The international financial reporting standards in russia

International Financial Reporting Standards (IFRS) and their predecessor, International Accounting Standards (IAS) is gaining in worldwide recognition. All publicly traded companies in the EU must adopt them by 2005 and many other countries either have adopted them or plan to do so in the near future. After break up of Soviet Union, Russia has experienced a lot of turmoil and changes both political and economical the country has struggled to get rid of its socialist past and it has now evolved to be a more important partner in international affairs and economics. The need to develop the 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.

In 2002, the Russian Prime Minister announced that all Russian companies and banks must prepare their financial statements in accordance with international standards starting January 1, 2004. Implementing that decision will not be easy, for a variety of reasons. Not all international standards have been translated into Russian. Many Russian accountants are not sufficiently familiar with international standards to implement them. Some Russian universities have only recently started teaching international standards and the continuing education programs of the various Russian accounting associations are not yet prepared to offer comprehensive courses on international standards. Current Russian accounting standards conflict with international standards in several important ways and these conflicts will not be resolved in the near future.

This project paper considers the issues that arise when implementing new accounting regulations, some of which are not new and have been covered in the literature, but others of which are particular to the implementation of

IFRS reporting. Te method of implementation, the scope of IFRS, particular issues with local accounting practice and IFRS, the issues of enforcement of compliance with IFRS and its relationship with audit, the link between IFRS reporting and taxation and the provision of education and training are all considered. There is also review of the state of preparedness of local group listed entities with respect to the implementation of IFRS reporting.

There are many research areas for accounting research where the work could also inform the practice of IFRS accounting. The paper provides a contribution by highlighting how one country has moved to implement the requirement for group listed enterprises to prepare IFRS accounts and the issues that then arise for legislators, preparers and users.

Introduction of the study

Background of the study

Globalization is making a dramatic impact on the world economy, borders are getting less and less relevant and corporation 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 internalization 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.

The goal of the EU is to create a free market where capital labor, goods and services are to move freely. With the common currency, the European market has become more transparent for companies and it has made it easier to analyze business opportunities within the EU. The implementation of 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 IAS/IFRS.

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

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 financial reporting still remains the State, in the person of the tax authorities. Nevertheless, voices of the other interest 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.

As transition economies go through the process of shedding their centrally planned accounting model and replacing it with a market oriented model that uses international standards they face a number of problems. Very few people know the new rules, since the international standards must first be translated into their language. Accountants who can read the international standards promulgated by the International Accounting Standards Board and its predecessor, the International Accounting Standards Committee in the original English have a competitive advantage in this regard, but trying to fully exploit this advantage may be frustrating if potential clients or employers do not place much value on international standards. There is also an inertia barrier to overcome. It is difficult to change the status quo (Friedman & Friedman 1984). Accountants and managers who have been using the old system for 20 or 30 years do not want to change because they feel comfortable with the system they learned in school or on the job when they were young. Those individuals also happen to be the people who are now in charge of enterprises and accounting departments, so their approval must be had before any new system can be adopted and implemented.

2. 1. 1. International Standards in Russia

As we know from our previous readings, accounting is part of the legislative system. That is a problem because Russia will never have true international standards if government has to legislate it. There will always be a lag and style and language problems. The original plan by the Russian Finance Ministry in 1998 was to adopt all IAS by 2000. That did not happen. The new target for full adoption and implementation is 2004, at least in the case of banks and publicly traded companies. However, that target is also unlikely to be met. In fact, not a single accountant interviewed thought that international standards would be fully adopted and implemented by 2004. One accountant estimated that full implementation would take ten years (RobertW. & Galina G., 2004)

In the case of the standard on impairment, many Russian companies and their accountants do not want to apply the impairment rules because many companies have assets that are overvalued. Applying the impairment standard would cause the asset side of the balance sheet to shrink, considerably in many cases, and they do not want that to happen. In extreme cases, a company that appears healthy could appear to be insolvent if the impairment rules were applied. This hesitancy is not unique to Russia. The same situation exists in Republika Srpska, the Serbian part of Bosnia, and in other formerly centrally planned economies.

Perhaps the main reason why the standard on financial instruments has not been adopted is lack of demand. Very few Russian enterprises use complex financial instruments, and the ones that do are already applying the IAS or U. S. GAAP on this topic. Also, this standard is difficult to understand and many Russian accountants are not eager to make the effort to learn a standard that they probably will not use in the foreseeable future.

Another point that could be made about Russia's adoption of international standards is that even the standards that have been adopted may not always be international standards. For example, the Russian standard on income taxes is based on the old version of the IAS income tax standard, not the new one. This fact is known within much of the Russian accounting community but may not be as well known outside of Russia. Another, less well known fact about Russia's accounting standards is that the Russian versions of the standards that have been adopted are not mere translations of the English language originals. In many cases they are abbreviated, simplified versions of the original English language IAS. RAS tend to be much shorter, more detailed and conceptual. They cover a fraction of the content of IAS. In short, it may not be accurate to state that Russia has adopted IAS. It would be more descriptive to say that Russian accounting standards are merely based on IAS. Often the differences between RAS and IAS are not large or important. However, the difference may be substantial, such as in the area of accruals principles.

Another reason why RAS will never be identical to the international standards is because there is a timing lag between the time a new international standard is issued in the UK and the time that new standard is translated into Russian and adopted as part of the Russian accounting rules. This lag could be overcome if the Russian Duma made it a rule that all new international accounting standards will automatically and immediately become part of the Russian rules. However, the Duma will never make such a rule, for reasons of national pride and sovereignty. So the lag will be permanent, even though there is a theoretical solution that would correct this lag.

The degree to which the Russian accounting community understands the international standards depends on several factors. The Russian translation of the original English version of the standards was not available until late 1998. The translation was mediocre, in some respects.

Part of the problem was because there were no Russian terms to convey some of the concepts. In other cases, the Russian translators simply used the wrong word or said things in such a way as to make the sentence or phrase unintelligible. In at least one case, the translator left out the word " not," with the result that the Russian version of the standard instructed the reader to do something, when in fact the English version of the rule said not to do something. These kinds of mistakes and imperfections are to be expected the first time a technical document is translated, especially in cases where no terms exist for some of the words and ideas that need to be translated.

The Russian accountants who cannot read English are limited to reading the Russian translation of the international standards. That places them at a competitive disadvantage, for the reasons mentioned above. The Russian translation is mediocre in some places and in other places is downright incorrect. The Russian speaking accountant has no way of knowing how accurate the reading of a particular sentence or paragraph might be, but must rely on what is written because there is no other alternative. Russian accountants who were educated in a university that did not teach the international standards have a problem reading the international standards in any language because the standards contain concepts that the Russian accountant was never exposed to during the years at the university. Such accountants must learn the new rules as best they can, either by self-study or by attending some lectures or seminars on the various topics.

Another reason why the accountants in the outlying regions are not as knowledgeable about international standards as are the big city accountants is due to differences in demand. Most clients that need statements prepared according to international standards are in Moscow or St. Petersburg. A few big enterprises are scattered around other parts of Russia, mostly in the bigger cities. The accountants who service smaller clients have little or no need to know the international standards, so they do not take the time to learn them. The result is a two-tier system where the accountants and the employees who work for their clients in Moscow or St. Petersburg know at least something about international standards, whereas their counterparts in the outlying regions know less, or perhaps nothing about international standards.

2. 1. 2. Developing Russian Accounting Standards (RAS) and Establishing IFRS in Russia

As Valeria Petrovets (2006) mentioned in his study, during the first period after break up 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 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 (Yegorov, L., 2002).

Until year 2006, it had been 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 Organization 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.

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 represent their consolidated financial statements for 2004 according to IFRS. At the first stage the statement according to IFRS should be represent 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 the Finance of the Russian Federation approved “ The Conceptual for accounting and finance reporting development in the Russian Federation on medium-term perspective”, which defines the main directions of transaction 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 the legislated status. The Conception provides two stages in the transaction:

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.

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.

2. 1. 3. National Accounting Differences

Accounting differences

In presentation, recognition, and measurement

In perception, and interpretation

Different accounting principles

Different objectives of financial reporting

Country-specific social, economic, and cultural environment

Figure (1): Reasons for International Accounting Problems

Accounting differences between different countries depend on what purpose 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 be different." In addition, different countries have different attitudes about how the legislations are followed.

It is believed 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.

Accounting principles are formed in accordance with the purpose 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.

Motivation of the study

The main purpose of my study is to investigate how the process of IFRS adoption for the national accounting system develops in Russia. And also, there is some additional purposes that I am going to study are to show how Russia works with the reformation of its accounting system, how the 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 project paper is written with the intention to contribute to the picture of international harmonization of financial reporting and how far Russia has advanced for IFRS implementation. This study might be interesting for those who are interested in international questions and international accounting.

Objectives of the study

The objective of this study is to find out what problems do Russian non – banking companies have in connection with IFRS implementation. And also to determine how the country's historical and cultural background affects their transaction to IFRS.

Literature of the study

As it has been known from previous studies, so many researchers have been written about International Accounting Standards (IAS), International Standards on Auditing (ISA), accounting harmonization, accounting education and accounting reform in transition economies in recent years. A few books and articles have focused on accounting reform in Russia.

An early study by Mills and Brown (1966) discussed how shifting from a production model to a profitability accounting model would help Soviet enterprise managers make decisions that would increase the efficiency of their firms and help them to better allocate resources. In a similar vein, Thornton (1983) discussed changes in the way the Soviets accounted for factor costs over a twenty-five year period. A study by Scott (1969) stated that Soviet accounting after the 1965 reforms started to place more emphasis on enterprise profitability, which helped move the Soviet economy closer to a Western market model.

Other authors have also touched on this theme. Horwitz (1970) discussed the effect that decentralization has on the management accounting control system. Chastain (1982) described how the Soviet accounting system was not able to keep up with the needs of enterprise managers. He also assesses the implications of that inability for the accounting profession.

Turk and Garrod (1996) discussed the lessons Slovenia learned when it began the process of changing to International Accounting Standards. The Slovenian experience is not unlike the Russian experience in many ways. Preobragenskaya and McGee did research on the relationship between IAS and foreign direct investment (FDI) in Russia (2003a) and on the state of auditing in Russia (2003b). Their FDI study concluded that the lack of credibility of Russian financial statements was hampering inflows of foreign capital. Their audit study found that the state of auditing in Russia is not yet up to western standards.

A few studies have been made on accounting education in Eastern Europe or the former Soviet Union. According to one scholar, Houghton Mifflin’s 1300-page Principles of Accounting was the first Western accounting text sold in the Soviet Union (Collingwood 1991). It was translated and distributed by Finansy I Statistika, Moscow’s government owned publisher. Kobrack and Feldman (1991) speculated whether the reform process in the Soviet economy could create a new market for accounting textbooks. McGee has written about educating accounting professors in Bosnia & Herzegovina (2003a) and reforming accounting education in Armenia (2003b).

There are several sources of information on recent developments in accounting reform in Russia. The International Center for Accounting Reform in Moscow [www. icar. ru/] publishes the ICAR Newsletter. The World Bank publishes Transition Newsletter, which gives current information about various aspects of market reforms in transition economies, including accounting reform in Russia. The Russian websites of the Big-Four accounting firms also have current information and, in some cases, publications.

The Deloitte & Touche Russian website has an e-library link that contains a variety of items on various aspects of doing business in Russia. It has a Doing Business in Russia Online Guide, which includes much information on accounting and tax topics. It has several newsletters that address accounting, tax and legislative issues on various countries, including Russia. Russia – Legislative News is a monthly newsletter that contains accounting and tax items. Legislative Tracking is a daily publication that keeps readers abreast of Russian pending legislation.

Ernst & Young publishes An EYe on Russia, a monthly newsletter on current business, accounting and tax issues. It also has a Russian Legislation website that contains downloadable documents on Russian accounting, tax and related legislation that have been translated into English.

There are various strands in the literature on international accounting harmonization which cover such areas as: the degrees of harmonization (Tay and Parker, 1990; Emenyonu and Gray, 1996; Murphy, 2000), whether international accounting harmonization is appropriate (Hove, 1986; Cairns, 1997: Flower, 1997) and the degree of compliance with IFRS (Cairns, 2001; Street and Gray, 2001). Most of the relevance of this study on the implementation of IFRS would seem to be the research on the appropriateness of IFRS for developing or transitional economies, the practical implications of implementing IFRS within a country located in the continental European tradition of accounting and research on the changes to national accounting in transitional economies.

In his 1998 study, based on a review of the literature on accounting and developing countries, Nobes noted various points about the appropriateness of IFRS for developing countries. Nobes talked about developing countries but Russia is a developed country and at the same time keeps on developing. He suggested that given the likely users of most enterprise financial statements in developing countries were the tax authorities and owners and lenders to private enterprises, adopting IFRS in developing countries, where IFRS are stated to be investor oriented (IASB, 2003; F9), may not be appropriate. In particular many of the later IAS (IAS 22-38) might not be relevant for presenting accounting information for taxation purposes. Nobes also suggested that, given the lack of a developed accountancy profession to interpret and apply the more judgmental aspects of IFRS (either as auditors or accountants), there could also be issues of the reliability of accounting information. Though he provided examples, he did not make explicit that this could be a particular issue for any accounting information based to a large extent on market data such as fair value (Nobes, 1998a). Further research on transitional economies has indicated structural issues with a lack of active stock markets, and corruption, which may affect the reliability of IFRS financial statements and estimations of fair values (EBRD, 2000; Sucher and Bychkova, 2001).

However, much change has been state sponsored, rather than spontaneous, and the Ministry of Finance has continued to play a key role (Seal et al., 1995). This may therefore indicate that change may be very slow. Garrod and McLeay (1996) also highlighted how governments have adapted the previous state-controlled accounting systems to meet the envisaged demands of new users as well as state demands for tax collection and dealt with the general issues of conflicting objectives for financial reporting. They comment on the problems of establishing the right balance between state and professional involvement in the regulation of accounting and the difficulties that have arisen in valuation of assets, in the absence of fully functioning markets, and the scope of financial statements (Garrod and McLeay, 1996).

In much of the previous research there has been an emphasis on the de jure situation with accounting change in Central Europe, and less focus on the de facto situation which might be quite different (as suggested by Bailey, 1995). There is a need for further research on the actual operation of financial reporting within enterprises to ensure that any implementation process pays due regard to the de facto situation rather than merely the de jure situation. There has also been a tendency in the academic research to study individual countries as comprising enterprises all with similar financial reporting objectives.

However, within a country there are different groups of enterprises with different reporting objectives depending on their size, funding and ownership structure. Indeed, some authors have suggested that, within the classification literature, there may be different ‘ types’ of accounting systems in operation in any one country (Nobes, 1998b). This could be taken further to suggest that there are different groups of professional auditors and accountants trained under different reporting systems (e. g. some auditors trained under an international system of exams in accounting; some under a local examination system). Any research on the changes to national accounting should reflect this diversity of needs and resources.

The Big Four audit firms have played a large role in the move to IFRS around the world, as they are often the auditors of IFRS statements and they have the large resources needed to maintain appropriate knowledge and expertise in IFRS.

There has been relatively little research on their role in transitional economies (though Seal et ai, 1995, and Sucher and Alexander, 2002, are exceptions and some concerns about their roles are raised in some of the World Bank reports). Some consideration needs to be given to their role in the move to IFRS within the transitional economies.

The literature suggests that there may be contextual factors which affect the appropriateness and effectiveness of the implementation of IFRS in a transitional economy such as the Russian Federation. These factors may be divided into the position of the Ministry of Finance in initiating and implementing reform; the role of the particular users of financial statements, and the relationship between financial reporting and taxation which in turn may relate to the national tradition in accounting (Anglo Saxon versus continental European). Then it is suggested that there are specific factors which may affect the effectiveness of and the ability to implement IFRS: differences between local and IFRS accounting standards, particular issues with individual IFRS and the reliability and availability of market data for fair values, and the approach to enforcing compliance, with particular regard to the role of auditors. There may also he additional factors concerning how the IFRS are translated and the extent of education and training in IFRS.

Summarize, critically evaluation of the articles, conclusion and suggestions

From the above literature reviews we can summarize the followings. 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 theoretical background. The authors and their books are well-known and widely used for social studies similar to this study. 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.

Accounting is one of the spheres that has been transformed since the beginning of the

1990s. Its reformation and supervision have been executed by various governmental bodies, although considerable resources from international organizations have also been attracted to the process. The adoption of national standards based on IFRS was chosen as the vehicle for change. But change occurs slowly and the country is huge.

There is a lag between the time standards are adopted and the time they are implemented. Some of the reasons are the lack of demand for quality information, mostly from inside users of financial information, and the mentality and education level of the majority of accountants and educators in accounting. This situation may be understandable for a country that is in transition and that existed in the absence of freedom and market relationships for many decades. From the authors' point of view, from the options under consideration, the preferred option toward the transition to IFRS is to make it compulsory to provide IFRS statements for companies that are in the zone of public interest. It is not necessary to have Russian Financial Statements for such companies. For other companies it can be left up to them which rules, if any, to use for their financial statements. There are several problems with forcing IFRS down the throats of any segment of the accounting and financial community. One structural problem is the difficulty of harmonizing the legislative branch so that the various players are on the same field. There is a lack of coordination between or among the various parties. There is a serious lack of high quality consultants on IFRS implementation. All these factors do not help in the transition to IFRS. If Russia is to succeed in transforming its economy into something where markets dominate, it will have to overcome these barriers. But force is not required. Markets are the absence of force. Markets are just voluntary exchange. Markets develop naturally when no one prevents anyone else from trading what he has for what he wants. It seems illogical to use force to implement markets. There is some evidence