ACCOUNTING AND FINANCIAL SYSTEM REFORM IN EASTERN EUROPE AND ASIA

Accounting and Financial System Reform in Eastern Europe and Asia

Robert W. McGee
Andreas School of Business
Barry University
Miami Shores, Florida
USA

Galina G. Preobragenskaya
School of International Business
Omsk State University
Omsk, Russia

Springer

Springer

Library of Congress Control Number: 2005935081

ISBN-10: 0-387-25709-8
ISBN-13: 978-0387-25709-9

e-ISBN-10: 0-387- 25710-1
e-ISBN-13: 978-0387-25710-5

Printed on acid-free paper.

Printed in the United States of America.

9 8 7 6 5 4 3 2 1

springeronline.com

TABLE OF CONTENTS

PREFACE

Much has been written about the economic and political problems of countries that are in the process of changing from centrally planned systems to market systems. Most studies have focused on the economic, legal, political and sociological problems these economies have had to face during the transition period. However, not much has been written about the dramatic changes that have to be made to the accounting and financial system of a transition economy. This book was written to help fill that gap.

This book is the second in a series to examine accounting and financial system reform in transition economies. The first book used Russia as a case study. The present volume in the series examines some additional aspects of the reform in Russia and also looks at the accounting and financial system reform efforts that are being made in Ukraine, Bosnia & Herzegovina, Armenia and five Central Asian republics.

The series focuses on accounting reform, including the adoption and implementation of International Financial Reporting Standards; accounting education in both the universities and the private sector; accounting certification; corporate governance; and taxation and public finance.

Chapter 1

INTRODUCTION

Much of the information included in this book is based on the authors' experience of living and working in Eastern Europe and the former Soviet Union. Some data was gathered during the course of interviews with a variety of accounting practitioners and educators. Much of our research findings tended to confirm what was discussed in the existing literature. Thus, part of this book updates and expands on existing literature. However, new information was also uncovered that has not yet been discussed or addressed in the literature.

Most of the chapters in this book were first presented as conference papers, which improved the quality of the final product in several ways. When the various manuscripts were in the early draft stage a series of anonymous reviewers provided suggestions that led to improvements in subsequent drafts. Comments from participants at the conferences resulted in further changes. A few of the chapters won the conference *best paper* award.

This book examines not only accounting reforms but also other aspects of financial system reform, in the broad sense of that term. Issues relating to corporate governance, foreign direct investment, taxation and public finance, accounting education and accounting and finance certification are also discussed.

Reformers of accounting and financial systems in transition economies encounter several common problems regardless of the country. We have found that translation is a common problem. Sometimes terms simply do not exist in the target language for certain accounting and finance concepts. Translators have to somehow overcome these problems. Another problem relating to translation is finding translators who know both English and the target language as well as accounting. In some countries, such people are difficult or impossible to find. What one must do in such cases is find good translators, then train them in accounting terminology.

Another common problem we have encountered, regardless of the country being examined, is the quality of materials that have already been translated into the target language. First editions are especially prone to mediocre translation. One particularly interesting example comes to mind. When the first edition of the Russian translation of the International Accounting Standards (IAS) was issued during the late 1990s, the translators left out the word "not" in one place. It was in a section that gave a list of things not to do. But because that word was missing, readers of that page were led to believe that everything on the list were things that *should* be done, when in fact they were things that should *not* be done. Thus, readers of the

Russian edition were prone to do exactly the wrong thing for a half decade or so, until the second Russian edition was published. It is not clear whether the second edition corrected this mistake, either, so perhaps current Russian readers continue to be misled by this omission.

Although translation is a common problem that must be faced and dealt with in any transition economy, it was not the only problem we found. There is also a problem of what might best be called inertia. Many accountants in the transition economies we studied simply do not want to change what they are doing. In some cases it is because they do not see the need for change. In other cases it is because they are afraid, or even terrified of change. Whenever there is change, there are winners and losers. Those who perceive themselves as being losers tend to resist change. The older generation of accountants, especially those who are approaching retirement age, also tend to resist change. There is a certain logic to this position. Why go through the considerable effort of learning the new rules if you are only a few years away from retirement? But problems result when the people who think this way also try to prevent changes from taking place. It is one thing to decide not to upgrade your own skills. It is quite a different thing to work toward maintaining the status quo, which is what some older accountants who are also in positions of power have done in some transition economies.

Another common problem of implementing accounting reforms that we have found to be common to the transition economies we have studied is education. Accountants who are already in practice need to learn the new rules. The new generation of accounting students need to be taught the new rules. But there is a shortage of professors who are capable of teaching the new rules, especially in the early years of reform. Professors have to be trained before students can become exposed to the new rules that their country has adopted.

Another problem that is common to all of the countries we have studied is the credibility of accounting certification. In some transition economies it is possible to buy an accounting certification. In other cases accounting certification is not credible because the examinations are too easy to pass and do not test on international accounting and auditing standards.

International investors do not place much credibility in the financial statements of companies that are audited by local audit firms. Sometimes this lack of credibility is because of the widespread perception that audit opinions can be bought. Another reason is because many individuals who work for local audit firms have little or no knowledge of international accounting and audit standards. However, this lack of knowledge has not always proven to be a problem for the local accountants and auditors because there is a general lack of demand for the preparation of financial statements that are based on international financial reporting standards.

Most companies that have such statements have them because they want to attract foreign capital. They prepare U.S. GAAP statements if they intend to list their shares on an American stock exchange or if they intend to borrow from a bank in the United States. They prepare IFRS statements if they want to raise capital in London or another European city. Enterprises that do not intend to raise foreign capital have little or no incentive to go through the time, trouble, effort and expense of issuing IFRS statements because there is little or no demand for such statements. In many countries, the statements are prepared for the tax authorities, since financial accounting tends to be tax driven.

This book discusses the process of accounting and financial system reform in several East European and former Soviet countries. Chapter two examines the problems Russia faces in adopting and implementing International Financial Reporting Standards (IFRS), which many Russian companies are now required to follow. Chapter three discusses accounting reform in Ukraine. Chapter four discusses Armenia, a former Soviet republic.

Part two looks at accounting education and certification. Although the emphasis is on accounting education in universities, some time is also spent discussing accounting education for practitioners. One chapter is devoted to private sector accounting education in Russia.

Accounting certification is the subject of another chapter. One of the main problems of accounting certification throughout the former Soviet Union and the former centrally planned economies of Eastern Europe is the lack of credibility. There is a new regional accounting certification program aimed at overcoming this pervasive lack of credibility. It started in Central Asia a few years ago and is now spreading to some of the other former Soviet republics. Certification is at two levels and all exams are given in the Russian language, which makes the exams accessible to a wide audience. Prior to this program, any accountant in the former Soviet Union or centrally planned East European country had to take a certification exam in English in order to have a credible accounting certification.

Part three examines recent changes in corporate governance in various East European countries. Companies need good corporate governance practices not only to run efficiently but also to attract foreign investment. Yet present corporate governance practices leave much to be desired. Transparency and shareholder rights are relatively new concepts in Eastern Europe and the former Soviet Union. Traditionally, there has been a tendency to hide relevant facts rather than disclose them. This view must change if companies in transition economies are to have good corporate governance practices.

Part four presents a comparative study of Russia and some other transition economies in the area of taxation and public finance. Prior to the collapse of the former Soviet Union, tax systems were much different. There were no private corporations to tax and the government owned all assets. As enterprises began to become privatized and as new enterprises were formed in the private sector, tax systems had to be developed to raise the funds needed by government. This section compares some transition economies to some more developed economies in the area of public finance.

The final chapter addresses the issue of tax evasion and presents the results of a survey taken of Romanian students and professors. This volume is the second volume in a series that addresses problems of accounting and financial system reform in transition economies. The first volume focused on Russia. Other volumes will look at other transition economies, or specific areas, such as public finance.

PART ONE

ACCOUNTING REFORM

Chapter 2

ACCOUNTING REFORM IN RUSSIA

Abstract

This chapter examines factors that affect the accounting system in Russia as it moves toward the adoption and implementation of International Financial Reporting Standards (IFRS). Current rules are examined and selected Russian Accounting Standards (RAS) are compared to IFRS, followed by a discussion of how closely Russian accountants actually follow the rules and the factors that affect accounting practice. The reliability of Russian financial statements is also discussed, followed by a discussion of Russia's options for the future, which groups support the various options, and the likely outcomes. Conclusions are presented in the final section.

INTRODUCTION

Since the early 1990s, Russia has been transformed from a rigid centralized economy into an emerging market economy. Of course, the transition has been and continues to be painful. Practically all spheres were affected – the economy, politics, culture, the social sphere, education, the army, and so on. Accounting is not an exception. It is directly connected to the transformation taking place in the realms of finance, taxation and entrepreneurship.

The direction of the change in accounting and the transformation of accounting rules toward the adoption and implementation of International Financial Reporting Standards (IFRS) were set by legislation. The process was started with the passage of the "Programme for the Reformation of Accounting in accordance with International Accounting Standards," approved by the government in 1998 (Programme 1998).

In this chapter we examine the current stage of the reform process, how far Russian regulations have moved the country's accounting system toward the path to IFRS, how the new regulations are implemented in practice, why practices are evolving in the present direction, which portions of the reform still need to be implemented, which problems exist now and which problems might emerge in the future.

This chapter is structured as follows. In the first section, factors affecting the introduction of IFRS into accounting practice are examined. The second section looks at the recent past and the current state of accounting regulation. A comparison is then made of IFRS and the Russian Accounting Standards (RAS) from a conceptual perspective. Some asset and liability accounts are examined in the light of IFRS. We then look at the extent to which Russian accountants follow the rules and the factors affecting the process. Conclusions about the reliability of Russian financial statements end the second section. In the third section we examine the various options for moving forward, which groups represent the various viewpoints and the arguments offered to support the various viewpoints (Nikolaeva 2003). There is also a discussion of the problems likely to be encountered on the path of transition to IFRS. We present our conclusions in the final section. We did not include sample Russian financial statements. However, such statements may be found in Alexander and Archer (2003).

Factors Governing the Implementation of IFRS by Russian Companies

It is possible to identify two groups of factors that are driving the transformation process toward the implementation of standards that comply with IFRS. The first group might be characterized as external or exogenous factors that affect a company. This group consists of potentially interested parties such as investors and creditors, who are interested in a company's transparency. The degree of satisfaction this group has with the quality of a company's financial statements, while not the only factor involved in the investment decision, directly affects whether they will form a relationship with a particular company. A high degree of transparency increases confidence and decreases perceived risk. That, in turn, reduces the cost of attracting capital. The existence of financial statements prepared using IFRS or US-GAAP is one of the mandatory terms for Russian companies that want to borrow from Western banks. Additionally, Russian securities (shares) are just coming to the stock exchanges, so the real prices for Russian company shares, and the real value of Russian companies, is still in the process of formation. Information about Russian companies that is presented using the usual language of business – accounting – with statements prepared using either IFRS or US-GAAP will help the stock market to reflect the real value of the listed Russian companies.

The second group of factors that are acting as a force for change are internal or endogenous factors. Company management needs reliable, high quality information to make efficient decisions. Historically, as shall be discussed below, financial information that managers receive has been prepared according to Russian accounting rules. This information was in most cases little more than a compilation of categorized accounting entries. Such bookkeeping information was of little help in providing managers with the information they needed for decision making purposes. It did little to help them plan or exercise control. The bookkeeping system was set up to tell managers what happened yesterday, not to help them to predict what will happen in the future. Adopting IFRS or US-GAAP assists Russian managers in the decision making process more than do RAS. Thus, there is an internal demand to adopt IFRS or US-GAAP. While some Russian companies decide to adopt US-GAAP rather than IFRS, the remainder of this article will refer only to IFRS in the interests of simplicity.

The presence of financial statements prepared in IFRS format has other positive effects as well. In addition to enhancing a company's transparency such statements also help to strengthen corporate governance and increase confidence and trust between managers and shareholders.

The Russian Accounting System: A Short History

The accounting system in any society is directly related to the level of political, economic and legal development of that country. It is always a result of, and a *servant* of the environment in which it exists. It develops with, or is degraded by its surroundings. In order to understand what the accounting system is at the beginning of 21st century Russia, it is necessary to take a short look into the recent past of Russian accounting.

For more than 70 years, until the end of the 1980s, there were almost no private enterprises in Russia. Everything belonged to the state. Under conditions of a planned, centralized economy, accounting was aimed at discovering and monitoring deviations from set models of enterprise behavior. One of the major functions of accounting was to collect statistical information, starting from the bottom and moving vertically to the higher levels of the Soviet hierarchy – enterprise – association – ministry – republic – country. The data was not consolidated, merely summarized. Accounting data formed the basis for control and execution of the plan and as an indicator for the development of future plans. Indexes like profit, profitability, solvency and so forth played no role, especially if the price setting process was centralized throughout the whole country (Gorelik 1974; Lebow & Tondkar 1986). A secondary function of accounting was the safety and controlling of assets that belonged to the state. Actually, a main function of an accountant was to make entries and fill in registers, which are more of a bookkeeping nature. Every step of this process was prescribed by numerous and detailed instructions. All companies employed the Uniform Chart of Accounts, issued from Moscow, perhaps adjusted for some industries. Unification was one of the basic principles of accounting under the centralized Soviet system. As for the double-entry principle, communists were not able to create a "socialist" alternative to it, so they employed it, with Lenin's approval (Shama & McMahan 1990).

The coming of "glasnost" to politics at the beginning of the 1990s brought with it the appearance of private property. Privatization, starting in 1992, converted most Russians into nominal owners of former state enterprises. Many completely new private companies appeared. The first companies with foreign capital were founded. The last decade of the 20th century might be called a revolution that Russia went through. The revolution encompassed economics, legislation and culture. As a consequence, and accompanying this change was the necessity of making crucial and substantial changes to the accounting system. Many changes have occurred and they continue to occur as the new accounting spreads throughout Russia. Some of these changes are the subject of this chapter.

THE LEGAL BASE

The Russian legal system is based on civil law, much like Germany, France, Japan and numerous other countries. The main users of financial information are not (or were not, at least) shareholders, like in the common law countries (US, UK), but rather state agencies and creditors (especially banks). Also, unlike common law countries, where standards are developed in the non-state sector by professional representatives, in civil law countries accounting regulations are made by state organizations. Thus, in Russia, Government Decision 6 March 1998 #273 states that one of the Finance Ministry's functions is to provide "methodological regulation of accounting and financial reporting" (except for banks). The system of normative regulation of accounting in Russia consists of four levels, depending on the status of a regulated standard act. Status is determined by the level of the legislative act (Federal Law, Provision on accounting, etc.) and by the extent of the act's consequences.

Table 1*
The Scheme of Accounting Regulation in the Russian Federation (RF)
(with examples of standard acts, related to one or more levels)

Level	Example	Status	
		Kind of document / Body, responsible for accepting	Obligation to follow (+)
1 level	FL "On Accounting" (Fed. Law #129)	Federal Law (FL)	+

	"On Joint-Stock companies" (Fed. Law #208) "On Limited Liability Companies" (Fed. Law #86) FL "On the Central Bank (Bank of Russia)" (Fed. Law #86)	FL FL FL	+ + +
	Programme for the Reformation of Accounting in accordance with International Accounting Standards	Government of RF	+
2 level (nor-mative-legis- lative acts)	Accounting Standards (PBU); Statement on accounting rules for banks	Ministry of Finance (MF) Central Bank (CB)	+ +
	Methodological Instruction (Instruction on Accounting 1999)	MF, CB	+
3 level	Chart of Accounts and Instruction of its implementation	MF	Recommended
	Accounting Standards, Methodological Instructions (Instruction on Accounting 1999)	MF, Other ministries	Recommended
4 level	Local normative acts, adopted on the company level	Company	-

*Source: The Table was developed by the authors

The *First Level* consists of standard acts that actually constitute accounting legislation. These laws include the Law "On Accounting," other Federal Laws, President's Orders and Governmental Decrees (Fed. Law #129, prov. 3). The place of these laws in the total scheme is illustrated in Table 1. It is necessary to mention that the Law "On Accounting" is the main legislative act, which determines the main methodological base, the content and procedures for financial statement presentation.

The *Second Level* consists of Accounting Standards, other standard Acts and methodological instructions that have passed through the Justice Ministry (JM) of the Russian Federation's registration process. According to prov. 10 President's decree 23 May 1996 #763 "On the Procedure for Publishing and Enacting Presidential Decrees, Governmental Decrees and Normative Legislation Acts of Federal Executive Bodies" (On the Procedure 1996), legislative acts that have not passed the state registration process cannot have legal consequences, as they have not come into force. It is therefore not possible to refer to such decrees as having legal force in a court of law.

The *Third Level* includes the Chart of Accounts and Instructions for its Implementation; some Accounting Standards, Instructions, etc. The difference between the second and the third level is that the third level is not mandatory but rather a set of recommendations because these items have not passed through the appropriate registration procedure. The "Chart of Accounts and Instruction on its Implementation," approved by MF Order 31 October 2000 #94, which has been in force since 2001, is not referred to as a normative-legislation Act (Chart of Accounts 2000). In contrast to previous Chart of Accounts status, the new law determines only the general rules for accounting entries. Its status, which is to provide recommendations only, was confirmed by the Justice Ministry. This reduction in legal status seems to be a logical step on the path to the transformation of the accounting system, by changing the emphasis from bookkeeping (making entries) to end results (financial statements).

It is necessary to point out that sometimes acts (such as Accounting Standards or Methodological Instructions), depending on the state registration of a certain act, can be categorized on the second or third level. For example, "Methodological Instructions on Fixed Assets Accounting," approved by MF Order #33 dated 20 July 1998 has not passed the state registration procedure by the Justice Ministry because the Justice Ministry stated that the Instruction does not have to be registered. It is a Methodological Act of the third level. On the other hand, "Methodological Instruction on Inventory," approved by MF Order #119 dated 28 December 2001, has been registered by the Justice Ministry, which makes it a second level act, in spite of the fact that it is also of a methodological nature.

The *Fourth Level* consists of acts that are developed by a company and that are obligatory for employment in the organization's framework. It is a chart of accounts that a company processes itself on the basis of MF "Chart of Accounts." Accounting Policies. Financial Statement forms are also developed by the company on the basis of recommendations provided by the Ministry of Finance (MF) (On Financial Statements Forms 2003).

The above scheme of accounting regulation is built into the classification of regulated acts, depending on their legal status.

All organizations are divided into a few separate categories. Different groups employ different rules for accounting and financial reporting.

Banks and other credit organizations. Unlike the other groups, the accounting and financial reporting rules for banks and other credit organizations are set by the Central Bank (CB) of the Russian Federation. It is one of the functions of the Central Bank as set forth in prov. 4 (p. 14) of FL#86 "On Central Bank", dated 10 July 2002. Based on this law, the Central Bank developed "Statement on Accounting for Credit Organizations Located within the Territory of the Russian Federation." It is interesting to note that this is the only second-level act in the Russian normative regulations (although it applies to a restricted subset of companies – banks) that mentions and defines some accounting concepts and rules, including the going concern assumption, consistency, prudence (conservatism in American English), timeliness, and substance over form.

Normative acts, which will be examined here, always contain a proviso that they do not apply to banks and other credit organizations. As for IFRS, it is necessary to point out that Russian banks started converting to IFRS before other Russian enterprises. Starting in 2004 all Russian banks are required to issue financial statements that comply with IFRS (in addition to statements based on Russian Accounting Standards, which will remain in effect until 1 January 2006) (On transition of Banks 2003).

1. *Sub-national governmental units (different levels of governments -- state, municipal, public schools, hospitals – that take money from budgets)*. At present the Ministry of Finance of the Russian Federation is the body that carries out the accounting regulation of sub-national governmental units. The present chapter will not examine such accounting rules, since they do not apply to the private sector and examining them would take us too far afield of the main topic. Normative acts, which will be examined, in most cases have a proviso that they do not apply to sub-national governmental units.

2. *Other companies that might be subdivided into the following groups*:

2.1. *Companies that apply a pared-down (simplified) tax system*. According to tax legislation, a certain group of companies (mostly small businesses that have annual sales not exceeding $500,000) can apply a pared-down tax system. At this time they do not have to follow accounting rules except for the rules that pertain to fixed assets and intangibles. These companies account for sales using the tax rules (p. 3 prov. 4 of FL "On Accounting"). It might also be mentioned that this is the only category of companies that *should* or *can* apply the cash method, because the cash method is stipulated for the pared-down system by the tax rules. As for financial statement preparation, relieving such companies from the requirement of preparing financial statements is not provided directly by law.

2.2. *Companies that do not fall into any of the above categories*. This category includes all companies, regardless of line of business or ownership, that are covered by the legislation mentioned in

Table 1. They are obliged to comply with the accounting rules and to produce financial statements according to Russian Federation rules.

In addition, "Statement on Accounting and Financial Reporting in the Russian Federation," prov. 91 (approved by the Ministry of Finance of the Russian Federation Order #34H, dated 29 July 1998, which is a second-level Act according to our classification) stipulates that companies having subsidiaries or affiliates must produce consolidated financial statements. There is a Methodological Instruction on the preparation and presentation of consolidated reporting. However, there are no rules requiring companies to provide consolidated statements to the government authorities.

Legal Changes in the Last Decade

Changes in the legal system began to take place in the early 1990s when a new Chart of Accounts was approved and the format of financial statements was changed to more closely correspond to those used in developed market economies. The interest in accounting rose remarkably during this period, partly because the revolution in taxation placed increasing emphasis in financial accounting data. The principal changes concerning accounting regulation, in the authors' view, had to do with the way the government viewed accounting and its place in the scheme of things. Examples of this change in viewpoint include assertions that:

- the main function of accounting and financial reporting is to provide interested users with complete and reliable information on enterprise activity and its financial condition to help them make informed decisions;
- the users of financial statements consist of internal users – managers, founders, property owners – and external – investors, creditors and other.

The first major Act to declare the new direction that accounting and financial reporting should take at the state level was the "Programme for the Reformation of Accounting in Accordance with International Accounting Standards," approved by Government Decree #283 dated 6 March 1998 (a Level One Act). The Programme stipulated that the purpose of accounting regulation "will consist of providing access to all interested users to information that reflects an unbiased picture of financial position and financial results of enterprise business activity. In order to achieve this result the following issues are to be resolved:

- shifting emphasis in accounting regulation from the process of accounting procedures to the financial statements;
- financial accounting regulation;
- the effective combination of legislative injunctions with professional organizations' recommendations;

- careful implementation of International Accounting Standards for national regulation."

The Programme included Plans of Action for the period 1998-2000. It was planned that by 2000 the whole regulatory system would be reformed. The results of the move toward accounting reform included:

1. A set of Accounting Standards (Poloshenia po Buhgalterskomy Uchetu, PBU) was developed and put into force. They more or less correspond with IFRS (the list of PBU is in Table 3). As part of this adoption process, new terms and concepts were introduced that were never before known to the majority of Russian accountants, such as "materiality," "events after the balance sheet date," "segment information," "discontinued operations," "contingencies," "deferred taxes," and so forth.
2. The emphasis in accounting regulation shifted from accounting procedures to the financial reporting process. Accounting Standards emphasize not how to *make entries* but rather how to *report* and *disclose* information. The content and format of financial statements have been adjusted to correspond more closely to those of developed market economies. The new formats cannot be compared to what existed under the old system in terms of disclosure requirements.
3. Tax accounting and financial accounting have been legally separated. Taxes are not calculated based on financial reporting data as of 1 January 2004.
4. The first professional accounting organization was founded in 1997 – Institute of Professional Accountants of Russia. It laid the foundation for the possibility of transferring regulatory functions from the state to the accounting profession.
5. Some changes also took place in the sphere of professional education. The educational system for accountants changed, as did professional accounting certification. A course on IFRS was introduced into the university curriculum.
6. The institution of auditing was introduced and has been in operation since 1993. The law "On Auditing" came into force. The adoption of new auditing standards based on International Standards on Auditing (ISA) is in process.

FINANCIAL STATEMENTS AND REPORTING – RAS AND IFRS

Below is a comparison of some IFRS and Russian rules. It's necessary to mention, that since accounting rules (and not just Russian rules) change, it does not make sense to examine "rules in general." Thus, a large portion of IFRS was revised. The revised Standards took effect in 2005. In this chapter provisions that are in force at 1 January 2004 are considered. One of the authors' aims was to study the current situation and the trends in Russian accounting system reformation.

Conceptual Provisions

1. General Provisions: The objective of financial reporting and users; responsibility for producing statements

The clear formulation of financial reporting objectives is absent in legislation and in other acts. The provision that comes closest to making such a formulation states that it is "a forming of complete reliable information about enterprise activity and its financial status, that is necessary for internal users of financial statements – managers, founders, owners and property owners, and for external users – investors, creditors and others." (Fed. Law #129)

2. Basic Principles

Accrual principle. This principle is not formulated directly anywhere in the law. However, Provision 10 of "Statement on Accounting and Financial Reporting," dated 29 July 1998, requires that a company's accounting policy should assume distinctness of economic events, which means that events should be recorded in the period to which they relate, not the period when the cash flow takes place. Also, the conditions for recognizing income (prov. 12 PBU 9/98) and expenses (prov. 18 PBU 10/99) comply with the accrual principle, which requires income and expense to be recognized and included in the financial statements in the period when the transaction occurs, not when cash is received or paid.

Going Concern assumption. This concept is not formulated anywhere as such in the accounting law. However, it is included in substance. Prov. 10 of "Statement on Accounting and Financial Reporting," dated 29 July 1998, includes a requirement that company accounting policy should assume continuity of operations. The mechanism of financial reporting in the event of liquidation is not addressed.

Other Principles. The accounting law does mention most of the other accounting principles that are included in IFRS and US-GAAP, such as the accounting entity assumption, accounting policy consistency, prudence, substance over form and rationality.

3. Qualitative Characteristics

Understandability. Russia so far does not have any legislative act or accounting regulation that mentions this term.

Relevance. In Russia, quality is not discussed, at least not in any official pronouncements.

Materiality as a component of relevance. According to prov. 1 of "On Financial Statements Forms (approved by MF RF Order 67H dated 22 July 2003), an item is considered to be material if failure to disclose it might affect economic decisions of interested users, based on reported information.

Timeliness. In the Russian regulation timeliness is mentioned as a quality that is necessary to consider when developing accounting policy. (prov. 7 PBU 1/98)

Reliability. According to prov. 6 PBU 4/99, "Reported accounting information must provide reliable and complete presentation of the financial position of an enterprise and its performance in its financial statements." Reliability of financial statements relates to compliance with accounting rules.

Neutrality has been listed as one of the requirements of sound financial statements. (prov. 7 PBU 4/99). This Standard states that "information is not neutral if by means of selection or presentation it influences users' decisions with an intent to predetermine results or consequences."

Prudence is also mentioned as one of the requirements of accounting policy (Statement on Accounting, Order 34H).

Comparability. Russian regulations (prov. 9, PBU 4/99) stipulate that an entity must follow the same content and format for its financial statements from one period to another. Changes regarding the content or form of financial statements must be disclosed if they are material.

4.The Elements of Financial Statements

The elements, related to financial position of an enterprise, definitions.

Assets. The term "asset" is used widely in the Russian regulations. But *assets* are nowhere defined. The only attempts at a definition of *asset* are found in prov. 2 PBU 9/99 and prov. 2 PBU 10/99, which specify that an asset is cash and other property, which is a far cry from the definition presented in the *Framework* (IASC 1994). Actually, the term *asset* in Russian accounting terminology is associated with items located on the left side of the balance sheet. The concepts of control or economic benefits are not employed.

Liability. Like assets, despite the widespread use of the term *liability*, its definition is not given in the Russian regulations. In fact, the term *liability* in Russian accounting terminology is associated with the term *accounts payable* or with items located on the right side of the balance sheet. This portion of the balance sheet is called *Passive* and includes both liabilities and equity. The items on the left side of the balance sheet (assets) are referred to as *Active.*

Equity. This is a comparatively new term in Russian accounting terminology. Its appearance in the Chart of Accounts in 1992 was the result of global changes in the economic structure – with the appearance of private ownership and, consequently, owners. At present it is a widely used term and, like assets and liabilities, it is not clearly defined in any Acts. In fact, it means exactly the same thing as the definition given in the *Framework* (IASC 1994).

Definitions of elements relating to performance

Income. According to prov. 2, PBU 9/99, "income of an enterprise is recognized as an increase of economic benefits as a result of an inflow of assets (cash, other property), or (and) a decrease in liabilities resulting in an increase in an enterprise's equity, except contributions of owners." Thus, the definition of income is the same under the Framework (IASC 1994) and under the Russian rules.

Expenses. According to prov. 2 PBU 10/99, "Expenses of an enterprise are a decrease in economic benefits as a result of outflows of assets (cash, other property) and (or) incurrences of liabilities, resulting in decreases in equity of an enterprise, except those relating to the distribution to equity owners." Thus, the Russian definition is the same as the definition given in the *Framework* (IASC 1994).

Criteria for the recognition of elements in financial statements.

In the Russian system the recognition procedure is prescribed for *income* (prov. 12-16, PBU 9/99). The conditions for the recognition of income include the existence of a right to receive income; the amount of which might be measured; the absence of vagueness concerning the receipt of an asset as payment that will result in an increase in economic benefits; the ownership rights have passed to a buyer (or service has been performed); expenses relating to the transaction can be measured.

Expenses are recognized (prov. 16, PBU 10/99) if an expense has been incurred according to the terms of a contract in accordance with legislative requirements and business customs; if its sum can be measured; if there is no vagueness concerning the transferring of an asset that will result in the decrease of economic benefits.

Criteria for the recognition of assets, liabilities and equity are not prescribed in the Russian regulations.

Content, format and procedure of financial statement presentation

- General provisions

The law "On Accounting" (p. 2, prov. 13) stipulates that all organizations are required to produce financial statements. The reporting period is the calendar year – 1 January to 31 December. The deadline for issuing statements is 90 days after the end of the year. Statements are sent to owners, the statistical authorities, other state bodies and other entities prescribed by law. The Tax Service is also entitled to receive the financial statements according to the Tax Code (prov. 23). The format of the financial statements is proscribed by the Ministry of Finance of the Russian Federation.

Companies that have subsidiaries and associates must produce consolidated statements, the preparation of which is regulated by "Methodological recommendations on Consolidated Financial Statement Preparation" (approved by MF RF Order #112 dated 30 December 1996) (Level 3 document). In general, the consolidated statements are to follow Russian accounting rules. However, the Russian rules do not have to be followed if all of the following requirements are met:

- Consolidated statements are prepared on the basis of IFRS;
- The group ensures the reliability of the financial statements prepared according to IFRS;
- The disclosure includes accounting rules and procedures that are different from MF RF rules.

In all the Russian accounting regulations, this is the only Act that allows for the possibility of IFRS statements instead of statements prepared according to Russian Accounting Standards (RAS). However, the last proviso makes this possibility unrealistic.

The accounting statements include the Balance Sheet; Income and Loss Statement; supplements, including a Cash Flow Statement; Statement of Changes in Equity; Supplement to the Balance Sheet; Statement on the use of Special Purpose Funds (recommended); Auditor's Report; and Footnotes. Companies develop their financial statements using the basic forms that are recommended by "On Financial Statements Forms" (2003).

- *Balance Sheet.* The format of the Balance Sheet is similar to the account form IFRS Balance Sheet. An example is provided in Table 2.

Table 2
Balance Sheet
Company XXX at 31 December 200X

Asset	Passive
1. Non current Assets	3. Equity and Reserves
2. Current Assets	4. Long-Term liabilities
	5. Short-term liabilities
Balance	Balance

According to Russian regulations, all assets are subdivided into non-current (long-term) and current (short-term), depending on the time it takes for them to be used up or converted into cash. Assets and liabilities are presented as current if the term of their existence is not more than 12 months (prov. 19 PBU 4/99). This definition differs from that provided by IFRS, in that according to IAS1, to be recognized as a current asset, cash and cash equivalents cannot have any limitations on their use. There is no such condition in the Russian definition.

The following kinds of assets might be classified as current: cash; short-term investments; accounts receivable (expected to be received within 12 months after the balance sheet date); value added tax (receivable); inventories, including raw materials, work in process, finished goods, goods, goods given on consignment; and prepaid expenses. Interestingly, receivables expected to be paid after 12 months from the balance sheet date are also included as current assets.

The following kinds of assets are classified as non-current: deferred tax assets; long-term investments; investment property; construction in progress; fixed assets; and intangibles.

Liabilities must be recognized as current if they are expected to be liquidated within 12 months from the balance sheet date. Current liabilities includes loans and borrowings; accounts payable; salaries payable; dividends payable; off-budget fund liabilities; tax liabilities; deferred revenue; and reserves of future expenses. Long-term liabilities include loans from banks and others; deferred tax liabilities; others.

Equity in the balance sheet consists of: contributed capital; treasury stock; capital surplus; reserve capital (that previously was distributed for certain uses); and retained earnings. All of these items also appear in the equity section of a balance sheet prepared according to IFRS. Thus, it is possible to say that Russian balance sheets are similar to IFRS balance sheet.

- *Profit and Loss Statement.*

The Russian form of a Profit and Loss statement corresponds to the functional classification scheme, including the purpose of expenditures (manufacturing, distribution, administrative). Unlike IAS 8, financing costs are not included in non-operating items in Russian income statements. They are included with operating expenses. The corporation's share of profits and losses of associates and joint ventures are accounted for by the equity method. Starting in 2003, deferred tax assets and deferred tax liabilities are included in the Profit and Loss statement that shows permanent interest of the body, responsible for accounting regulation (Ministry of Finance) in taxation matters.

Revenue. The criteria for revenue recognition are identical to the criteria for income recognition examined above. The main difference between the Russian rule and IFRS is that the Russian rule requires ownership to have passed from a seller to a buyer, unlike IFRS. The measurement concept requires that revenue be measured at fair value, determined as "the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's-length transaction."

According to the Russian rules, if a transaction price is not set by the parties, the price used will be the price usually charged in similar circumstances for similar goods. In the Profit and Loss Statement, the following items should be stated separately: revenue, operating income, non-operating income, and extraordinary items. Expenses are measured by the amount of the payment or the amount payable.

- The *Changes in Equity Statement* is one of the required financial statements. The format of the Russian Statement in all general respects complies with IAS 1 requirements, and includes the requirement to disclose all changes in equity for the period, with different categories for contributed capital, capital surplus, reserve capital and retained earnings. There are also disclosures for changes in accounting policies, revaluation of fixed assets, foreign currency translation and so forth.
- The *Cash Flow Statement (CFS)* is one of the required statements. The Russian rules stipulate that the Cash Flow Statement disclose transactions involving cash on hand and in banks. IFRS requires the CFS to also disclose cash equivalent transactions.

As is the case with IAS 7, the Russian Cash Flow Statement is divided into the following categories: operating, investing and financing activities. Russian rules allow only the direct method. There are also some differences in the classification of some transactions. For example, IAS 7 classifies interest income and dividend income as operating items, whereas the Russian rules classify them as investing activities. IFRS classifies the payment of dividends as financing activities. Russian rules classify these payments as operating items (Epstein & Mirza 2002).

In order to have accounting rules that approximate IFRS a number of Russian accounting standards (PBU) have been adopted that address matters never before addressed in Russian accounting. Table 3 shows which areas are now covered by PBU and makes a comparison between the two sets of standards (IFRS and PBU).

Table 3
Comparison of IFRS and PBU

IFRS	**PBU**	
	Title	**Status (JM)/# Order's Registr.**
IFRS 1 *First-time Adoption of International Financial Reporting Standards*	-	-

IAS1. *Presentation of Financial Statements*	PBU 1/98 "*Accounting Policy*", approved by MF RF Order #60 dated 9 Dec1998, came into effect on 1 January 1999;	31 Dec 1998 #1673
	PBU 4/99 "*Financial Statements*", approved by MF RF Order #43н dated 6 July1999, came into effect on 1 January2000.	-
IAS 2 *Inventories*	PBU 5/01 "*Inventories*", approved by MF RF Order #44н dated 9 June 2001, came into effect on 1 January 2002.	19 July 2001 #2806
IAS 7 *Cash Flow Statements*	-	-
IAS 8 *Net Profit or Loss for the Period, fundamental Errors and Changes in Accounting Policies*	-	-
IAS 10 *Events After the Balance Sheet Date*	PBU 7/98 "*Events After the Balance Sheet Date*", approved by MF RF Order #56н dated 25 Nov 1998, came into effect on 1 January1999.	31 Dec 1998 #1674
IAS 11 *Construction Contracts*	PBU 2/94 "*Construction Contracts*", approved by MF RF Order #167 dated 20 Dec 1994, came into effect on 1 January1995.	-
IAS 12 *Accounting for Taxes on Income*	PBU 18/02 "*Accounting for Taxes on Income*", approved by MF RF Order #114н dated 19 Nov 2002, came into effect on 1 January 2003.	31 Dec 2002 #4090
IAS 14 *Reporting Financial Information by Segment*	PBU 12/2000 "*Reporting Financial Information by Segment*", approved by MF RF Order #11н dated 27 Jan 2000, came into effect for the year 2000.	-

IAS 15 *Information Reflecting Effect of Changing Prices*	-	-
IAS 16 *Property, Plant and Equipment*	PBU 6/01 *"Fixed Assets"*, approved by MF RF Order #26н dated 30 March 2001, came into effect for the year 2001.	28 Apr 2001 #2689
IAS 17 *Accounting for Leases*	-	-
IAS 18 *Revenue*	-	-
IAS 19 *Retirement Benefit Costs*	-	-
IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*	PBU 13/2000 *"Accounting for Government Assistance"*, approved by MF RF Order #92н dated 16 Oct 2000, came into effect for the year 2001.	-
IAS 21 *The Effects of Changes in Foreign Exchange Rates*	PBU 3/2000 *"Foreign Currency Denominated Assets and Liabilities"*, approved by MF RF Order #2н dated 10 Jan 2000, came into effect for the year 2000.	-
IAS 22 *Business Combinations*	-	-
IAS 23 *Borrowing Costs*	PBU 15/01 *"Accounting for Borrowings and Related Expenses"*, approved by MF RF Order #60н dated 2 Aug 2001, came into effect for the year 2001.	-
IAS 24 *Related Parties Disclosures*	PBU 11/2000 *"Affiliated parties Disclosure"*, approved by MF RF Order #5н dated 13 Jan 2000, came into effect for the year 2000.	10 May 2000 #2215
IAS 26 *Accounting and Reporting by Retirement Benefit Plans*	-	-
IAS 27 *Consolidated Financial Statements and*	-	-

Accounting for Investments in Subsidiaries		
IAS 28 *Accounting for Investments in Associates*	-	-
IAS 29 *Financial Reporting in Hyperinflationary Economies*	-	-
IAS 30 *Disclosure in the Financial Statements of Banks and Similar Financial Institutions*	It's regulated by the Central Bank, not studied in the paper	-
IAS 31 *Financial Reporting in Joint Ventures*	-	-
IAS 32 *Financial Instruments: Disclosure and Presentation*	-	-
IAS 33 *Earning per Share*	Methodological Guidance on *Earning per Share Disclosure*, approved by MF RF Order #29н dated 21 March 2000	-
IAS 34 *Interim Financial reporting*	-	-
IAS 35 *Discontinuing operations*	PBU 16/02 *"Discontinued operations Disclosure"*, approved by MF RF Order #66н dated 2 Jul 2002, came into effect for the year 2002.	2Aug 2002 #3655
IAS 36 *Impairment of Assets*	-	-
IAS 37 *Provisions, Contingent Liabilities, and Contingent Assets*	PBU 8/01 *"Contingencies"*, approved by MF RF Order #96н dated 28 Nov 2001, came into effect for the year 2002.	28 Dec 2001 #3138
IAS 38 *Intangible Assets*	PBU 14/2000 *"Accounting for Intangibles"*, approved by MF RF Order #91н dated 16 Oct 2000, came into effect for the year 2001.	-
IAS 39 *Financial instruments: Recognition*	-	-

and Measurement		
IAS 40 *Investment Property*	-	-
IAS 40 *Agriculture*	-	-
-	PBU 19/02 *"Accounting for Investments"*, approved by MF RF Order #126н dated 10 Dec 2002, came into effect for the year 2003.	27 Dec 2002 #4085
-	PBU 17/02 *"Research and Development Costs"*, approved by MF RF Order #115н dated 19 Nov 2002, came into effect for the year 2003.	11 Dec 2002 #4022
-	PBU 9/99 *"Incomes"*, approved by MF RF Order #32н dated 6 May 1999, came into effect for the year 2000.	31 May 1999 #1791
-	PBU 10/99 *"Expenses"*, approved by MF RF Order #33н dated 6 May 1999, came into effect for the year 2000 (Order #33)	31 May 1999 #1790

PBU 7/98, "Events after the Balance Sheet Date" became effective 1 January 1999. Basic PBU 7/98 regulations match IAS 10 requirements.

PBU 8/98 "Contingencies" took effect 1 January 1999 and required disclosures of contingencies. The requirements prescribed by the PBU are basically the same as those of IAS 37.

PBU 12/2000, "Reporting Financial Information by Segment," has been in force since 2000. The spectrum of Russian companies required to report segment information is different from the requirement in IAS 14, which stipulates that segment information is required only by those companies that have publicly traded debt or equity issues or are in the process of preparing a public offering (Epstein & Mirza 2002). The Russian rules require segment reporting for all companies except small businesses. The Russian rule is identical to the former IAS 14 before it was revised in mid-1998. This provides an example of an instance where the Russian rule makers developed a PBU to comply with IFRS but fell behind in the process. The Russian definitions of a business and geographical segments are identical to those of

IAS 14. As provided by IAS 14 and by the PBU, an entity chooses which categorization is primary and which is secondary. Requirements for primary reporting disclosure according to PBU, unlike IAS 14, do not include separate disclosure for interest and dividends, contingencies, liabilities, extraordinary items that are directly attributable to a segment, or significant non-cash expenses other than from depreciation and amortization. The requirements for secondary reporting are identical for PBU 12/2000 and IAS 14. Actually, it might be said that the Russian PBU matches the spirit of the corresponding IFRS.

Since 2000, Russian companies are required to disclose affiliated person information, according to PBU 11/2000, "Affiliated Parties Disclosure." The requirements set forth in this PBU are much the same as those set forth in IAS 24, "Related-Party Disclosures."

PBU "Discontinued Operations Disclosure" came into force effective for 2003 annual reporting. It in all principal provisions complies with IAS 35, "Discontinued Operations" as far as disclosure requirements are concerned.

Below we discuss the rules for accounting for some assets and liabilities. Space does not permit a full examination of all items in the balance sheet and income statement. The purpose of this research is to estimate the degree of differences between the two systems for some principal items, not to identify all differences. In this chapter we study the most material items from the standpoint of their weight in a company's balance sheet. Also we study the reasons why there might be material differences between IFRS and RAS. Some items, such as inflation accounting, are not examined in this chapter.

In the comparison of the two systems – Russian and IFRS – not all differences and potential differences are examined or highlighted. Only general rules are considered. For example, IFRS allows the inclusion of interest expense into the cost of inventory in very limited circumstances. But the usual rule is not to include such costs. In the comparison below, the option not to include interest costs in the cost of inventory – the general rule– is chosen just because it is the general rule.

Inventory constitutes a material portion of assets for companies engaged in trade, retail and production. In Table 4 we compare the general provisions of PBU 5/01 "Inventories," which has been in force for annual reporting since 2002, with IAS 2, "Inventory."

Table 4
Comparison of IAS2 and PBU 5/01 rules
On Inventory

Requirements	
IAS 2	**PBU 5/01**
Content	
Goods for sale, Raw materials,	Goods for sale, Raw materials,