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(Translated from Russian)

The end of 2011 has been eventful for those involved in financial reporting. One of the most significant events was the official introduction in Russia of International Financial Reporting Standards (IFRS) and “Interpretations of IFRS” (Order of the Ministry of Finance of 25 November 2011 #160n). From the beginning of 2012, the Federal Law “On Consolidated Financial Statements” (hereinafter referred to as the “Law”) will come into force and a number of entities will have to prepare and publish consolidated reports in accordance with IFRS for the first time.

Due to the long-term collaboration between the professional community and regulators, Russia is finally aligning with the majority of countries that require public companies to prepare consolidated financial statement in accordance with IFRS. Adoption of IFRS is another step being taken by Russian companies towards improving the quality, transparency and comparability of their financial statements.

Scope

The Law covers credit institutions, insurance companies, and entities whose securities are traded on organized exchanges and/or through other trade organizers in the securities market. It also applies to entities that, in accordance with their constitutional documents or federal laws, are obliged to file, present or publish consolidated financial statements, or perform all three of these actions.

This Law is particularly important for companies that have not previously prepared consolidated financial statements in compliance with IFRS, have filed financial reports in accordance with other internationally-recognized standards, or have filed reports by later dates than those stipulated in the Law.

The first matter with regard the application of the Law (disregarding industry specific requirements, such as the requirements for banks, etc.) is that IFRS are required of companies which have Russian and/or foreign subsidiaries that, together with their subsidiaries, constitute a group of companies. The law does not establish formal requirements for companies that do not have subsidiaries to prepare IFRS financial statements, but, for reasons of practicality, it is recommended that such companies contact the authorized federal executive body to confirm what is required of them.

Secondly, if an entity has subsidiaries whose securities are listed on a stock exchange and/or are traded through other trade organizers in the securities market but the parent company does not have such securities, the consolidated financial statements need to be prepared for the subsidiaries. In this case, the parent company is under no obligation to prepare consolidated financial reports.

Thirdly, other Russian laws may require consolidated financial statements to be prepared. For instance, Federal Law № 39-FZ of 22 April 1996 “On the Securities Market” (and amended on 30 November 2011) stipulates that entities which produce prospectuses and quarterly accounting issuer’s reports should publish consolidated financial statements. In such instances, consolidated financial statements should be prepared in accordance with IFRS.

Nevertheless, there are some exceptions. If an entity, whose securities are listed on a stock exchange and/or are traded through other trade organizers in the securities market, files consolidated financial statements in accordance with internationally recognized standards other than IFRS (for example, in accordance with US GAAP), the entity is entitled to postpone adoption of IFRS until 2015. Similar postponements are also given to entities that have debt securities trading on stock exchanges and/or traded through other trade organizers in the securities market (as long as this is the only reason for the company being required to prepare IFRS consolidated financial statements).

How urgent is it?

The law covers financial statements for FY 2012, not including those that are covered by the aforementioned exceptions. Audited financial statements should be filed as is prescribed no later than 120 days after the end of the reporting year.

The rules of IFRS specifically require that comparative data from the previous reporting period is included in financial statements. Unless the Russian Ministry of Finance or another authorized federal executive body introduces specific waivers, IFRS statements for 2012 will need to include financial information for 2011, including the opening statement of financial position as at 1 January 2011. Thus, entities are strongly advised to start planning for the transition to IFRS, which includes having the necessary staff and financial resources, implementing new or restructured business processes, deciding upon an accounting policy and schemes, and establishing timings for preparing consolidated financial statements, etc.

In addition, consolidated financial statements are subject to mandatory external audit. The auditor will verify the opening balances, including, for example, the residual inventory. It might not be possible to verify this retrospectively without a preliminary examination of inventories. In this case, the auditor may include certain limitations in the auditor's report or even omit the auditor's opinion. Early involvement of auditors is strongly advised.

Interpretation

Application and interpretation of the Law are expected to become the subject of heated debate throughout 2012. The topics that are likely to provoke the most significant debate are the following:

Waiving the requirement to disclose or provide information on securities, including consolidated financial statements: under certain circumstances in accordance with Article 30.1 of Law 39-FZ, an issuing company may apply to the Federal Financial Markets Service for permission not to disclose or provide information on its securities.

Being able to choose one of various approaches to for the purposes of the opening statement of financial position under IFRS: in accordance with IFRS 1, an entity filing a consolidated financial statement for the first time can use exemptions to general IFRS requirements. In practice, one of the most frequently used exemptions is the opportunity to revalue all property, plant and equipment or specific items of property, plant and equipment in the opening statement of financial position under IFRS. This one-time revaluation does not entail an obligation to revalue the property, plant and equipment in the future.

Companies need to consider these and other options in order to optimize their transition to IFRS.

Factors of success

A successful transition to IFRS requires highly qualified staff. According to a survey conducted by Deloitte CIS (in 2011) of companies in the Russian energy and resources sector, only 30% of the companies surveyed have employees with the relevant officially recognized qualifications and competencies.

Another important step is to develop a strategy for the transition to IFRS, which includes establishing a working group responsible for preparing the financial reports, selecting an auditor, and other issues.

We wish all companies success in resolving these issues and we hope they can draw the maximum benefit from the introduction of IFRS.

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