

Russian corporate governance Roundtable

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*INTRODUCTION OF IAS/IFRS

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* The views expressed in this paper are those of the author and do not necessarily represent the opinions of the OECD or its member countries.

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1. BACKGROUND

1. Information disclosure is a linchpin element of the system of corporate governance. A policy-making document approved by the Organization for Economic Cooperation and Development (OECD) in 1999 says that “The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company”.² Shareholders’ right to be regularly and promptly provided with full and accurate information about their company is also recorded as a separate principle of corporate governance in the Code of Corporate Conduct, as drawn up under the guidance of the Federal Commission for the Securities Market.³

2. Both documents pay special attention to financial disclosure and its independent auditing. Timely and full financial disclosure has a direct bearing on those assessments of the company’s financial and business standing which are made by its shareholders and other investors, including potential investors. It is important that such disclosure reveals the actual position of the company and is comparable with similar information about other companies, an objective which is usually achieved by implementing generally recognized, quality standards for preparing such reports. The OECD document, for example, stresses that “information should be prepared, audited, and disclosed in accordance with high quality standards of accounting, financial and non-financial disclosure, and audit”.⁴ Either the US GAAP (Generally Accepted Accounting Principles) or the IAS (International Accounting Standards) developed by the IAS Board are relied upon throughout the world for the purposes of preparing high-quality financial disclosure/reporting.

3. With the globalization of the capital markets, the number of companies that opt for the IAS has been steadily growing. In 2002, the European Parliament passed a resolution introducing, starting 2005, consolidated IAS accounting for all publicly traded EU companies. This requirement applies to almost 7,000 European businesses. In July 2002, the Australian Financial Accounting Board announced its support to the IAS introduction starting 1 January 2005 applicable to all Australian “reporting entities” (i.e., any entities that are to make public submissions under law). The accounting standard-setter in the US, together with the IASC, launched in September 2002 a joint Convergence Project, aiming to eliminate as soon as possible certain outstanding differences between US GAAP standards and IAS.

4. As a result, international capital markets, starting with the European market, will be relying on the IAS for their universal financial reporting language in three to four years. In this context, the transition to IAS by Russian companies for purposes of financial reporting would not only enhance the overall quality of their financial disclosures and their transparency, it would help integrate Russia in the global international capital market.

¹ 1999 OECD Principles of Corporate Governance, Section IY.

² Code of Corporate Conduct, Moscow, 2002, Chapter 1, Article 1.4.

³ 1999 OECD Principles of Corporate Governance, Section IY.

2. PROGRESS TO DATE

5. Although the transition of Russian companies to the IAS has been on the agenda of the Russian Government since 1997, the effective Russian legislation contains no specific requirement for the IAS-compliant accounting and reporting, or measures to introduce IAS in Russia.

Application of IAS by Russian companies: the scope of companies

6. Today many companies already have IAS accounts. According to audit and consultancy firms and investment companies, in 2002 about 120 banks and 40 larger companies listed on the organized market prepared their accounts in accordance with the US GAAP (see Appendices 1 and 2). Many companies with IAS accounts have obtained listings on foreign capital markets, others (e.g., Red October, NLMK, Severstal) have not. Experts believe that certain companies introduce IAS accounts with no realistic plans to attract foreign investors but rather for purposes of improving corporate governance and their business image. Such companies include, among others, some major steel companies (Severstal or NLMK). According to certain public sources (Internet, communications by the Bank of Russia officials, mass media publications), about 120 Russian banks have been preparing their accounts according to the IAS.

Application of IAS by Russian companies: consolidated accounting

7. Companies tend to present their consolidated accounts in the IAS or US GAAP, although there are exceptions to the rule: Severstal, for instance, has published in its web-site its audited consolidated 2000 IAS accounts. In most cases companies publish their individual accounts (financial reporting by a legal entity) drawn up in accordance with the Russian accounting standards, while their consolidated accounts may be in the IAS or US GAAP. Besides, IAS consolidated accounts are usually published together with the auditor's statement, although there are exceptions too: Norilsk Nickel, e.g., has published its consolidated 2001 accounts with the auditor's review statement (i.e. of limited audit procedures).

8. There are also significant variations in the periods and publication of accounts. More or less strict deadlines are being observed by those companies that prepare their IAS and US GAAP accounts to be submitted to foreign exchange regulators, or else by smaller companies that are subsidiaries of foreign corporations or. At the same time, certain companies place their financial accounts in the Internet some 6-9 months after the end of the reporting year.

Application of IAS by Russian companies: lack of legislative requirements

9. As of today, there are no legislative requirements for IAS accounting although since mid-2002 the Russian Government has been actively discussing the IAS transition process for certain groups of businesses. However, since no substantive steps have been taken in that direction so far, businesses that prepare IAS accounts do it in addition to RAS accounting and reporting. According to Russia's Federal Commission on Securities Market (FCSM), many of these organizations do prepare consolidated Russian accounts and do the same for the US GAAP.

Application of IAS by Russian companies: issues of accuracy control

10. Since legislation presents no specific requirement of IAS statements, there is no statutory control over their quality. Moreover, the auditor's statements of the financial accounts drawn in accordance with the IAS have no legal force in the Russian Federation as long as the laws applicable to audit define it as "presentation of the opinion on the accuracy of financial (accounting) statements of the audited entities and on *the compliance of the accounting rules and procedures with the legislation of the Russian Federation*," whereas the auditor's statement is an official document intended for the users of financial (accounting) statements of the audited entities that, in the manner prescribed, contains an opinion of the accuracy of the financial (accounting) statements of the audited entity and of *the compliance of its accounting rules and procedures with the legislation of the Russian Federation*." However, Russian laws on accounting make no references to the IAS.

Application of IAS by Russian companies: requirements by organizers of trading on securities market

11. Organizers of trade on the Russian capital market do not, as a rule, require IAS accounts to grant such issuers a listing. The only exception is the Russian Trading System, which back in 1999 introduced the requirement whereby issuers whose securities are incorporated in the Tier One listing (currently, A1 listing) should present their accounts in the IAS or US GAAP.

Application of IAS by Russian companies: low level of financial statements disclosure

12. As a result, with no legislative requirement to make IAS disclosures, the accuracy or availability of IAS accounts is very low. Experts believe that in 2000 only about 11 percent of businesses that prepare IAS accounts made them available to general public through publications including their own web-sites, and about 25 percent in 2002. Other companies did not publish their statements at all or published them in a severely abridged form, without any comments, which drastically hampered any analysis the users of such accounts may want to undertake. Besides, the majority of the companies publish their IAS accounts only in English. Given all that, despite the significant progress in the preparation of IAS accounts by Russian companies, it would be premature to announce an improvement in the quality of IAS disclosures made by the Russian companies, rather one may suggest that Russian companies have come to recognize IAS as a necessary condition for their involvement in the market economy.

Development of Russian accounting provisions (standards)

13. In 2001-2003 the Russian Ministry of Finance continued to develop Russian accounting provisions (standards) (PBU – “principles of accounting”) based on the IAS. All in all, between 1998 and 2003, 18 PBUs were drafted. According to experts (CBA, FBC, and PWC together with the Big Four), the newly prepared PBUs in many respects helped to bring Russian financial accounting closer to the IAS, although it would be too early to announce their real convergence as long as Russian standards fail to take into account material conceptual aspects of the IAS as far as recognition and valuation of items, presentation and disclosure of information, e.g., fair value, consolidated reporting, priority of substance over form, let alone important discrepancies in certain finer points (e.g., deferred taxes method or intangible assets recognition and valuation method).

Problems faced by the reporting businesses and their accounts users

14. While there are differences between Russian accounting principles (PBUs) and IAS, there are problems facing the users of financial statements as well as companies that prepare and submit their statements:

- The entities that rely on the IAS have to pay twice for their accounting and reporting under the RAS and under the IAS, and for having both sets of accounts audited;
- Users of financial information have to absorb additional costs of accessing IAS and US GAAP accounts, and processing different types of accounts (Russian PBU-based statements by individual entities, and consolidated accounts under the IAS and US GAAP).

Restraints to IAS legislative introduction

15. At the same time, it is important to remember about the significant restraints to the process of national legislative implementation of the IAS stemming from the instability of such standards and their “common law” nature that fails to fit the Russian legal framework, and also from the administration of the implementation process whereby the original IAS are developed in English, with the Russian party having but very limited impact on the process of development and application of the standards. While such restraints have substantially complicated the IAS implementation process in Europe, the opportunities for the European Union to contribute to the IAS development and application process are beyond any comparison with Russia. It would be suffice to point out that there has been no official IAS translation into Russian for three years already (the last version published in 1999 has become hopelessly obsolete). Russia is not in a position to resolve this issue since all translation rights belong to the IASC. It would hardly be possible to introduce any statutory requirement under law to implement IAS in the absence of their complete and regularly updated Russian translation.

3. ACTIONS PLANNED: GOVERNMENT'S APPROACH

Announcement of IAS introduction by regulators.

16. At the end of 2001 the Bank of Russian and the Russian Government, in their joint Strategy for the Development of the Banking Sector in Russia (statement made 30 December 2001), recognized the need for the Russian companies, including banks, to switch over to the IAS starting 2004. In June 2002, the Russian FCSM declared the need for the professional members of the capital market and issuers to start using IAS. It is expected that practical recommendations for the IAS transition of professional agents will be ready by the end of 2003 as part of the EBRD-funded capital market project.

Government Plan of Actions to reform accounting and financial reporting

17. In its session of 23 January 2003, the Russian Government discussed a 2003 action plan prepared by the Finance Ministry to reform the accounting and financial reporting which provided for the transition of Russian organizations to the IAS for their consolidated reporting, while businesses would still have to present their individual accounts under the Russian accounting standards. The same Action Plan envisaged continued efforts to develop the IAS-based Russian accounting standards. Additionally, the Russian Government instructed its ministries and departments to develop and submit to the Russian Government a concept paper on the mid-term prospects for accounting and reporting in Russia (The Concept Paper henceforth) aiming, among other things, to have Russian companies use IAS for their accounting purposes.

Versions of the Concept of the development of accounting and reporting in the mid-term perspective

18. To date, two versions of the Concept Paper have been prepared in compliance with the Russian Government's instruction.

19. The key differences between the two versions of the Concept Paper relate to the proposed requirements vis-à-vis individual accounting by businesses (reporting by a legal entity).

- The first option would be to require mandatory submission of consolidated IAS accounts supplementing Russian accounts by individual legal entities;
- The second option is a transition to the IAS for purposes of consolidated accounting and individual accounting by legal entities replacing Russian rules of accounting and reporting

20. The range of companies subject to the IAS accounting and reporting may include issuers of publicly traded and/or negotiable securities, financial market participants and other groups of entities that would be required to prepare and submit IAS accounts by their regulators (e.g., government-owned unitary enterprises as required by the Russian Property Management Ministry). Other companies would continue to use Russian standards for their accounting and reporting (the first option), or would partially implement IAS, probably, in their abridged version, and the rest of the companies would prepare their reporting only for tax purposes (the second option).

The Russian Finance Ministry's version: a conservative strategy

21. The former version of the Concept paper, prepared by the Russian Ministry of Finance, whereby the companies are required to prepare IAS accounts in addition to their RAS accounts, suits best the government agencies as it provides for a minimum of costs to be incurred by the government in the course of such transition when there is still the requirement to submit Russian accounts. This is the way that has the smallest inherent risk: the old traditional accounting and reporting is preserved in full, and any errors committed in the initial years of IAS accounting would not cause any disruptions in the financial disclosures. To have this option implemented, it would suffice to introduce a legislative requirement to prepare consolidated IAS accounts.

22. The principal drawbacks of this version of the Concept Paper lie, firstly, in the growing costs of accounting and auditing where the regular rules of RAS accounting, reporting and auditing would have to be supplemented with similar IAS-based requirements. Another important drawback is the multiplicity of public reporting standards that may have a negative effect on the comparability of the disclosures and lead to certain information confusion.

The version offered by the Ministry of Economic Development and Trade and the FCSM: a market strategy

23. The second version of the Concept Paper, prepared jointly by the Ministry of Economic Development and Trade, and Russia's FCSM, with the participation by the Russian Union of Industrialists and Entrepreneurs, whereby the IAS transition cancels Russian accounting standards, is a more radical and risky way as it provides for the replacement of the traditional accounting and reporting with new market-oriented rules. Under this version, the IAS transition would be phased: the first to embrace IAS accounting would be publicly traded companies, financial institutions (credit agencies, certain types of professional members of the securities market), and natural monopolies. They would be followed by all other open joint-stock companies and certain government-owned unitary enterprises. At the same time, all other organizations (at their choice) may opt for IAS-based accounting and reporting, or prepare statements for tax purposes only. This option is in line with the willingness of this country to become fully integrated in the global financial markets where after 2005 there would be basically two key accounting standards, IAS and the US Generally Accepted Accounting Principles (US GAAP). Additionally, this option, if and when implemented, would eliminate in future any multiplicity of financial statements, which is a positive factor both for those who prepare statements and those who use them.

The market strategy: cost to the government

24. At the same time, this option would from the very start require considerably more costs to be invested by the government, among other things, in the implementation of an efficient system of control over the accuracy and compliance of statements with the IAS; development of new methods of statistical observations; transformation of tax laws as far as acquisition of data for tax assessment is concerned; changes in the corporate law relating to the application of financial indicators for dividend purposes, calculation of net assets, etc. Additionally, the lack of IAS accountants at businesses, audit firms, investment companies or equally in regulatory agencies creates additional risk of mistakes and poor-quality IAS disclosures. The government agencies may be required to invest additional efforts in IAS training.

The market strategy: delegation of standard-setting authority in financial accounting

25. Finally, there is yet another argument that opponents of this second option present, namely, that it would presuppose, effectively, waiving the controls over the accounting and reporting methodology to some international agency, thus depriving national regulators, to certain extent, of their decisive rule-setting role in the financial accounting.

The Concept of Development of Accounting and Reporting: lack of consensus among regulators

26. In sum, the versions of the Concept Paper as prepared by different agencies contradict each other in certain material aspects, and make their coordination and consolidation into one government-sponsored paper an unlikely task. This lack of consensus in the Russian Government on specific steps towards IAS implementation in the Russian entities as of mid-2003 means effectively that the earlier declaration by the Russian Government and personally by its Prime Minister Kasyanov that Russian businesses would be switching over to the IAS starting 2004 is unlikely to come true, since there is hardly any practical or legislative framework for any such transition as of June 2003, and there is no time left for its development. The practical framework for the IAS transition would include the availability of qualified IAS accountants, Russian-language IAS training and certification system, IAS materials, including practical application of the IAS, all in the Russian language. As part of the efforts to establish the legislative framework underlying the transition to the IAS consolidated accounting, the Government plans to elaborate and submit to the State Duma a draft law "On Consolidated Reporting." To date, the draft has been prepared by the Russian Finance Ministry and circulated for coordination to various ministries and agencies. The version formulated by the Finance Ministry of Russia refers to the mandatory consolidated IAS accounting by groups of entities with a parent holding. However, this draft offers no specific mechanism for the implementation of the standards, and is substantially declarative. This was the reason why key ministries responsible for the development of the economy and

capital markets in Russia, i.e. the Ministry of Economic Development and Trade, and the FCSM, refused to support the current version of the paper and demanded that it should be significantly revised.

IAS introduction: Bank of Russia's strategy

27. In 2002-2003 the Central Bank worked hard to prepare their plan for the transition of credit institutions to the IAS, and regulations defining the IAS transition procedures. In their official communication dated 2 June 2003 "On the transition of the Russian banking sector to the International Accounting Standards," the Bank of Russia announced that starting 1 January 2004 all credit institutions were expected to start doing their financial accounting in accordance with the IAS. The IAS accounts would be prepared on the basis of the Russian standards accounts through transformation in accordance with a method offered by the Central Bank. Throughout the transition period, until 1 January 2006, credit institutions would have also to present accounts prepared under the Russian standards. Starting 1 January 2006 supervisory regulation shall be based on IAS accounts. The Bank of Russia also plans to organize training in the IAS.

The 2003 Plan of Actions by the Interdepartmental Commission: the conservative strategy

28. In accordance with the 2003 Plan of Actions to prepare the economy for the introduction of International Accounting Standards (IAS), approved by the Interdepartmental Commission for the reform of accounting and financial reporting (the IC) on 6 March 2003, apart from actions aiming to introduce IAS in Russia, a substantial effort is to be allocated by the Russian Finance Ministry to develop accounting provisions (standards), and their methodological recommendations on the translation of Russian accounts into consolidated IAS accounts. Hence, the IC Plan of Actions is based on the first version of the Accounting and Reporting Concept in the mid-term perspective striving to preserve and enhance the system of Russian principles of accounting and reporting. Additionally, the above Plan envisages an active methodological role for the Finance Ministry in the course of transition to the IAS, including development of relevant methodological recommendations for the transformation of accounts (similar to the Bank of Russia's plans). The practical experience generated by the leading Russian and international consultancies and audit firms in the methodology materials attests to the need to retain for this purpose highly qualified IAS professionals. Thus, should the above recommendations by the Finance Ministry and the Bank of Russia be prepared without or with a limited contribution by the profession, the risk is that the resulting document would lack the necessary quality, which would inevitably affect the quality of the accounts prepared basing on it.

IAS introduction: professional training.

29. As a result of the acute deficit of qualified IAS specialists, the issue today has engaged several agencies and professional associations at once:

- the Finance Ministry's Department for the organization of the audit business, together with the Audit Council, started developing the IAS qualifications curricula for auditors;
- together with the Russian Institute of Professional Accountants, the Finance Ministry launched their efforts to amend the certification programs for chief accountants and other professions to be engaged in the preparation of IAS consolidated accounts;
- The Bank of Russia, as already mentioned above, has plants to train employees of credit institutions who would be preparing and submitting IAS accounts.

30. Additionally, early in 2003 a Russian-language IAS training and certification curriculum was launched by the International Association of Bookkeepers, and ACCA and other certification systems are considering similar options. Apparently, should the government be ready to commit itself to specific dates and ways to introduce Russian entities to the IAS, a relevant market for the IAS training and certification of professionals is bound to be well-saturated.

4. ACTIONS PLANNED: BUSINESS COMMUNITY APPROACH

Business community approach: transition to self-regulation

31. Representatives of the business community offer a different approach to the IAS introduction. Generally supportive of the position held by the Ministry for Economic Development and FCSM (see paragraph 24), the Russian Union of Industrialists and Entrepreneurs puts forth a more radical version for the IAS implementation making IAS the only standard of disclosure and removing the government from the process of regulation over the financial accounting rules. Following a short transitional period, when, as the Union expects, the Russian PBU rules as prepared by the Finance Ministry would be in effect, the function of standard-setting in accounting and reporting should be fully transferred to a professional organization of accounting and financial reporting. Moreover, throughout the transition, the number of mandatory PBUs would be cut down to a few key ones while the other standards would be optional, and no more new PBUs would be developed.

Key arguments of the RUIE (Russian Union of Industrialists and Entrepreneurs): financial accounts should be based on market standards

32. Financial accounts should be drawn on the standards compliant with the market economy. PBUs fail this test since, firstly, they are different from IAS in certain material aspects, and, secondly, they have not been written professionally enough and contain so many errors and contradictions that their application does more harm than benefit to the disclosure system.

Key arguments of the RUIE: no need for PBUs

33. Financial accounting standards must be applied by a limited range of companies, primarily publicly significant entities listed in the Concept Paper of the Ministry for Economic Development and FCSM (see paragraph 24). The requirement to use effective PBUs is applicable instead to all Russian entities, with the exception of non-profit, credit or small business entities; there are few PBUs that limit the scope of applicable entities to open joint-stock companies. But the majority of Russian entities do not need such a complex system of accounts which, ultimately, has no active user. If the businesses can give up PBUs, and a limited scope of companies introduce IAS, the rest of the Russian businesses would be able to drastically cut their accounting costs.

Key arguments of the RUIE: the need for a professional approach to standards development

34. The complexity of today's requirements to the financial accounting system, brought about by the integration of the Russian economy in the global marketplace, explains the need for a highly professional approach to the standard-setting in the financial accounting. It is very unlikely to find it today at the level of government agencies, with their scarce resources and lack of qualified experts. It would then appear feasible to delegate development of accounting and financial reporting standards to a professional organization which may also offer information and consultancy services supplying Russian enterprises with timely information about the changing international standards as they summarize the accounting practices and prepare their recommendations on standards application, and actively contribute to the work of the IAS Committee.

Similarity of views of the business and government agencies responsible for the promotion of market environment in Russia

35. Overall, the RUIE approach is fairly close to the market strategy formulated in the Concept Paper by the Russian Ministry for Economic Development and FCSM, suggesting there is uniformity of views on part of those who actively participate in the investment process and promotion of market ways in Russia, the views on the routes of reform for the national system of accounting and financial reporting. The Ministry for Economic Development has been very supportive of the idea to have a non-governmental professional organization in Russia which would become engaged with issues of accounting and reporting standards. Besides, the idea of self-regulation in the sphere of development and application of accounting and financial reporting standards is generally in line with the one of the key areas of the administrative reform aiming to limit government's interference with the economic activities of

business agents, eliminate excessive government regulation, and promote a system of self-regulating organizations in the economy.⁵

5. Key issues of IAS implementation in Russia

36. Successful IAS implementation requires that a set of issues should be addressed first to establish the needed legislative and regulatory framework for the IAS application. The issues fall into the following groups:

- Legal issues
- Human resources issues
- Issues of supervision over IAS reporting

Legal issues

37. The IAS have no legal status in Russia. It is necessary:

- To make amendments in normative legal acts introducing requirements to present accounts under the IAS
- To publish the official IAS translation into Russian on a permanent basis.

Giving IAS a legal status

38. The IAS could acquire a legal status in a few possible ways:

- Introducing IAS into the Russian laws through approval of legal normative acts, e.g. by the Russian Government (the way chosen by the European Union);
- By reference, i.e. incorporating into laws certain references to the IAS together with their clear-cut description as accounting and reporting standards approved by the IAS Committee Board whose official Russian translation is to be published in official documents (the way chosen by certain CIS countries, e.g., Kazakhstan).
- Establishing own accounting and reporting standards complying with international standards or certain regulations that would spell out the rules for the translation of the statements into IAS (the way chosen by the Russian Central Bank).

39. Each of the above methods has its pros and cons.

Giving IAS a legal status: incorporation of IAS in the national legislation

40. Incorporation of IAS wording into the Russian legislation would inevitably face the problem of “legal cleansing” of such wording to bring it in compliance with the Russian law, which might substantially distort the meaning of such standards. This option would require highly qualified experts to work on the text to make sure there is no distortion to the meaning.

Giving IAS a legal status: direct “import” of IAS

41. Implementation of IAS by reference is more in line with the purpose that Russian companies would pursue to be able to apply original IAS. At the same time, this option would require that there is a constantly updated Russian

⁵ See paragraph 1 of the Decree by the Russian President “On measures of administrative reform in 2003-2004”

language translation of the standards officially recognized as such by the Russian government, which would put Russian laws dependent, to certain extent, on the IASC since neither the Government nor the Central Bank of Russia would be in a position to arrange for the Russian translation where such rights belong to the IASC. This may become a case of the prejudiced independence of the Russian legal environment, where the law would then be dependent on a private entity of the IASC. In view of the negative experience of Kazakhstan where the new version of the law “On accounting and financial reporting” introduced the requirement for the entities to prepare their financial statements under the IAS, proved abortive in the absence of an official IAS translation, it is important to be very careful in evaluating the consequences of such a transition to IAS.

Giving IAS a legal status: endorsement of IAS with the national regulatory acts

42. The way chosen by the Central Bank of Russia, namely, promulgation of a regulation defining the rules for the translation of financial statements prepared under the RAS into IAS-based accounts, might be somewhat contradictory to the effecting IAS rules that give the exclusive right to interpret and explain IAS to the standard-setting authority, viz., the IAS Committee. So, should the regulations promulgated by the Central Bank be in any respect different from the IAS, the statement prepared under such regulations may not be accepted as IAS-compliant, which would be exactly what the auditor’s statement should say on the authenticity of such statements. As a result, what could happen would be a situation whereby certain Russian banks would be preparing, for a certain duration of time, at least three different sets of accounts: under the IAS (original), under the IAS (according to the Central Bank), and for tax purposes. Additionally, during the two-year transition period, banks would also have to prepare their financial statements under the Russian accounting standards.

43. Basically, the third option is nothing new for Russian companies: the 1998 Accounting Reform Program compliant with the IAS, in fact, provided for the introduction of a system of national Russian standards (*PBU* – principles of accounting) based on the IAS. The PBUs prepared to date appear to be rather far from the original. At the same time, Russia has retained its independence in the standard-setting and, in contrast to Kazakhstan, is not dependent on the intentions IASC may have towards the Russian translation.

IAS introduction: international experience.

44. In terms of international experience in IAS implementation, it may be instructive to look into a study called “GAAP 2002: convergence” and prepared by the biggest auditors BDO, Deloitte Touche Tomatsu, Ernst & Young, Grant Thornton, KPMG, PricewaterhouseCoopers, who polled 59 countries on issues of dissemination and convergence with IAS. The study has shown a clear trend towards IAS convergence in different countries (over 90 percent of polled countries voiced this intention); however, less than half of them are prepared to accept IAS as their national standards or replace their national standards for IAS. Most of them, 58 percent of the countries, have opted for the elimination of differences between IAS and national accounting standards. Importantly, though, in the countries that have chosen to do it, national standards come either from the existing or specifically established non-governmental professional entities. It is the Financial Accounting Board in Australia, or a Committee on Disclosures and Accounting Standards specially created by the Singapore Ministry of Finance. We believe that the convergence option that aims to eliminate differences between national standards and IAS can only succeed if promoted by national professional agencies that set the standards and actively contribute to the development of the original IAS, supporting the work of the IAS Committee.

45. At the same time, almost one third of the respondent countries believe IAS translations into the national languages come too late. This seemingly pure technical issue nevertheless enlarges the risk of direct “import” of IAS, since in this case the applicability of national laws becomes directly dependent on the timely and orderly actions by a private institution – the IAS Committee as the due holder of the copyright to IAS translation and publication. In this context, a mechanism allowing to approve standards at the national level may come as a reasonable mitigating measure against the risk of untimely deliverance of the IAS Russian translation or their imperfect translation. At the same time, it is very important for the national standard-setter to rule out any discrepancies between their endorsed text and the original IAS text, which is hardly possible at the level of normative legal acts since IAS are conceptually based on the common law, so different from the Russian law.

Human resources issues

46. The lack of qualified IAS accountants is the issue that is not limited to Russia: it exists all over the world. The scarcity of qualified human resources is translated into the growing price for the services of consultants helping to prepare IAS accounts: experts claim that between 2000 and 2002 prices for the services of IAS accounts preparation appreciated approximately 30-40 percent. A similar situation is with the auditors: the cost of audit of IAS accounts, according to experts, is 15-20% more expensive on average than the audit of RAS accounts. Undoubtedly, the issue of excessive demand over supply could be tackled in a regular market way through the gradual increase of supply and the resulting change of prices that professionals charge. At the same time, should there be a mandatory requirement to prepare IAS-based accounts, the human resources issue might be elevated to a different level, impacting the quality of IAS statements.

Lack of a Russian-language IAS training and certification curriculum.

47. The issue of shortage of qualified IAS professionals is largely due to the fact that there is no Russian-language IAS training and certification curriculum.

48. As a result, various ministries and professional institutions have been planning to sponsor various IAS training courses in Russian (see 30). However, experts express doubt about the quality of such newly prepared curricula. The situation is made even more complex because of the uncertainty over the authority that should assess the quality of such training programs: the original source of the standards, the IASC, so far has not been doing any evaluation of the existing training programs despite the earlier plans to introduce a system of evaluation.

Issues of supervision of IAS accounting

49. At this stage of transition to IAS accounting, companies have to address the issue of quality control over the information disclosed under the IAS. The related issue is how such control can be exercised. Apparently, there are three levels where such control is needed:

- one is the level of government regulators, with relevant sanctions to those companies whose accounts fail to comply with the IAS (the Federal Commission on Securities Market; the Central Bank (for credit institutions), and the Russian Property Management Ministry (for state-owned unitary enterprises)).
- self-regulation - through organizers of trading on the securities market (vis-à-vis issuers), through other professional self-regulating organizations (vis-à-vis professional participants in the securities market, insurers investment funds and other financial market agents).
- Independent auditing - through the introduction of mandatory audit of financial account prepared under the IAS.
- Internal control – by companies' check-up commissions and audit committees.

50. Principal problems related to oversight over the use of IAS include the qualifications of auditors, the lack of methods for running such checks, which are available to Russian regulators, the absence of necessary IAS guidelines in Russian, and the dearth of financing, considering that IAS professionals are very expensive. It is obvious at the same time that in order for their supervision to be successful, the overseers should have the necessary resources to do their work, including competent specialists familiar both with requirements applicable to financial statements and with procedures for exercising control over their fulfillment.⁶ This problem should be kept in mind when devising a model for oversight over the execution and submission of financial statements.⁷

⁵ Standard # 1 on Financial Information. Enforcement of Standards of Financial Information in Europe, Section C 'Enforcers'. – The Committee of European Securities Regulators, March 2003.

⁶ See also Section 6 of this Report, "Recommendations for Discussion".

Independent audit.

51. The exercise of control over corporate financial activities by an independent auditor is among the key elements of the overall system for financial monitoring. The role of such external audits is emphasized both by the Code of Corporate Governance and in the OECD Principles of Corporate Governance, which say, in particular, that “an annual audit should be conducted by an independent auditor in order to provide an external and objective assurance on the way in which financial statements have been prepared and presented”.⁸ Implementing IAS for Russian enterprises will involve tackling the following problems:

- Obligatory nature of external audits for statements prepared according to IAS requirements, including both consolidated and individual corporate reports;
- Legal status for an external auditor’s report on IAS-based financial statements, which is based, for its part, on checks performed in accordance with International Audit Standards; and
- Independence of external audits.

Obligatory nature of external audits for statements prepared according to IAS requirements.

52. Existing Russian legislation requires that companies meeting certain criteria depending on their corporate structures, lines of activity, and revenues should at all times submit their financial statements to independent auditors as individual corporate reports prepared according to Russian standards, while consolidated/summary statements are not subject to obligatory auditing at all.

Legal status for an external auditor’s report on IAS-based financial statements

53. Existing Russian legislation on auditing stipulates that “an external auditor’s report shall be an official document intended for users of financial/accounting statements prepared by the parties being audited in accordance with applicable federal auditing rules/standards and representing the audit organization’s or individual auditor’s opinion, as expressed in compliance with the established form, about the accuracy of such statements and the conformity of the audited party’s accounting procedures to the relevant legislation of the Russian Federation”.⁸ Therefore, an external auditor’s report drawn up according to International Audit Standards on an IAS-based statement has no legal force in the Russian Federation, meaning that an auditor actually bears no legal liability for the contents of such report.⁹ Consequently, in the event that an external audit is performed in bad faith, the rights of the corresponding investor or other interested user of the resulting financial statement to receive accurate information turn out legally vulnerable, and instead of improving the quality of financial reporting, the implementation of IAS may have directly opposite results. The legislative solution to this problem should take account of the fact that lending a legal status means, before everything else, making the external auditor legally liable for the results of their audits and for the contents of their reports on such audits of IAS-based statements.

Independence of external audits.

54. The problem of auditor independence is the subject of special sections in the professional ethics codes for auditors and accountants, which are being approved both at international level (as the Ethics Code drafted by the International Federation of Accountants - IFAC) and at the level of professional organizations in individual countries. With the implementation of IAS, this problem acquires an added urgency, considering that audit, most notably international, organizations today enjoy a kind of professional monopoly on IAS owing to the apparent want of qualified personnel both at reporting companies and at regulatory agencies (see Section 51 above). It is quite often in practice that an audit organization issues a report on a statement prepared with the involvement of its own employees. Even where such services are called “advisory services” rather than “the services of preparing financial statements”, there are doubts about the independence of such audits. This is why the issue of a ban on the combining of advisory

⁷ 1999 OECD Principles of Corporate Governance, Section IY.

⁸ Federal Audit Law, Article 10.

⁹ Audits of statements prepared according to IAS are also discussed in Section 11 above.

services and audit services is the focal matter of ensuring the high quality and accuracy of audited IAS-based statements.

Internal control

55. Audit committees have been lately playing an ever greater role in ensuring corporate financial transparency and trustworthy financial disclosure in countries with developed capital markets along with traditional internal control authorities which are in-house divisions of companies (like internal audit commissions in Russia). Such committees perform their mission, above all, thanks to the independent status enjoyed by their members who may not be affiliated with either the board of directors or the chief executive authority of the corresponding company.

56. Some Russian companies these days also have external audit committees, as recommended by the Code of Corporate Conduct: “It is recommended – for the board of directors’ efficient control over the company’s financial and business activities, in the first place, the implementation of its financial and business plans, - that a special committee – the external audit committee - be set up under the board of directors to be responsible for this aspect of work”.¹⁰

57. Yet independence is a vital, but still an insufficient condition for the external audit committee’s efficient work. For this body to be able to promptly detect offenses or adverse trends in the preparation and submission of the company’s financial statements, its members should have the necessary qualifications in the fields of financial disclosure, accounting, and financial reporting. IAS, for their part, make increased requirements on the qualifications of members of external audit committees, especially where national accounting and reporting rules are substantially different from their international counterparts. Russia in this respect is no exception: Russian accounting rules have considerable differences from IAS in terms of both asset and obligation evaluation and posting and the scope of information disclosed in explanatory notes to financial statements.

6. RECOMMENDATIONS FOR DISCUSSION.

Complex Approach

58. Application of the IAS is one of the aspects of a more comprehensive issue of better quality public disclosures by Russian businesses. Hence the need for a more comprehensive approach to the issue of public disclosure in general. What you would find below are some underlying principles for the preparation and presentation of such disclosures compliant with the needs of financial markets and corporate ethics.

Public reporting – single set of standards

59. Any public financial statement, be it consolidated or unconsolidated accounts by a legal entity, should be prepared in accordance with the same standard, i.e. IAS. Presentation of different components of financial accounts to the user, if drawn from different standards, would significantly impair the usefulness of such disclosure and its cross-company comparability. Effectively, gradual transition to any IAS-based public disclosures by commercial entities presupposes *abandonment of any such practice whereby national accounting standards would be developed on the basis of the effective IAS*, i.e. a reform of the Russian system of Russian accounts as all public financial reporting would be based on the IAS. In the course of a limited transition period, Russian accounting rules can be allowed to be developed but in a more long-term perspective only IAS should be applied for financial accounting and reporting.

¹⁰ Code of Corporate Conduct, Moscow, 2002. Chapter 8, Article 1.1.2.

Financial reporting: a scope of entities

60. The IAS financial accounting and reporting requirements should apply exclusively to those entities that make public disclosures, and to a few other publicly significant institutions, including financial agencies – credit and insurance institutions, professional participants in the securities market, investment and private pension funds, and natural monopolies. Other organizations that are not subject to the mandatory requirement to prepare IAS accounts can make them at their own discretion to supplement the reporting they submit to the tax authorities, or statistical authorities, or other regulators.

IAS implementation: a step-by-step approach

61. The IAS transition should be phased, in line with the abilities and needs of its participants, and might begin with the preparation and submission by publicly traded issuers and financial institutions, to be followed gradually to IAS accounting by all joint-stock companies, and some state-owned unitary enterprises. Although none of the participants in the IAS transition seem to object to the step-by-step approach, there is such a key thing as coordination between different agencies and legislative bodies. To date, the Russian accounting has been used mostly by tax authorities and statistical agencies. Hence, for the financial accounting and reporting to follow uniform standards, issues of tax and statistical reporting should be addressed.

Giving IAS a legal status: an integrated approach

62. The choice of the way to implement IAS in the practices of Russian businesses should be made given a maximum possible integrated approach whereby the high quality of financial accounts should not rule out independence in the area of normative regulation of the process. It is also possible that this may require a separate mechanism for the recognition of IAS both at the sovereign level and at the intergovernmental level. Two ways to legitimize IAS are the most feasible:

1. IAS would be accepted at the level of an international organization while national laws would have a relevant reference to the standards the international organization approve; under this option, it would be possible to retain the original IAS text as it is to be approved in its original version at the international level; on the other hand, it would be possible to incorporate IAS in the national legislation by reference to an international agency instead of the private institution that the IASC is;
2. IAS would be approved as Russian standards by a self-regulating organization that under law is vested in a right to set standards of financial reporting. In this case, it would be easier to incorporate IAS in the Russian law, but it would then be required to constantly update the national standards every time IAS are changed.

Control over IAS application for disclosures and submission of financial information.

63. With the organizations switching over to the IAS for purposes of public financial disclosures, special attention should be given to issues of supervision over proper application of the IAS, and timely and complete disclosures. Controls over the timeliness of submission and disclosure of IAS-based financial accounts, together with their completeness, should be installed at several levels: government (FCSM, Bank of Russia, Russian Property Management Ministry, etc.), self-regulation and audit.

Government regulation over the process of IAS introduction and application.

64. While working on the government regulation policies in the step-by-step IAS implementation, one should bear in mind that the principal value of IAS accounts, compared to Russian standards accounting, lies in its universal acceptance practically by any market, any investors or other stakeholders (e.g. counterparts). In contrast to RAS accounts, users of IAS accounts include, apart from tax and statistical authorities, a broad section of financial market agents. However, this is true only of the accounts that come with a proper auditor's statement, i.e. **compliant with the IAS in all material aspects**. Should a company deflect, for any reason, from IAS requirements (e.g., to comply with the requirements of the home law), its accounts would not have the auditor's statement and be accepted by the user. It is thus important that the government's regulation of the IAS implementation be limited to its **control over the**

compliance with the procedures and deadlines for the submission and disclosure of IAS accounts, as well as their accuracy (together with the auditors), **allowing no interference in the issues of methodology or preparation of the accounts**. It would be advisable that the government authorities that regulate financial accounting (primarily FCSM and Central Bank) be very thorough in their formulation of regulatory documents on financial accounting, defining requirements that are there to help them with the controlling and supervisory functions rather than define the way IAS financial accounts should be prepared.

IAS introduction: role of independent audit

65. Application of the IAS should equip the users with reliable financial information. That is why independent audit is so important. The system of accounting and financial reporting in the Russian Federation must evolve together with the development of the institute of audit, enhanced requirements to auditors, and the introduction of the International Auditing Standards.

66. Therefore, it is imperative to make such amendments to legislation on accounting and auditing as will provide for the following:

- *Obligatory nature of external audits* of IAS-based financial statements, including consolidated reports and individual corporate reports; and
- *Legal status for an external auditor's report* on an IAS-based financial statement checked in conformity with International Audit Standards.

67. *The independence of external audits* should be ensured by auditing standards and the Auditor Ethics Code which has been approved by IFAC and is similar to the Ethics Code for Professional Accountants and Auditors.

IAS introduction: information and consultancy support

68. Should the decision to switch over to the IAS be made, there should be a **system** set up to provide businesses and other stakeholders with IAS-related information, practical advice on the IAS implementation, pending changes in IAS, etc. Such information and consultative service would be appropriate to set up as a professional organization, supported by business and professional community and government agencies. Moreover, heeding to the interests of Russian businesses and accounts users, it would be necessary to arrange for **Russia's active involvement in the IASC proceedings**, both through professional and regulatory authorities. In line with the European experience, an ad hoc professional group may be set up to address substantive issues of financial accounting (EFRAG), the role which can be played by a self-regulating organization on financial reporting.

IAS introduction: self-regulation as the role of the profession

69. The IAS implementation should proceed along with highly professional quality of the drafted regulatory documents, methodological and training materials on the IAS. It spells out a bigger role for the professional community in its practical support of the IAS transition. The contribution of the profession towards the successful completion of this transition is extremely important, and is not limited to such traditional areas as professional training or certification of accountants; it can be also instrumental supporting the government in its supervision of the financial reporting. The assistance may lie in the direct human resources sponsorship of governmental agencies at the time of inspections and analysis of the reporting, as well as in the establishment of a system of effective control inside the profession over the quality of IAS audit and consultancy services. Moreover, accountancy and audit self-regulating professions may assume certain functions needed to develop practical advice on the IAS application and thus support businesses which are implementing international standards. *Thus, it would be advisable to delegate a self-regulating professional organization all issues of development and approval of practical recommendations (instructions) on accounting and application of financial reporting standards.*

Measures needed in the transition period: transitional period for companies employing internationally accepted standards other than IAS.

70. A vast majority of major Russian issuers prepare their accounts under the US GAAP to obtain listing on the US capital market. Their immediate implementation of the IAS would be contingent on the very high costs that may not always be justified from the point of view of their accounts users. The US Generally Accepted Accounting Principles (US GAAP) tend to converge with the IAS as suggested by the joint consultations of the two standard-setting authorities: FASB (US Financial Accounting Standards Board) and the IASC Board. Besides, as of 2001, the IASC Board has been pursuing a standing project for the IAS convergence with the national financial accounting and reporting standards, primarily with US GAAP. By 2005 the differences between the two accounting systems are expected to be mostly smoothed over. As a result, companies in Russia which are presently relying on the US GAAP will find it much easier to switch over to the IAS after 2005. It would then made sense to offer companies that prepare their financial accounts under internationally recognized standards other than the IAS, an opportunity to continue to present such accounts instead of the IAS based accounts during a certain grace period (transitional period) from three to five years.

Professional monitoring of IAS reporting.

71. It would also be necessary to set up a group of professionals to monitor the IAS reporting presented by Russian companies. Such an authority should better be established at the earliest stage of the IAS implementation (2005-2006). Although it would not be able to ensure actual control over the process of IAS reporting, such monitoring would help identify key problems in accounting or those companies that tend to violate IAS rules. The information about such companies guilty of violations and about their violations should be made public.

APPENDIX 1: LIST OF COMPANIES THAT ARE PREPARING IAS OR US GAAP ACCOUNTS¹

1.	▪ AvtoVAZ	21.	▪ Purneftegaz
2.	▪ ALROSA	22.	▪ RAO UES
3.	▪ Aeroflot	23.	▪ RBC Information Systems
4.	▪ Baltika	24.	▪ Rostelecom
5.	▪ Bashinformsvyaz	25.	▪ RTK-Leasing
6.	▪ Vimm-Bill-Dann	26.	▪ Sakhalinmorneftegas
7.	▪ Volzhsky Telecom	27.	▪ Sberbank
8.	▪ VSMPO	28.	▪ North-West Telecom
9.	▪ GAZ	29.	▪ Severstal
10.	▪ Gasprom	30.	▪ Siberian Telecom
11.	▪ GUM	31.	▪ Siberian-Ural Aluminum
12.	▪ Far East Shipping Company	32.	▪ Slavneft
13.	▪ Red October	33.	▪ Transneft
14.	▪ Irkutskenergo	34.	▪ Transnefteprodukt
15.	▪ KamAZ	35.	▪ Uralsvyazinform
16.	▪ Lenenergo	36.	▪ Central Telecom
17.	▪ Magnitogorsk Steel	37.	▪ CUM
18.	▪ Murmancelectrosvyaz	38.	▪ Southern Telecom
19.	▪ Norilsk Nickel		
20.	▪ Primorie Shipping Company		

¹ Source: FBK Audit Firm, ICAR, public sources (Internet).

APPENDIX 2. COMPANIES THAT HAVE BEEN PREPARING US GAAP ACCOUNTS²

<ul style="list-style-type: none">▪ 1. Vypelcom▪ 2. Golden Telecom▪ 3. Irkutskenergo▪ 4. Kalina Concern▪ 5. LUKOIL▪ 6. MGTS▪ 7. Mosenergo▪ 8. MTS▪ 9. NLMK	<ul style="list-style-type: none">▪ 10. Unified companies (Izhora)▪ 11.▪ 12. North-West Telecom▪ 13 Sibneft▪ 14 Surgutneftegas▪ 15 Tatneft▪ 16TNK▪ 17 YUCOS
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² Source: FBK Audit Firm, ICAR, public sources (Internet).