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*Implementation of the International Financial
Reporting Standards in Russia:
Problems and Experiences*

Kandidatuppsats / Bachelor Thesis
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Acknowledgements

IFRS is an interesting new area in the world of accounting, and having researched the situation in Russia has been yet more interesting for me as I am of Russian decent. Thanks to this trip I learned a lot about Russia and its economic system, an area which has seen a lot of changes in recent years.

It was crucial that I got the opportunity to attend the conference about IFRS in St. Petersburg on November 24-25, 2005. I therefore wish to thank first of all Mr. Sergey Moderov who organized this event. Without his help it would not have been possible for me to attend the meeting and he also helped me to find the subjects for my interviews.

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Last but not least my thoughts go to my dear husband who morally and in every other way supported me greatly. Without his help I would definitely not have had the strength to go through with this project.

Valeria Petrovets, Göteborg, January 2006

Abbreviations

ACCA	Association of Chartered Certified Accountants
CIPA	Certification for International Professional Accountants
CIS	Commonwealth of Independent States
EBRD	European Bank for Reconstruction and Development
EU	European Union
GAAP	General Accepted Accounting Principles
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IFAC	International Federation of Accounts
IFR	International Financial Reporting
IFRS	International Financial Reporting Standards
IGAF	International Group of Accounting Firms
ISA	International Standards on Auditing
RAS	Russian Accounting Standards
USSR	Union of Soviet Socialist Republics

Abstract

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Title: Implementation of the International Financial Reporting Standards in Russia: Problems and Experiences

Background and problem: After the break up of the Soviet Union, Russia has experienced a lot of turmoil and change both politically and economically. The country has struggled to get rid of its socialist past and it has now evolved to be a more and more important partner in international affairs and economics. The need to develop a modern accounting system has therefore been obvious and the country had two choices: to develop its own system or to adopt an existing one, like IFRS.

Purpose: The main purpose of this thesis is to investigate how the process of IFRS adoption for the national accounting system develops in Russia. The additional purposes are to show how Russia works with reformation of its accounting system, how the national historic and economic development affected accounting and financial reporting, and to define obstacles and problems which the country in general, and separate companies, in particular, have come across in connection with IFRS implementation. Another purpose has been to contribute to Göteborg University with useful information with a subject that nobody has researched at the School of Business, Economics and Law before.

Delimitations: As the field of study Russian non-banking companies which use IFRS were chosen. The study is delimited by description and analyse the general and common problems and obstacles for industrial companies they meet on their way of IFRS implementation.

Method: The most important source of information was a conference about IFRS in Russia held in St. Petersburg in November 2005. The lectures given and interviews made with attendants from this conference provided the author with unique first hand material. People interviewed were auditors as well as financial managers at companies. Other printed information about IFRS in Russia was mainly found on the Internet as it is still a new subject with relatively little written about it.

Analysis and conclusions: The Russian government works for a reformation of the accounting system and to encourage companies to shift to IFRS. The reasons why companies shift to IFRS are many. The strongest incentive is that this will more easily attract foreign investors and give them loans at a lower interest. The Bank of Russia also encourages this step and has demanded that banks use IFRS already from January 1, 2004. The transition is slowed because of the fact that a considerable part of the Russian economy is in the grey sector. IFRS introduction implies high costs for companies in form of education and IT. On the other hand, these investments help modernize the companies and improve their operational and strategic management. Factors that affect statement quality were also researched. Among them there are converging and transformation methods, degree of information disclosure and auditing. The fate of IFRS in Russia is, however, not clear yet because of problems with the translation and a fear of losing political control.

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1. Introduction

Here the background, problem discussion and problem definition is presented. The problem leads us to the purpose of this study and the delimitations. This first chapter ends with a thesis outline.

1.1 Background

Globalization is making a dramatic impact on the world economy, borders are getting less and less relevant and cooperation and trade between companies situated on different continents is now very common. More and more companies have become global in their commercial activities and international trade with shares and credits is constantly increasing. As companies and capital needs have left the national level, capital internalisation has become a necessity. The demand for an open financial market is now stronger than ever. Globalization makes comparability and harmonization of the accounting and financial reporting top priority.¹

The goal of the EU is to create a free market where capital, labour, goods and services are to move freely. Thanks to the common currency, the European market has become more transparent for companies and it has made it easier to analyse business opportunities within the EU. The implementation of the International Accounting Standards (IAS) and the International Financial Reporting Standards (IFRS) will further improve the transparency of companies' information and also be an important step in the EU's commitment for a common European capital market. For investors and lenders it is important to have comparable and quality information and this can only be achieved if countries cooperate in creating a common system like the IAS/IFRS.

From January 1, 2005, all listed companies within the EU will have prepared their consolidated financial statements according to IAS/IFRS², created by the International Accounting Standards Board (IASB) based in London.

“The IAS regulation represents the biggest change in European financial reporting for 30 years and will make the EU the world's first region to have one common set of accounting standards. This very important step towards international convergence of accounting standards will improve the transparency of companies' reported information and provide a key plank in the EU's drive for a single European capital market.”³

The IASB actively promotes their standards around the world. According to Deloitte, in more than 100 countries worldwide, the use of IFRS is permitted or required. Many of them have adopted special programs for transitioning or converging their national standards with the IFRS.⁴

¹ Choi, Fredrick D.S. & Meek, Gary K. (2005) *International Accounting*, Pearson Prentice Hall, Upper Saddle River, pp.4-18

² www.iasplus.com/pastnews/2002jun.htm, 11.02.2006

³ www.pwglobal.com, 20.11.2005

⁴ www.iasplus.com/country/useias.htm, 05.12.2005

After the break up of the Soviet Union in 1992, Russia had to change its economic system from a planned economy to a market economy. In a command economy the means of production are in public ownership, the state dominates the economy, and economic activity is supposed to respond to state direction. By contrast, in a market economy the means of production are mainly in private ownership, the state creates the legal framework in which economic activity takes place, and economic activity is supposed to respond to market forces.⁵ Such a transition obviously has important consequences for accounting, which ceases to be an instrument of state economic administration and instead becomes an instrument at the disposal of the business community.⁶

New types of companies and enterprises desperately needed new accounting standards. In a market economy the objective of companies' financial reporting is to give useful information to present and potential investors, creditors and other interested parties to facilitate their decisions. Though until now the role and the conception of Russian accounting have changed dramatically, the main user of the financial reporting still remains the State, in the person of the tax authorities. Nevertheless, voices of the other interested parties – investors, creditors, managers and also accountants and auditors - become more and more important. In that way, the Russian accounting and financial reporting develop, approaching international standards.⁷

1.2 Discussion of the Problem

An increasing number of companies both within and outside of the EU use IFRS today. The process of adopting IFRS varies on account of political, economical and cultural differences in the countries in question. IFRS implementation is a comprehensive process that might significantly affect a country's infrastructure and involve many different groups/parties. All of the parties involved, both at state and private levels, are forced to undertake big changes, which results in increased workload for everyone concerned.⁸

Under the socialist system, accounting was primarily regarded as a means of plan fulfilment and carried out by comparing accounted figures to planned figures.⁹ This was especially true for the USSR. The break-up of the Soviet Union brought with it a necessity to reform the Russian accounting system. The reformation of the domestic accounting and financial reporting was based on the contradiction between the purpose behind the existing domestic accounting principles with its strict regulation of all accounting procedures on the one hand, and new demands brought on by the objective changes in the sphere of economy and business on the other hand. A reformation of the Russian accounting system and financial reporting became a bare necessity. Two possible alternatives existed: to establish individual accounting standards or adapt some of the existing ones.¹⁰

⁵ Nobes, C. & Parker, R. (2002) *Comparative International Accounting*, Prentice Hall, p.323

⁶ Bailey, D. (1995) 'Accounting in Transition in the Transitional Economy', *European Accounting Review*, Vol.4, No.4

⁷ Barabanov, A. (2003) 'Mezhdunarodnyje standarty finansovoj otchetnosti – Obzor', www.cfin.ru/ias/overview.shtml, 14.12.2005

⁸ Nobes, C. & Parker, R. (2002) *Comparative International Accounting*, Prentice Hall, pp.73-99

⁹ www.oecd.org/dataoecd/16/26/35118918.pdf, 21.01.2006

¹⁰ Burenin, A. (2005) 'Nasha tsel – otchetnost, na osnovanii kotoroj mozjno prinimat resheniya', www.nsfo.ru/item.php?doc_id=512&sec_id=25, 21.01.2006

If Russian companies were operating within Russia alone, they could very well have managed with their own domestic accounting standards. However, business has become much more international today, with Russian companies operating abroad and foreign companies establishing themselves in Russia. Implementation of new accounting standards was an important prerequisite for the realization of business opportunities on international markets, as well as an instrument for financial improvement, i.e. enhanced business efficiency. Besides, new standards would also give rise to certain competitive advantages, in particular when it comes to interpreting the outcome of a company's business activities in a more simple and understandable form. An international accounting system would facilitate better management decisions and the possibility of comparing domestic and foreign companies regarding their financial deliverables.¹¹

At that time, like today, there were two principal international systems of accounting standards in Europe: US GAAP (General Accepted Accounting Principles) and IAS (International Accounting Standards). As the Russian accounting system was originally influenced by the French and German standards, and given Russia's geographical location within that area, the choice fell on IAS, later IFRS.¹²

The reformation of an accounting system is impossible without a concurrent reformation of a country's legislation, primarily those pertaining to fiscal¹³ and civil codes. Besides, IFRS implementation is complicated by the lack of legislated regulation in the IFRS area, for example, the term "IFRS" is not at all presented in the federal legislation. It is evident that it is not possible to combine fiscal and financial reporting. Their purposes, establishing and using principles are not only different, but sometimes even diametrically opposite. Therefore, one of the first steps is the separation of fiscal and financial reporting, together with setting up separation bodies responsible for the regulation.¹⁴ It is also clear that transition to the new international accounting standards is a long and problem-ridden process, which presumably will take several years.¹⁵

One of the choices now facing Russia is whether to adopt and use IFRS as it is, or to establish domestic accounting standards based on IFRS but at the same time adjusted to the national prerequisites, as was done in for example Australia. The difficulty lies in the fact that IFRS is regulated by a foreign non-commercial organization – IASB (International Accounting Standards Board) – where Russia is not represented nor does Russia finance it. Besides, the question of the official translation of IFRS and their later versions and new standards into Russian is still not solved.¹⁶

¹¹ Shnejdman, L. (2003) 'Zachem nuzhny mezhdunarodnyje standarty otchetnosti?', www.gaap.ru/biblio/gaap-ias/ideology/014.asp, 21.01.2006

¹² Yegorov, L. (2002) 'Istorija razvitija ucheta v Rossii', the Financial Academy at the Russian Government, Moskva

¹³ Romanovskij, V. (2005) 'Termina MSFO etshe net v zakonodatelstve', *Delovoj Peterburg*, No.213.

¹⁴ NSFO (2005) 'Nalogovyje posledstvija perekhoda na MSFO', www.ipnou.ru/docs/article/doklad3.doc, 21.01.2006

¹⁵ www.nsfo.ru/item.php?doc_id=515&sec_id=25, 21.01.2006

¹⁶ Burenin, A. (2005) 'Nasha tsel – otchetnost, na osnovanii kotoroj mozjno prinimat reshenija', www.nsfo.ru/item.php?doc_id=512&sec_id=25, 21.01.2006

1.3 Definitions of the Problem

The discussion of the problem leads us to the following questions that this thesis will seek to answer:

- What problems do Russian non-banking companies have in connection with IFRS implementation?
- How does the country's historical and cultural background affect their transition to IFRS?

1.4 Purpose of the Study and Contemplated Contribution

The main purpose of this thesis is to investigate how the process of IFRS adoption for the national accounting system develops in Russia. The additional purposes are to show how Russia works with the reformation of its accounting system, how the national historic and economic development affected accounting and financial reporting, as well as to define obstacles and problems which the country in general, and separate companies, in particular, have come across in connection with IFRS implementation.

The thesis is written with the intention to contribute to the picture of international harmonisation of financial reporting and how far Russia has advanced for IFRS implementation. The study might be interesting for those who are interested in international questions and international accounting. It might also be useful for Swedish companies who have subsidiaries in Russia and other parties who operate internationally. The purpose is also to contribute useful information to Göteborg University with a subject that has not been researched at the School of Business, Economics and Law before.

1.5 Delimitations

This study has no intention to show the complete picture of IFRS introduction or further implementation in the Russian Federation. As the field of study chosen was Russian non-banking companies. Furthermore, the objective has never been to go into great detail, but first of all to describe the general and common problems and obstacles for non-banking companies in all branches they encounter on their way of IFRS implementation.

1.6 Thesis Outline

Chapter 2 gives a detailed description of the methodology. A theoretical background for research methods is given, followed by explanations of how the data collection for this thesis was made. The chapter ends with a discussion on the credibility.

In Chapter 3, the reader gets acquainted with the development of the economic state of Russia from the early 1990's. It is followed by a description of the accounting system in the Soviet Union and a theoretical discussion on the differences of national accounting. A lot of information about various aspects of Russian Accounting Standards (RAS) and IFRS in Russia is presented here. It ends with a detailed account about the legal problems that the official translation of IFRS has caused. It also gives some possible ways that IFRS can develop internationally.

The first part of Chapter 4 describes the companies whose representatives have been interviewed in this study. The second part contains a compilation of the interviews made, both with company representatives and auditors.

The analysis is made in Chapter 5 and the thesis ends with conclusions in Chapter 6.

2. Methodology

In this chapter, the author presents the research techniques for gathering and processing information. Then follows a description of how the gathering of data and interviews were carried out and analysed. The chapter ends with a closer discussion on the validity of the material and on the conclusions that can be made from it.

2.1 Research Method

When doing research there are two ways of gathering and processing the data: quantitative and qualitative research.

Quantitative research is commonly used for statistical purposes where there is a lot of measurable data present. The nature of the data is easily validated and can be presented numerically.¹⁷ The difficulty for the reader is to know whether the data is correct or what could potentially be missing. It is hard to evaluate a number, the method of data gathering must therefore be thoroughly scrutinised. As Mark Twain said, that there are three kinds of untruths: “lies, damn lies and statistics.”¹⁸

This thesis has a completely different kind of nature. Data is collected mainly through interviews and second hand sources and is not numerical. A different approach must therefore be applied. Qualitative research could be described as research for “soft” data, which means that data is not easily presented in diagrams and figures and answers the questions “how?” and “why?”¹⁹ rather than “how many?” Interviewing, on the other hand, allows the opportunity to ask follow-up questions and evolve the interview in a different direction. The drawback is that the result heavily depends on the author’s own competence as subjective views can easily influence the material.

Andersen²⁰ describes several different aims or goals for research with a deeper involvement per each step: descriptive, explorative/problem-identifying, explanatory/understanding, diagnostic, problem-solving/normative and intervention-oriented.

As pointed out in the delimitation section, the aim of this thesis is to describe the experience Russian companies have had with the introduction of IFRS. The data collection was carried out in St. Petersburg, Russia, where a number of auditors and other persons related to the use of IFRS were interviewed in connection with a conference about IFRS. As IFRS in Russia is still very new, little has been written on the subject. This thesis will qualify as *descriptive* research since the goal is to describe an issue rather than to understand or interpret it. Furthermore, it is also *explorative* or *problem-identifying* research and may, on account of its relative novelty, make a good basis for further studies in the same field later on.

¹⁷ Lundahl U. & Skärvad P-H. (1992) *Utredningsmetodik för samhällsvetare och ekonomer*, Studentlitteratur, Lund, p. 82

¹⁸ www.bbc.co.uk/dna/h2g2/A1091350, 15.02.2006

¹⁹ Merriam, S.B. (1992) *Qualitative Research and Case Study Applications in Education*, Jossey-Bass Publishers, San Fransisco, p. 3-8

²⁰ Andersen I. (1998) *Den uppenbara verkligheten*, Studentlitteratur, Lund, p. 18-22

2.1.1 Approach

First, background research of the matter was conducted in Sweden. Some sources, mainly from the Internet, were collected in order to have more information prior to the conference. After the conference, a great deal of time had to be spent in order to compile all the written and recorded data. At this point more information about international accounting and IFRS in Russia was found in other secondary sources.

The information from the interviews was divided depending on if it was an auditor or a company representative. The auditors supplied more background data on accounting and auditing in general, and thus they have contributed to the frame of reference and the empirical chapter, while the company representatives tell us only about their personal experience and are thus presented in the chapter about the empirical studies.

When the compilation of the data was done it was time to analyse it. With the help of the analyses, connections between the frame of reference and the empirical studies were sought. As the subject of IFRS implementation is vast and complex, the quantity of the information collected was very large. When writing the analysis, a lot of attention has been paid to find the most significant and important issues that could best answer the purposes of this study.

2.2 Data Collection

There are two ways to gather data: from primary or secondary sources. Primary data is the data especially gathered for a specific purpose by the author him or herself. Secondary data is when the material has been gathered by others and thus might have been influenced by them.²¹

2.2.1 Secondary Data

A crucial event that made this thesis possible was the conference held in St. Petersburg,²² Russia, on November 24-25, 2005, on the subject of the transition to IFRS in Russia. The organizer was the Institute of Enterprise Problems under the supervision of the International Chambers of Commerce in Russia. The speakers were financial auditors, politicians, managers and others with connection to the issue. The conference was held exclusively in Russian, as was all the printed material handed out.

The Internet has today become one of our most important sources of information, no matter what subject. It is very easy and cheap to get material published on the web and the possibility of immediate feedback and discussing various issues are unbeatable. One problem is that pages can be withdrawn and thus the source can disappear. Still, the Internet has been extensively used for this thesis as it was almost the only way the author could access Russian

²¹ Lundahl U. & Skärvad P-H. (1992) *Utredningsmetodik för samhällsvetare och ekonomer*, Studentlitteratur, Lund, p. 78.

²² Praktičeskaja konferentsija "Mezhdunarodnyje standarty finansovoj otčetnosti (MSFO): Praktika perehoda i vnedrenija" (Practical Conference "International Financial Reporting Standards (IFRS): The Practice of Transition and Implementation")

material on the subject. The author deliberately concentrated on Russian material because this material is fresher than the material in the West, but also to give the reader the possibility to get acquainted with Russian information as it is very unusual that westerners speak the language. KPMG mentions that "... the ongoing transition to a market economy is changing the face of Russian accounting, making it difficult for even full-time accounting professionals keep up to date."²³ Bear in mind that this is still a fresh subject and little is written about it, especially regarding articles published in the west. A search was done in the University's database about IFRS in Russia and practically nothing was found. Only a few articles from the Big Four came up during this investigation.

The printed sources used have primarily been for the theoretical background. Some up-to-date information has come from magazines such as Business Week and other theses written at Göteborg University.

2.2.2 Primary Data

The only opportunity to interview people was at or in connection with the above mentioned conference. Before the author's departure to St. Petersburg, several attempts were made to get in touch with auditors and financial managers that were going to attend the conference. Society in Russia is still very hierarchic and it is much harder than in Sweden for students to conduct interviews without having a personal connection. It was thanks to Mr Sergey Vladimirovich Moderov, manager at the Institute of Enterprise Problems, that several of the persons interviewed agreed to participate. He was also the only person that had agreed to be interviewed before the conference, all others were contacted on site. Other interesting and relevant companies like PriceWaterhouseCoopers were regrettably not interested in giving an interview. All interviews were done face-to-face and they took between 1-1,5 hours each. Thanks to the open form of the discussions the author received a lot of information that was not foreseen by the questions asked. They were recorded with a Dictaphone, except for Mr Gregory Kharenko, who did not agree to have the talks recorded. The author considers that this decision did not affect the quality of the interview as notes were written during and immediately after the conversation. Ms Irina Vladimirovna Krasilnikova, with whom a lengthy informal talk was held at the conference, was also not taped as the circumstances were not suitable for it. Chapter 4, The Problems of Russian Translation of IFRS, is to a large extent based on this informal talk. A lot of information received from the auditors was used for Chapter 3, Frame of Reference.

We can thus deduct that the selection process was not by any means optimal. The author had only a limited time in St. Petersburg (4 working days) and had to use the time to interview the people that had agreed and could not spend any time searching for others that could replace those that could or did not want to be interviewed. Nevertheless, the author's goal was fulfilled in that representatives from three companies and two auditors were interviewed.

As the following interviewed persons were important not only for the empirical studies but also for the theoretical background, the author chose to present them in this chapter.

²³ <http://www.kpmg.ru/index.shtml/en/services/assurance/russianaudit/index.html>, 12.02.2006

Mr *Sergey Vladimirovich Moderov*, Head of International Financial Reporting Department, **Институт Проблем Предпринимательства (Institute of Enterprise Problems)**

The Institute of Enterprise Problems was established within the area of auditing and consulting in 1992. The company is a member of the Kreston International Group and offers a wide range of services in the fields of corporate law, tax, auditing, management consulting, property valuation, marketing and PR. The company has about 300 employees. The head office is situated in St Petersburg; its branches are in Moscow and Khabarovsk.

Ms *Anna Yefremova*, Director of Department Audit Services, **Razvitye Business System (Business System Developing)**

Ms *Zhanna Zyikova*, Head Consultant, **Razvitye Business System**

The company was founded 5 years ago and offers consulting services in the fields of strategic, corporate, financial, investment and risk management, accounting, tax, HR management and PR. The company works with IT system implementation for budgeting, internal management, and IFRS transition. The company makes auditing according to both national and international standards. They have about 300 employees. The company is a member of the International Group of Accounting Firms (IGAF Worldwide), one of largest accounting networks in the world.

Ms *Irina Krasilnikova*, Managing Director, фонд «Национальная организация по стандартам финисового учета и отчетности» (**Fund “National Organisation for Accounting and Financial Reporting”**)

The fund was founded in October 2003, with a view to further the implementation of international standards for accounting and financial reporting in the Russian Federation within the context of Russia’s integration in the international economic community. The fund sees its mission as stimulating long-term economic development by means of a foundation institution of financial reporting, required for making effective economic decisions. The fund is a non-commercial organization comprising representatives from all professions involved in making audits and/or issuing financial statements, as well as of representatives from regulated bodies.

The following persons were interviewed from the business sphere. Descriptions of their companies are presented in Chapter 5 with the empirical studies.

Mr *Aleksandr Obermeister*, Financial Director, **Metrocom**

Ms *Ludmila Ignatyeva*, Financial Director, **Intercos-IV**

Mr *Gregory Kharenko*, Head of Investor Relations, **TGC-1**

2.3 Discussion on Credibility

It is important that the material used in any report is trustworthy and relevant to the subject at hand. The reader must have the possibility to review sources and methodology in order to draw the necessary conclusions – this is done by an appraisal of the reliability and validity.²⁴

2.3.1 Reliability

Reliability tells us how trustworthy a study is.²⁵ Andersen²⁶ evolves the definition by emphasising that reliability is “how sure and exact we measure what we measure – regardless of what we intend to measure.”

Most of the secondary data used was chosen in order to accomplish a theoretical foundation on how to plan and write this thesis. As the reader has probably noticed, this means widely used reference literature by Andersen²⁷ and Lundahl and Skärvad.²⁸ Written data that discusses IFRS in Russia could only be found in articles. Since the subject is new and dynamic, it is crucial to use new articles on the matter as the discussions in articles published before 2005 were mostly found to be obsolete. The subject of international accounting is not a matter normally discussed in main stream media but mostly in academic, political and economic journals and books, which underlines the seriousness and quality of the discussion.

The author speaks Russian fluently as it is her first language, so there was no risk of a language barrier while attending the conference and during the interviews. However, as Russia has completely changed its economic system over the last 15 years, new terminology is being used consistently, and if a Russian-speaking person has been out of the country for only a few years, it is wise to learn the new terminology which today is heavily influenced by English, as opposed to the old terminology which was based on German and French.

The interviews were all done in the same way without any pressing time schedule. They were finished when the author found that all questions were answered satisfactory and the discussions had ended in a natural way and not due to lack of time. Therefore, the author feels that all interviewed persons had the same possibility to answer the questions and hold a dialogue.

2.3.2 Validity

Validity is described as how well a study measures what it is supposed to measure. It is often divided into internal and external validity. Internal validity describes the level of accuracy or how well the study mirrors reality. The external validity shows how well the result of the study can be generalized into a wider context. However, if we are talking about a study that deals with a very specific case it can be hard to draw conclusions for the wider perspective.²⁹

²⁴ Andersen I. (1998) *Den uppenbara verkligheten*, Studentlitteratur, Lund, p. 14.

²⁵ Lundahl U. & Skärvad P-H. (1992) *Utredningsmetodik för samhällsvetare och ekonomer*, Studentlitteratur, Lund, p. 89.

²⁶ Andersen, p. 85.

²⁷ Andersen I. (1998) *Den uppenbara verkligheten*, Studentlitteratur, Lund.

²⁸ Lundahl U. & Skärvad P-H. (1992) *Utredningsmetodik för samhällsvetare och ekonomer*, Studentlitteratur, Lund.

²⁹ Merriam, S.B. (1992) *Qualitative Research and Case Study Applications in Education*, Jossey-Bass Publishers, San Fransisco, p. 201-212.

As pointed out earlier, the most important sources were the conference in St. Petersburg and the interviews made in connection with it. The attendants are specialists on the matter, either as the end users of IFRS (financial directors) or as the controlling authority (auditors) or similar. Having heard their lectures and discussed with them, the author feels that their expertise should not be put into question. The internal validity should therefore be considered trustworthy for a study of this size.

This research is not very extensive as this was not the purpose. Regrettably, not all companies desired are represented on the list of people interviewed, but that choice was out of the author's control. Having spoken to only seven people can limit the extent of the conclusions and generalizations be made, but on the other hand, they represent different backgrounds and company profiles, and should make an acceptable mix in order accomplish a well-founded study. The fact that two out of three companies are not listed should not have a crucial influence on the result as the Russian Stock Exchange is underdeveloped and many companies do not implement IFRS because they want to enter the Stock exchange, but for other reasons like to make it easier to get credits.

2.3.3 Criticism of the Sources

In order to evaluate a study, a thorough analysis of the sources is in place. As earlier described, most of the written sources were used for the theoretical background. The authors and their books are well-known and widely used for social studies akin to this one. The newer written sources that have been taken from the Internet have come from magazines, newspapers and portals associated with accounting issues and were chosen out of a greater selection. Judging from the way these articles were written, the author has come to the conclusion that they contribute to the result of this research.

The conference in St. Petersburg was very well organized and all speakers were in one way or another involved with accounting and IFRS. The conference had one informative part, where information like news and plans for the future was presented. The other part was of a more analysing character with problems and experiences discussed in detail. The author of this thesis was also invited to speak and indeed held a lecture on Sweden's experience of IFRS.

The interviews were carried out in a friendly atmosphere and the answers often – although not always – showed a lot of resemblance. The author still considers them as trustworthy sources based on the answers offered by the interviewees. It is much harder to know what information they left out, but this research does not contain any sensitive data, and it is therefore fair to say that the people interviewed have left out no important answers on purpose. However, only one of three companies is listed on the Stock Exchange, TGC-1, and their representative was the only one who handed over an annual report for the author to keep. The other two only permitted reading from it at site, but did not want to hand over a copy. One other possible issue of criticism is that Mr Gregory Kharenko does not have IFRS and accounting as a field of expertise and could not always give detailed information for a question, and given more time another person would have been more suitable for this investigation.

3. Frame of Reference

The chapter starts with the history of the economic state of Russia after the break-up of the Soviet Union followed by a description of the accounting system in the Soviet Union. After an explanation of differences of national accounting and the need for international harmonization, a whole sub-chapter is devoted to RAS and IFRS in Russia: historical background, a comparison between Russian accounting standards and IFRS, cultural characteristics and the methods of preparation reports according to IFRS. The chapter ends with a detailed account of the problems of Russian translation of IFRS.

3.1 Russia and its Economy³⁰

The Soviet Union's collapse in 1992 introduced radical changes into all aspects of Russian society. The Russian government had two alternatives: to stabilize the economy with the help of traditional methods and only after that to start the preparation for economic liberalization or to start market reforms right away together with some measures for stabilization of the economic situation. The choice was made in favour of the latter one.

A new government, which primarily consisted in the main of young economists, was formed. They were acquainted with the main trends of western economic concepts but they didn't have any experience of practical house holding and administration at the state level. Judging from appearances, there was no well thought-out plan of the transition from a command economy to a market one or a clear ideological objective for the new development of the society either: everything that predetermined the reforms outcome. Having had a fixation on the market, the "young reformers" considered that it could quite quickly regulate all economic relationships by itself.

The first stage of the reforms (January 1992 – December 1992) began from the price liberalization of consumer goods and services and giving up the centralized resource distribution. As the industry was still highly monopolized it lead to extremely rapid increases in prices. The chaos increased and in May 1992 the government abandoned the monetary restrictions and went over to the policy of cheap credits and favourable terms for international trade. It led to inflation growth. Autumn 1992 prices were rising at the rate of 5% per week. At the end of 1992 they grew by 100-150 times, and on certain products even more. At the same time the increase in an average salary was 10-15 times. Additionally, it was complicated with the policy of strict monetary restrictions and giving up the protectionism of domestic producers. The result was deep economic recession.

The other reform direction at this period was privatization of state property. In 1992-1993, several privatization programs were approved and carried out. One of them was a program of "voucher privatization": the Russian government estimated the assets of all the state enterprises at 4 trillion roubles and of that 1.5 trillion (35% of the properties) were to be redistributed among 150 million of the population of the Russian Federation, i.e. 10,000 roubles per person on a single paper, which was designed, by the way, by Deloitte Touche Tohmatsu. The voucher could be sold, exchanged for shares in a cheque investment fund (and later receive dividends) or exchanged for shares of a company. Every company should have

³⁰ Makarov, D. (2002) '*Sotsialno-ekonomicheskije i politicheskije razvitije Rossii v postsovetiskij period*', the State University of Yelets, Yelets

offered at least 29% of its shares for sale in exchange for vouchers. The result of the privatization was that the majority of the population did not get anything. According to the magazine “Деньги”, of 126 millions citizens, 25 million gave their vouchers to the investment funds (most did not bring any dividends), 40 million invested in companies shares and the remaining 61 million of vouchers were sold (at an average price of \$20), and those who bought them became the owners of 35% of the national property according to the evaluation of 1992. Most of them became “oligarchs”, and head Russian companies today.³¹

After 1995, monetary and fiscal measures helped to lower inflation rates but industrial recession could only be stopped in 1997. Financial stabilization was achieved by growing issue of state bonds with high interest rates. The money, received from the bonds sale, was used for repayment of previous debts. In fact, a huge “financial pyramid” was created on a state level. The result was that in August 1998, the government decreed a 90-day moratorium for all foreign credits repayments and stop for short-term rouble bonds as well. By the end of the year the exchange-value of the rouble fell four times, and was followed by the fall of all securities and a deep crisis for the entire banking system. In comparison with 1991, the GDP fell 40%.

The long-term consequences were that people lost trust in the banking system and the securities market, not to mention their trust in the government. This trust was not strengthened by the fact that Russia changed Prime Ministers a couple of times during the last 2 years of Boris Yeltsin’s reign. On December 31, 1999, Boris Yeltsin announced his resignation and was succeeded by Vladimir Putin in March 2000.

Since becoming Russia’s President, Vladimir Putin has passed into law a series of fundamental reforms, including a flat income tax of 13 percent, a reduced profits tax, and new land and legal codes. Under Putin the Russian government has balanced the budget several years in a row and now no longer relies on Western loans for support. Thanks to these reforms, Russia’s economy has boomed. The economy has grown every year since 1999. Foreign direct investment hit an all time high in 2003, hard currency reserves are bursting, inflation is modest and real per capita incomes have grown by more than a third in four years.³²

Today the Russian economy is one of the fastest growing in the world. Last year, it grew 7.2% - the fastest in nearly a century - and it is forecast to grow 6.0% this year. The stock market has soared 80% this year and investment, profits and wages are rising too. At the same time, inflation is still a problem and last year reached 11.7%, while this year it is already at 13%. Nevertheless, ratings agencies have edged up sovereign debt towards investment grade and the corporate-bond market is growing. This is partly due to the sensible economic reforms pursued by the Putin’s government in its first term, not least its decision to cut personal income tax to 13% and tax on corporate profits to 24%.

Jason Bush at Business Week magazine notes:

“Also fuelling growth and helping stability is the greater importance of local, as opposed to foreign, investors. Today at least 60% of the cash invested in Russian stocks is estimated to come from local sources, as speedy economic expansion and handsome oil profits bloat the cash balances of Russian companies, banks, and wealthy

³¹ www.aferizm.ru, 08.12.2005

³² McFaul, M. (2005) ‘The Putin Paradox’, www.americanprogress.org, 15.12.2005

individuals. Local money is less likely than foreign money to flee the country at the first whiff of trouble.”³³

3.2 Accounting in the Soviet Union

Accounting in the Soviet economy had quite a low status, one could call it a routine bookkeeping rather than accounting. The accounting was standardized and the Soviet Union was the largest area in the world which used the common accounting norms. As everything was state-owned, no one was interested in “true and fair view”.

“The main objective of accounting systems under the command economy of traditional Communism is the provision of financial statistics (often in terms of quantities rather than values) for use in higher-level budgets; there is very little emphasis on accountability, which is a crucial element in accounting in market-based economy in which managers are delegated with the control of resources by the shareholders of companies who are granted limited liability in order to encourage investment”³⁴

Taxes were not important in the economic system. The prudence principle did not exist and the realization principle was different; according to the Soviet realization principle, a company’s profit came into existence only when the company had received cash. There was only one value principle – full real cost, i.e. cost of acquisition or production, since any other market values did not exist officially.³⁵

There was no demand that Soviet enterprises made an income statement. Profit and loss were shown in a balance sheet. Bookkeeping of revenues and costs were made on a cash basis. It was not necessary to specify revenues or costs either. Intangible assets did not “exist”. The assets were depreciated but the Soviet rules for depreciation differed quite a lot from the international ones. For example, one of the differences was that depreciation did not affect assets value, instead it was reflected in production costs.³⁶

In the Soviet Union everything (including accounting) was subordinated to the planning process. Every enterprise had its own planning department that had to draw up plans and budgets, which in its turn were used as a basis for fixed prices. State auditors and controllers saw to it that established plans were followed and fulfilled.³⁷

After the Soviet Union had broken up, the old accounting system didn’t meet the requirements of new economic relationships. Moreover, the Russian government wanted to draw foreign investors and in January 1992 the first reformation of Russian accounting had begun.

³³ www.businessweek.com, 08.12.2005

³⁴ Nobes, C. & Parker, R. (2002) *Comparative International Accounting*, Prentice Hall, p.323

³⁵ Walton, P. et al. (1998), *International Accounting*, International Thomson Business Press, London, p.296-298

³⁶ Rydell, M. & Wittboldt, P. (1997) *Kalla fakta om rysk redovisning*, Handelshögskolan vid GU, p.12

³⁷ Walton, P. et al. (1998), *International Accounting*, International Thomson Business Press, London, p. 299-300

3.3 National Accounting Differences

The general purpose of financial reporting is to provide a company's results and accounts to interested persons, normally the owners of the business, creditors and authorities. As stated earlier, a company often operated only within the borders of one country, accounting rules and policies were adapted to specific country demands. Thus, although the general purpose of financial reporting is the same in most countries, there are many differences in their accounting, as it is affected by environment and culture in every individual country. How these differences arose might be illustrated in the figure below.³⁸

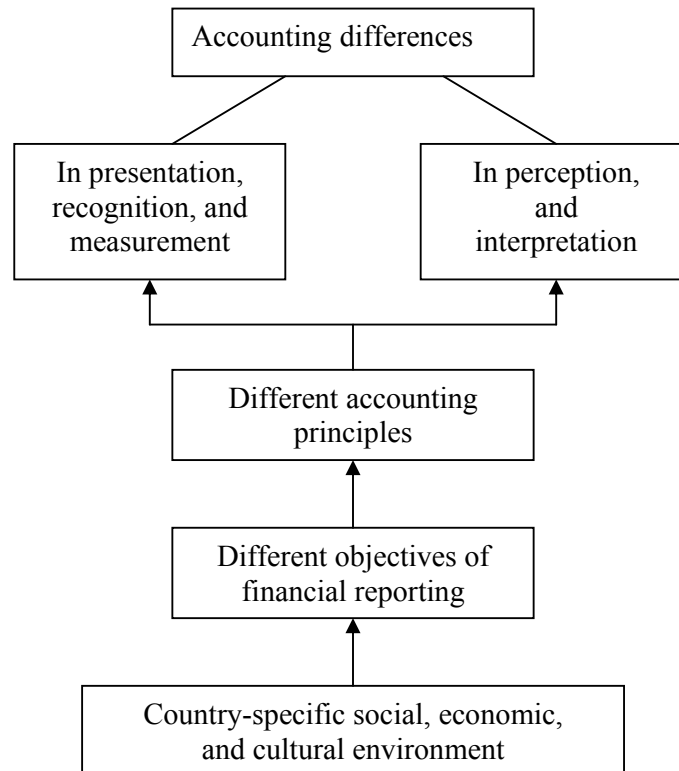


Figure 1. Reasons for the International Accounting Problem.

Accounting differences between different countries depend on what purposes the country has with the financial reporting – if the information is intended mainly for present and potential investors or for tax authorities and creditors. Interested parties of a company's annual report are also employees, suppliers, clients and other organizations. With the help of financial statements, users receive information that they need and companies are ready to present.

The different purposes of financial reporting are primarily influenced by economic, social and cultural factors. One of the important cultural variables is the means used for financial reporting regulation: “because of this, if change is triggered in two countries at the same time by the same event, the means chosen for regulating may well be different.”³⁹ In addition, different countries have different attitudes about how the legislations are followed. It can be illustrated in this light-hearted paragraph:

³⁸ Walton, P. et al, (1998) *International Accounting*, International Thomson Business Press, London, p.2

³⁹ Walton, P. et al, p.4

“International understanding on rules is very difficult because the rules have different meanings: in Germany everything is forbidden unless it is explicitly allowed by the law, whereas in England everything is allowed except what it is explicitly forbidden in the law. In China, on the other hand, everything is forbidden, even though it is allowed by the law, whereas in Italy everything is allowed, especially if it is forbidden”.⁴⁰

It is believable that cultural differences affect accounting. Nevertheless, it can be difficult to apply them to the measurement of accounting differences. More direct links can be established between accounting, legal and accounting systems.⁴¹

Accounting principles are formed in accordance with the purposes a company has with its financial reporting and that can be significant for the way in which balance and income statements are formulated. The differences in accounting principles can also lead to identical or similar operations and transactions being evaluated and accounted differently, thus showing a different annual profit.

There are two dominant accounting traditions, the continental and the Anglo-Saxon tradition. In the Anglo-Saxon tradition, accounting serves to satisfy needs of capital markets and potential investors. The majority of companies are represented on the Stock Exchange, protection of investors’ interests plays a key role in financial reporting. Accounting in the Anglo-Saxon tradition is strongly oriented on a “true and fair view” of the economic situation of a company.

As there was predominance of family-owned companies in the European economy, financed mostly by banks or by bonds, the main purpose of financial reporting in the continental tradition was protection of the interests of creditors and tax authorities. State authorities have quite a big influence on accounting policies. One of the most significant principles was the principle of conservatism, which leads to undervaluation of assets and overvaluation of liabilities and therefore to an understatement of a company’s value. As accounting is strongly linked with taxation in this tradition, companies tend to show a lower income. Non-current assets are often depreciated at a more rapid pace, which results in increasing expenses and, thus, a lower income.

As Russian accounting was affected to a certain extent by Germany and France, its accounting follows the continental model.⁴²

Those two different accounting orientations lead to the fact that one company, presented at Stock Exchanges in countries with different accounting traditions, will present different figures in its financial statement, depending on a country’s accounting tradition.

⁴⁰ Walton, P. et al, (1998) *International Accounting*, International Thomson Business Press, London, p.4

⁴¹ Nobes, C. & Parker, R. (2002) *Comparative International Accounting*, Prentice Hall, Harlow, p.31

⁴² *Istorija razvitija buhgalterskogo ucheta v Rossii*, www.referat.ru, 07.02.2004

3.4 Need for International Harmonization of Financial Reporting

Accounting can be called an economic language, used by the individual cultural groups and adapted to their needs. As a result of increasing globalization, the need for a common economic language has developed so that interested parties all over the world may communicate with each other and interpret the information supplied by financial statements.

The term “harmonization” means the reducing of differences in financial reporting between countries whereas standardization is used to mean the application of exactly the same rules.⁴³ As accounting is affected by many environmental and cultural factors, it would not be realistic to standardize international accounting, while harmonization is “an attempt to set in process a narrowing of differences which will remove the most important obstacles to international comparability.”⁴⁴

There are a lot of parties who are interested in harmonization of financial reporting. First of all, they are multinational companies: today there are more than 60,000 multinational companies⁴⁵ and their internal deliveries make about one-third of the international trade turnover.⁴⁶ Their great efforts for preparing consolidated financial statements could be greatly simplified if they were able to make it on the same basis. If accounting were more comparable and more reliable, it could reduce the risk for investors and therefore lower the cost of capital. Besides multinationals, C. Nobes and R. Parker define three more groups, who might benefit from international accounting harmonization: various intergovernmental transnational bodies (as, for example, the World Bank), international accountancy firms, the tax authorities throughout the world and governments in developing countries.⁴⁷

Having a common accounting language throughout the world is undoubtedly a necessity, but then there is the question if it is necessary for all types of companies, as, for example, smaller companies operating in national markets. IFRS is a complicated set of rules that give rise to high expenses for a company. There are discussions that only certain types of companies should begin to use IFRS.

3.5 The International Accounting Standards Board and IFRS

The International Accounting Standards Board (IASB) is an independent and privately financed organization, based in London, that works on creating international accounting standards. The organization was founded in 1973 under the name the International Accounting Standards Committee (IASC) by the accounting bodies from 9 different countries; Australia, Canada, Germany, Japan, Mexico, the Netherlands, USA and Great Britain. The purpose was to increase comparability and quality of financial statements on a global perspective. In 1981, IASC established a close connection with the International Federation of Accounts (IFAC) and they agreed that IASC would have autonomy in setting international accounting standards and in publishing discussion documents on international accounting

⁴³ Walton, P. et al, p.8

⁴⁴ Walton, P. et al, p.9

⁴⁵ www.yaleglobal.yale.edu/about/globalinc.jsp, 21.12.2005

⁴⁶ Barabanov, A. (2003) 'Mezhdunarodnyje standarty finansovoj otchetnosti – Obzor', www.cfin.ru/ias/overview.shtml, 21.12.2005

⁴⁷ Nobes, C. & Parker, R. (2002) *Comparative International Accounting*, Prentice Hall, p.74

issues. At the same time, all members of IFAC became members of IASC.⁴⁸ In 1997, IASC decided that it had to be reorganized to be able to keep working on accounting statements of high quality, first of all they needed more resources in the form of full-time staff.⁴⁹ The result of the reorganization was that the International Accounting Standards Board was founded in 2001. Over 150 accountancy bodies from over 110 countries became members of IASB.⁵⁰

The aim of IASB is “to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require transparent and comparable information in general purpose financial statements.”⁵¹ IASB collaborates with national accounting bodies and organization for the international harmonization of financial reporting.

After the foundation of IASB, a decision that standards, issued by the Board, would be called the International Financial Reporting Standards (IFRS). IASB adopted all the International Accounting Standards (IAS), earlier prepared by IASC. IASB’s recommendations are based on the “Framework for the Preparation and Presentation of Financial Statements”, published by IASC in 1989 and adopted by IASB in 2001. In its recommendations IASB often gives two alternative ways of using of the standards: a main alternative, *Benchmark Treatment*, and another, *Allowed Alternative*. In that way, IASB takes into consideration existed differences in countries’ accounting since, as was said above, harmonization means reducing and not the elimination of the differences.⁵²

On June 7, 2002, the Council of the EU adopted the so-called IAS 2005 Decree.⁵³ The Decree demanded that all listed companies prepare their consolidated financial statements according to IFRS. The member countries can decide for themselves if this company circle would be extended to certain types of companies or to all of them, and if financial statements of private businesses would be included. IASB works not only with accounting harmonization between EU’s member and candidate countries, but also with harmonization of financial reporting all over the world.

3.6 RAS and IFRS in the Russian Federation

Russian companies are still in a transition period regarding their accounting system. IFRS is used alongside the new Russian Accounting Standards (RAS) and US GAAP. Whereas US GAAP stands on its own, IFRS and RAS are more closely connected since the latter is based on the former. To understand today’s situation, one must have knowledge of the development of post-Soviet accounting in Russia, which is explained in this chapter.

⁴⁸ www.iasb.org/about/history.asp, 21.12.2005

⁴⁹ www.iasplus.com, 21.12.2005

⁵⁰ Nobes, C. & Parker, R., p.77

⁵¹ www.iasb.org, 21.12.2005

⁵² www.redovisningsradet.se, 21.12.2005

⁵³ www.iasplus.com/pastnews/2002jun.htm, 11.02.2006

3.6.1 Regulation of Accounting and Financial Reporting in Russia⁵⁴

Today's accounting system is regulated by a system of legal acts: first of all, by laws and legislative acts (Presidential Decrees, Governmental Regulations).⁵⁵ The most important ones are:

- Federal Law "On Accounting"
- Civil Code of the Russian Federation
- Federal Law "On Governmental Support of Small Business in the Russian Federation"
- Federal Law "On Joint-Stock Companies"
- Federal Law "On Limited Liability Companies"
- Regulation on Accounting and Reporting in the Russian Federation
- Resolution of the Government of the Russian Federation No.1355 of 7 December 1994

The Federal Law "On Accounting" is a main law, regulating accounting area, and contains the major accounting requirements. The Civil Code is a significant part of the system of the system of legal acts on accounting, as it consolidates many issues regarding accounting. It defines the existence of an independent balance sheet as one of the indications of a legal entity, establishes the necessity of approving the annual financial statements and instances where an audit opinion is required. It provides definitions of subsidiaries and associated companies and determines procedures for reorganization and liquidation of legal entities of different forms.

The second level of the system of legal acts consists of accounting regulations that are issued by the Ministry of Finance. At present, there are 22 standards on accounting (RAS) that establish principles and general accounting rules. They will be discussed in the following chapters.

The third level of documents include methodical instructions on accounting, including recommendations in which specific procedures for applying principles and regulations of accounting are set forth for particular types of activities. The fourth level includes belonging to the company itself, which determines its accounting policy in all systematic, technical and organizational aspects.

3.6.2 Developing RAS and Establishing IFRS in Russia

During the first period after the break up of the Soviet Union, not much happened with the accounting system as the government was occupied with other, more important, issues. From 1993, the balance sheet, and from 1996, all financial reports were made in net figures according to international practice. In 1994 the Ministry of Finance approved the first accounting standard and marked the beginning of new Russian Accounting Standards (RAS). The Federal Law "On Accounting" was issued at the end of 1996. A new free market economy demanded further changes in the Russian accounting system and in March 1997 an

⁵⁴ petersburgcity.com/business/bguidе/accounting/, 21.01.2006

⁵⁵ www1.minfin.ru/buh/b_zak.htm, 21.12.2005

order for an accounting reform program was signed by Yeltsin. One of the important parts of the program was the development of RAS in compliance with IAS.⁵⁶

Until now it has been a of work in transition to IFRS: there were 22 new accounting standards approved (which were written on IFRS basis), the Institute of Professional Accountants and the fund “National Organisation for Accounting and Financial Reporting” were founded, a number of legal codes in this area were approved and the first official IFRS Russian translation was made.

Russian companies first began to prepare their financial reports when the question of their introduction into European Stock Exchanges became apparent.

“The pioneers were Gazprom, which issued IAS accounts in connection with its admission to the London Stock Exchange in 1996, and AvtoVAZ, which first prepared IAS financial statements in 1994, as well as several major oil companies. A parallel process has also been underway in the Russian banking sector, driven by the need to present IAS-compliant financials to partners among Western financial institutions.”⁵⁷

Until 2004, using the IFRS was voluntary. Subsequent reformation of the national accounting leads to legislated regulation of the financial reporting according to the IFRS. At the end of 2003 the Central Bank issued a directive which obliges all banks to present their consolidated financial statements for 2004 according to IFRS. At the first stage the statements according to IFRS should be presented to the Central Bank together with Russian financial reporting. In 2007, a complete bank system transition to IFRS and abandonment of the national standards is planned.

In (2004) the Ministry of Finance of the Russian Federation approved “The Conception for accounting and finance reporting development in the Russian Federation on medium-term perspective”, which defines the main directions of transition to finance reporting according to the IFRS for Russian companies. The Conception raises the question of the necessity for the legislated approval of the IFRS. It is supposed that consolidated accounts, made according to the IFRS, will get legislated status. The Conception provides two stages in the transition:

I Stage: 2004 – 2007

Compulsory transition to IFRS of consolidated accounts for companies of major national interest, except for those companies listed on other stock exchanges and which prepare their financial reports according to other international standards (for example, US GAAP).

Approval of the Russian financial reporting standards for legal persons, prepared on the basis of the IFRS.

Rapprochement of the tax legislation with the accounts norms.

II Stage: 2008 - 2010

Compulsory transition to the IFRS of consolidated accounts for the other companies, including companies, listed on other stock exchanges and which prepare their financial reports according to other international standards.

⁵⁶ Yegorov, L. (2002) ‘Istorija razvitiya ucheta v Rossii’, the Financial Academy at the Russian Government, Moskva

⁵⁷ www.gaap.ru, 20.11.2005

Evaluation of the possibility of preparing the individual financial statements for certain types of companies directly according to the IFRS (instead of the Russian standards).

It is assumed that consolidated financial statements, prepared according to IFRS, will get status of one form of official financial statements. Accordingly the draft law “About Consolidated Financial Statements” has been prepared, which was adopted in the second reading by the State Duma on December 25, 2005. According to the draft law, consolidated accounts should be presented by Russian companies listed on Stock Exchange and also banks and any other companies, obliged to make their financial statements according to IFRS by the Russian legislation. A parent company will present a consolidated statement in three cases:

1. The presence of effective control is the main ground for consolidation. For example, a parent company exercises control over a subsidiary even if it owns less than half its voting rights.
2. The presence of control, based on realization of potential rights of a company on some share of other companies' property. For example, ownership of share options, which can be realized, i.e. converted in regular shares.
3. The presence of effective control over companies of special character, which operative management is not included in strategic or financial politics of a parent company.⁵⁸

3.6.3 The Main Differences Between RAS and IFRS⁵⁹

Users

The main differences between IFRS and RAS are connected with the historically stipulated difference of target group of users of financial reporting. Financial statements, prepared in accordance to IFRS, are used by investors as well as other companies and financial institutions, while the financial statements, prepared according to former RAS, were used by state authorities and by the state bureau of statistics. As those groups of users had different interests and different information needs, basic principles of the financial reporting was developed in different directions.

Substance over form⁶⁰

The “substance over form” concept is a core idea in IFRS, but it is not always applied in the Russian accounting system. According to IFRS, financial reality of the entity does not always correspond with the legal form of the transactions and events that underlie them. In the Russian accounting system, transactions and events are, as a rule, accounted for in accordance with their legal form, which often does not reflect their economic substance. An example when form prevails over substance in Russian accounting is that it is impossible to write off an asset from the balance if there are no legally required documents, irrespective of the fact that the management knows that those entities do not exist any more.

⁵⁸ Moderov, S (2005) 'Kontrol nad kompanijami. MSFO i zakon "O konsolidirovannoj otchtnosti"', <http://ippnou.ru/article.php?idarticle=001958>, 25.12.2005

⁵⁹ Barabanov, A. (2003) 'Mezhdunarodnyje standarty finansovoj otchetnosti – Obzor', www.cfin.ru/ias/overview.shtml, 21.12.2005

⁶⁰ www.oecd.org/dataoecd/16/26/35118918.pdf, 21.01.2005

Transparency

IFRS strives for the transparency of financial reporting. Their objective is to present satisfactory information volume for mass users. The Russian standards have only recently launched into broad information disclosure, and there are a lot of pitfalls in this question. For example, in 2002 the Ministry of Finance introduced the demand for information disclosure about “related parties”, or in Russian terms, “affiliated persons”. In economical and fiscal conditions of Russia, the management of companies, with the aim of understating value of redeemed shares and tax deviation, deliberately lowered asset value or withdrew assets from the company’s balance account by founding subsidiaries. Many banks are not interested in disclosure of the information about related parties and groups of interdependent clients or about offshore operations, therefore at the moment of financial reporting a “creative” method approach is often used, allowing hidden risks. In practice, the demand is hardly followed. Even if such information is disclosed, it is often vague and insufficient, the problem is that Russian companies do not have enough experience or even wish to disclose such information today.

Going concern concept

According to IFRS, financial statements are made on the assumption that a company will continue to operate indefinitely. It is assumed that the company has no intention or necessity for liquidation of its assets or for significantly cutting the volume of its operations. Should such a necessity or intention arise, the financial statement should be prepared on the basis of the other principle and the principle should be disclosed.

In the Russian accounting system, at the moment of preparation of a financial statement, the going concern concept is often not taken in consideration. A user, irrespective of if it is a creditor, a shareholder or a client, has no assurance that the financial situation or indices, presented in the statement at a certain date, will stay the same. Thus, a user, making decisions about the future of this or that company, is faced with a higher risk.

Comparability

IFRS strives for users to have the possibility to compare a company’s financial statements over the different periods of time to define its perspective changes in its financial situation and its financial indices. The users should have the possibility to compare financial statements between the different companies.

Owing to repeated changes in accounting policies, tax legislation and inflation, financial statements, made according to the Russian accounting principles over different periods of time, cannot be considered comparable. In addition, the Russian accounting system does not demand disclosure of accounting policies, used for preparation of a financial statement, changes of the policies and effects of these changes. The lack of disclosure of such information creates difficulties for comparability of companies’ financial reporting.

Matching and realization principles

The other important IFRS principle, which differs from the Russian accounting system, and in its turn leads to a many differences in financial reporting, is how expenses are reflected. IFRS recommends following the matching principle according to the rule that expenses are to be accounted for in the period of expected revenues, whereas in the Russian system bookkeeping of expenses demands first to fulfill certain document requirements. According to IFRS, revenues are accounted for at the moment of sale and not at the moment when payment is received.

The necessity of the presence of required documentation often does not allow Russian companies to account for all the transactions relevant to the given period. This difference leads to inaccuracies in financial statements.

A financial statement, made according to the matching and realization principle, informs users not only about previous transactions related to payments and receiving of liquid assets, but also about future payment obligations and future receipt of liquid resources. Thus, it presents useful information, needed for making economic decisions. In the Russian system, the decision that revenue should be accounted for at the delivery moment was made only few years ago.

Prudence

The principle (sometimes it is also called *the principle of conservatism*) assumes some caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such as a probability of getting money on client claims, a period of useful life for buildings and equipment or quantity of guarantee claims. According to IFRS, this uncertainty is reflected by information disclosure about characteristics and frequency of mentioned cases. The principle provides for a certain caution, making estimates in financial statements, such that assets or income are not overstated and liabilities or expenses are not understated. In Russian accounting, potential losses are not reflected in the financial report until they are incurred.

The more detailed differences, regarding certain standards, are presented in Appendix 2.

3.6.4. Some Cultural Characteristics and Their Influence on Russian Accounting⁶¹

Even within Western market economies there are differences in interpretation and emphasis regarding IFRS adaptation: the same rule could be interpreted differently by a German and a British accountant for cultural reasons. There are some analytics that stressed the point that RAS might never be identical to the international standards and the main problem is interpretation. That is because Russian culture and Russian thought processes come into play. The way Russian accountants interpret the rules will always be different than the way an English accountant will interpret the language contained in the various international standards.

There are many reasons why interpretations differ. One of them is conflict in definitions. Both IAS and the Russian Civil Code contain a great many definitions but the Code definitions are often different from the IAS ones. Another reason is a timing lag between the time a new international standard is issued in the UK and the time that a new standard is translated into Russian and adopted as a part of the Russian accounting rules. Russian accountants who cannot read in English are limited to reading the Russian translation, which may already have some translation inaccuracies. Most of them were educated in a university that did not teach the international standards and thus they have a problem reading the international standards in

⁶¹ McGee, R.W. & Preobragenskaya G.G. (2004) *Problems of Implementing International Accounting Standards in a Transition Economy*, Barry University, Miami Shores, www.pappers.ssrn.com, 07.02.2006

any language because the standards contain concepts that were never exposed during their university years.

Another problem is that the Russian accounting community operates as a two-tier system. Accountants who work in large metropolitan centers as Moscow and St. Petersburg are more knowledgeable about IFRS than those who live and work outside of them. The first ones have more and better access to accounting material and courses, and there are differences in demand as well. The majority of clients who prepare statements according to IFRS are in Moscow or St. Petersburg. Many accountants and even university professors who live in regions know little or even nothing about international standards. It is unlikely that the situation will change soon as there is the same difference between economy students from Moscow and St. Petersburg and students from other parts of the country. The first ones have a higher probability of having professors who have actually read and used IFRS while regional universities have different attitude about the need to teach IFRS, and the level and quality of educational material available to students is also not good.⁶² Nevertheless, even if accounting education is better in Moscow and St. Petersburg, it is still based on RAS rather than on international standards and courses on IFRS often only explain general concepts.

One more problem on the way to IFRS implementation is insufficient computerisation in Russia. For example, for every computer in Russia there are 26 in the USA. Once again there is a big difference between Moscow and other regions: while on average in Russia only 10% of families have a personal computer, in Moscow this number is 32%. However, even among those who have a computer, 89% have never used the Internet and only 5% of Russians have the opportunity to use the Internet on a regular basis. Some experts believe that Russia might need 25-30 years to overtake the West regarding IT.⁶³

3.6.5 Methods of Preparation of Financial Reports According to IFRS

According to PwC, around 40 of Russia's 50 leading non-banking companies prepared either IAS or US GAAP financial statements in 2003.⁶⁴ Last year 25% of the 100 largest Russian companies prepared their financial reporting according to IFRS (Appendix 1).⁶⁵

In Russia, companies use two methods for preparing financial statements according to IFRS: transformation and converging.⁶⁶ Transformation signifies that at the end of a reporting period, information prepared according to the national accounting standards, is to be modified and corrected according IFRS principles. The method is based on special transformation tables. One of the big disadvantages is that economic information, prepared according to IFRS, is available only at the end of a reporting period, besides often after the transformation is complete it is necessary to make additional corrections. According to some estimates, the error margin can be anywhere from 10% to 50%.⁶⁷ Converging means that data is registered

⁶² McGee, R.W. & Preobragenskaya G.G. (2003) *Accounting Education in a Transition Economy: a Case Study of Russian Universities*, Barry University, Miami Shores, www.pappers.ssrn.com, 07.02.2006

⁶³ Dolin, G. (2004) 'Kompjuterizatsija v mire I Rossii', www.hardvision.ru/to_articles/act_desc/id_249, 15.02.2006

⁶⁴ www.pwc.com/ru/eng/ins-sol/issues/03-06-09_ls_ko.html, 21.01.2006

⁶⁵ www.expert.ru/expert/ratings/exp200/, 14.12.2004

⁶⁶ Interview with the auditors and the conference material

⁶⁷ Barabanov, A. (2003) 'Mezhdunarodnyje standarty finansovoj otchetnosti – Obzor', www.cfin.ru/ias/overview.shtml, 14.12.2005

in two systems simultaneously: one according to RAS and one according to IFRS. The choice of the method is based on pros and cons. To prepare financial reporting via converging, a company needs to computerise the accounting systems which demands a lot of time and money. According to the magazine “Люди дела”, implementation of a new similar IT system can cost from 5,300 to 135,000 US dollars, which includes the purchase of necessary devices, IT programs and financial and technical consultations.⁶⁸

Most companies make periodical transformations of their financial reporting by their own powers or with help of specialists from consulting companies. The converging is used mostly by subsidiaries of foreign companies. The Russian Central Bank has chosen the transformation method as a main method for transition of the bank system to IFRS.

3.7 The Problems of Russian Translation of IFRS

Regardless that a lot has been accomplished regarding IFRS introduction, the term “IFRS” is not presented in the federal codes. Today, everyone admits the necessity of a legislated adoption of IFRS for Russian circumstances. The concept of IFRS in the normative system of the Russian Federation is planned. However, it is clear that implementation of IFRS crucially depends upon the availability of a high quality authoritative translation into the Russian language. At present it is one of the most complicated and emotionally charged questions. Its complexity is determined by a number of different factors. The official text of the international standards is drawn up and spread in English. Until recently all translations in other languages were published by the International Accounting Standards Board or under its supervision. In the EU, the IASB gave the translation rights to the member countries, whereas in Russia the question of an authoritative translation is still not solved.

There are plans to establish a non-governmental body, consisting of translators and specialists in accounting and financial reporting, audit financial analysis, management, etc., who will work with Russian translations of IFRS. However, the future of this organization is under question. There is already one Russian translation of IFRS and its copyright belongs to the Russian company “Askeri”. A new translation, without abusing copyright laws, is hardly possible.⁶⁹ That’s why the Ministry of Finance, who a year ago promised to publish the official IFRS translation in a near future, has not done so yet. The matter of the translation is further complicated by the fact that Askeri has had legal proceedings with the IASB.

In 1997, the publishing house “Askeri- ACCA” bought the rights for translation and publishing of IFRS in Russia and paid 42,000 US dollars.⁷⁰ The translation was made by a highly qualified group of people: as well as the translator there were also 16 editors, leading specialists in accounting and finance. The book was published in 1998. In 2001, the director of the publishing house, Oleg Askeri, accidentally found their translation on a home page that everybody could download for free - and some other organization was named as the translator. By that time, the free version of the translation was available for about a year

⁶⁸ Jakovleva, A. (2005) ‘Perehod russkih kompanij na mezhdunarodnije standarty finansovoj otchetnosti, *Ljudi dela*, March-April, No. 60-61, ld.ludidela.ru/0504/0504-34-05.html, 14.12.2004

⁶⁹ Informal talk with I. V. Krasilnikova, director of the fund “National Organisation for Accounting and financial Reporting”

⁷⁰ Aljakrinskaja, N. (2004) ‘Chisto russkij standart’, Moscow news, no.45, www.mn.ru/issue.php?2004-45-17, 28.12.2005

during which some 33,000 users had downloaded it. The company, which published the free IFRS translation, turned out to be the famous auditing company “PriceWaterhouseCoopers”. All the demands to withdraw the translation from the home page were left without answer, then, Askeri felt forced to sue PwC. As was determined later, the files with the Russian translation were given to PwC by the International Accounting Standards Board (IASB). Today, IASB asserts that the files were given after the licensed agreement with Askeri Company had expired. However, according to Oleg Askeri, the agreement did not give the copyright to IASB and it did not have the right to hand over the translation to a third party. The court examination on the copyright for the Russian IFRS translation ended in PwC’s favour. The judge of the Supreme Court in London sided with Askeri and satisfied its demands to acknowledge the Russian translation of IFRS as a property of the Askeri Group.

Although the IASB declared its intention to grant the rights to the IFRS translation into Russian to the Russian government, nothing has happened yet. The official IASB’s home page contained a Russian translation of IFRS until recently, for a fee of £69. According to Oleg Askeri, even this translation was an altered version of their translation. “If it is necessary, I can prove that IASB has just tried to change our text by replacing the key terms”, said Askeri.⁷¹ Larisa Gorbatova, member of the advice council under IASB, stated that the main reason for the lack of an official translation is the conflict with Askeri on the grounds that any translation of IFRS, even if only partially based on their material, cannot be used.⁷²

Another aspect of the translation problem is that the standards are not something permanent; they change and are updated continuously. Does it mean that for every new version of IFRS a new copyright should be bought? Actually, there are two versions of the International Financial Reporting Standards: one issued by IASB (the complete version) and the other used within the EU (with some exceptions). The EU’s regulations are free sources and one can use them freely without breaching anybody’s copyright, but one must pay for the use of IASB’s IFRS version.

The “National Organisation for Accounting and Financial Reporting” fund suggests another possible way to avoid the necessity of an IFRS translation. The organization suggests building a national financial reporting standard on the methodical base of IFRS. This alternative has several advantages. First, these standards will align to national needs and specificities to a much greater extent. Second, the question of IASB’s copyright for IFRS does not pose a problem. Furthermore, the question of the international standards is not just professional but also a political one. IFRS can be viewed to have become a kind of political weapon. As Russia is not a member of IASB, it does not have the opportunity to take part in IFRS elaboration and affect its formulation. In this respect, i.e. regarding the political influence in the area of financial reporting, Russia may even consider cooperating with China in working out new common standards for accounting and financial reporting.

⁷¹ Mikhalenko, O. (2005) ‘Komandir MSFO’, *Russkij polis*, Februari, No.2, www.in-sure.ru/ru/basic/journal/archive/2005/rp58/doc11461.html , 06.01.2006

⁷² Mikhalenko, O. (2005)

4. Empirical Studies

The first part of the chapter gives a thorough description of all companies whose representatives have been interviewed. The auditors have already been presented in Chapter 2. The second part presents a compilation of the interviews of the company representatives and the auditors.

4.1 Introduction of Companies

INTERCOS-IV Ltd.

The company was founded in 1991 by four engineers who originally owned equal shares of the company. The European Bank for Reconstruction and Development (EBRD) acquired just over 10% of the company in 2002. The company has three subsidiaries. Intercos-IV focuses its activity on the design and manufacturing of dies and moulds for the automotive industry. The company is a closed corporation and is not listed on the stock exchange.

Today it is a leading-edge manufacturer of large-sized tooling for the automotive industry in Russia. Practically all of the largest automotive enterprises in CIS (Commonwealth of Independent States) and foreign companies such as Volkswagen, Ford, Daewoo Motors, Hayes Lemmerz, and Caterpillar are among their customers. The company provides the entire production cycle: from tooling design and manufacturing to mass serial production of details at their press line.

Total assets 2004	Turnover 2004	Employees
US \$6,900,000	US \$5,570,000	150 people

Intercos-IV is a medium-sized company.

METROCOM Ltd.

The company was founded by St. Petersburg Metropolitan (55% holding) and Andrew Corporation from the USA (45% holding). The Russian financial company “Menatep” acquired the Andrew Corporation holding in 2001. Metrocom is not listed on the stock exchange.

This telecommunications company based in St. Petersburg offers a wide range of services within telephone communication and internet and data transmission. The company owns a broad fibre optical communication net (more than 1,000 km) in the tunnels of St. Petersburg’s underground. Their services are used both by companies (more than 2,500) and private citizens (several tens of thousands). Metrocom’s telephone cards are also in popular demand, covering some 37% of the market.

Total assets 2004	Turnover 2004	Employees
US \$31,729,000	US \$28,388,000	200 people

Metrocom is also a medium-sized company.

JSC LENENERGO

The company considers its foundation date year 1886, when Carl Simens founded the “Electric Lighting Company” in St. Petersburg. The company was registered in 1993 in its present form as a joint stock corporation. The company is owned by RAO UES (49%), Fortum (30.7%), Brunswick (7%), private citizens (5.7%) and various financial investors (7.8%).

Today, JSC Lenenergo is the largest regional energy company in northeastern Russia. The company supplies electricity to an area comprising some 87,000 km² (which approximately equals that of Belgium, Denmark and Albania together). The area has a population of more than 6 million people. The company’s geographically advantageous vicinity to Finland and the Baltic states enabled it to enter the international energy market. Until recently, Lenenergo combined production and power supply with the sale of electricity. Lenenergo was reorganized in the autumn of 2005, regrouping into 4 new companies. A representative of one of them, the TGC-1 (Territorial Generating Company No.1) was interviewed regarding IFRS. The data presented is taken from Lenenergo’s annual rapport 2004.

Total assets 2004	Turnover 2004	Employees
US \$1,800 million	US \$ 1,000 million	12,500

Lenenergo is a large-sized company.

4.2 Interview Compilation

The interview compilation is divided in two parts. In the first part the interviews with the three companies are presented, in the second part the interviews with the auditors follow. It is not mentioned which of the respondents has said what, but the respondents will be referred as C1, C2, C3 and A1, A2. In the second part only part, of the answers will be presented. The reason is that the objective with a lot of questions for the auditors was to get a general idea of today’s economical and accounting environment in Russia, which is reflected in the frame of reference part of the work (Chapter 3).

4.2.1 The Companies

The reason for introducing IFRS in the company

In two of the companies, IFRS has been introduced by foreign investors. In one case the investor wanted to have financial reports according to IFRS to be able to compare the company’s results with results of other subsidiaries, in the other case the investor wanted to see a financial statement which it could understand. C3 introduced IFRS in search of more favourable loan conditions.

The method of preparation statements according to IFRS

All three companies use the method of transformation for making their financial statements according to IFRS. While C2 and C3 make transformation from RAS statements, C1, as they register accounting data simultaneously in two systems (according RAS and according US GAAP), makes transformation to IFRS from the US GAAP data system.

Necessary preparation for IFRS transition

C2 and C3 needed to have quite a lot preparation before IFRS introduction. First, their accountants had to have some kind of education/training in IFRS and then the implementation of IFRS demanded installation of an information system. Neither of the companies had any accounting IT system. For C1, after several years of preparing their financial statements according to US GAAP, the introduction was much easier: they already had both educated accountants and a good IT system.

Period of time needed for IFRS implementation

It did not take long for C1, as they already had convergence between RAS and US GAAP. As the respondent says there was no need in any special preparations. For C2 the IFRS implementation took about 3 years and C3 could not give the exact time but it also took several years.

Number of people working with IFRS questions

C2 has only one person who prepares financial reports according to IFRS. In C1 there are two people who work with the issue and C3 needs seven people for preparation of the company's consolidated financial statement according to IFRS. All of them are the companies' financial directors or accountants in a high position.

Using external help

All companies used external help from IT consultants. All three companies receive consulting from their auditing firms on a regular basis. The interesting fact is that all three companies once had a Big-Four company as their auditor or even changed several of them, but at the moment none of them uses services from the Big-Four. C1 and C3 still have foreign companies as their auditors while C2 gets help from a Russian auditing company. One respondent explained the change in auditors was because the services of a Big-Four company were not worth their price while two other companies did not want to mention the reasons for change. Another respondent said that even though the Big-Four help is very expensive the advantage is that they always possess the newest information about IFRS.

Companies expenditures in connection with IFRS implementation

The author could not get exact information about how much IFRS implementation cost the companies. However, the author understood that it is quite a costly project. Although C1 already had everything required, nevertheless, it still cost to continue with staff education. C3 also mentioned big problems with adjusting the IT system, which resulted in very high costs for the company.

Importance of IFRS for executive management

All three respondents point out the importance of IFRS implementation for the companies' executive management but they see it as an opportunity to attract foreign capital rather than an instrument of operational or strategic management. However, C2 points out that computerisation (which was required because of the IFRS introduction) helped the company to shift the company's management on another, higher level. C3 mentions that while RAS statements are for the company's operational management, the top management uses IFRS data for 5-year strategic planning.

Education in IFRS

All respondents affirm that the companies have educational plans regarding IFRS. Normally every year a company reserves some amount for their accountants' education. They also try to

take part in conferences about IFRS. Regarding the question of whether respondents consider that their companies have sufficient knowledge about IFRS, C1 and C3 answer that they are sure that their companies are sufficiently qualified in IFRS issues, while C2 does not think that companies' employees possess sufficient knowledge in the area.

IFRS sources

C1 does not have any full translation or original version of IFRS. Normally they use materials that the respondent received from different education courses. C2 has the Russian translation by Askeri, but they normally use the original English version of IFRS, which they have in electronic form. The version was received from their former auditor, which is one of the members of the Big-Four. C3 uses the Russian translation by Askeri.

IFRS effects on financial statements

The respondents were not especially willing to talk about how IFRS affect numbers in their financial statements. However, the author understood that both the balance sheet and income statement are affected and numbers are usually lower than those according to RAS. Almost the only exception is leasing operations, when they are registered according to IFRS total assets increase.

It was easier to get information about “problem” areas for IFRS reports. All three companies noted the difficulties with the evaluation of non-current assets, both tangible and intangible. In case of the energy company the difficulty is that a great part of the buildings and equipment can be several decades old and after a number of years of hyperinflation, old figures do not mean anything. In 2001, the government published lists with inflation indexes for different types of assets, nevertheless no list can be so detailed so as to cover all areas. The telecommunication company often has difficulties with evaluation and accounting intangible assets. According to the respondent, US GAAP has more detailed instructions for the telecommunications branch than IFRS has. The other problem is that while both RAS and IFRS allow re-evaluation of assets, US GAAP does not, so the transformation data from US GAAP to IFRS has to be collected from RAS.

Though inflation in Russia is getting lower, all the companies use the international standard for accounting in countries with hyperinflation which also provokes questions about which inflation index to use. The matter is that the inflation is not the same in different industries, how correct is it to use the same index for everyone?

IFRS concept of “substance over form” was also mentioned several times by all of the respondents. As in Russia, the concept of “form over substance” is used and it inevitably provokes accounting difficulties and therefore differences in financial statements.

Negative effects of IFRS implementation

C2 points out that companies using IFRS find themselves in unequal competition conditions in the Russian market. IFRS demand transparency while many Russian companies still often conduct “grey” business, which they prefer not to show in their official financial statements. Otherwise, all three respondents are positive towards IFRS implementation. Of course, it is expensive to introduce IFRS in a company but the respondents believe that IFRS represent the future of the Russian accounting.

4.2.2 The Auditors

Auditor's role for IFRS implementation

Both respondents are in agreement that auditing companies are very important for the process of implementation of IFRS. A1 says that auditing firms are normally the first instance where companies apply for help and consulting when they are faced with the necessity of IFRS introduction in the company. Besides, according to A2, in Russia it is very common that an auditing company both consults and audits a company.

Financial report users

Both respondents confirm that the main users of financial reports are owners and investors, normally foreign owners and investors want to have financial reports presented according to IFRS as they prefer to read reports, which principles they are acquainted with and understand. A1 adds that lately more and more Russian owners want to use IFRS in their companies accounting for improvement and developing of management accounting.

Structure of Russian companies' owners

According to A2, there are two types of limited companies in Russia: those that appeared during the privatization period and those that were founded later by private persons. Many employees got shares of their organizations during the privatization. Later, some of them sold their share but there are still many who did not. Perhaps it is the only occasion in Russia when minority shareholders are physical persons because private persons do not usually risk being involved in share trade. The Russian share market is not developed to the same extent as it is in the West. There are maybe only 10-15 companies whose shares circulate on the market. A1 confirms the above but adds that recently together with Russia's economic development the share market has begun to return to life. Nevertheless, there is still a fresh memory of the default of 1998 in everybody's mind.

Companies' capital financing

Both respondents say that Russian companies are mostly financed by credits. Many enterprisers do not have enough capital for foundation and further investments. The cost of capital is quite high in Russia and today the owners try to get credits from foreign investors. Often foreign loans are 1-3% cheaper than those that national banks grant. On the other hand, it is not unusual that Russian companies can have very low solidity, up to and including that A2 saw negative numbers for assets, and still the companies were granted credits. Of course, banks are not stupid. The reasons that they give money to companies with such finances are personal relationships and that bank management knows that not all operations are reflected in the official statements, either because of companies' executives unwillingness to reflect those transaction or a lack of the legal means to do it.

The current difference between RAS and IFRS

A2 says that if one looks at written normative, i.e. IFRS and the new RAS, the difference will not be that big, but the problem is that many companies often work after the old standards, therefore in practice the difference is huge. The accountants try to follow the tax legislation while financial statements have much lower priority.

Types of companies that implement IFRS

According to both respondents, IFRS implementation does not depend on the type of company. It can be any limited company (listed or not listed), trading company, etc. In short, any company that wants to enter the international security markets.

Location of companies working with IFRS

A1 says that in Russia there are many large mining companies which are located throughout the country. However, companies' executive management are usually located in big cities, i.e. Moscow, St. Petersburg, and so on. There are some companies that have their head offices outside the Russian economic center but it is not typical. A2 says that companies that are interesting for investors (and therefore those that use IFRS) are normally situated in big cities.

Company problems during IFRS implementation

A2 believes that one of the main problems for accountants in companies that have begun to work with IFRS is undoubtedly lack of sufficient knowledge about IFRS. Another problem is that of mentality. In Russia in the past accountants only had to carry out exact normative instruction, whereas IFRS often give recommendations and leave a lot of space for independent appraisal, and this mind barrier is not easy to get over. A1 has the same opinion about the lack of qualified accountants, ready to work with IFRS, but the respondent notes that the situation is actually getting better as more and more accountants are interested in studying IFRS. Another problem, according to A1, is the creation, installation and further custom adaptation of accounting IT programs.

Both respondents point out the problem of the consolidation of a group of companies when IFRS is introduced. It is common in Russia that several people own a number of companies that are connected with each other by fact but not legally. Often it is done with the intention to evade taxes. A lot of internal transactions are never officially recorded. When the owners later decide to introduce IFRS in the company, they are faced with the choice of exposing illegal transactions and paying taxes and maybe paying a fine or even something worse, or there is another, more "subtle" way: to find a less honest auditor who can help alter the company's financial statement in a more favourable way.

Problem factors

Both respondents consider that company size is the factor that primarily affects IFRS implementation. On the one hand big companies have more financial means to undertake the IFRS transition correctly. They have more possibilities to educate their employees and to hire the best consultants, but the structure of a big company is much more complex than in smaller companies where the process of implementation can be much simpler and quicker. As for industry branches, A1 notes that until recently there was no standard for the mining industry and even the new one, published by IASB, has too many gaps and deficiencies. A2 believes that it is about equally difficult for any branch, maybe the transition is more problematic for agricultural companies but the explanation lies instead in the much lower educational level for those who traditionally work in this branch, and not in the standard difficulty.

Education in IFRS

According to the respondents, there is currently a large market in the area of IFRS education. There are different international certifications available after finishing an educational course in IFRS, such as, CIPA (Certification for International Professional Accountants) which is comparable to being a Certified Public Accountant in the United States, or ACCA DipIFR (Diploma in the International Financial Reporting), issued by the Association of Chartered Certified Accountants (ACCA) based in London. If an accountant wants to work with IFRS issues, he or she should have certification first.

Quality of financial statements, made according to IFRS

A1 believes that quality of financial statements depends on the qualification of those who make the statements as well as those who audit financial reports. Therefore, as much as one can rely on an auditing company is as much as one can rely on financial statements audited by them. A2 is much more pessimistic regarding this question. A2 notes that the most common method of making financial statements according to IFRS is transformation, therefore inaccuracies and mistakes of Russian book-keeping followed with transformation inaccuracies resulted in numbers that stretched the truth. The number of companies making their reports by converging is still low, they are pioneers of accounting development in Russia. However, A2 said that step by step converging will be a more and more common method. The quality of the financial statements is also affected by insufficient computerisation in book-keeping: if everything at head offices is computerised, it does not mean that all subsidiaries have the same level of equipment.

Auditing companies problems in connection with IFRS implementation

A2 points out the difficulty of getting information about IFRS. There are not many sources where you can get high quality information. It is very useful to know English but in Russia it is still a problem for many specialists. For that reason (information exchange) many auditing companies unite in partnerships or become members of international accounting networks. Another good source of information is different conferences about IFRS, like the one the author attended. A1 considers fluidity in auditing companies as a big problem especially among young specialists. After receiving training and education in an auditing company they often find a higher paid position in an industrial company.

5. Analysis

In this chapter the reasons for the introduction of IFRS by Russian companies are presented. It follows by a thorough explanation of the problems and difficulties that have been and still exist with the implementation. The chapter ends with a discussion on the reliability that financial reports, made according to IFRS, have.

5.1 Reasons for IFRS Introduction in Companies

From the beginning of the 1990s, the Russian government and the Ministry of Finance have tried to create more favourable conditions for the implementation of new accounting standards in Russia. They appeal to companies to voluntarily implement the standards. However, the results of their efforts can be seen in the rating of the 400 largest Russian companies from the Russian magazine “Expert” (Appendix1). The companies in the list are shown according to their turnover volume. Of the 100 largest Russian companies, 25% presented their financial statements for 2004 according to IFRS, 16% - according to GAAP, 38% - according to RAS and 21% - according to managerial accounting.⁷³ What is it – managerial accounting? It means that a company does not use any set of standards and makes its financial statement according to their economists’ best ideas about accounting, normally in Excel.

However, 25% companies from the list have already implemented IFRS and use them for preparation of their financial statements. Is it a low or a high figure? The answer depends on the point of view. On the grounds of Russian legislation development and economic trends, there are some reasons to suppose that those 21% of the companies on the list (which actually do not have any approved form of financial statements) are the next candidates for IFRS introduction.

In the interviews both the auditors and the companies’ representatives were almost unanimous Regarding to the reasons for IFRS introduction. The necessity to prepare financial statements according to IFRS appears first of all at companies that work with foreign banks and investors. Another reason is the wish of the owners to have the opportunity to evaluate a company’s economic development and to compare it with other competitors. IFRS help to make these evaluations and comparisons more objective. Besides, IFRS implementation helps a company set internal accounting and exercise better control over a company’s operational and strategic management.

One more possible reason mentioned during the conference in St. Petersburg was that financial statements prepared according to IFRS help companies lower capital costs. Credit ratings are often based on the expected quality of a company’s financial statements. In addition, many banks, both national and foreign, include a paragraph in credit agreements about the possibility of interest rates lowering in case a company presents its financial statement according to international accounting standards.

⁷³ In Russian “управленческая отчетность”, author’s translation.

5.2 Companies' Problems in Connection with IFRS Implementation

Implementation of IFRS is a large and complex project that demands investments both in material and immaterial resources and can take a company up to several years. In this part of the chapter most general problems regarding IFRS introduction will be analysed.

5.2.1 Education

One of the basic conditions for successful IFRS implementation is employees' sufficient knowledge and competence about the matter. The research shows that even educated specialists of the interviewed companies often acquire help from external consultants. Even if a financial statement is prepared by an external party, consultants need help with some pieces of specific information. The companies' employees always know better the branch's special characteristic and features which can escape some other's attention, besides the employees should have a certain level of knowledge to answer consultants questions.

Today in Russia there is a real boom in the market of upgrading accounting education and accounting certification in the area of US GAAP and IFRS. Strangely enough, only private companies offer their services whereas universities keep quiet. According to the interviewed auditors, economic students at the best Russian universities in Moscow and St. Petersburg do not even have any special accounting courses in international accounting standards. Those who arrange such courses are larger accounting and auditing companies or special education centers. The author does not have enough facts to evaluate the quality of the education but it is a reliable judgement to suppose courses arranged by large international firms have a higher quality. The large international firms have much more experience in the education of international standards all over the world, and they also have more resources. To work with IFRS questions it is important to acquire a kind of international accounting certification. The latest news is that ACCA started to offer a special exam in Russian, ACCA DipIFR. It is an important step toward spreading knowledge about IFRS.

5.2.2 Computerisation

Everybody understands the necessity of computerisation for accounting. It is a theoretical axiom. In practice, Russian reality gives a completely different picture. There are still many companies that not only lack special accounting software but even computers. Even really large companies use Excel as a base for preparing their consolidated financial statements.

IFRS implementation is not possible without computerisation. For example, the valuation of some types of assets demands constant data collection and analysis. Installation of an IT system is one the most expensive costs during IFRS implementation. Any new IT system always demands adjustments and employee training. In case of Russia, the difficulties are complicated with the fact that it is not one more IT system but the first one. The interviewed companies are in different stages of computerisation. One of them does not have any big problems and is able to prepare the financial statements according to three different standards (RAS, US GAAP and IFRS). Another is in the "medium" stage – they have adjusted the

system but they still do not use all the software possibilities, while the third is just in the beginning stages.

5.2.3 IFRS sources

The solution of problems with the translation of IFRS and their later versions in Russian is a crucial question for IFRS implementation in Russia as well as world-wide spread. Actually, the situation looks quite ridiculous. According to the directive from the Bank of the Russian Federation all banks began to prepare their financial statements already two years ago, from January 1, 2004, but there is still no approved version of the Russian translation. While definitions are the base of any theory, different IFRS definitions are still heatedly discussed in Russia. Unfortunately, not all Russian economists can avoid translation problems and use the original version of IFRS. In Moscow and St Petersburg there are economists with such high knowledge of English, but outside of the Russian economic centers they are great in lacking.

5.2.4 Transparency

One of the benefits of IFRS is the transparency of the company's figures. All information should be open and easily analysed. When all companies use the same system it will be much easier to do trustworthy analyses and comparisons between them. In Russia things are different. There a lot of companies have a part of their business in the "grey" sector, i.e. legal business which is hidden from reporting in order to evade taxes.

A problem with the grey sector is that companies that use and do not use IFRS do not compete on the same premises. Honest companies must be more effective to make the same profits. This problem affects mostly medium-sized companies as the large companies in Russia are often in a monopoly or oligopoly situation and small companies do not use IFRS. Although at first glance, it should always be more favourable economically to have business in the grey sector, things are actually changing. The government under Putin has increased the struggle to reform Russia's business structure, both through legislation and enforcing the laws. Nevertheless, more transparent companies have the advantage to get favourable loans more easily.

5.3 Reliability of Russian Financial Statements Prepared According to IFRS

The quality of financial statements can be affected by different factors. In this part of the chapter, some of the most common ones are presented and the effects they have which can result in deviation in the final data.

5.3.1 Users

IFRS puts more emphasis on the information needs of shareholders and potential investors, but Russian financial markets are greatly undeveloped and today the Russian Stock Exchange does not function to the same extent as Western Stock Exchanges do. Thus, Russian listed companies do not have the same motivation to prepare complete and transparent financial statements. Many Russian accountants and managers give priority to the needs and demands of tax authorities.

In addition, there is another kind of mental barrier as well. During the Soviet period Russian accountants were bookkeepers rather than accountants. They didn't have to make any decisions and their main task was recording data. Then later in the 1990s there were a lot of tax detailed regulations that companies were to follow. IFRS demands the ability to see the whole economic picture of a company's business activity and exercise professional judgement while many Russian accountants are still not accustomed to make decisions on their own, without detailed instructions from above. This barrier is not easy to overcome as it demands that many other changes have happened. However, understanding financial statement objectives is getting better and spreading at the same time that financial markets are growing.

5.3.2 Financial Statements Data Quality

There is a perception that financial statements prepared according to IFRS have a higher quality, but there are reasons to doubt how good these statements really are. The final data quality greatly depends on which method of statement preparation a company uses. There are two methods used in Russia, transformation and converging, which should lead to the same result. However, it can be assumed that if a company with a number of subsidiaries uses the transformation method, its financial statement will contain many more deviations from the real data than the statement of a company without any subsidiaries or with just a few. The fact that subsidiaries often prepare statements according RAS, and then final IFRS adjustments are made in the head company, does not make the situation better. Transformation from RAS to IFRS can take up to 6 months and it is clear that such information cannot be called "fresh". Many companies still prefer transformation as it has an undisputable price advantage. Besides, it does not demand a high educational level for employees. Converging, i.e. parallel data recording according RAS and IFRS, is undoubtedly a much more reliable method, but at the same time much more expensive.

It is clear that any international standards by themselves do not guarantee validity of financial reporting (there have been a number of scandals because of manipulation with financial statements both in the USA and Europe). The auditors interviewed unanimously agreed that auditing firms and the professional skills of their employees play a very important role for

validity and quality of financial reporting. The question is if Russian auditing firms are able to provide high quality audit services according International Standards on Auditing (ISA). It is no surprise then that many companies reporting according to IFRS use the services of foreign auditing firms that are presumably more qualified. Another problem with Russian auditing firms is that there are still those that will agree to sign anything because of money-hunting or for fear of losing a client. Thus there arises a problem of auditor independency and integrity. It seems that Russian companies have a different idea about the relationship between a company and its auditor. They often see their auditors in the first place as advisors and consultants and prefer to change an auditor if they cannot receive the expected kind of help. This perception may partly be explained by the fact that deducting the cost of auditing of IFRS financial statements was allowed fairly recently. The concept of auditing itself is very new in Russia which is confirmed by the fact that the word “auditor” is directly borrowed from English and did not exist 15 years ago.

However, there are reasons to consider that IFRS statements will get better with every year at the same time as both Russian companies and Russian auditors will accumulate more experience in the subject.

5.3.3 Information Disclosure

The role of information disclosure and the necessity of higher transparency is a hot topic on both sides of the Atlantic Ocean. The question is discussed in Russia as well. In Russian practice, as in the world, there is a certain minimum level of information disclosure for external parties which is defined by the Russian Civil Code. In connection to the bank system transition to IFRS, legislated demands on information disclosure in the financial market were strengthened. Nevertheless, the level is much lower than the European one and, in addition, Russian companies are usually unwilling to disclose any information. If Russian companies do not follow the Russian standards, will they follow the IFRS demand more? S. Moderov questions the issue as well:

“However, will it be advantageous for large Russian companies to demonstrate all their companies for special purposes – offshore, “pocket” banks, pension funds and similar, as it is demanded by IFRS? Probably not. In this situation the auditor will have to control the existence of such companies and not to approve a financial statement, if those companies are not included in a consolidated financial statement.”⁷⁴

Their unwillingness is complicated by the problem of high cost of information disclosure, for example, about operations with related parties. The matter is that all operations should be recorded and registered, which returns us again to the problem of companies’ computerisations.

⁷⁴ Moderov. S (2005) ”Kontrol nad kompanijami. MSFO i zakon ”O konsolidirovannoj otchtnosti”, <http://ipnou.ru/article.php?idarticle=001958>, 25.12.2005

6. Conclusions and Further Studies

In the final chapter the author presents the conclusions of this study. The author describes the analysed problems connected with implementation of IFRS in Russia. It ends with a list of proposals for further studies that can be made as a natural continuation of this thesis.

6.1 Conclusions

Russia has changed its society, political and economic structure more in these last fifteen years than many other countries do in a hundred years. The system of today is a synthesis of the country's history, and is a blend of old socialist legacy, early post-Soviet era and modern day society. This is also reflected in Russian business life where different branches of the same company can work under completely different premises. A parent company based in Moscow can have a lot of international partners and not differ a lot from similar companies in the west, while a regional branch can have very obsolete equipment and might be totally unprepared for any international contacts. This discrepancy is a serious drawback as it is impossible to introduce IFRS without modern computers and business systems software throughout the company.

This leads us to the second and probably most important topic. In order to produce reliable reports, the people involved, both auditors and economists, need to have proper education. There is a Russian IFRS translation but legal problems about the copyright of the translation have slowed down the process of spreading it. While companies in many other countries around the world can use English as their second (or first) language of business, this is not the case in Russia. Even highly educated and competent professionals often have virtually no knowledge of English and this excludes the possibility to use the original English version for most companies. The subject of proper education cannot be emphasised enough. If economists have better skills then statements even made according to the transformation method can show more reliable figures.

Furthermore, the anarchic era during Yeltsin caused a rise for illegal business. Corruption and other economic criminality is still a big problem although the government has increased its efforts to improve the country's status in this area. That is one of the problems for companies that have a large grey sector - with IFRS follows greater transparency, which makes it harder to evade taxes through accounting tricks. In spite of this, Russian companies have found a very good advantage with IFRS. The greater transparency makes it a lot easier to attract foreign investors and loans with favourable terms, and this is the single most important reason why Russian companies choose to shift to IFRS, despite the often costly investments that need to be done in order to have good results. Since companies that have implemented IFRS will be able to use information of higher quality and easier accessibility, their business efficiency will increase.

Any system with a controlling body cannot function satisfactorily if the controlling body cannot work independently. Business ethics in Russia is unfortunately often not worth mentioning. The pressure on auditors can be high and it is not a rare fact that they help their clients with procedures that are not completely legal. It is important to work towards independent auditing. As auditors are often consulted for advice, they play the role of both the advisor and the controlling body. This double standard must change in order to have a more

acceptable business reputation. The role of the auditor is indisputable for lowering the risk of shareholders and external investors, i.e. users of financial statements, and thus to favour further development of financial markets in Russia.

Russia has modernized its own accounting system (RAS) which is based on IFRS, although there are many differences between the two standards. Russia has two choices: either to adopt IFRS as its own standard or continue to develop RAS, which today is based on but less detailed than IFRS. Russian companies that have many foreign investors or partners or are subsidiaries to foreign companies are likely to opt for IFRS, but the author got the impression through magazines and the interviews that it is more likely that RAS will be the dominating accounting standard in the future, especially if the dispute about the Russian translation of IFRS is not permanently solved in the near future. Since Russia is not a member of IASB they do not have any influence on the future development of IFRS and questions related to them, and a fear of losing political control might also move Russia towards the second choice.

6.2 Further Studies

- This study has come up with some interesting and, for western readers, also surprising facts about Russian business. We have learned that there are successful companies that have, at the same time, an odd mix of modern and old technology. Their accounting systems have seldom been at a level suitable for modern management. It would be interesting to see if the transition to modern companies regarding computerisation and accounting as management tools will speed up, or if the polarity in Russian business will remain for a long time.
- What would the results be if IFRS is widely implemented in Russian business and the state does not change its tax legislation accordingly?
- The competence of the auditors is very important. Do Russian auditors meet the demands?
- Another area of interest that can be further investigated is relations and mutual expectations between auditors and companies. Do they have a lot of conflicts consistently before the reports are published?
- As IFRS is a new way of thinking for Russian companies, education is crucial for good implementation. This study has only scratched the surface but has still exposed some problems in this area. Is the education satisfactory for Russian auditors and economists?
- A study of the quality of financial reports that have been done according to IFRS is in order. How truthful are the reports done according to converging and transformation methods? This thesis has shown that transformation can give very incorrect numbers.
- Little investigation has been done on the new version of RAS, which is based on IFRS. Does it fulfil or differ a lot from western standards?

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Appendix

Appendix 1

The Largest Companies in Russia in Terms of Turnover Volume

2005	2004	Company	Region	Branch	Growth rate (%)	Turn over 2004 (M US\$)	Net profit 2004 (M US\$)	Accounting standard
1	1	Gazprom		Petroleum and gas industry	19.2	33,892.30	7,136.85	IFRS
2	3	Lukoil		Petroleum and gas industry	39.9	28,810.00	4,248.00	GAAP
3	4	RAO "EAS Rosii"		Electro energy	14.6	23,582.80	1,108.57	IFRS
4	2	RZHD1		Transport	10.9	22,884.90	303.64	RAS
5	5	YUKOS		Petroleum and gas industry	--	22,100.00	n.a.	--
6	6	THK-BP		Petroleum and gas industry	28.8	14,298.00	4,017.00	GAAP
7	7	OAO "Surgutneftegas"		Petroleum and gas industry	31	10,690.90	2,414.98	RAS
8	9	Sibneft		Petroleum and gas industry	21.4	8,022.90	2,045.60	GAAP
9	8	Sberbank Rosii		Bank	13	7,537.30	669.21	IFRS
10	10	GMK "Norilskij Nikel"		Non-ferrous metallurgy	28.2	6,742.00	1,832.00	IFRS
11	12	Svjazinvest		Telecommunication	23.5	6,352.80	599.39	Managerial accounting
12	19	Severstalj		Ferrous metallurgy	101.5	6,268.80	1,401.20	IFRS

13	--	Slavneft		Petroleum and gas industry	69.2	6,124.00	1,219.00	GAAP
14	21	Evráz Grúp		Ferrous metallurgy	160.9	5,924.60	1,248.20	IFRS
15	15	AFK "Sistema"		Telecommunication	42.6	5,711.30	411.20	GAAP
16	13	AvtoVAZ	Samarskaja region	Heavy engineering industry	22.8	5,570.30	158.74	IFRS
17	11	Rusal		Non-ferrous metallurgy	12.7	5,400.00	n.a.	GAAP
18	14	Tatneft	Republic of Tatarstan	Petroleum and gas industry	29.3	5,232.20	854.46	RAS
19	16	AK "Transneft"		Transport	31.8	5,220.00	1,428.00	IFRS
20	18	Magnitorskij metallurgicheskiy kombinat	Cheljabinskaja region	Ferrous metallurgy	48.8	4,829.00	1,217.00	IFRS
21	20	Novolipetskiy metallurgicheskiy kombinat	Lipetskaja region	Ferrous metallurgy	72.7	4,538.70	1,772.50	GAAP
22	17	Rosneft		Petroleum and gas industry	32.3	4,515.10	837.30	GAAP
23	64	Rosgosstrah		Insurance	216.3	3,876.90	-23.24	RAS
24	--	Mechel		Ferrous metallurgy	68.4	3,636.00	1,342.70	GAAP
25	22	AK "Aprosa"	Republic of Saha (Jakutija)	Industry of precious metals and diamonds	29.9	2,704.70	420.47	IFRS
26	26	UGMK-holding		Non-ferrous metallurgy	67	2,535.70	156.96	Managerial accounting
27	25	SUAL-holding		Non-ferrous metallurgy	27.1	2,300.00	n.a.	IFRS
28	23	Rosenergoatom		Electro energy	7.2	2,219.80	-45.45	RAS
29	24	Aeroflot		Transport	18.1	2,158.80	172.10	IFRS
30	28	Vypelkom		Telecommunication	50.9	2,146.60	350.40	GAAP

31	30	Bashneft	Republic of Bashkortostan	Petroleum and gas industry	45.2	1,993.40	178.73	RAS
32	27	Trubnaja metallurgicheskaja kompanija		Ferrous metallurgy	29.5	1,857.60	38.34	Managerial accounting
33	--	Gruppa SOK		Heavy engineering industry	17.7	1,705.60	n.a.	Managerial accounting
34	31	GAS	Nizhegorodskaja region	Heavy engineering industry	27.2	1,618.80	2.77	RAS
35	37	KamAZ	Republic of Tatarstan	Heavy engineering industry	58.5	1,612.70	7.22	Managerial accounting
36	163	SUEK		Coal industry	579.2	1,559.60	163.05	RAS
37	--	AHK "Sukhoj"		Heavy engineering industry	-29.4	1,496.90	83.60	Managerial accounting
38	40	Megafon		Telecommunication	70.6	1,480.10	172.00	GAAP
39	33	TVEL		Heavy engineering industry	24.3	1,474.10	278.63	Managerial accounting
40	--	Pochta Rosii		Telecommunication	20.6	1,430.40	19.03	Managerial accounting
41	34	Vneshtorgbank		Bank	21.6	1,412.00	263.00	IFRS
42	--	PVO "Almaz-Antej"		Heavy engineering industry	17.1	1,326.80	54.82	Managerial accounting
43	--	Toyota Motor	Moscow	Cars	--	1,310.10	64.87	RAS
44	32	Ilim Pall Enterprise		Wood and paper industry	6.8	1,301.00	n.a.	Managerial accounting
45	--	Severstaljtrans		Transport	--	1,274.30	86.10	Managerial accounting
46	--	MHK "Evrohim"		Chemical and petroleum chemical industry	58	1,201.00	180.75	RAS

47	--	Aljans		Petroleum and gas industry	52.8	1,194.50	32.19	Managerial accounting
48	38	Vimm-Bill Produkty Pitanja		Food company	19	1,189.30	23.00	GAAP
49	80	Promyshlenno-metallurgicheskij holding		Ferrous metallurgy	157.1	1,188.50	237.39	Managerial accounting
50	41	Nizhnekamskneftehim	Republic of Tatarstan	Chemical and petroleum chemical industry	35.7	1,175.60	115.42	RAS
51	54	Salavatnefteorgsintes	Republic of Bashkortostan	Chemical and petroleum chemical industry	81.7	1,169.10	43.98	RAS
52	55	Metro Cash and Kerry	Moscow	Retail trade	83.2	1,168.60	20.48	RAS
53	--	CV "Protek"	Moscow	Wholesale trade	20	1,136.40	30.43	RAS
54	29	Strojtransgaz		Construction	-20.8	1,119.60	24.57	RAS
55	--	Pjaterochka		Retail trade	36.7	1,105.80	74.40	IFRS
56	--	Uraljskaja stalj	Orenburgskaja region	Ferrous metallurgy	185.9	1,024.30	82.61	RAS
57	43	FosArgo		Chemical and petroleum chemical industry	24.8	1,020.60	117.06	Managerial accounting
58	46	Baltika		Food company	26.6	994	132.00	GAAP
59	--	Russneft		Petroleum and gas industry	337.9	953.3	114.42	RAS
60	--	SIA International Ltd	Moscow	Wholesale trade	30	942.4	58.39	RAS
61	52	Vyksunskij metallurgicheskij zavod	Nizhegorodskaja region	Ferrous metallurgy	41.6	923.9	70.33	RAS

62	65	Oskoljskij elektrometallurgicheskij kombinat	Belgorodskaja region	Ferrous metallurgy	66.6	899.9	186.30	RAS
63	60	NovaTEK		Petroleum and gas industry	46	874.3	197.57	IFRS
64	53	Sun Interbrew		Food company	32.2	859.1	62.64	GAAP
65	45	Philip Morris Izhora	Leningradskaja region	Tobacco industry	5.9	847.2	250.55	RAS
66	67	Tander	Krasnodarskij region	Retail trade	61.5	845.3	0.03	RAS
67	69	Ford Motor Company	Leningradskaja region	Heavy engineering industry	63.2	843.2	11.53	RAS
68	47	PO "Uraljvagonzavod"	Sverdlovskaja region	Heavy engineering industry	9.8	838.1	0.06	RAS
69	99	Ashan	Moscow region	Retail trade	121.4	835.3	11.87	RAS
70	44	Alfa-bank		Bank	4.3	834.5	152.80	IFRS
71	--	Evroset	Moscow	Retail trade	237.7	829.3	8.60	IFRS
72	88	Michailovskij GOK	Kurskaja region	Ferrous metallurgy	95.3	820.7	241.37	RAS
73	42	UralSib	Moscow	Insurance	-61.4	800.7	0.04	RAS
74	51	Severstalj-Avto		Heavy engineering industry	18.8	799.1	46.56	IFRS
75	--	Rusargo		Agriculture	--	772.1	70.19	Managerial accounting
76	--	Merlion	Moscow	Wholesale trade	14.7	768.9	n.a.	GAAP
77	90	Transmashholding		Heavy engineering industry	80.5	762	5.50	Managerial accounting
78	116	Lebedinskij GOK	Belgorod region	Ferrous metallurgy	125.6	753.9	301.47	RAS
79	57	Bashkirenergo	Republic of Bashkortostan	Electro energy	21.6	748.5	24.51	RAS

80	59	Tatenergo	Republic of Tatarstan	Electro energy	24.1	741.6	56.46	RAS
81	70	Itera		Petroleum and gas industry	43.7	734.4	43.47	RAS
82	61	Domostroitel'nij Kombinat N1	Moscow	Construction	24.6	728.3	33.97	RAS
83	--	MAIR		Ferrous metallurgy	-	712	34.98	IFRS
84	48	Razgul'jaj-Ukrros		Food company	-7.6	700	34.91	IFRS
85	94	Ingosstrah	Moscow	Insurance	55.2	671.9	27.18	RAS
86	101	Silovye mashiny		Heavy engineering industry	76.5	662	10.00	IFRS
87	62	Uralsmash-Izhora		Heavy engineering industry	13.7	661.4	69.70	IFRS
88	--	Transstroj		Construction	-5.1	660.4	14.57	Managerial accounting
89	95	Perekrestok	Moscow	Retail trade	66	660	16.80	IFRS
90	--	Avtomir	Moscow	Retail trade	46.2	654	n.a.	Managerial accounting
91	71	Irkutskenergo	Irkutsk region	Electro energy	25	636.6	32.14	RAS
92	--	Rolf Holding	Moscow	Retail trade	65.8	623.8	27.34	RAS
93	66	Irkut		Heavy engineering industry	11.9	621.8	68.40	IFRS
94	74	Akron		Chemical and petroleum chemical industry	23.6	614.4	45.25	Managerial accounting
95	73	Nacional'naja kompjuternaja korporacija		IT	22.8	613.2	n.a.	Managerial accounting
96	--	SOGAZ		Insurance	95.6	608.1	6.25	RAS

97	97	Golden Telecom		Telecommunication	52.1	584	64.80	GAAP
98	56	Aerokosmicheskoye oborudovaniye		Heavy engineering industry	-7.5	583	35.70	Managerial accounting
99	--	Sibuglemet		Coal industry	301.5	576.1	97.18	RAS
100	72	Objedinennyye konditery		Food company	16.1	571.9	50.74	IFRS
101	82	Mars	Moscow region	Food company	25.1	570.8	56.34	RAS

Source: *Expert*, October 2005, No.38, www.expert.ru/expert/ratings/exp200/, 14.12.2004
(Translation from Russian is made by the author)

Appendix 2

Differences between Russian Accounting Standards and IAS

The table below is based in the publication “GAAP 2001 - A Survey of National Accounting Rules,” which represents the results of a joint survey conducted by the seven leading accounting firms, including PricewaterhouseCoopers. This table compares the Russian rules that were in force as of January 1, 2004, and IFRS after the Improvements project.

Russian accounting may differ from that required by IFRS because of the absence of specific Russian rules on recognition and measurement in the following areas:

the classification of business combinations between acquisitions and unitings of interest	IAS 22
provisions in the context of business combinations accounted for as acquisitions	IAS 22
consolidation of special purpose entities	SIC 12
the restatement of financial statements of a company reporting in the currency of a hyperinflationary economy in terms of the measuring unit current as of the balance sheet date	IAS 21
the translation of the financial statements of hyperinflationary subsidiaries	IAS 21
the treatment of accumulated deferred exchange differences on disposal of a foreign entity	IAS 21
de-recognition of financial assets	IAS 39
the recognition of operating lease incentives	IAS 17, SIC 15
accounting for defined benefit pension plans and some other types of employee benefits	IAS 19
accounting for an issuer’s financial instruments	IAS 32
hedge accounting for derivatives	IAS 39

There are no specific rules requiring disclosures of:

the fair values of financial assets and liabilities	IAS 32
the fair values of investment properties	IAS 40
third party information, except by certain reporting companies with a specific legal form (joint stock companies); the definition of a related party is a narrower one, based on legislation	IAS 24

certain segment information (e.g. a reconciliation between the information by reportable segment and the aggregated information in financial statements, significant non-cash expenses, other than depreciation and amortization, that were included in segment expense and, therefore, deducted in measuring the segment result — for each reportable segment)	IAS 14
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There are inconsistencies between Russian rules and IFRS that could lead to differences for many enterprises in certain areas. Under Russian rules:

goodwill is calculated by reference to the book value of acquired net assets	IAS 22
proportionate consolidation may be used for subsidiaries in which the parent holds 50 percent or less of the voting shares	IAS 27
revaluation of property, plant and equipment is allowed but gives different results than IFRS and need not be kept up-to-date	IAS 16
the useful life of property, plant and equipment is usually determined using periods prescribed by the government for tax purposes that are longer than those for which the assets are expected to be used, but in practice the management of a company sets the periods in the accounting policy	IAS 16
if investment properties are revalued, they are still depreciated	IAS 40
finance leases are generally defined in legal terms and the right of capitalization is given to a lessor or a lessee by a contract	IAS 17
lessors recognize finance lease income differently	IAS 17
the completed contract method can be used for the recognition of revenues under construction contracts when the outcome of a construction contract can be estimated reliably	IAS 11
trading, available-for-sale and derivative financial assets are not recognized at fair value	IAS 39
trading and derivative liabilities are not recognized at fair value	IAS 39
any financial investments are not required to be carried at fair value	IAS 39
provisions can be established more widely or less widely than under IFRS, and there is no requirement for discounting	IAS 37
own (treasury) shares are shown as assets	SIC 16
the correction of errors is included in the determination of the net profit or loss for the reporting period, but separate disclosure and pro-forma restated comparative information are not required	IAS 8
revenue recognition rules do not differentiate between exchanges of goods of a similar nature and value and exchanges of dissimilar goods, and do not discuss adjustment for the amount of cash or cash equivalents transferred in exchanges for dissimilar goods	IAS 18, IAS 16.2 1
extraordinary items must be disclosed separately	IAS 8.6/12

In certain enterprises, these other issues could lead to differences from IFRS:

some parent companies do not prepare consolidated financial statements	IAS 27.7
in the definition of control, it is not required that the ability to govern decision-making be accompanied by the objective of obtaining benefits from the entity's activities	IAS 27
certain subsidiaries may be excluded from consolidation beyond those referred to in IFRS	IAS 27
a subsidiary that is a bank may be excluded from consolidation if it is dissimilar from the rest of the group	IAS 27
certain set-up costs that have been paid by a company's founder can be capitalized	IAS 38
internally generated brands and similar items can be capitalized if the enterprise has an exclusive legal right	IAS 38
inventories are generally carried at cost rather than at the lower of cost and net realizable value; this is often not an important difference because of inflation	IAS 2
the realizable value of inventories can be measured without deduction of selling	IAS 26
certain overheads in addition to those related to production can be capitalized	IAS 2

Source: PricewaterhouseCoopers: Doing Business in the Russian Federation (2003)

Appendix 3

Interview Questions to Auditors

1. How long have you worked with IFRS issues?
Как давно Вы занимаетесь вопросами МСФО?
2. In your opinion, what role does an auditor have in the IFRS implementation?
Какую роль играет аудитор при переходе на МСФО, по вашему мнению?
3. For whom are financial statements issued in Russia? Who are the users?
Для кого делается финансовая отчетность в России? Кто ее пользователи?
4. How are Russian companies financed? The structure of company ownership: other companies, several large shareholders, a number of small shareholders?
Как финансируются компании? Структура владения компаниями: другие предприятия, несколько крупных акционеров, большое количество мелких акционеров?
5. What accounting principles dominate in Russia?
Какие принципы отчетности доминируют в России?
6. How far has current Russian accounting evolved in comparison to the Soviet era?
Как далеко ушла сегодняшняя система финансовой отчетности от советской?
7. How big is the difference between IFRS and the national accounting standards?
Насколько большая разница между МСФО и национальной системой?
8. Is there a fixed date when all listed companies should use IFRS? Is there any plan of transition to IFRS? Is there any plan?
Есть ли конкретная дата, когда МСФО начинает действовать для всех ОАО, котирующихся на бирже? Есть ли план?
9. How did the transition to new financial reporting standards come about? Who were the initiators and who was responsible for the transition? Is there any organization or committee for IFRS in Russia?
Как происходил переход к новой системе отчетности? Кто инициаторы, кто несет ответственность за переход? Есть ли в России официальное ведомство или комиссия по МСФО?
10. Is there any authorised translation of IFRS? Who works on the IFRS translation and interpretation?
Есть ли официальный перевод МСФО? Кто занимается переводом и толкованием?
11. Does Russia receive any support from the IASB?
Получаете ли Россия какую-нибудь поддержку от IASB?
12. In your opinion, how will IFRS implementation affect the state, regulated organizations, auditing organizations, companies?
Как, по Вашему мнению, МСФО повлияет на государство, регулирующие организации, аудиторские организации, предприятия?

13. Are there any problems brought about by the tax system, as IFRS is mostly oriented towards the capital market?

Есть ли проблемы из-за налоговой системы, так как МСФО в первую очередь ориентирован на рынок капитала?

14. Do only listed companies implement IFRS?

Только ОАО переходят на МСФО?

15. In your opinion, is it really necessary to replace national standards?

Нужно ли вообще заменять национальную систему?

16. Are there many companies working according to IFRS? Are they mostly concentrated around big cities, e.g. Moscow, St. Petersburg, or are they spread all over the country?

Много ли компаний работает уже по МСФО? Концентрированы они больше вокруг Москвы, Петербурга или есть по всей России?

17. What problems do companies meet during transition to IFRS?

С какими трудностями сталкиваются предприятия?

18. On what factors do problems depend: company size, branch, etc?

От чего зависят трудности: размеров компании, отрасли и т.д.?

19. Who teaches companies and their accountants about IFRS?

Кто обучает предприятия и их экономистов МСФО?

20. Are financial reports, made according IFRS, of high quality? Are they reliable?

Насколько качественна на данный момент отчетность предприятий, использующих МСФО? Можно ли ей доверять?

21. What problems do auditing companies have in connection with the transition? What reactions have you come across?

Какие проблемы у аудиторских фирм в связи с переходом? Какие реакции вы наблюдаете на предприятиях?

22. In your opinion, what is positive and what is negative in connection with the transition?

Что положительно, что отрицательно, по-Вашему мнению, в связи с переходом?

Appendix 4

Interview Questions to Companies' Representatives

1. Why did your company begin to make financial reports according to IFRS?
Почему Ваша компания начала составлять отчетность по МСФО?
2. How long did it take your company to transit to IFRS?
Сколько времени у Вас занял переход на МСФО?
3. Did you need any special preparation or training for the transition?
Понадобилась ли Вам какая-то специальная подготовка для перехода?
4. How many people work with IFRS?
Сколько человек занимается учетом по МСФО?
5. Did you use any external help in the connection with the transition? If yes – to what extent?
If no – why?
Потребовалась ли Вам помощь внешних консультантов? Если да – то в каком объеме?
Если нет – почему?
6. Did you have to change your company's IT-system significantly, or even install a new one?
Пришлось ли Вам вносить значительные изменения в компьютерную программу или устанавливать новую?
7. Did the transition to IFRS require high expenditures and resources?
Переход на МСФО потребовал больших затрат и ресурсов?
8. How important are IFRS financial reports for your executive management group? How deeply is the management involved in IFRS questions?
Насколько руководству предприятия важна отчетность по МСФО? Насколько руководство вовлечено в вопросы МСФО?
9. In which way do you make financial statements according to IFRS: by means of transformation or by converging?
Как Вы ведете учет по МСФО: с помощью трансформации или используете параллельный учет?
10. What kind of training did the company's economists get regarding IFRS?
Какие курсы повышения квалификации по МСФО посещали Ваши экономисты?
11. Is there any educational/training plan regarding IFRS in the company?
Есть ли на предприятия какой-то план повышения квалификации по МСФО для сотрудников?
12. What IFRS source does your company use (translation, English original)?
Каким источником по МСФО (перевод, английский текст) Вы пользуетесь?

13. On the whole, how were your financial reports affected by using IFRS?
Каким изменениям подверглась Ваша отчетность в связи использованием МСФО?
14. Are there any “more problematic” accounting transactions?
Есть ли какие-то более «проблемные» транзакции?
15. How has accounting according to IFRS affected numbers, in terms of your company’s profit, assets, and equity?
Как учет по МСФО повлиял на цифры, отражающие результат, активы, уставной капитал?
16. Are there any standards that you cannot use?
Есть ли стандарты, которыми Ваша компания не пользуется?
17. Are there negative effects because of IFRS implementation?
Есть ли негативные эффекты от введения МСФО?
18. In your opinion, does your company have sufficient knowledge about IFRS?
Считаете ли Вы, что Ваша компания имеет достаточно знаний по МСФО?