

## ANALYSIS OF THE APPLICATION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS FOR DRAWING UP CONSOLIDATED FINANCIAL REPORTING IN RUSSIA

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### Abstract

**Purpose** - The purpose of this research is to study the practice of dissemination of IFRS in Russia, and to disclose the quantitative characteristics of their use.

**Findings** - The paper reveals the dynamics of the involvement of Russian largest companies by sales revenues for the period 2005-2017 in the practice of drawing up financial reporting using IFRS. Also their industry affiliation was analyzed. The changes in the reasons that led to the described practice were studied. And these reasons were identified by comparing the results of the survey of more than 300 companies.

**Originality/value**. The originality of this research is determined by the data presentation on the application of IFRS by the largest Russian companies by sales revenues, the total revenue of which in 2017 is 77.26% of Russian GDP, and the fact that despite the current legislative requirement for the drawing up the financial reporting using IFRS by certain groups of companies, such as banks, funds, insurance companies, the key role for the IFRS application belongs not to a legislator, but to the owners of companies.

**Keywords:** IFRS, consolidated financial reporting, problems, legislation

**JEL code:** M410

### Introduction

The importance of consolidated financial reporting as a source of information on financial and operational activities of group of companies has significantly increased due to the globalization, that changed the structure of the world economy and covered almost all spheres of society: the economy, politics, culture, religion and etc. ‘Global’ rules for disclosure of consolidated financial reporting - International Financial Reporting Standards (IFRS) - developed by the Foundation of the International Financial Reporting Standards, established in 1973. These standards can be regarded as a key element of information infrastructure of the global economy that provides standardized data on financial and economic activities of economic entities. The comparability of financial reporting data is very important for making business decisions. It can’t be achieved by using national accounting standards, that’s why IFRS became widespread during recent years, and were adopted in the most countries. Russia was no exception. According to the Federal Law “On Consolidated Financial Reporting”, starting from 2012 it becomes mandatory for

entities of public importance to draw up and disclosure consolidated financial reporting according to IFRS.

Since 2005 the majority of European countries are required to use IFRS, at least by public companies. The countries achieved this result by two ways: 1) a one-step replacement of national standards with IFRS for the drawing up consolidated financial reporting; 2) a two-stage transfer to IFRS: the country enacts a regulatory document providing for a combined use of standards, thus allowing companies to decide themselves what standards (national, international, or American) they will use for drawing up consolidated financial reporting, and then a requirement is enacted for mandatory use of IFRS for the consolidated financial reporting. The first strategy of replacing national standards with IFRS was used by Great Britain, while Germany followed the second one (Sokolova, 2006). Russia followed the second way.

Many authors write about application of IFRS in different countries. Only in 2017 there were papers on IFRS in Australia, Brazil, China, Latin America, Europe, BRICS countries, and etc. (Xun Gong and C. Cortese; N.L. Pawsey; E. Onali, G. Ginesti, L.V. Ballestra; A.X. Beiruth et al.; J. Carneiro, L.L. Rodrigues, R. Craig). Application of IFRS in Russia was described in J. Richard, D. Bensadon, N. Praquin (2016), A. Ghio and R. Verona (2017), N. Generalova, G. Soboleva, N. Sokolova (2016). This research is devoted to the history of the implementation of IFRS in Russia and the characteristics of companies that apply them in their practice.

### **History of IFRS implementation in Russia**

Since 1990s a reform of standards was launched in Russia. It was due to the renunciation of the state-controlled economy and transition to a market-driven one. The centrepiece of the reform at the government level was IFRS. The impetus for the reform came from the seminar on issues of accounting at joint ventures organized by the United Nations Centre for Transnational Corporations together with the USSR Chamber of Commerce and Industry in June 1989 in Moscow. However, it was the State Programme of the Russian Federation for Transition to an Internationally Accepted Accounting and Statistics System in Accordance with the Requirements of a Developing Market that was considered to be an official beginning of the reform. The Programme provided for transition to IFRS by 2000. At the same year the approach accepted in the Soviet period were rejected, and the requirement to make consolidated financial reporting according to the national accounting standards was enacted. In 1998 the plan for adapting Russian accounting principles to modern economic environment was revised, and Russia adopted the policy of a “balanced and gradual” application of IFRS (Generalova and Sokolova, 2014). This approach implies preservation of the national accounting and reporting system based on IFRS and introduction of the requirement to use IFRS in consolidated statements of public companies. By that time, the most important regulatory documents regulating accounting practices on the basis of key IFRS principles had already been adopted.

At the end of the 1990s separate companies started using IFRS in their consolidated financial statements on a voluntary basis. For instance, Gazprom and RAO UES have used IFRS in their consolidated financial statements since 1998. Voluntary use of IFRS by Russian companies in their consolidated statements was driven by the establishment of market relations, which created the necessity to raise capital through market mechanisms by attracting investments in the international capital markets. This determined the necessity to change statutory requirements to accounting standards.

In 1999 both national and international rules for drawing up consolidated financial statements were used, and the companies were given a statutory right to choose between the standards. Just one year before this way was chosen in Germany where 5 years’ experience of

permission for using IFRS was accumulated by this time (Sokolova, 2006). In 2005 the largest Russian stock exchanges, MICEX Stock Exchange and RTS Stock Exchange, introduced a requirement to use IFRS in financial statements for companies listing their stocks and bonds on the “A” quotation lists of the first and the second levels (Rules of listing...).

### **Current stage of IFRS application in Russia**

Since 2012 the majority of Russian publicly important companies are required to use IFRS for consolidated financial statements. This requirement is a part of Federal Law 208-FZ “On Consolidated Financial Reporting”, adopted July 27, 2010. Figure 1 shows the influence of its enacting on the trends in adoption of IFRS by Russian companies for 2005-2017, according to the data obtained from the “RAEX 600”<sup>1</sup> annual ranking of the largest Russian companies by sales revenue that is formed by rating agency “RAEX (Expert RA)”. Until 2005, the rating agency did not include the data on accounting standards and financial statements used by the companies in their financial reporting into its ranking tables. This ranking includes 600 Russian companies from practically all major sections of the economy based on their sales revenues. Until 2015 this rating included 400 companies, that’s why all the calculations in this research were made for 400 companies. The proportion of total annual revenue of the companies included in the 2017 ranking – 66,555 billion roubles and Russia’s GDP for 2016 – 86,149 billion roubles, was 77.26%.<sup>2</sup> All mentioned above allows us to recognise that examined data is indicative for the characteristic of the situation in Russia.

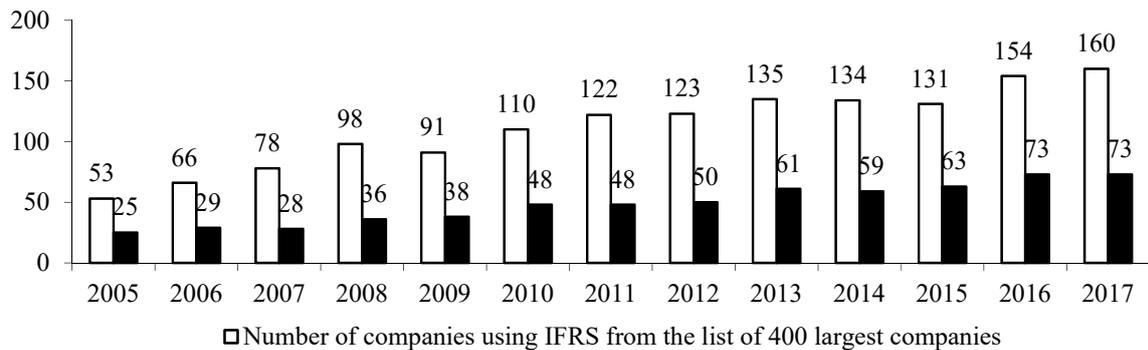
As you can see from Figure 1, dynamics of IFRS application for the top 100 companies and through the entire group under consideration (400 companies) are practically the same; for instance, the increase from 2005 to 2017 was 2.92 times and 3.02 times, respectively. There are exceptions of years 2007, 2009, 2014, 2015. In 2007, there was a reduction by one company in the list of top 100 largest companies represented in the “RAEX 600” ranking, which resulted from the shift in the rankings of individual companies when they were rated by sales revenue. In 2009, the number of companies (in the list of 400) using IFRS on their financial statements was reduced by 7, which can be attributed to the impact of the economic crisis. In 2014, there was an insignificant reduction in the lists of both 100 and 400 largest companies due to the companies’ shifts in the ranking. In 2015, the number of companies drawing up reporting under IFRS from the list of 400 largest companies continues to reduce by 3, while the number of companies in the list of the 100 largest

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<sup>1</sup> RAEX-600 is the rating of 600 largest Russian companies, which includes the most representative list of leading Russian companies, ranked by the sales revenue in order to identify the leaders of business in Russia. In 1995-2003, the rating included only 200 industrial companies. In 2004, the list was expanded to 400 companies from all spheres of economy. Since 2015, the list includes 600 companies. The results of the rating are published in autumn in the newspaper “Kommersant” and on the agency's website. (<https://raexpert.ru/ratings/expert400>). “RAEX 600” employs methods approved by PricewaterhouseCoopers (<https://raexpert.ru/ratings/expert400/2012/part02/p06>). The rating agency collects the data on the companies in three stages: 1) based on the rankings of previous years, statistical reports for the year in question, operating statistical records, and information from the mass media, the agency compiles a list of companies that can be potentially included in the ranking. After preliminary selection, about 600 companies are left on the list; 2) then a survey of companies that are potential candidates for the ranking is conducted. Information on key performance indicators for the last two years is requested; 3) any gaps in the information collected are filled using the data provided by the Federal Service of State Statistics and corporate websites. The information provided by the Federal Service of State Statistics and the Federal Tax Service is taken from the SPARK Interfax professional market and company analysis system.

<sup>2</sup> The company’s position in the “RAEX 600 the largest companies by sales revenues” ranking is determined by grading their sales of goods (work, services) for the year preceding the year of the ranking compilation. The companies’ revenue for the 2017 ranking is taken from financial statements for 2016. The value of GDP is given as of 05.11.18. Source [www.gks.ru](http://www.gks.ru)

companies increased by 4. In 2017 list of 400 largest companies was updated by 2.5%, 10 companies were included into the ranking, list of top 100 – by 1.0% (1 company). At the same time, the percentage of companies using IFRS in their reporting for the entire group under consideration (2005 - 13.25%; 2017 - 40.0%) is lower than that of the leaders - the top 100 companies in the ranking (2005 - 25%; 2017 - 73%). This apparently proves that the course taken by the Russian government is correct, and introduction of mandatory IFRS not for all companies, but only for the publicly important ones, was justified.



**Figure 1.** Dynamics of IFRS adoption by largest Russian companies by sales revenues (calculated on the basis of the data obtained from the “RAEX 600” ranking) ([https://raexpert.ru/rankingtable/top\\_companies/2017/main](https://raexpert.ru/rankingtable/top_companies/2017/main))

In 2011, the proportion of companies using IFRS for making financial reporting exceeded 30% of the total list of companies included in the “RAEX 600” ranking. By that time, the proportion of the top 100 companies using IFRS was almost 50%. In the past several years, since there appeared a possibility to use IFRS financial statements on US stock exchanges and also due to the introduction in the European Union (EU) of the requirement to submit consolidated financial statements compliant with IFRS, new companies that abandoned the use of US GAAP in favour of IFRS began to be added to the list of Russian companies using IFRS. This was done by such companies as Baltika Breweries in 2005, OJSC Concern “Kalina”, Magnitogorsk Iron and Steel Works - the United Company RUSAL, Polymetal, in 2011.

The important characteristics of IFRS distribution is branch of activities of companies using them in their practice. In the Table, the data represented in Figure 1 is supplemented with information on sectors of the economy where the largest Russian companies reporting under IFRS included in the “RAEX 600” ranking operate.

**Table.** Sectors of the economy where the largest companies by sales revenues reporting under IFRS from the “RAEX 600” ranking operate during 2005-2017, %

Sectors of economy	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Total number of companies reporting under IFRS	100	100	100	100	100	100	100	100	100	100	100	100	100
Banks	41.5	36.4	33.3	30.6	29.6	27.3	25.9	21.1	20.7	24.6	23.7	24.7	20.0
Mechanical engineering industry	9.4	9.1	6.4	6.1	8.8	6.4	7.1	7.3	8.2	9.0	6.9	7.1	6.9
Petroleum industry	3.8	4.5	3.9	3.1	3.3	2.7	3.6	3.3	6.7	6.0	6.9	7.1	8.1

Retail industry	11.3	10.6	5.1	8.2	4.4	6.4	8.9	6.5	6.7	6.7	6.9	5.8	5.6
Insurance	0	0	0	2.0	3.3	3.6	3.6	3.3	5.9	5.2	5.3	3.9	3.8
Transport	7.5	10.6	11.6	8.2	6.6	6.4	7.1	8.1	7.4	6.7	6.9	5.2	5.0
Chemical and petrochemical industry	3.8	3.0	6.4	3.1	5.5	6.4	8.9	8.1	7.4	7.5	7.6	6.5	6.3
Iron and steel industry	7.6	4.6	5.1	7.1	6.6	4.5	6.3	5.7	5.2	5.2	6.1	5.8	6.3
Electric power industry	1.9	3.0	5.1	5.1	13.2	11.8	13.4	13.0	8.9	6.0	5.3	7.1	6.9
Other (less than 5 companies working in the sector)	13.2	18.2	23.1	26.5	18.7	24.5	15.2	23.6	22.9	23.1	24.4	26.6	31.2

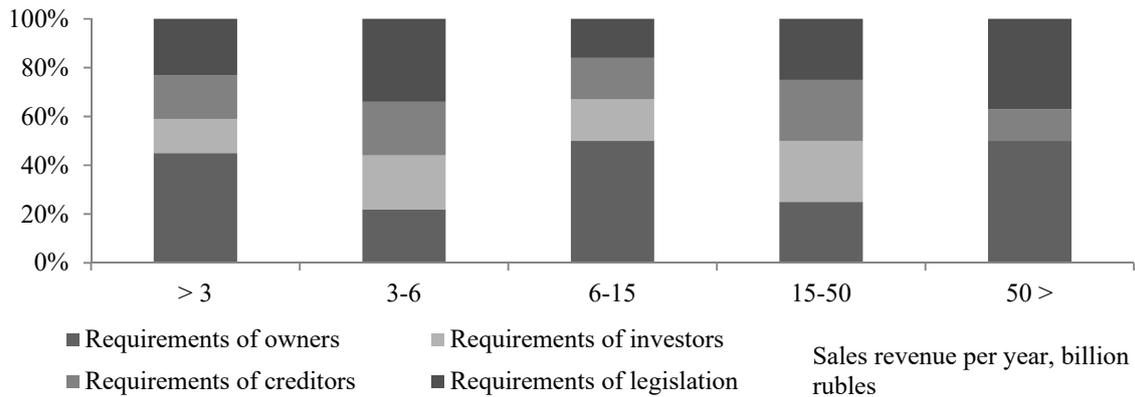
*Note:* Calculations are made by authors on the basis of the “RAEX 600” ranking of the largest companies by sales revenues, [https://raexpert.ru/rankingtable/top\\_companies/2017/main](https://raexpert.ru/rankingtable/top_companies/2017/main)

The banking sector is the most stable, which is typical for almost all countries, and not just Russia. Thus, most of the largest Russian companies using IFRS on their financial statements (41.5% companies in 2005 and 20.0% in 2017) are credit institutions, for which the Bank of Russia prescribes reporting under IFRS, but their share in the total number of companies has been declining. In 2017, the second largest number of companies (8.1%) belongs to the petroleum industry. The third place belongs to mechanical engineering industry and electric power industry – 6.9%. A positive qualitative indicator in the dynamics of IFRS application by the largest companies from different sectors of the economy is the increase more than 18% for the period of 2005-2017 seen in the “other” section, indicating a “broad advancement” of IFRS in Russia.

The figure 1 and table given above show that the legal requirement to draw up financial statements under IFRS did not lead to a substantial increase in the number of companies. The share of banks has significantly decreased, because earlier instruction (of the Central Bank) was only for banks. So application of IFRS in Russia expanded due to an increase in number of companies from 53/25 (2005) to 160/73 (2017).

### **Reasons for drawing up the financial reporting using IFRS**

It rather appears that the introduction of legislative requirements gave legitimacy to the common practice. Additional research revealed that 15 (20.55%) Russian companies from the top-100 of the “RAEX 600” rating draw up the financial statements under IFRS on their own initiative, i.e. without legal requirements. The reasons of IFRS application were disclosed in the results of the survey conducted in 2016 by journal “IFRS in practice” in cooperation with audit and consulting company “Baker Tilly Russaudit”. The researches summarised the opinions of experts from 300 companies divided into 5 groups according to the sales revenue (Skoromnikova, 2016) (fig. 2).



**Figure 2.** The reasons of drawing up financial reporting using IFRS (Skoromnikova, 2016)

Figure 2 demonstrates that the main reason of drawing up financial reporting using IFRS in three groups of companies was the requirements of owners (from 50% in the largest companies to 45% in small ones). Only 25% and 22% of companies with sales revenue of 15-30 billion rubles and 3-6 billion rubles per year respectively made their decisions on standards of drawing up the financial statements on this group of users. Other reasons vary for different groups of companies. So, the second reason of using IFRS by companies with sales revenue more than 50 and less than 3 billion rubles per year was requirements of legislation (37% and 23% respectively). At the same time for companies with revenue 15-50 billion rubles we can see an interesting situation - the requirements of all four groups of users of financial reporting had an equal impact on the choice of standards by companies (25%). Thus, legal requirements became the important reason of drawing up financial reporting using IFRS for all the companies, except companies with revenue 6-15 billion rubles (only 16%). In 2012 a similar research was done, and had similar results (Yurieva, 2012). The main reason of drawing up financial reporting using IFRS in all groups of companies was the requirements of owners (from 35% in the largest companies to 49% in small ones). For medium-sized companies the reason is the requirements of the foreign parent company to provide audited financial reporting under IFRS for understanding Russian business and including it in consolidated financial reporting. Authors believe that owners of large companies want to see the company's reporting in the international format, since they do not recognize reporting prepared under national standards acceptable for making management decisions (Skoromnikova, 2016). Owners often consider financial reporting under IFRS necessary for IPO on the London Stock Exchange, as well as Russian ones. Early in 2011 this reason was specified in an interview conducted by the journal IFRS in Practice, with A. Kuznetsov, the head of the IFRS group in the Pharmastandart, which is one of the leaders of the Russian pharmaceutical industry in the development and production of modern medicines. According to his estimates, financial reporting under IFRS became the key for the IPO and exceeded all expectations, since it significantly increased capitalization up to \$2 billion (Kuznetsov, 2011). Another reason for owners to draw up financial reporting under IFRS concerns the issue of selling business. The second reason of using IFRS by companies with sales revenue more than 50 and 15-30 billion rubles per year was requirements of creditors (24% and 29% respectively), and by companies with sales revenue 6-15 billion rubles per year - requirements of investors (24%). For other groups of companies legislation requirements were on the second place. Thus, legal requirements became the important reason of drawing up financial reporting using IFRS for the companies with low indicators of sales revenue

(less than 3 and 3-6 billion rubles - 20% and 27%), and also for the companies with sales revenue 30-50 billion rubles per year - 27%.

Thus, the results of the survey of “Baker Tilly Russaudit” confirms above mentioned conclusions on the largest companies using IFRS from “RAEX 600” ranking that the introduction of legislative requirements as the methodological basis for drawing up financial reporting according to IFRS didn’t lead to any significant changes in practice for Russian companies. It proves the balanced character of the policy chosen by the RF government in adopting IFRS, the policy which found its manifestation in the enactment of the Federal Law “On Consolidated Financial Reporting” and also took into account the interests and needs of companies themselves.

The long period of IFRS application by Russian companies let specialists gain considerable experience in this sphere and reveal a number of important problems. There are two approaches to the analysis of problems of IFRS implementation and application in Russian accounting literature. Proponents of the first approach describe each problem separately, or dedicate their work to only one of them, followers of the second one - unite them into the groups. Thus, M.L. Pyatov, I.A. Smirnova and N.V. Generalova (2010) applied the first approach. They examined in detail the terminological problem of applying IFRS. The essence of this problem is the difficulty of translating texts of standards drawn up in English and based on the Anglo-American practice that is not always clear to Russian specialists. Also authors often write on other problems of IFRS application: *legal* – N.V. Generalova and N.A. Sokolova (2014), O.E. Orlova (2014), V.S. Plotnikov and O.V. Plotnikova (2015), Yu.I. Sigidov and D.A. Nastenka (2013), G.I. Zolotaryova and E.A. Tregubov (2013); *organizational and methodological* – E.B. Abdalova and S.N. Karelskaya (2016), S.P. Baranenko and A.V. Busygina (2014), N. Generalova and E. Popova (2016), M.V. Drutskaya and N.A. Karpova (2014); Z.N. Ismuhambetova (2014); T.A. Murtazaev, E.N. Dombrovskaya (2015), L.N. Sorokina (2014). The illustrations of the second approach are the works of I.N. Ilysheva, S.A. Kuzubova, O.S. Neverova (2008); F.V. Kerimov (2007), N.A. Sokolova (2006) et al. where authors stand out from two to five groups of problems. So, I.N. Ilysheva and et al. describe five groups of problems: legal, methodological, psychological, economic and staffing (Ilysheva, Kuzubov and Neverova, 2008). F.V. Kerimov specify the following problems: application of the methodology of IFRS; organization of accounting and reporting system in the company; socio-psychological complex; quality control of financial reporting in Russian companies; infrastructure and external environment of the process of making reporting according to IFRS (Kerimov, 2007). N.A. Sokolova writes about two groups of problems: legal and psychological (Sokolova, 2006). Consolidated financial reporting in Russia since 2012 must be drawn up according to IFRS, that’s why it is possible to consider that these problems are inherent to this kind of reporting.

Based on the results of paper analysis, five main groups of problems of IFRS application, described by Russian authors, were identified:

1) *Legal*: constant innovation texts of the standards; lack of industry guidance on their application (for example, oil and gas, energy and other sectors of economy); lack of materials about accumulated experience on application of IFRS by Russian companies; complexity of texts of the standards; lack of examples with the analysis of specific situations; untimely translation of IFRS documents into Russian, complicating the involvement of Russian experts in the discussions of IFRS draft; some meaningful deviations in translation of standards into Russian; lack of statutory documents with detailed description of rules of IFRS application in Russia; absence of statutory documents, revealing the methodology of transformation of financial reporting, prepared in accordance with national rules, into IFRS.

- 2) *Organizational and methodological*: lack of high-quality automated systems for making financial reporting under IFRS; low relevance of reporting due to aggressive duration of its preparation; making financial reporting by transformation of reporting prepared in accordance with Russian accounting standards.
- 3) *Psychological*: difficulty of understanding the requirements of IFRS by Russian preparers and users; need for professional judgment after a long period of direct regulation of accounting rules; orientation of Russian practitioners on the requirements of the tax authority.
- 4) *Economic*: additional costs on training, consulting, auditing of financial reporting, for the automation of the process of making financial reporting under IFRS; low demand for this reporting by external users.
- 5) *Staffing*: a limited number of qualified personnel in the field of making and auditing of financial reporting under IFRS.

The specificity of drawing up consolidated financial reporting influences on the problems of IFRS application. It is especially clearly appears in the groups of legal, organizational and methodological problems. The following legal problems concerning drawing up consolidated financial reporting can be identified: constant revision of standards dealing with consolidated financial reporting; lack of a unified methodology for formation of consolidated financial reporting item; uncertainty disclosure of complex and non-transparent structures of group of companies; ambiguity of the calculation of goodwill, minority interests and etc.; lack of guidance for recording operations in some industries, for example aerospace, working in a long production cycle (two, three or more years), and etc.; and in the group of *organizational and methodological* problems: lack of quality of the automated systems of data consolidation; various functional currencies (errors of conversion of indicators when excluding internal rotation); possibility of excluding from the scope of consolidation companies with bad reporting indicators; aggregated indicators conceal the financial position and financial results of each company within the group; absence of unified methods of analysis consolidated financial reporting, taking into account the limitations of information and errors of making financial statements by transformation.

Today many of the described problems were resolved and/or eliminated in the process of developing infrastructure for IFRS application, or at least become less critical. Thus, the translation of IFRS documents into Russian become quite correct, standards are translated and introduced into the legal field very quickly, programs to automate the process of drawing up financial reporting under IFRS appeared, including even domestic developers, the personnel issue is not so critical because the system of state and commercial education adapted and was able to satisfy the need for qualified staff, experience in professional decisions concerning methodologies for drawing up and analysis of financial reporting under IFRS was gained, and etc. In the context of overcoming the problems of IFRS application in Russia, one of the most controversial issues is the development of instructions on the IFRS application in Russia at the state level. Moreover, such “instructions” should be detailed and unequivocal regulatory documents due to the mentality of the Russian accountant, established under the strict regulation of accounting rules during Soviet period. The authors of this paper consider that such regulatory document will contradict the nature of IFRS based on the principle of applying professional judgment by compilers who should strive for the most reliable disclosure of financial position and financial performance of companies.

### **Conclusion**

IFRS should be recognized as an integral part of ensuring the smooth functioning of the world economy and its continuous development in the context of globalization. Russia was no exception. In Russia modern accounting theory and practice develop in accordance with global

trends. In parallel with the development of national accounting system IFRS are more actively and widely implemented in order to allow Russian business to enter the global capital markets, and researchers to compare data on companies in Russia with those statements of companies in other countries. The achievement of the research goal made it possible to reveal the dynamics of the involvement of Russian largest companies by sales revenues for the period 2005-2017 in the practice of drawing up financial reporting using IFRS. The presented quantitative data show that in Russian practice IFRS are gradually becoming an important part of functioning of large Russian business, and covering more companies, more business spheres (economic activities), gradually reducing dominance of financial institutions among the preparers of financial statements according with IFRS.

The analysis of the practice of applying IFRS in large business companies also made it possible to understand that legislator delayed the introduction of the regulatory requirements of standards application. Russian laws developed after, or in response to an increasingly extending practice of using IFRS in the country. This conclusion was confirmed by the results of the survey of specialists of 300 companies. This survey was conducted in 2016 by "IFRS in practice" journal in cooperation with the auditing and consulting company Baker Tilly Rusaudit (Skoromnikova, 2016). Respondents talked about the reasons for applying IFRS in their companies. In the result their answers allowed to confirm the conclusion that the legal requirements were not the only motivator for the IFRS application.

At the final stage of this research a review of publications of Russian authors on the problems of IFRS application in Russia including the specific problems of drawing up of consolidated financial statements. Five groups of problems of applying IFRS were identified as a result of review of existing opinions of different scientists: legal, organizational and methodological, psychological, economic, staffing, and specific problems arising from the consolidation of statements were formulated. The authors believe that the development of national regulatory documents - detailed instructions on the IFRS application in Russia will not benefit either the preparers or its users, but will lead to incompatibility of reporting. The solution of the problems of IFRS application is in the development of the infrastructure for its use, namely the improvement of its main elements: legislative recognition of IFRS in the Russian Federation; approval procedure for IFRS; a mechanism for summarizing and disseminating the experience of applying IFRS; the order of the official translation of IFRS into Russian; quality control of financial reporting drawing up under IFRS, including audit; IFRS training.

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