the comparison between Russian and international standards it is possible to say that the difference is still significant. The main differences are priority of contents over the form, the addressee of the reports, interpretation of assets/property, use of charge method, opportunities to use professional opinion of accountants. That is why at this point the main task of reforming the accounting system in Russia is to smooth gradually lack of correspondence between Russian and international standards.

Besides, it is necessary to admit that the attention of Russian accounting system to requirements of tax authorities is still the main obstacle on the way of transformation. Many Russian companies try to unite accounting and taxing reports but as there are fines for breach of tax law in Russia and there is no fine for breach of accounting rules, this results in breaking accounting principles which mean invalid reports. That is why definition between financial and tax reporting in Russia is also a very important task which has to be solved in the near future.

As a conclusion it should be noted that now in the situation of crisis, many Russian companies consider making reports by IFRS as an extra burden. These reports do not affect the price of loans in the outer market and there is almost no possibility to get loans there because of lack of extra liquidity. As is obvious from the experience of foreign companies, in the crisis situation reports by IFRS do not help much either.

But as the head of MDM bank, Andrey Ilyin, said: “No reports help in the situation of crisis, the thing that can help is well-organized system of preventive control of risks which can not function without quality and timely financial information, including reports prepared by IFRS.” The reporting done by IFRS is more unbiased than prepared by Russian standards. Besides its function is not only to
report, but also to predict and that is very important in the situation of crisis (Klementjeva, 2008).

So, in the situation of crisis Russian companies have to think about the methods which will decrease the expenses for making reports by IFRS. One of such methods is to use correctly the requirements of Russian normative legal acts on accounting which can eliminate 90% of differences between Russian and international accounting systems (Suharev; 2007). That is why it is easier and cheaper for the management of the companies to let accountants get new knowledge than to try to transform the reports and to invite external specialists for it.
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