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25 years in Russia

Financial reporting
How do you do it?

Metals and Mining, Energy, Oil and Gas, Fertilisers

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Dear readers,

This year we are once again coming out with the results of the survey on the financial reporting process. This is the fourth consecutive year that we are conducting this survey. As usual, the purpose of the survey is to review the existing financial reporting practices in Russian companies. The data we have collected will help our readers to compare their financial reporting processes with the existing practices of their peers.

We looked into the three key stages of preparing financial statements according to IFRS: closing accounting registers according to the Russian Accounting Standards (RAS), transformation and consolidation. We examined the correlation between the duration of financial statements preparation and the extent of automation and standardisation of financial reporting processes. Finally, we reviewed the key factors that affect the duration and the complexity of financial reporting processes.

We received responses from 50 companies.

The high level of uncertainty in today's economic environment has made the cost management process a priority for most companies. Finding new ways of optimising finance department operations may also contribute to achieving this goal.

We hope that you will find our survey interesting and its findings will serve as the basis for a discussion of the key targets and priorities of your finance function and your company as a whole.

Yours truly,
Kelly Allin
Partner
Energy & Resources

Key findings

Industry leaders in IFRS financial statements preparation publish their financial statements about *27 working days earlier* than other survey participants in average.

66%

of respondents appointed independent directors to the Board

58

The average time that the participants spend on preparing their financial statements according to IFRS is 58 days

84%

of respondents have Audit's Committee vested with the financial statement approval function

50%

one of the financial function's key priorities is to increase its efficiency of the finance department

64%

of respondents use IFRS accounts for management reporting

60%

of respondents perform manual monitoring of prices for the transfer pricing purpose

43%

of respondents resolve transfer pricing issues via a dedicated department in the parent company

46%

of respondents prepare IFRS finalize statements by transformation using excel

About the survey

Objective

Our survey was focused on the following issues:

- Existing financial reporting practices
- Review of financial reporting dynamics as compared to the last year
- Formalisation of internal controls
- Assessment of tax risks
- Comparative analysis of the priorities of finance leaders

The data we collected showed a distinct correlation between the time it takes to prepare financial statements and the extent of the standardisation of accounting processes according to RAS, the harmonisation of RAS and IFRS accounting policies and the automation of financial reporting according to IFRS.

Basis of analysis

According to the data we received in the course of our research, a closer correlation exists between a company's results and its size (based on its revenue) than its industry. In some sections, we presented the data by industry. The survey results were therefore presented by groups of companies based on their total revenue:

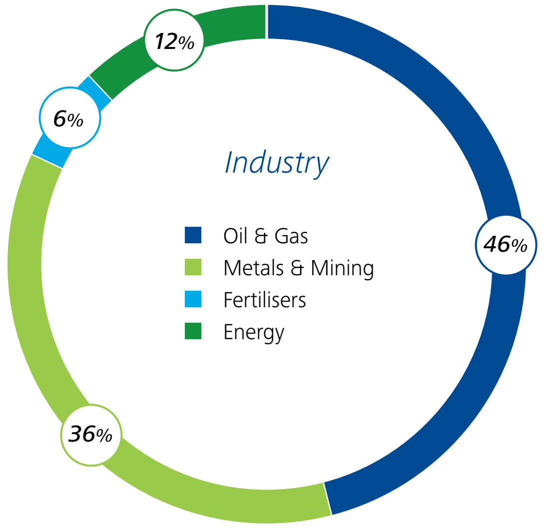
- Over USD 10 billion
- From USD 1 billion to USD 10 billion
- Less than USD 1 billion

By industry:

- Oil production and refining; oil services
- Metals and mining
- Fertilisers
- Electric Utilities

Apart from benchmarking within these groups, we also compared the dynamics of various indicators related to the financial reporting of the 24 companies which participated both in this and previous surveys.

Participants in the survey



Number of Companies in the Group

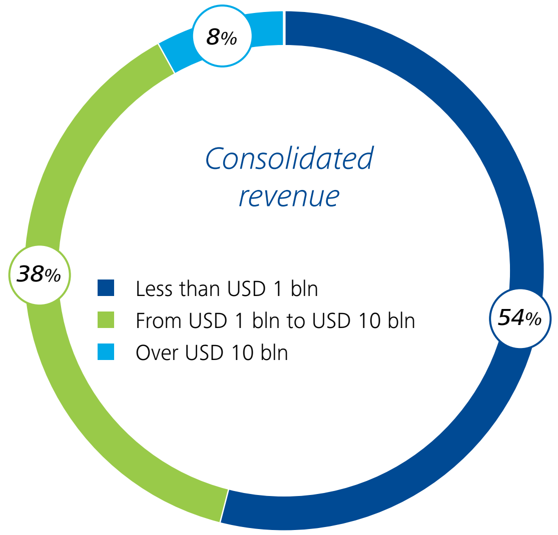
Most companies whose revenue exceeds USD 1 billion prepare different types of financial statements for different groups of users. Many of these companies have listed securities on financial markets. They are therefore subject to additional requirements with regard to the time-frames for financial statement preparation.

As a rule, the higher a group's revenue, the more subsidiaries there are in the group to generate it.

The average number of subsidiaries for companies with less than USD 1 billion revenue is less than ten. It is 10-100 for USD 1 to USD 10 billion companies and over 100 for over USD 10 billion companies.

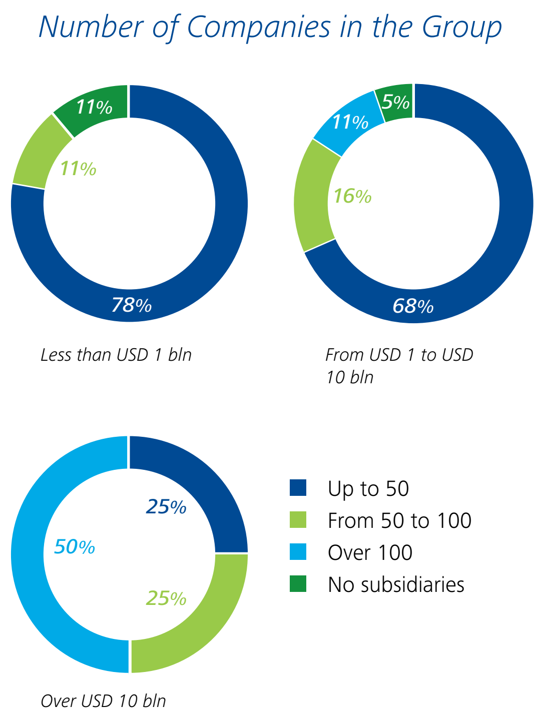
Industry

The survey covered 50 companies from the mining, oil and gas, energy, metallurgy, and fertiliser production industries.



Consolidated revenue

To present the survey results, we grouped the participants based on their consolidated revenue: over USD 10 billion; USD 1 – 10 billion and less than USD 1 billion.



RAS accounting

Harmonisation of accounting policies under RAS and IFRS seen as a more efficient way to accelerate fast closing

Most Russian companies use the information from RAS accounting registers as source data for preparing financial statements according to IFRS. This is why the extent of harmonisation of RAS accounting processes has a significant impact on the duration of the preparation of financial statements according to IFRS.

It is typical in Russian practice that IFRS financial statements are prepared by means of parallel accounting or transformation. Accounting in two parallel information systems is a process where each transaction is recorded in two data bases simultaneously: RAS accounting registers and IFRS accounting registers.* The information in each database is processed according to the respective accounting standards. As a rule, the information from RAS registers is not used for the purposes of parallel accounting.

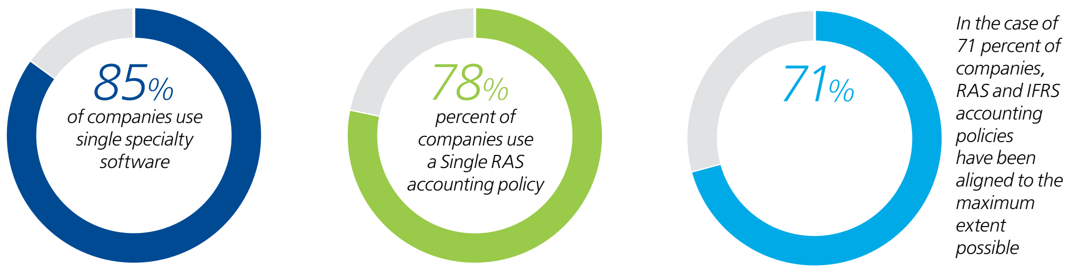
The other way of preparing IFRS financial statements is transformation. The information from RAS accounting registers is transferred to the IFRS chart of accounts and a number of accounting adjustments are made. Transformation is only prepared as of the reporting date.

As the quality of the source data has a significant impact on the transformation process, we started our survey with the RAS accounting process. To minimise adjustments during the transformation, source data should be unified, i.e. these data should be prepared on the basis of a single accounting policy and a single information system, and RAS and IFRS accounting policies should be aligned as much as possible. We analysed the extent of the harmonisation of RAS accounting processes on the basis of the following:

- Use of a single set of accounting policies by all subsidiaries within a group;
- Use of a single information system by all entities within a group;
- Convergence of RAS and IFRS accounting policies.

At least one of these methods of accounting process harmonisation has been implemented by 89 percent of participants. The extent to which each method has been implemented individually is rather high when looking at the aggregate of the respondents' data.

The extent of harmonisation of RAS accounting processes (each method is considered separately)



Meanwhile, the analysis of the combined implementation of several benchmarks shows that more than half of respondents meet all three parameters, although the share of such respondents was smaller by 15 percentage points in 2014.

* Hereinafter, "IFRS financial statements" means consolidated financial statements according to both IFRS and GAAP, which are also recognised as international accounting standards.

Convergence of RAS and IFRS accounting policies became one of the main improvements in 2015

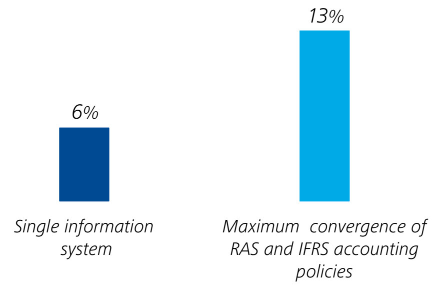
Results show that, many companies can accelerate the preparation of IFRS financial statements by standardising RAS accounting and converging RAS and IFRS accounting policies.

We reviewed the dynamics of RAS accounting process harmonisation in the companies which participated in our survey both this year and last.

Those of them which harmonised RAS accounting processes focused on the convergence of RAS and IFRS accounting policies. Thirteen percent of respondents who participated in the survey in 2014 and 2015 worked to align the accounting policies this year. Almost all of them had previously implemented a single set of RAS accounting policies for all subsidiaries within the group.

Accounting process harmonisation by industry

Progress in accounting process harmonisation (vs. 2014)



Companies with a revenue of over USD 1 billion show a higher extent of RAS accounting process harmonisation than companies with less than USD 1 billion in revenue. The reason seems to be that in the case of larger companies, more extra work is required due to the lack of accounting process harmonisation. It is much easier to make extra adjustments to address divergences in accounting policies for a group consisting of 5 or 6 companies than for a large group consisting of 50 or even 100 entities. This is why groups comprising more subsidiaries are more focused on accounting process harmonisation.

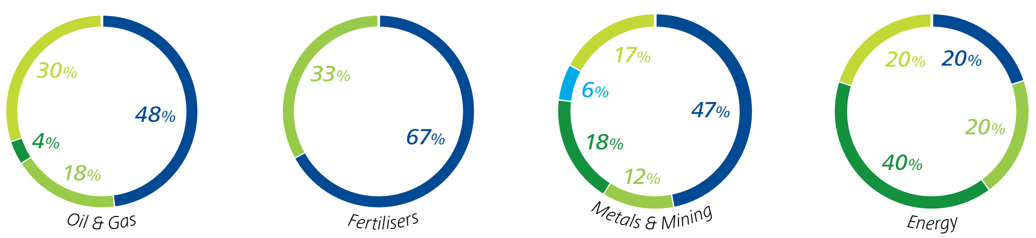
Use of specialty software in IFRS reporting

Excel remains the most popular software used for accounting purposes in Russia, but its popularity is fading compared to previous years

In order to automate preparation of financial reports, companies use the following:

The companies keep their accounting records using specialty software. The best practice is to use the same software for both RAS and IFRS accounting. A large share of respondents (46 percent) perform the transformation of their financial statements in Excel. For the purposes of this survey, we treated the Excel-based process as non-automated. Hence, automation is the Company's transition from using Excel to using designated accounting applications.

Transformation automation in 2015



- Excel only
- SAP
- 1C
- Oracle
- Combination of different specialty software or other systems

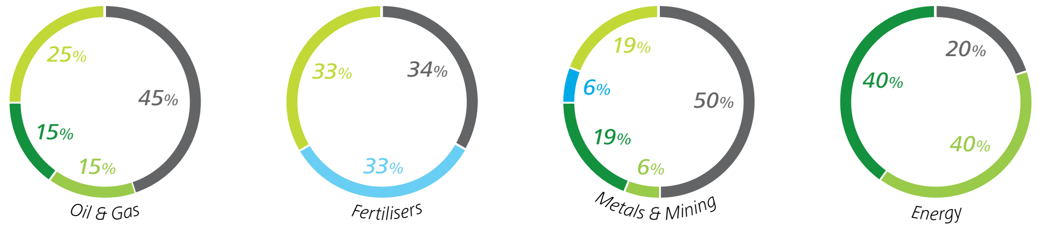
However, Excel still may be a good solution for companies that do not have more than ten subsidiaries and make a relatively small number of transformation adjustments.

A significant advantage of solutions based on 1C, SAP, Oracle and other designated software is the application of standard data processing algorithms specifically designed for financial statement transformation.

High-revenue groups show a much higher extent of financial statement transformation process automation. As companies with over USD 1 billion revenues usually need to consolidate more than 10 legal entities, they have to prepare a lot of transformation tables, which makes designated software a more efficient way to perform the transformation. An alternative is to implement parallel IFRS (and RAS) accounting.

Elimination of intragroup transactions automated by half of survey participants

Automation of consolidation process



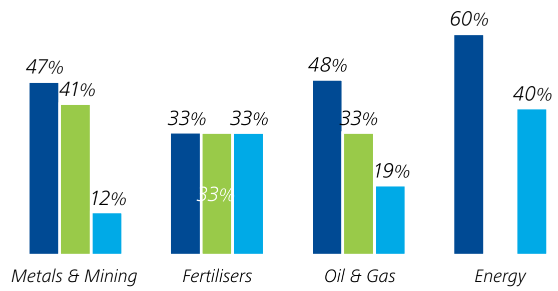
- Hyperion
- SAP
- 1C
- Oracle
- Combination of different specialty software or other systems
- None

The consolidation process is primarily automated by large groups. They need to bring a large number of separate transformation models together. Using specific software helps companies to achieve this goal in the most efficient way.

One of the most labour-intensive stages of the consolidation process is the elimination of intragroup transactions (IGT). Large groups with numerous subsidiaries use very large reconciliation matrices. The goal is to collect accurate and complete data on outstanding balances and intragroup transactions, as well as to detect all variances in a timely manner.

A designated information system is a much easier means of achieving this goal than Excel. The reconciliation of intragroup transactions is automated in 48% of the companies. The extent of automation is considerably higher in companies with over USD 1 billion of revenue.

Intragroup transaction reconciliation automation

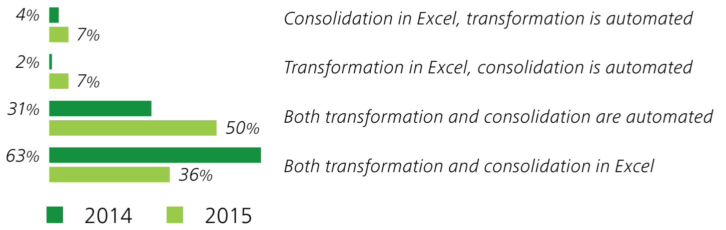


- Automated reconciliation
- Reconciliation not automated
- Partially automated reconciliation

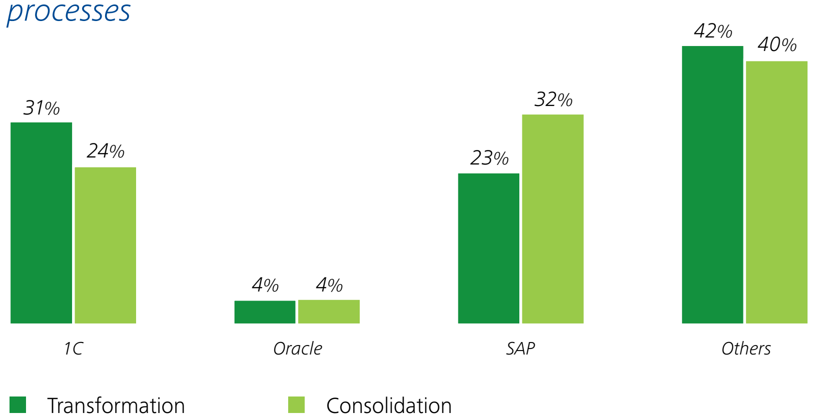
Closing the reporting period

A 20 percent increase in automation levels for consolidation and transformation compared to the previous year

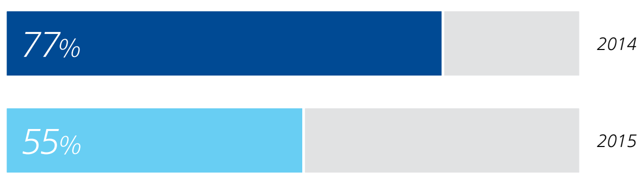
Correlation between the extent of automation for transformation and consolidation of financial statements



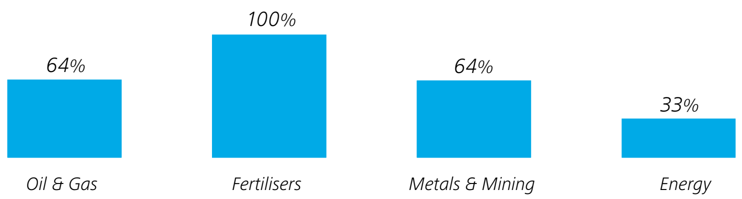
Software platforms used to automate the transformation and consolidation processes



Financial reporting automation targets among Excel users



Excel users planning to automate their financial reporting



Approximately 50 percent of participants have automated both the consolidation and transformation processes. 36 percent of respondents use Excel for both processes. In some rare cases, companies prefer to automate only one of these processes.

Most often the companies which have automated at least one of their accounting processes use 1C or SAP. 1C is more frequently used by companies with revenues of less than USD 1 billion, while SAP is preferred by companies with revenues over USD 1 billion.

The analysis shows that respondents gradually stop using Excel when automating the transformation and consolidation processes. A growing number of survey participants are using 1C, SAP, or a combination of their products. SAP users mostly perform the full range of procedures within one program when preparing financial reports, while 1C is often used for transformation purposes.

More than half of Excel users plan to automate their financial reporting further

Many Excel users plan further automation.

The majority of Excel users (55%) plan further automation of the financial reporting process. Meanwhile, the number of respondents planning automation has decreased compared to 2014, partially due to automation being implemented already.

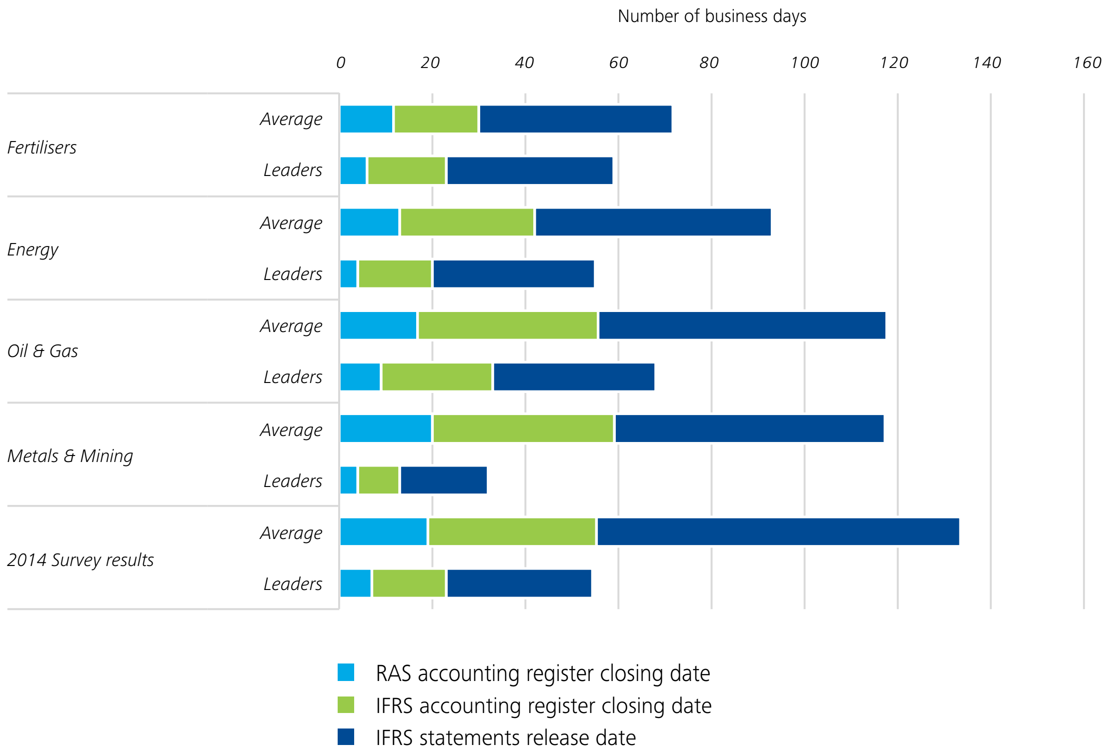
On average, companies that participated in the survey have speeded up the preparation of financial reporting compared to the previous year

It is crucial for shareholders, investors and creditors to receive the company's financial statements as early as possible after the end of the reporting period. The sooner financial statements are prepared, the sooner they can be published.

The faster accounting registers are closed, the sooner the company can prepare its financial statements. The duration of their closing depends on the efficiency of the accounting process structure. The companies that have harmonised and automated their accounting processes were the most time-efficient at closing their books.

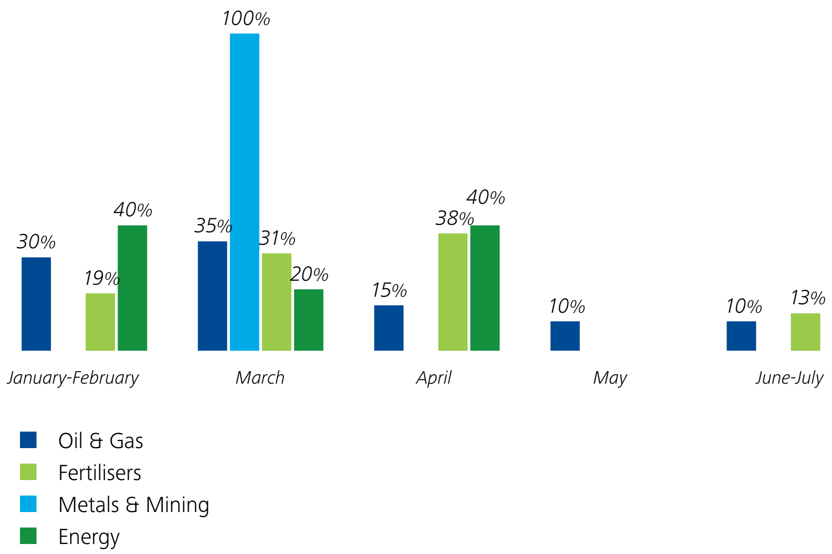
Similar to last year, there was a distinct correlation between the size of the company and the time required to prepare its financial statements. The duration of reporting periods varies significantly in different groups. Companies with over USD 10 billion in revenue have the shortest average reporting period. This is due to a higher level of accounting process automation and harmonisation. Furthermore, a number of companies have established Shared Service Centers (SSCs), which accelerated the preparation of their financial statements considerably.

Average duration of various stages of financial statement preparation



The majority of survey participants release annual financial statements in March and April

Leaders



Leaders

We benchmarked the leading companies and other participants in two subgroups.

Sampling. Four respondents were selected as an example of companies with the earliest closing dates of the reporting period, one for each industry.

Extent of accounting processes harmonisation. All leading companies have implemented single RAS accounting policies within their group, ensured the highest possible convergence of RAS and IFRS policies, introduced uniform procedures for closing accounting registers, with three respondents out of four having used single software platforms within their group.

Extent of accounting processes automation. All leading companies use specialty software in order to perform transformation and consolidation of financial statements.

Most participants issue their financial statements in April and March (16 and 11 companies out of 50, respectively).

Internal controls and audit

Complex transactions and accounting estimates should be subject to an external auditor's scrutiny, survey participants believe

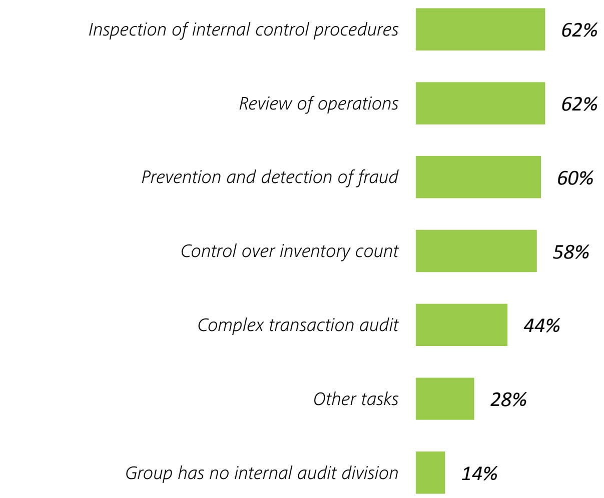
Internal controls are part of the business process which enables a company to implement operational objectives, prepare reliable financial statements, fulfill regulatory requirements and internal procedures.

Internal audit is an essential element of the internal control system. Internal audit specialists are responsible for performing assessments, facilitating improvements in corporate governance and risk management as well as streamlining internal controls using a systemic and consistent approach. They assist their companies in achieving their strategic goals by implementing a systematised and disciplined approach to assessment and efficiency improvements in controls and risk management.

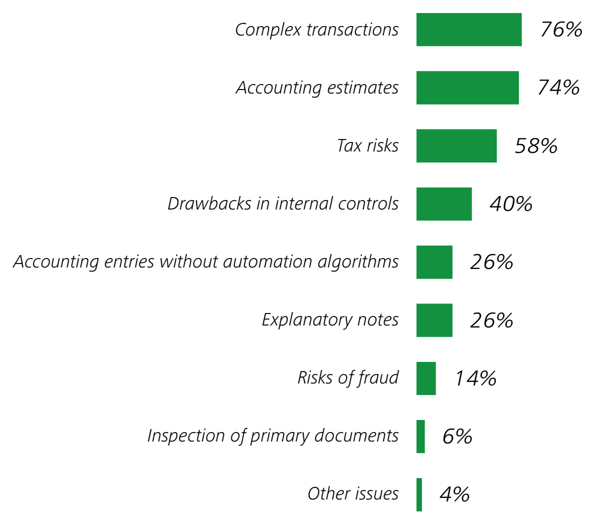
According to respondents, priority tasks for internal auditors in their companies are to monitor compliance with internal control procedures and identify risks of fraud.

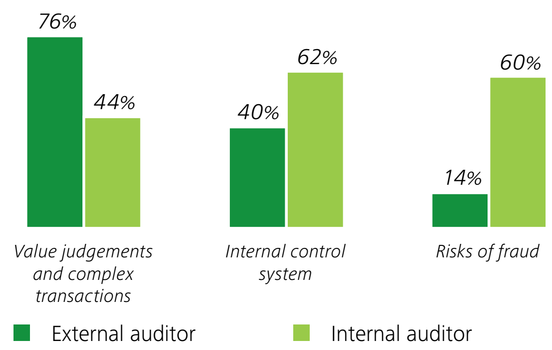
Companies expect external auditors to focus on complex transactions and accounting estimates. Respondents do not consider the identification of tax risks as a key priority for external auditors. All mentioned items are subject to professional judgement, i.e. their reconciliation with supportive documents would be insufficient in such cases, which necessitates the interpretation of standards and/or legislative requirements. Therefore, survey participants view it as highly practical to engage independent experts in cases like these.

Priorities for internal auditors



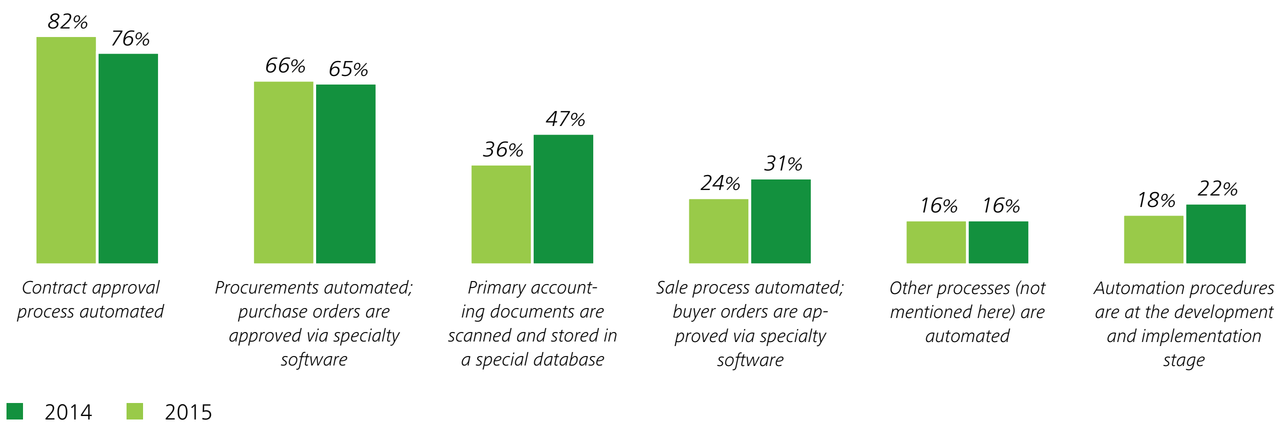
Core areas of scrutiny for external auditors





No changes in document flow automation levels among survey participants

Document flow automation



As a rule, companies strive to formalise the following operations:

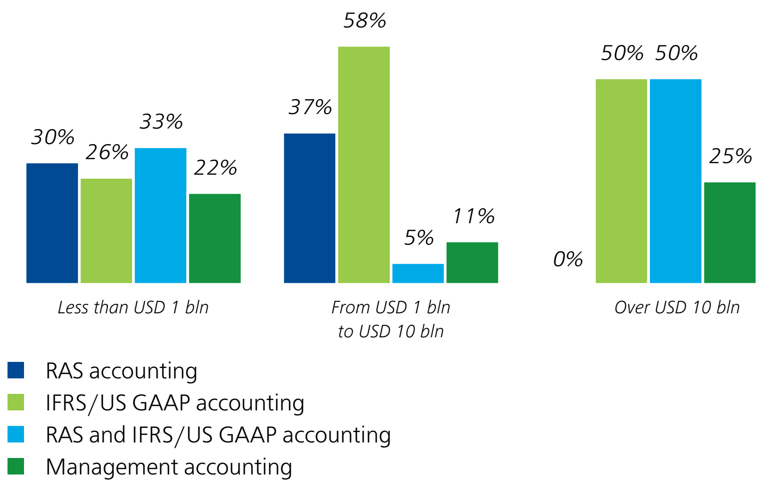
- Operations involving high business risks;
- Operations requiring professional judgement;
- Operations involving the risk of fraud.

This is the reason why most participants have automated their procurement and contract approval processes.

The extent of control formalisation is approximately the same in all groups of companies, so there are no separate diagrams for each group.

On average, management accounting is performed on the basis of both IFRS and RAS data and is industry-specific

Source data for management accounts by company group



Most survey participants prepare management reporting on the basis of RAS data. The RAS data is mostly used by companies with less than USD 1 billion of revenue, while bigger groups prefer to use their IFRS data, i.e. internal users of accounting information consider IFRS a more informative source. Besides, unlike RAS, IFRS contain clear rules for the consolidation of the financial statements, which is specifically relevant for larger groups with multiple subsidiaries.

Corporate governance

Sixty six percent of survey participants have invited independent directors to their audit committees

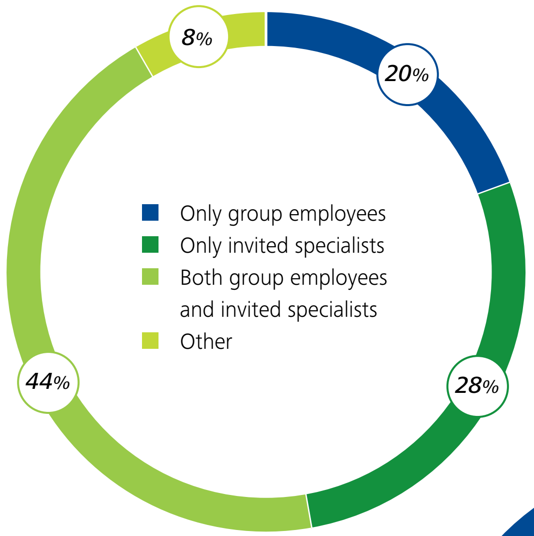
Audit committee

In many aspects, the quality of the provided financial data depends on the extent to which shareholder representatives are involved in the process of financial reporting preparation and release. The competent and unbiased analysis of the data presented in financial reports, as well as the monitoring of how internal controls are implemented during the preparation of financial data, allows companies to significantly reduce the risk of distorting the reports due to both technical errors and intended manipulations with source data or value judgement.

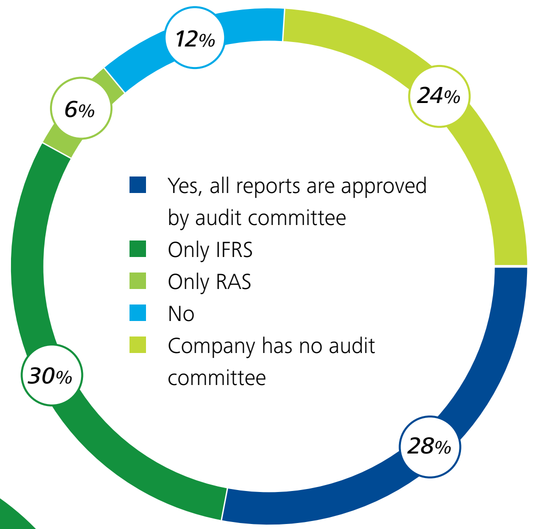
The audit committee and the embedded internal audit function are considered the most successful form of oversight for financial reporting and internal control monitoring. According to SOX and the Institute of Internal Auditors, the best practice is to establish an audit committee consisting of independent directors (independent BoD members), competent in financial matters.

According to 66 percent of respondents, there are independent directors in the BoDs of their companies. Eighty percent of companies with no independent directors have either no audit committee, or their audit committees have no authority to approve financial statements.

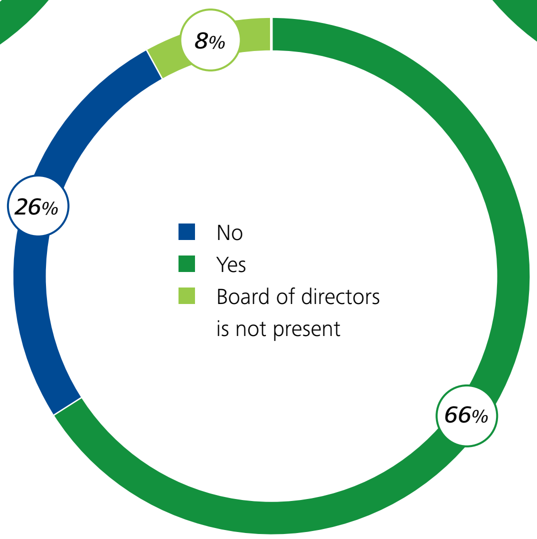
Audit committee structure



Approval of annual statements by audit committees



Independent directors in BoDs

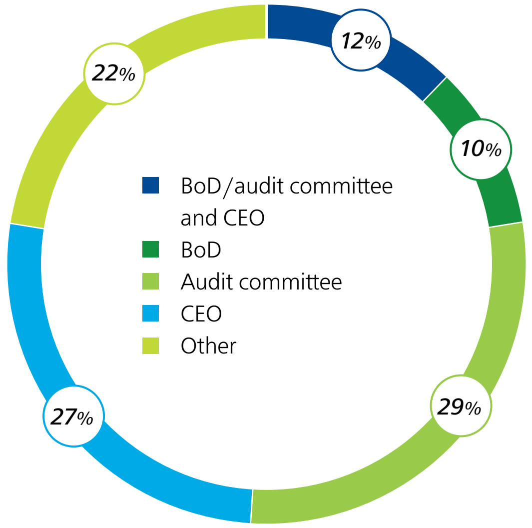


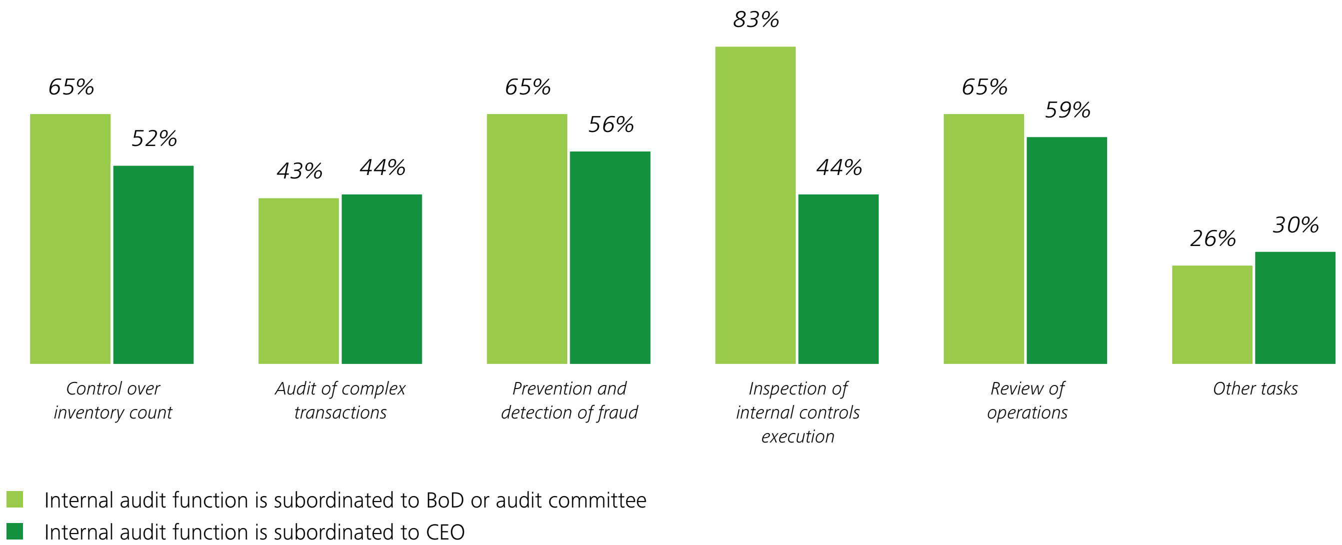
Internal audit responsibilities are in many ways similar to those of a security office

Internal audit

Very often, the internal audit function is part of the company structure and reports to the CEO. Fifty one percent of respondents (from companies with an internal audit function) indicated that the internal audit department head reports to the BoD or the audit committee. It is worth noting that the respondents who chose the "other" option represented companies in which the internal audit function is directly subordinated to a shareholder.

In the case of companies where the internal audit function is subordinated to the BoD, audit committee, or directly to a shareholder, detailed analysis shows that the internal audit department has a wider range of responsibilities and is more focused on internal control procedures and the risk of fraud.

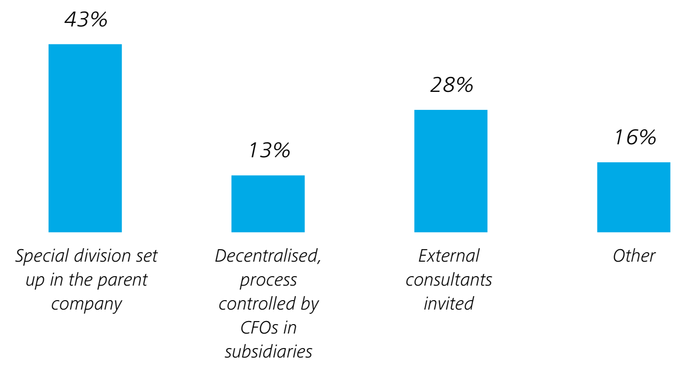




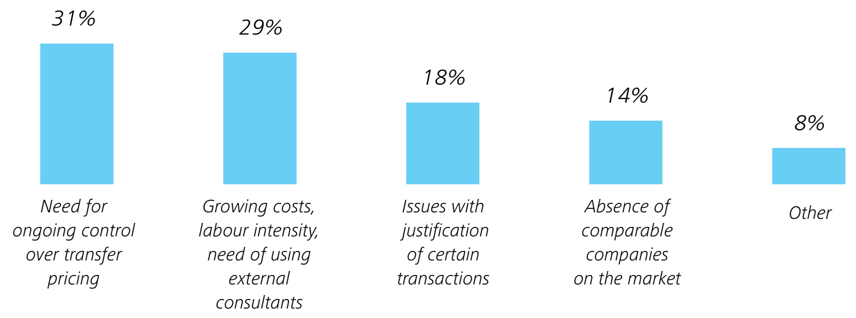
Taxes

'Manual' calculation has become the most popular method of resolving transfer pricing issues due to inconsistent legislation and the novelty of the subject

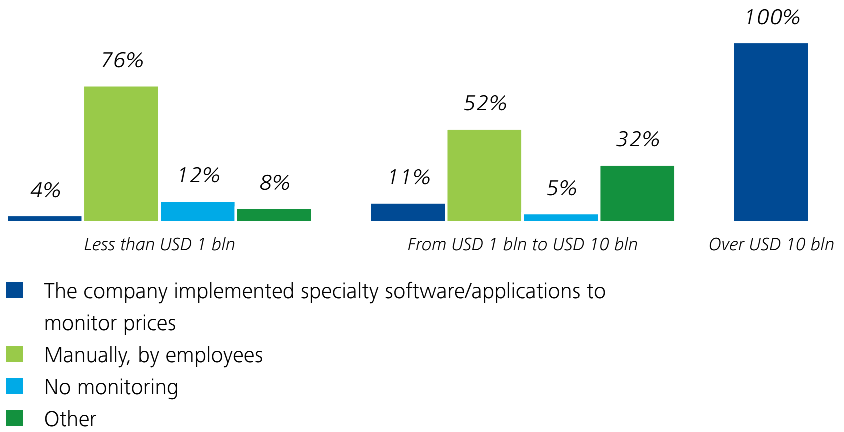
Addressing issues relating to transfer pricing



Consequences of applying new transfer pricing rules



Ongoing monitoring of transfer prices in intragroup transactions



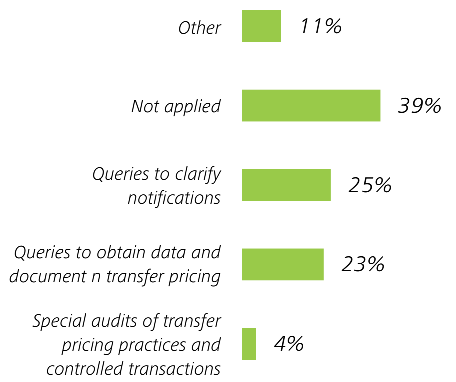
The tax risk inherent to the use of transfer pricing is the risk of unexpected additional tax liabilities on transactions. The risk is high if the event's probability is high and the event entails material consequences.

Almost all companies subject to transfer pricing rules have either set up a respective division, or employed external advisors to address the transfer pricing issues.

Among associated issues, survey participants indicated the need to regularly monitor prices and pointed to increased costs and high personnel involvement due to the need to comply with the legislative requirements.

At the time of the survey, few companies had experience of transfer pricing tax audits. Most queries from the tax authorities related to reporting and clarification of data.

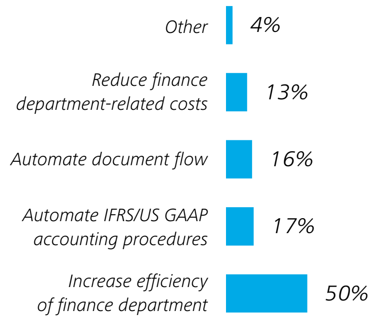
Tax audit measures applied by tax authorities



Change management

The majority of survey participants do not plan to alter their financial function. Increasing efficiency is a priority for respondents

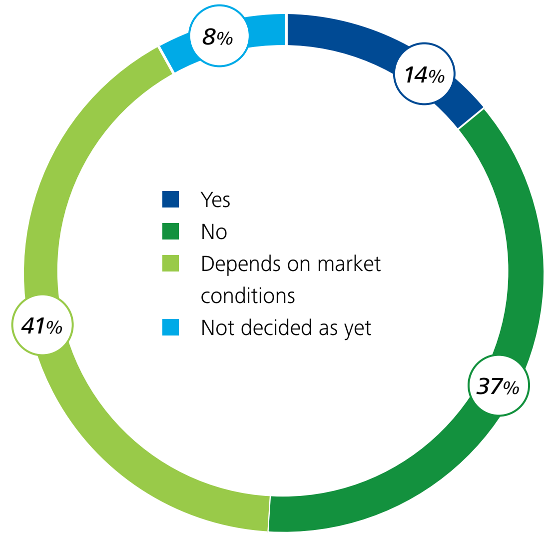
Key priorities of the finance department



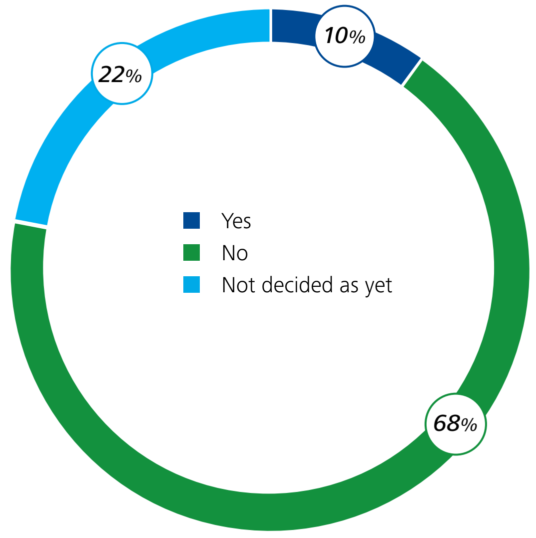
The short-term priorities of the participants of our survey are mostly determined by the current complicated macroeconomic environment. Most participants named cost optimisation and liquidity management as their key priorities.

Most companies do not plan to reorganise their finance department or place securities on the market in the near future. This is due to the high level of uncertainty in the current financial markets.

Debt or equity security listing plans



Finance department reorganisation plans for next year



Should companies pay attention to accounting policies against the backdrop of the complicated macroeconomic conditions?

Survey participants do not consider changes in the accounting policies a change management measure caused by the current economic conditions.

At the same time, companies preparing financial statements in the current situation may face difficulties related to value judgements, so called 'grey zones' in the application of standards and information disclosure.

In our view, the following areas deserve special attention:

1. Recoverable value of assets
   • A slump in oil and commodity prices;
   • Difficulties in justifying the use of DCF models for periods exceeding five years;
   • A rise in borrowing costs impacting WACC.

2. The quality of financial assets
   • The rating of banks in which companies opened accounts;
   • The recoverability of receivables;
   • The depreciation of AFS investments.

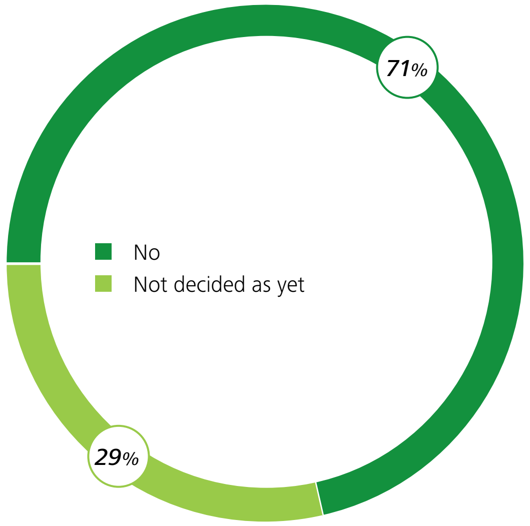
3. The recoverability of deferred tax assets on prior year losses

4. The accounting estimate application sequence and the current uncertainty with respect to values of accounting estimates

5. Additional disclosures
   • Estimation of recoverable values (sensitivity analysis, defining key value judgements, headroom, etc.);
   • Factors of uncertainty impacting the estimates (IAS 1);
   • Foreign exchange risk exposure;
   • Events post the reporting date (e.g. material price declines);
   • Covenant breaches.

Also, in 2018 new IFRS 9 and IFRS 15 standards are expected to take effect, requiring companies to analyse the potential impact of the new standards on their reporting and to introduce amendments to their accounting policies.

Plans to change IFRS/US GAAP policies due to the unstable economic environment and devaluation of the ruble



Summary

Key trends in the future development of finance departments are seen as follows:
• Standardisation of operations
• Process automation

These measures allow companies to increase the efficiency of their operating performance and speed up the preparation of their financial statements. As the automation of processes may require significant investment, the standardisation of processes may be a more cost- and time-efficient solution to ensure quick results.

Besides, a competent and independent review of financial reporting by an internal auditor, audit committee or BoD may limit the risk of significant distortions in the financial data which continues to rise due to the current economic situation and the resulting potential impact on reporting.

We hope that our readers will consider our findings useful when developing their own unique approach to making their financial reporting processes clearer and more time-efficient.

Contacts

Gennady Kamyshnikov
CIS Energy & Resources Leader
Partner
Tax & Legal
Tel: +7 (495) 787 06 00
Fax: +7 (495) 787 06 01
gkamyshnikov@deloitte.ru

Nikolay Demidov
CIS Mining Leader
Partner
Audit
Tel.: + 7 (495) 787 06 00
Fax: + 7 (495) 787 06 01
ndemidov@deloitte.ru

Elena Lazko
CIS Oil & Gas Leader
Partner
Consulting
Tel.: + 7 (495) 787 06 00
Fax: + 7 (495) 787 06 01
elazko@deloitte.ru

Vyacheslav Seronogov
CIS Power Leader
Partner
Corporate finance
Tel.: + 7 (495) 787 06 00
Fax: + 7 (495) 787 06 01
vseronogov@deloitte.ru

Dmitry Kulakov
Partner
Tax & Legal
Tel: +7 (495) 787 06 00
Fax: +7 (495) 787 06 01
dkulakov@deloitte.ru

Andrey Panin
Partner
Tax & Legal
Tel: +7 (495) 787 06 00
Fax: +7 (495) 787 06 01
apanin@deloitte.ru

Kelly Allin
Partner
Audit
Tel: +7 (495) 787 06 00
Fax: +7 (495) 787 06 01
kallin@deloitte.ru

deloitte.ru

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