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TOOLKIT

Moving to International Accounting Standards

Seminar for Management

Final Version

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Seminar Agenda

Agenda and Seminar Objectives

Session 1:	Introduction
Session 2:	Principles and assumptions of International Accounting Standards
Session 3:	Differences between Russian and International Accounting Standards
Session 4:	Options for moving to International Accounting Standards
Session 5:	Balance Sheet
Session 6:	Income Statement
Session 7:	Cash Flow Statement
Session 8:	Special issues in moving to International Accounting Standards
Session 9:	Implementation approach
Session 10:	Review of theory and homework discussion
Session 11:	Discussions with presenter and closure

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INSTRUCTOR'S NOTES

This seminar is structured over 2 1/2 days. On day 1 we will introduce International Accounting Standards (IAS), the differences between IAS and Russian Accounting Standards (RSA).

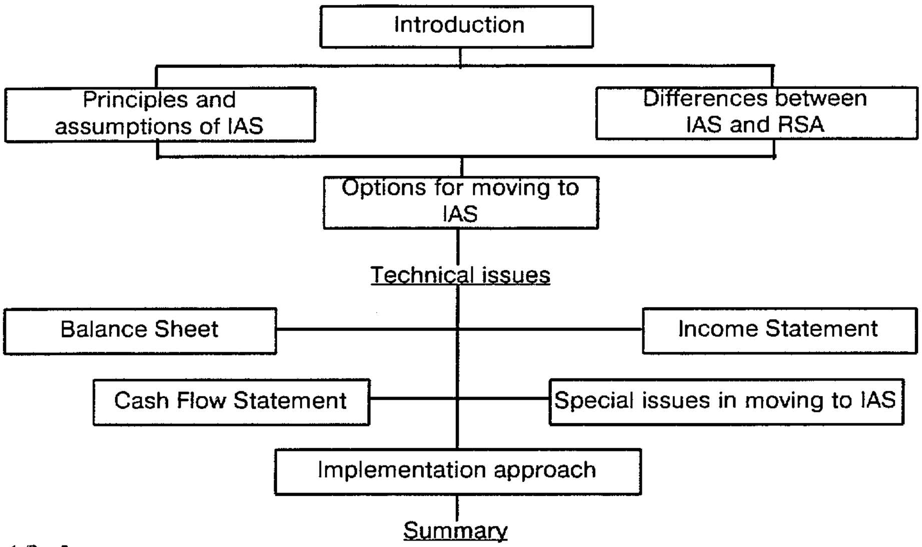
We will briefly discuss the available options for moving to International accounting Standards.

On Day 2 we will cover the technical aspects of moving to IAS - specifically issues related to the balance sheet, income statement and cash flow. We will talk in detail about implementation.

At the end of day 2 participants will be given an assignment to be completed at their organization, which will help them get a practical understanding of the issues in moving to IAS.

We will return after about a week to summarize the presentation and answer any questions that the participants may have.

Seminar Overview



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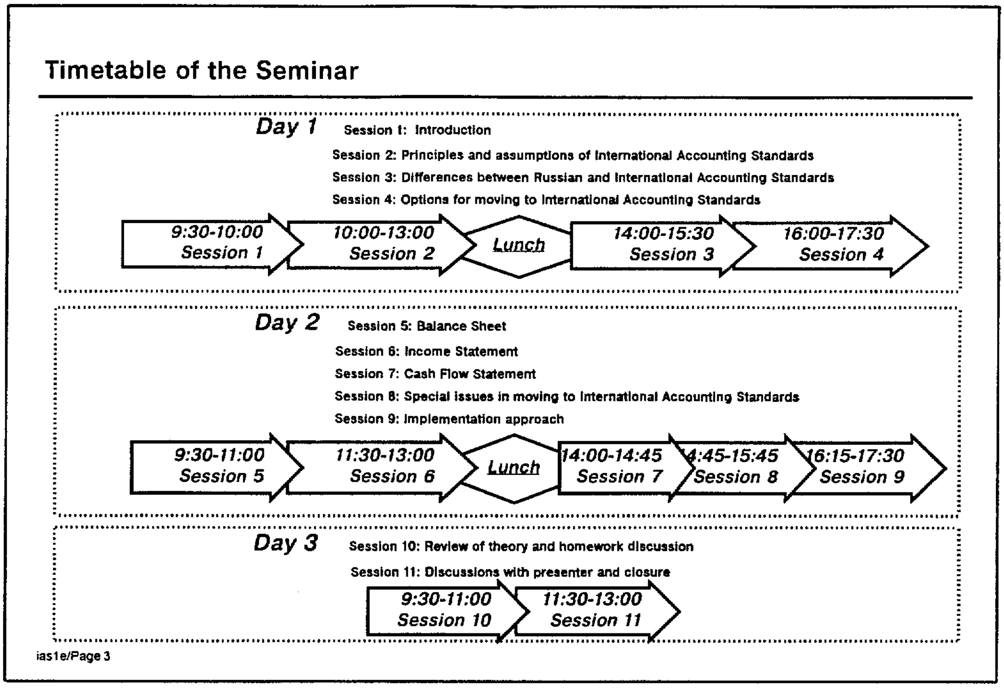
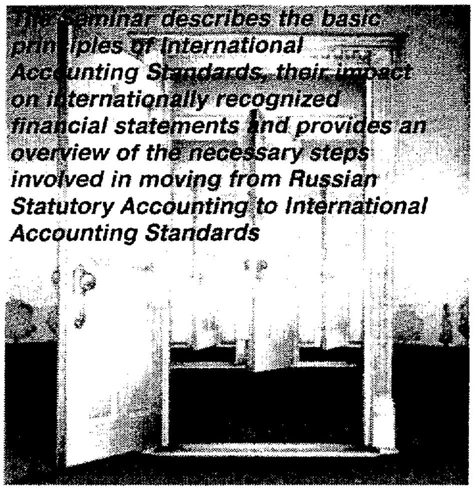
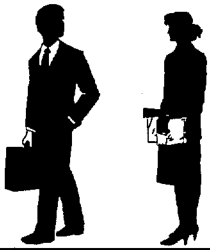
INSTRUCTOR'S NOTES



INSTRUCTOR'S NOTES

Seminar's Mission





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INSTRUCTOR'S NOTES

Seminar Objectives

- *To introduce International Accounting Standards:*
  - Basic concepts, principles and assumptions
  - Users of financial information
  - Types and formats of financial statements
- *To explain the most important differences between Russian and International Accounting Standards*
- *To explain the goals, options and benefits of moving to International Accounting Standards*
- *To introduce some important techniques in preparing IAS statements from the Russian format*
- *To practice reading and understanding 'western' financial statements:*
  - Standard annual report
    - Financial statements
    - Notes to financial statements

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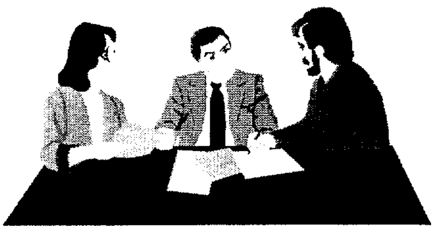
INSTRUCTOR'S NOTES

Instructor will also point out that reading 'western' financial statements helps to understand how conclusions and decision-making on the basis of financial statements are made.

Seminar Format

The Seminar will encourage your full participation in discussion sessions ...



... and will include class exercises and homework assignments to help you understand and practice using the material presented, and enable you to discuss the results with the presenter

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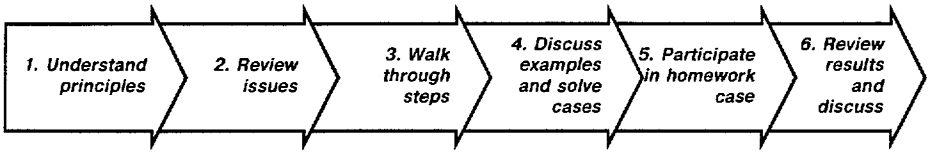
INSTRUCTOR'S NOTES

Approach to the Seminar - 'Learning by Doing' Method

During the Seminar we will:

- Describe main principles of International Accounting Standards and financial reporting
- Discuss the most important differences between International Accounting Standards and Russian Statutory Accounting
- Understand the benefits of moving to International Accounting Standards
- Identify relevant information for moving to International Accounting Standards
- Walk through the major steps of moving to International Accounting Standards
- Discuss implementation issues
- Practice using real cases and homework



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INSTRUCTOR'S NOTES

IAS and RSA Definitions

IAS - *International Accounting Standards*	*RSA - Russian Statutory Accounting*
• The *term IAS* covers a set of rules and regulations which are formulated and published by International Accounting Standards Committee to be observed in the preparation and presentation of financial statements ➲ *Example:* IAS #13 deals with presentation of current assets and current liabilities	• The *term RSA* covers a set of regulations and rules which are generally issued by various governmental organizations and govern accounting practices and financial reporting in Russia ➲ *Example:* Order #31 of Ministry of Finance dated March 27, 1996 sets guidance for financial reporting in 1996

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INSTRUCTOR'S NOTES

•It is important to mention to participants that:

- IAS is formulated by the International Accounting Standards Committee (IASC) who regularly publishes them in a handbook form. The book contains all the Standards and is updated annually
- IAS does not have the power of law. It serves as recommendations which should be followed
- However, IAS is recognized by the world business community as a major force which defines and drives accounting practices, policies, etc. in different countries around the world
- Russia is not a member of IASC, but seriously takes IAS into account and tries to follow them. Generally, the strategy for accounting in Russia is to move step-by-step to IAS

International Accounting Standards Committee (IASC)

IASC was formed in 1973. In 1995 there were 110 Member Bodies in 82 countries. They represent over one million accountants.

IASC develops International Accounting Standards (IAS)

- IAS observes such elements of financial statements as formats, recognition of items, disclosures, etc.
- IAS targets to improve and harmonize regulations, accounting standards and procedures of financial reporting around the world.
- IAS was designed with the purpose to meet the needs of most users who are making economic decisions (e.g. decide when to buy, hold or sell equity investments or to assess a company's net worth.)

Information about IASC and IAS can be obtained from:

International Accounting Standards Committee
167 Fleet Street,
London EC4A 2ES,
England

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INSTRUCTOR'S NOTES

Basic Terms and Definitions

- Monetary item - is money held and assets and liabilities to be received or paid in fixed amounts of money
- Non-monetary item - an item whose valuation is expressed in terms of acquisition cost (sometimes less depreciation)
- To capitalize an expense - to record an expense as an asset and then charge its cost to the profit and loss account over a period of time as opposed to charging it to the profit and loss account in full
- Consolidated financial statements - statements presenting the financial position of a company together with each of its subsidiaries and associated companies as if they were one legal entity
- Bad debt - amounts due from customers which the management has decided are uncollectible
- Allocation base - the basis for assignment of common costs to different cost centers
- Cost center - a unit of activity for which expenditures and expenses are accumulated

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INSTRUCTOR'S NOTES

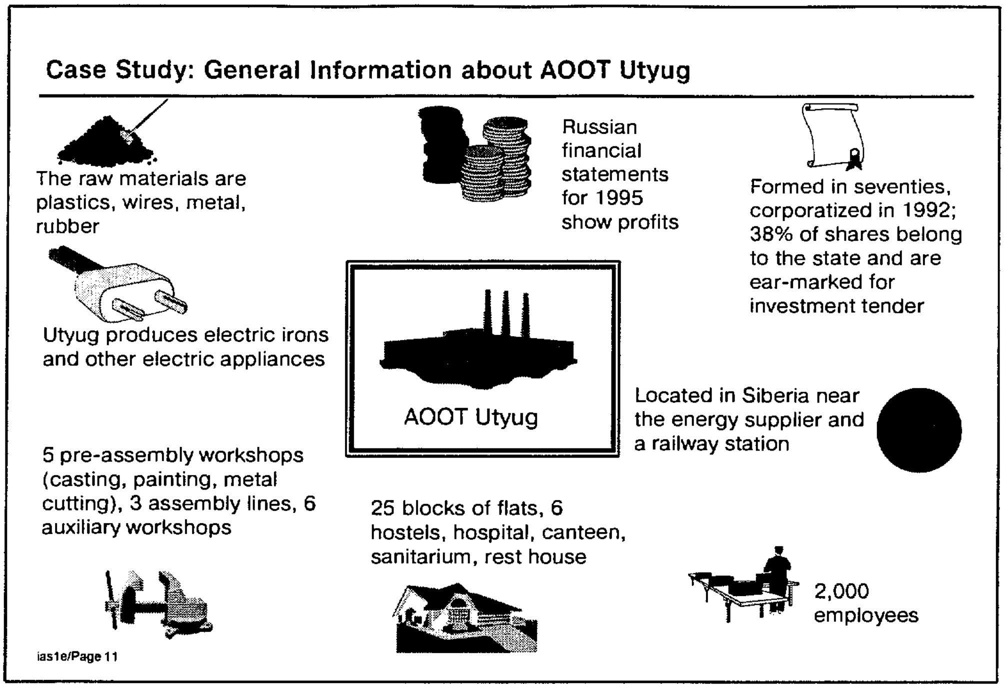
This slide should be given out to the participants as a handout.

The purpose of this slide is to provide participants with a glossary of basic terms that would be used further in the presentation.

Instructor should not read this slide but mention it so that participants refer to the glossary when needed.

Usually, the definition of allocation base can create a lot of misunderstanding. The instructor should provide an example if the need arises.

The cost of a truck might be assigned to periods based on miles driven during the period; the allocation base is miles.



INSTRUCTOR'S NOTES

Describe the company in general terms.

It is important to create an impression that this is a typical Russian company, similar to that which the participants come from.

Case Study: Utyug - Business Situation

Let us begin with a look at a common business situation:

- Utyug is negotiating a long-term export contract with foreign company
- Utyug requires 50% prepayment in order to finance production

Problem

- Customer requires information which Utyug is unable to provide:
  - Information needed for vendor reliability assessment:
    - Quarter sales of the required product for the last year
  - Information needed for price reasonableness assessment:
    - % of General and Administrative overhead in Cost of Sales
  - Information needed for credit risk assessment because of prepayment:
    - Net cash provided by operating activity
    - Current ratio

Information problem exists despite:

- 43 line accounting staff
- Computerized accounting performed at Utyug

What would you do?

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INSTRUCTOR'S NOTES

At this stage, just present the situation without making any conclusions.

Additionally:

• Firstly it may be explained that the customer needs information on sales for the last year in order to understand whether his order constitutes 15% or 85% of total sales. In the second case, the company is typically considered an unreliable vendor (i.e. - it is a one order company).

• Secondly, customer may need information on the % of overhead to understand what extent of the contract price is paid to support activities other than directly related to his contract. If the % of overhead is high, he may believe the price is unreasonable.

• Thirdly, net cash provided by operating activities or current ratio are typically used in order to assess liquidity and credit risk of the companies.

When the question: What would you do? is asked, the presenter should to summarize the suggestions of the participants on a flip chart or on a blank slide. It is important to keep them for further discussion

Definition: Current ratio - The ratio of the company's current assets to its current liabilities. The current ratio is an important indicator of the liquidity of a company.

Case Study: Utyug - Decision

Decision

- Provide the potential customer with Russian financial statements
  - Balance Sheet (Form #1)
  - Income Statement (Form #2)
  - Addendum to Balance Sheet (Form #5)

Information

Result

- The foreign company has decided to delay signing a contract
- Finance manager of the foreign company hired consultants to perform due diligence in order to assess viability of the company

Why do you think the customer delays signing the contract?

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INSTRUCTOR'S NOTES

When the decision is announced, Utyug's set of Russian financial statements (Form #1,2,5) should be distributed. All participants are asked to examine these statements (approx. 1-5 min)

Then the result is presented. The presenter asks why the foreign company has decided to delay signing a contract.

Case Study: Utyug - Customer Information Needs

The General Director needs to generate information to help resolve the problem and sign an attractive contract

- What specific information is needed to satisfy the potential customer?
- Is this information available?
- How could this information be used to help make a decision?

What issue lies behind the problem?

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INSTRUCTOR'S NOTES

Apart from many potential reasons to be named by participants, the following are important to mention:

1) Russian companies rarely maintain information on sales by business segment. Thus, it is unlikely that the sales data of this particular product is readily available. Additionally, if the company operates on a cash basis, their sales data is incomplete

2) Given that the Cost of Sales is distorted and overstated compared to its IAS counterpart, the information provided by Utyug will be understated from the IAS point of view, thus misleading the customer

3) Cash flow statements for Russian companies do not contain a separate classification of 'Cash Flow from Operating Activities' as required by IAS and do not give information which will help evaluate credit potential. Additionally, it is not easy to calculate current ratio from the Russian balance sheet because current assets and liabilities could not be easily identified

Ask the questions listed on the slide.

Now it is important to revisit the participants suggestions. After a discussion, an important conclusion which should be derived is the following:

What was suggested is not a solution to a problem, but rather attempts to solve consequence of a problem. The real problem stays the same. Given that participants would typically suggest "we have this information in this or that department" it is important to note that even if this information exists, it is typically:

- not readily available
- requires additional processing, which is time consuming, and
- is typically stored in a manner not easily understood.

Case Study: Utyug - Real Problem

Utyug may resolve this particular situation, but the real problem stays the same

Information at many companies is often either incomplete, not compatible, contains elements of double counting, or is stored in a fragmented manner

- This could harm the company in the long run

> ☛ *The real problem* is that Russian Statutory Accounting Standards do not provide a true and fair view of the company's financial position and performance for the purposes of users who make economic decisions

Russian Statutory Accounting is heavily regulated and thus it is not within the ability of many companies to influence financial reporting

- The General Director made his decision thinking solely in terms of regulations - his accounting professionals have never tried to create accounting statements other than prescribed. Thus General Director has no other means of satisfying the potential customer, investor, shareholder, etc.

Can anything be done?

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INSTRUCTOR'S NOTES

It important to mention that the concept of a true and fair view is dominant in the minds of users of financial statements

Russian financial statements are essentially computations of tax payable , and do not provide a true and fair view

Case Study: Utyug - Solution

The company can establish better relations with the customers, suppliers, shareholders, etc. if it moves to International Accounting Standards

- In many industries where the quality of products and manufacturing processes is regulated by industry standards (for example, ISO 9000), the quality of accounting products (i.e. financial statements) is regulated by IAS - International Accounting Standards
- IAS are world-wide recognized accounting standards
- RSA is moving towards IAS - early study and adoption of IAS can facilitate adjusting to changes in regulations and will explain the general logic of changes in accounting regulations
- Many IAS principles and practices can be adopted without contradicting RSA

Incorporating International Accounting Standards into the accounting function of the company is one of the vital requirements of conducting business in a modern competitive environment and can provide a company not only with powerful tools but also with significant competitive advantage

ias1e/Page 16 Note: ISO 9000 -

INSTRUCTOR'S NOTES

It is the key slide in adopting the idea of importance and possibility of moving to IAS

ISO 9000 - internationally recognized quality control standards of which nearly every Russian director is well aware. These standards govern many aspects of the business: quality of products and processes, equipment requirements, etc. Many companies buy products only if the vendor is certified to ISO 9000

Need for Moving to IAS

Most companies need access to international sources of finance:

- Companies did not receive access to funds as a result of privatization
- Only a limited number of companies received financial support from the state
- Current shareholders, such as employees or managers, typically do not have either the financial resources or credibility with financial institutions to support the operations of their companies

But... STOP

Financial information is a major barrier in the way of negotiating with potential lenders/investors

Because...

The format of presentation of financial information must be in a form suitable and familiar to investors

Hence...

The companies need to prepare and present financial statements that conform to IAS

Solution

Move to IAS-format statements

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INSTRUCTOR'S NOTES

Moving to IAS is Necessary When...

	YES	NO
Are you seeking a strategic partner?		
Are you planning an international securities issue?		
Are you looking for investors?		
Are you seeking finance in the West?		
Are you entering a joint project with a western counterpart?		
Is your company seeking to act as a sub-contractor for international institutions?		
Are you planning to receive a loan from international lending agencies (EBRD, WB, etc.)?		

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INSTRUCTOR'S NOTES

Instructor shall invite class discussion.

The presenter should not rush through the slide and should consider each situation one by one. He should also ask participants whether they are engaged in or are considering one of the business situations above.

It is important to note that even if the company has limited relations with international companies (which is rare) this may change in the future because of the trend of globalization in business.

Participants should be left with the impression the moving to IAS is not a task for the far away future - it is a task for today.

Conclude this slide with the following:

If the answer to any of these questions is yes, your company will benefit from conversion to IAS.

Benefits of Applying IAS to Accounting and Financial Statements

The transformation of financial statements in order to obtain financing is only one value of applying IAS standards. Benefits are:

- Presentation of company's performance in more simple and realistic format
- Comparability of financial results with other similar foreign companies
- Competitive advantage - enhanced accounting systems and skilled staff:
  - better pricing decisions
  - ability to generate data on demand
  - better image with foreign parties

How this seminar can help?

- Understand the requirements of international investors for financial reporting
- Learn to read financial statements of major players in the industry:
  - potential partners
  - competitors
- Know how to compare performance on cross-industry/country basis
- Discuss how IAS can be implemented

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INSTRUCTOR'S NOTES

Moving to International Accounting Standards

Session 2: Principles and assumptions of International Accounting Standards

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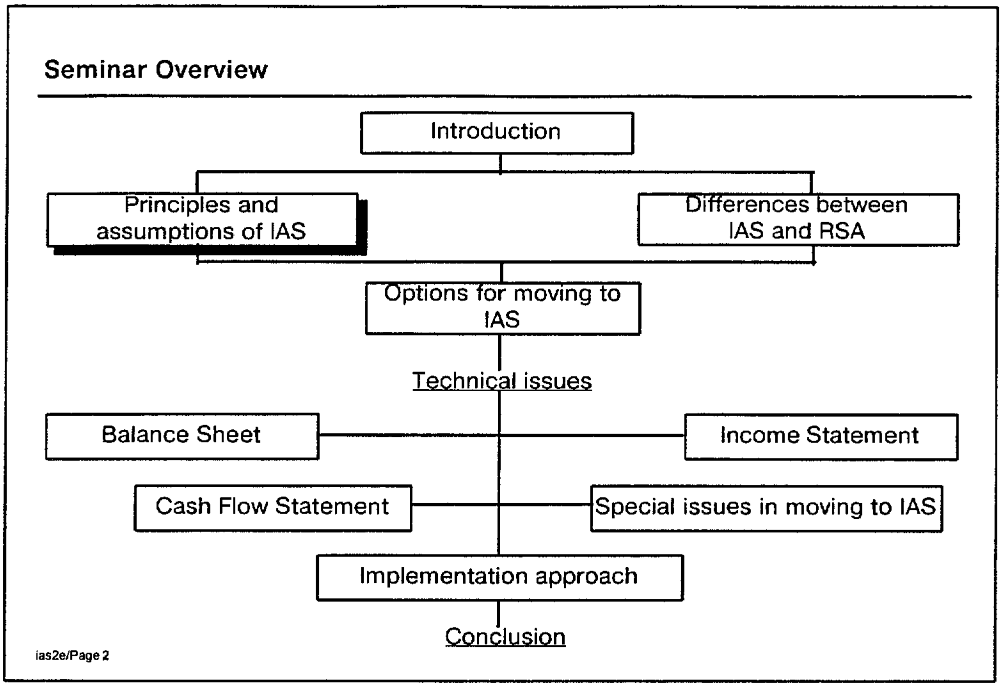
INSTRUCTOR'S NOTES



INSTRUCTOR'S NOTES

Session Agenda and Objectives

Agenda

- The need for accounting/financial information
- Introduction to IAS financial statements
- Principles and assumptions in IAS Accounting
- Sources of information about IAS accounting principles
- Differences in accounting between countries

Objectives

- **To introduce the principles** and assumptions **of International Accounting Standards.**
- To become familiar with the uses of IAS accounting and reporting and the principal IAS financial statements.

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INSTRUCTOR'S NOTES

What is Financial Information and Why is It Important?

Objectives of financial information

- To provide information on the financial position, performance and changes in financial position of an enterprise that are useful to a wide range of users in making economic decisions
- To show how well the management of the enterprise made use of the resources entrusted to it

Limitations

- Financial statements portray the financial effects of past events but their usefulness in forecasting future events is limited
- Financial statements do not always provide non-financial information, i.e. the enterprise's development plans or personnel policy
- Financial statements are based on certain principles and assumptions, which the user needs to understand to be able to read financial statements

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INSTRUCTOR'S NOTES

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External Users of Financial Information

Investors	*To determine whether they should buy, hold or sell and to assess ability of the enterprise to pay dividends.*
Employees	*To assess profitability and stability of their employers, to assess the ability of the enterprise to provide remuneration, retirement benefits, employment opportunities.*
Lenders	*To assess whether to provide the loan. To determine whether their loans, and the interest attached to them, will be paid when due.*
Suppliers and trade creditors	*To determine whether the enterprise can pay their bills when due. Trade creditors are likely to be interested in an enterprise over a shorter period than lenders.*
Customers	*To assess the continuation of the enterprise, especially when they have long-term involvement with the enterprise.*
Governments and their agencies	*To regulate activities of the enterprise, to allocate resources, determine taxation policies and as the basis for national income and similar statistics.*
	To provide the public with the information about the trends and developments in the prosperity of the enterprise and the range of its activities, including the number of people employed and the contribution to the local economy.

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INSTRUCTOR'S NOTES

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Where Do the Users Find Financial Information?

Financial statements:

- Balance sheet
- Income statement
- Statement of changes in financial position (statement of cash flow or statement of funds flow)
- Notes to the accounts and other explanatory material

Special purpose financial reports:

- Prospectuses
- Computations for taxation purposes

Auditors' opinion:

- An independent external opinion on the truth and fairness of financial statements

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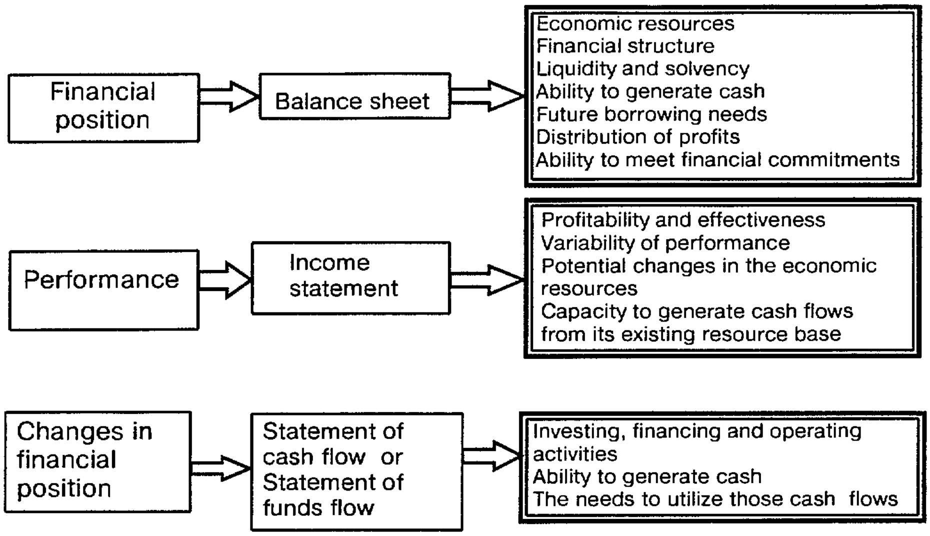
INSTRUCTOR'S NOTES

Where to Find Information on Financial Position, Performance, Changes in Financial Position



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INSTRUCTOR'S NOTES

This slide shows that information of financial position can be found in the balance sheet, and specifies the items that usually describe financial position.

The same is given for information of performance and changes in financial position.

To Understand IAS, You Must Be Familiar with Two of Its Key Underlying Assumptions

Accrual Basis	The effects of transactions and other events are recognized when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the period to which they relate. Financial statements prepared on the accrual basis inform users not only of past transactions, but also of obligations to pay cash in the future and of resources that represent cash to be received in the future.
Going Concern	The financial statements are prepared on the assumption that an enterprise is a going concern and will continue in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the need to liquidate or curtail materially the scale of its operations; if such an intention or need exists, the financial statements may have to be prepared on a different basis. If so, the basis used is disclosed.

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INSTRUCTOR'S NOTES

Concepts and Principles Used in Preparation of Financial Statements

OVERALL OBJECTIVE - TO PRESENT TRUE AND FAIR VIEW

Prudence	*Prudence is the inclusion of a degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty, such that assets and income are not overstated and liabilities or expenses are not understated. It calls for anticipation of all losses and expenses but defers recognition of gains or profits until they are realized.*
Substance over form principle	*It is necessary that the information about transactions and events is presented in accordance with their substance and economic reality and not their legal form.*
Completeness	*The information must be complete within the bounds of materiality and cost. An omission can cause information to be false or misleading.*
Consistency/ Comparability	*Users must be able to compare financial statements of an enterprise through time to identify trends. Users must be able to compare financial statements of different enterprises. Therefore, the policies should be consistent.*
Timeliness	*The information must be provided on a timely basis. If there is undue delay in the reporting of information it may lose its relevance.*

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INSTRUCTOR'S NOTES

Concepts and Principles Used in Preparation of Financial Statements

OVERALL OBJECTIVE - TO PRESENT TRUE AND FAIR VIEW

Understandability	*The information must be readily understandable by users. Users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence.*
Relevance	*The information must be relevant to the decision-making needs of users. Information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting their past evaluation.*
Materiality	*The information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statement. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement.*
Reliability	*The information must be reliable. It is reliable when it is free from material error and bias.*
Faithful representation	*The information must represent faithfully the transactions and other events it either represents or could reasonably be expected to represent.*

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INSTRUCTOR'S NOTES

Example on IAS Concepts: Reliability

- *Example: The company AOOT Utyug faces a claim for damages suffered by its customers because of a fault in its products. The claim is disputed under a legal action.*

  Q. What should the company Utyug recognize in its balance sheet? Is it appropriate to recognize the full amount of the claim in the balance sheet?

  A. It may be appropriate in this case for AOOT Utyug to recognize the claim in the balance sheet. It may, however, be inappropriate to recognize the full amount of the claim. It may be appropriate also to disclose the amount and circumstances of the claim in the notes to the accounts.

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INSTRUCTOR'S NOTES

The workbook should contain an example or illustration of each concept.

The slides focus on concepts that are most difficult to explain to Russian accounting and management personnel.

This slide should encourage the participation of the class. Therefore, instructor should open the problem and question first, and show the answer only after the class discussion.

Instructor must note, that here and further in the presentation the answer is not actually an answer but a list of options as it is the case in the real business situation. In the process of accounting a lot of management judgment (i.e. evaluation the list of options) is involved.

Example on IAS Concepts: Substance over Form

- *Example: The company AOOT Utyug disposed of an asset (sold a workshop) to another party. The documents purport to pass legal ownership to that party. Nevertheless, an agreement exists that ensures that the enterprise continues to enjoy the future economic benefits embodied in the asset: AOOT Utyug continues to receive the rent from leasing the workshop space.*

Q. Should the company AOOT Utyug report a sale?

A. The reporting of a sale does not represent faithfully the transaction entered into, because Utyug continues to receive economic benefits from the asset.

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INSTRUCTOR'S NOTES

This slide should encourage the participation of the class. Therefore, instructor should open the problem and question first, and show the answer only after the class discussion.

Example on IAS Concepts: Prudence

➲ Example: AOOT Utyug's sales department reported to the accounting department that trade receivables amounting to RUR 47 mln will never be collected because of the poor financial situation of some debtors.

Q. How should the company recognize these receivables in the balance sheet?

A. AOOT Utyug should recognize the bad debt as a loss in the amount of RUR 47 mln to comply with the concept of prudence.

But: The exercise of prudence does not allow the creation of hidden reserves or excessive provisions, the deliberate understatement of income or the deliberate overstatement of liabilities, because it would not be reliable and would not present a true and fair view.

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INSTRUCTOR'S NOTES

This slide should encourage the participation of the class. Therefore, instructor should open the problem and question first, and show the answer only after the class discussion.

Example on IAS Concepts: Comparability

- Example: The company AOOT Utyug made several investments in its supplier companies. The accounting department always recorded these transactions as "advances paid." External consultants suggested the company change its accounting practice.

  Q. How does the recording of this transaction relate to the principle of comparability if in the previous accounting period no such transaction was recorded?

  A. It is not appropriate for an enterprise to continue accounting in the same manner for a transaction or other event if the policy adopted is not in keeping with the characteristics of relevance and reliability.

  The principles of comparability and consistency should not prevent the company from changing its accounting policies when needed. It is inappropriate for an enterprise to leave its accounting policies unchanged when they do not describe fairly the business activities of the company.

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INSTRUCTOR'S NOTES

This slide should encourage the participation of the class. Therefore, instructor should open the problem and question first, and show the answer only after the class discussion.

Reasons for Significant Differences between RSA and IAS

	IAS	RSA
Users	*Investors, shareholders, employees*	*Mainly state and tax authorities*
Historical development	*Free market economy*	*Centralized government regulation of the planned economy*
Motivation	*To present true and fair view of the company*	*To impose state control and maximize tax collection*
Disclosure requirements	*Accurate, consistent and as detailed as possible*	*Incomplete and inconsistent*
Accounting profession development	*Significant role of professional accounting associations*	*Rigid state regulations, professional associations do not play significant role*
Role in the company	*Significant influence on decision-making*	*Supplementary, mainly control function*

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INSTRUCTOR'S NOTES

This slide and the next slide seeks to demonstrate the point that the RSA does not give 'true and fair view' because the purpose of RSA if not to present 'true and fair view'.

Practices which Arise as a Result of the Differences

Application of the IAS principles for the Russian companies may result in many differences in presenting the enterprise's performance, for example:

- Profit calculated according to different standards can be different
- Accrual principle of revenues and cost recognition is not consistently followed
- COGS and WIP are often distorted because of inadequate expense allocation methods

➲ Example: Payroll is often used as an allocation base, though in many cases other allocation bases could be more appropriate, i.e. machine-hours, labor hours, number of staff

➲ Example: Depreciable lives of fixed assets are shorter for IAS, thus depreciation expense is higher. Depreciation rates in Russia are set for tax purposes, irrespective of actual economic life

➲ Example: Certain incurred expenses are not allowable in RSA for tax purposes

Russian accounting does not intend to give a true and fair view of a company' financial position and results

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INSTRUCTOR'S NOTES

Russian accounts are designed to classify transactions according to the letter of the law for purposes of calculating tax payable.

Before Getting to the Statements Themselves, It Is Critical to Understand the Standard Elements of IAS Financial Statements

The elements directly related to the measurement of financial position in the balance sheet (BS)are:

- Assets
- Liabilities
- Equity

The elements directly related to the measurement of performance in the income statement(IS) are:

- Income
- Expenses

The elements directly related to the measurement of changes in funds in the statement of cash flow are:

- Income statement elements
- Changes in balance sheet elements

The presentation of these elements in the BS and IS involves sub-classification.

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INSTRUCTOR'S NOTES

The instructor shall introduce these major categories of financial statements to the seminar participants because the rest of the presentation deals with these categories.

The focus should be on these elements, because Russian accountants often view financial statements as 'templates' or balance sheet lines rather than a method for recording i.e. assets and liabilities.

Example on Classification of Elements of IAS Financial Statements

Assets and liabilities can be classified by their nature or function.

Assets

Current Assets	***Cash and cash equivalents expected to be realized during 1 year*** Accounts receivable, advances paid, prepaid expenses, etc.
Investments	Long-term investments in other firms
Property, plant equipment	Tangible, long-lived assets
Intangible assets	Such items like patents, franchises

Liabilities

Current liabilities	Obligations that are expected to be paid within 1 year of the reporting date Accounts payable, taxes payable, salaries payable, advances received
Long-term debt	Liabilities payable more than 1 year after the reporting date, including long-term loans, bonds, mortgages

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INSTRUCTOR'S NOTES

Instructor should focus attention on the point that the criteria for 'current' assets is normal operating cycle of the company which is usually 1year.

Management judgment is involved in determining the normal operating cycle of the company.

The First Key IAS Financial Statement is Balance Sheet

$\boxed{\text{Total Assets}} = \boxed{\text{Liabilities}} + \boxed{\text{Equity}}$,

or

$\boxed{\text{Equity}} = \boxed{\text{Total Assets}} - \boxed{\text{Liabilities}}$,

or $\boxed{\text{Investing}} = \boxed{\text{Financing}}$

The relative mix of assets reflects a firm's investment decisions, and the relative mix of liabilities plus shareholders equity reflects a firm's financing decisions.

Thus, we are viewing the same resources from two angles: a listing of resources the firm holds and a listing of the parties (creditors and owners) who have provided financing and who, therefore, have a claim on those assets.

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INSTRUCTOR'S NOTES

Key Balance Sheet Definitions

Asset	Resource controlled by the enterprise as a result of past events and from which future economic benefits are expected	• Used in production of goods/services to be sold • Exchanged for other assets • Used to settle a liability • Distributed to the owners of the enterprise • Many assets have physical form • Many assets are associated with legal rights
Liability	A present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow of resources	• Payment of cash • Transfer of other assets • Provision of services • Replacement of this obligation with another obligation • Conversion of the obligation to equity • Some liabilities can be measured only with a substantial degree of estimation
Equity	The residual interest in the assets of the enterprise after deducting all its liabilities	• Funds contributed by shareholders • Retained earnings and reserves • Normally, the aggregate value of equity only by coincidence corresponds with the aggregate market value of a company's share

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INSTRUCTOR'S NOTES

Handouts of BS, IS and SCF (ideally compiled as an annual report) should be provided to the participants at this time.

The Next Key IAS Financial Statement is the Income Statement

A measure of performance is profit. The elements directly related to the measurement of profit are income and expenses

Income	Increase in economic benefits during the accounting period in the form of increases in assets or decreases in liabilities that result in increases in equity, other than those relating to contributions from equity participants	• Revenues arise in the course of ordinary activities • Revenues include sales, fees, interest, dividends, royalties, rent • Gains represent increases in economic benefits and may, or may not, arise in the course of ordinary activities • Examples are disposal of non-current assets, revaluation of marketable securities, increase in the carrying amount of long- term assets • Gains are usually displayed separately
Expenses	Decreases in economic benefits during the accounting period in the form of outflows of assets or increases in liabilities that result in decreases in equity, other than those relating to distributions to equity participants	• Expenses are outflow of assets that arise in the course of ordinary activities • Outflow of assets take form of cash, inventory, property, plant, equipment • Expenses include cost of sales, wages, depreciation, etc. • Losses are decreases in economic benefits that may, or may not, arise in the course of ordinary activities, i.e. disasters (fire), disposal of non-current assets, unrealized losses, etc.

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INSTRUCTOR'S NOTES

Recognition and Measurement of Elements of Financial Statements

Q. When to record, for example, an asset or revenue? What amount of the asset to record?

A great deal of management judgment is involved in the process of recognition and measurement

RECOGNITION. An item that meets the definition of an element should be recognized if:

- It is probable that any future economic benefit associated with the item will flow to or from the enterprise (judgment over the degree of uncertainty), and
- The item has a cost or value that can be measured with reliability

Principle of prudence calls for recognition of all losses and expenses but defers recognition of gains or profits until they are realized. In the absence of certainty, events are to be reported in a way that tends to minimize income.

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INSTRUCTOR'S NOTES

Recognition, to recognize - to enter a transaction in the accounts. Recognition involves a decision whether to enter a transaction, when and to what amount.

Historic cost is the most used method of measurement

Under IAS, Financial Statements are Packed into a Standard Annual Board Report

A report for shareholders and other interested parties prepared once a year

Includes:

- Comments from management about the year's events
- Balance Sheet
- Income Statement
- Statement of Changes in Financial Position
- Summary of significant accounting principles
- Explanatory notes to the accounts
- The auditors' opinion

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INSTRUCTOR'S NOTES

This slides needs to demonstrate the format in which the information is presented to interested parties, that this information is not confidential and is aimed at interested users: shareholders, investors, employees.

Russian financial statements are not presented as a single package.

IAS vs. National Accounting Standards

IAS (International Accounting Standards)	Developed by IAS Committee with the purpose of improvement and harmonization of financial reporting between countries Members of IASC are professional accountancy bodies from 82 countries, including accountants, academic institutions and governments Objective - to publish accounting standards and to promote their world-wide acceptance
National accounting standards	
	National legal requirements with regard to the presentation and preparation of financial statements; as such, mandatory for execution National accounting standards differ between countries but most of them broadly comply with IAS
US GAAP	Developed by Financial Accounting Standards Boards (FASB) and adopted by the government agent Securities and Exchange Commission
Russian statutory accounting	Regulatory instructions are published by MoF

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INSTRUCTOR'S NOTES

This slide seeks to show the place of IAS vs. national accounting standards and gives examples of national accounting standards in two countries: USA (US GAAP) and Russia (RSA).

Differences in Accounting between Countries

It is important to understand that there is a need for harmonization of accounting because of multinational development to achieve comparability of financial information.

Causes of international differences:

- Legal system (common law system vs. Roman law system)
- Purpose of financial reporting (providers of finance vs. state control)
- Taxation and legislation

The following items are usually different in accounting between countries:

- Fairness vs. legality and taxation
- Prudence and accruals
- Provisions and reserves
- Valuation bases
- Consolidation

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INSTRUCTOR'S NOTES

Example on Country Differences in Accounting Treatment

Topic	*US GAAP*	*UK GAAP*	*IAS*
Inventories	*LIFO allowed*	*LIFO not allowed*	*LIFO allowed, but not preferred treatment*
R&D	*All expensed*	*Research expensed; certain developments can be capitalized*	*Research expensed; certain development can be capitalized*

IAS allows more flexibility in treatment of certain items. IAS prescribes underlying principles that form the benchmark basis for treatment.
National regulations can be more specific and sometimes vary between countries.

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INSTRUCTOR'S NOTES

This example intends to demonstrate that IAS is not a set of rigid rules but rather a set of underlying principles. This is the point that is very difficult for Russian accountants to accept.

This slide can be considered optional and presented in enough interest in differences in accounting between countries is shown.

Accounting Standards: Sources of Information

Official publications

IAS	International Accounting Standards Committee, 167 Fleet Street, London EC4A 2ES, England The text is updated annually.
US GAAP	FASB Current Text Accounting Standards (2 volumes) The text is regularly updated and supplied with explanatory documents.

Russian translations

IAS	International Accounting Standards (3 brochures). Published by Audit-Training Center, Moscow, 1992

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INSTRUCTOR'S NOTES

There are Textbooks which Describe IAS in Detail

Many accounting books have been published dedicated to international accounting rules, including IAS. Here is a proposed list for further information:

B Needles, H. Andserson, D. Coldwell Principles of Accounting, Moscow, Finansi i Statistika, 1996.

- A classic textbook of financial accounting

R. Anthony, J. Rees Accounting: Situations and Examples, Moscow, Finansi i Statistika, 1996

- A very good set of practical examples in financial accounting

Z. Rakhman, A. Sheremet Accounting in Market Economy, Moscow, Infra-M, 1996

- A book written by a Western and Russian authors providing some links between the two accounting systems

G. Mueller, H. Gernon, G. Miik Accounting: International Perspective, Moscow, Finansi i Statistika, 1996

- More theoretical book providing international comparisons

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INSTRUCTOR'S NOTES

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The Issues where Russian Statutory Accounting Made a Move towards IAS

- Introduction of Russian accounting standards:
  - Accounting policy
  - Foreign currency accounting
  - Capital construction
  - Long-term investments
  - Reporting
  - Inventory accounting (discussed)
- New set of financial statements
- Different treatment of costs for tax and financial accounting
- Accrual accounting
- Calculation of cost of sales and profit recognition
- Reserves/Provisions
- Statement of Cash Flow
- Concept of consolidation of accounts of subsidiaries

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INSTRUCTOR'S NOTES

Recent Changes in Russian Accounting

Recent changes to the regulations governing Russian accounting demonstrate a strong movement towards reporting under IAS

- State Program for the transition to international accounting of October 23, 1992;
- Regulatory documents:
  - Instruction of the Russian Government on the calculation of cost of sales and profit recognition changes in 1995 - introducing different treatment of costs for financial accounting and tax accounting;
  - Order of the MoF of October 19, 1995 No. 115 - Introduction of accrual accounting for sales in the annual report;
  - Order of the MoF of March 27, 1996 No. 31 - Adoption of a new set of financial statements, introducing a layout closer to international standards;
  - Order of the MoF of July 28, 1995 No. 81 - introducing the concept of consolidation of accounts for subsidiaries and related companies;
  - Introduction of Russian accounting standards - standards on accounting policy, foreign currency accounting, capital construction, long-term investments and reporting. A standard on inventory accounting is being discussed.

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INSTRUCTOR'S NOTES

Instructor should point out that there is still some way to go.

Exercise on IAS Principles

(A) Analyze some of the statements of the regulation on accounting and reporting in Russia No. 170 from the point of view of the IAS:

- (1) In case of change of opening balance at January 1 of the reporting year explanations must be provided. Which principle may be implied here?
- (2) Capital investments are to be reflected in the balance sheet at the actual cost incurred by the investor. Does it comply with the prudence principle? Why?
- (3) Capital construction objects that are temporarily used are not included in the fixed assets until their permanent input into operation. What would be the treatment in accordance with the principle of substance over form?
- (4) For intangibles with unspecified useful life the amortization is 10 years. Which IAS principles may it contradict?

(B) If a company is actively engaged in tolling, is it necessary to disclose the details of these operations in accordance with IAS principle of materiality and completeness?

(C) Russian accounting is maintained in Roubles. Does the balance sheet present a true and fair picture of the company without special inflation adjustments?

INSTRUCTOR'S NOTES

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Principles of IAS Accounting: Summary

- Financial statements are needed by a variety of users in the business activity of an enterprise. As such, they must be understood by those users
- Financial statements present information about financial position, performance and changes in financial position of the enterprise
- Financial statements normally comprise balance sheet, income statement and statement of changes in financial position and notes
- Financial statements must present true and fair view of the activities of the enterprise
- Western accounting is based on a number of internationally recognized assumptions and principles
- The assumptions and principles in the conditions of uncertainty leave room for management's judgment in recording events and transactions
- The sources of information on Western accounting principles are IAS and GAAP of different countries
- There are significant differences in accounting practices between countries
- Russian Statutory Accounting is moving towards IAS

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INSTRUCTOR'S NOTES

Moving to International Accounting Standards

Session 3: Differences between Russian and International Accounting Standards

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INSTRUCTOR'S NOTES

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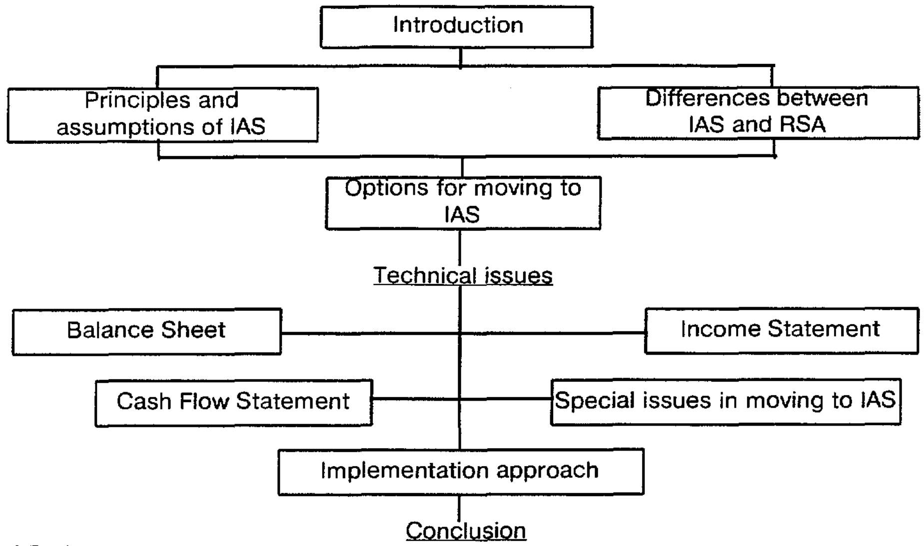
Seminar Overview



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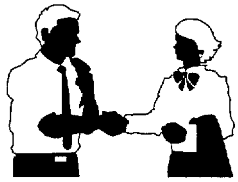
INSTRUCTOR'S NOTES

Session Agenda and Objectives

Agenda

- Differences in accounting principles
- Balance Sheet
- Income Statement
- Organizational issues



Objectives

- To demonstrate specific differences arising ***from different underlying principles between IAS and RSA***
- To discuss the impact of these differences on financial reporting
- To identify differences between the IAS and RSA balance sheet and income statement

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INSTRUCTOR'S NOTES

IAS and RSA: Different Standards, Principles and Assumptions

IAS accounting vs. Russian accounting - core conceptual differences

Concept Accounting	IAS	Russian Statutory
Going Concern	Companies are assumed to operate indefinitely	No such consideration is required
Consistency	Accounting policies are consistent over time	Compliance with changing regulation is required
Accruals	Revenues/costs are recognized in the period they are earned	Revenues and costs are not always recognized as earned
Matching	Product costs are associated with the revenue from that product	Costs are reported in accordance with tax principles
Substance Over Form	Transactions and events are presented in accordance with their substance and financial reality	Generally transactions are subject to regulations and result in form over substance
Materiality	All items which can affect decisions should be disclosed	Ministry of Finance determines disclosures
Prudence	Uncertainties and risk should be given adequate treatment	Prudence does not require consideration

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INSTRUCTOR'S NOTES

Differences in Financial Statements - Annual Reporting

IAS

- Balance Sheet
- Income Statement
- Cash Flow Statement
- Notes to the financial statements
  - Accounting policies
  - Foreign currencies
  - Segmental information
  - Profit on ordinary activities before taxation
  - Employee information
  - Interest and investment income
  - Insurance result
  - Interest payable
  - Taxation on profit on ordinary activities
  - Dividends
  - Earnings per share
  - Fixed assets: tangible assets, subsidiary undertakings, associated undertakings, other investments
  - Current assets: debtors, investments
  - Current liabilities
  - Long-term liabilities
  - Provisions for liabilities and charges
  - Deferred taxation
  - Shareholders funds
  - Share capital and share premium
  - Reserves
  - Share option schemes
  - Contingent liabilities
  - Operating lease commitments
  - Capital commitments

Russian Statutory Accounting

- Balance Sheet
- Statement of financial results of operation
- Addendum to balance sheet
  - Changes in equity and funds
  - Changes in borrowings
  - Debtors and creditors
  - Intangible assets
  - Changes in fixed assets
  - Investments
  - Social indicators
  - Changes in the sources of finance of long-term investments
  - Costs incurred by the company
  - Off-balance sheet items

- IAS do not prescribe which information should be included into annual report
- Exact format for disclosure governed by each country accounting regulation

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INSTRUCTOR'S NOTES

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IAS and RSA Balance Sheet: Assets

	19X2	19X1
Current Assets		
Cash and equivalents		
Marketable securities		
Accounts/Notes receivable		
Inventories		
Raw materials		
Work-in-progress		
Finished goods		
Merchandise		
Other current assets		
Total Current Assets		
Long-term Assets		
Property, plant and equipment		
Land		
Buildings		
Property, plant and equipment, at cost		
Less accumulated depreciation		
Net property, plant and equipment		
Financial leases		
Other long-term assets		
Investments in the affiliated companies		
Intangible assets		
Goodwill		
Other		
Total Long-term Assets		
TOTAL ASSETS		

ASSETS	Line code	Opening balance	Closing balance
	2	3	4
I. FIXED AND OTHER NON-CURRENT ASSETS			
Intangible assets			
acquisition cost* (04)	010		
accumulated amortization* (05)	011		
net book value	012		
Fixed assets			
Acquisition (revalued) cost* (01 03)	020		
accumulated depreciation* (02)	021		
net book value	022		
Uninstalled machinery and equipment (07)	030		
Construction in progress (08.61)	040		
Long term investments (06)	050		
Settlements with owners (75)	060		
Other non-current assets	070		
Total Section I	080		
II. INVENTORIES			
Raw materials in stock (10 15 16)	100		
Live stock (11)	110		
Low value and short life assets			
acquisition cost* (12 16)	120		
accumulated depreciation* (13)	121		
net book value	122		
Work in progress (20 21 23 29 30 36 44)	130		
Expenses of future periods (31)	140		
Finished goods in stock (40)	150		
Goods for resale (41)	162		
VAT reclaimable			
on purchases (19)	175		
Other inventories	176		
Total Section II	180		
III. DEBTORS, CASH AND OTHER MONETARY ASSETS			
Balance of cost of goods shipped but not paid for (debtors	199		
Debtors:			
Trade debtors for goods and services (62 76)	200		
Bills of exchange and promissory notes (62)	210		
Subsidiaries and related parties (78)	220		
State budget (68)	230		
Employees debtors (73)	240		
Other debtors	250		
Prepayments to suppliers and contractors (61)	260		
Short term investments (58)	270		
Cash and monetary assets:			
Cash at hand (50)	280		
Cash in bank (national currency) (51)	290		
Cash in bank (foreign currencies) (52)	300		
Other monetary assets (55 56 57)	310		
Other current assets	320		
Total Section III	330		
Losses:			
accumulated from previous years (88)	340		
this year	350	x	
TOTAL (add lines 080, 180, 330, 340 and 350)	380		

Note: Arrows indicate decrease in the liquidity across the balance sheet asset items
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INSTRUCTOR'S NOTES

The main purpose of this slide is to illustrate the differences in format and structure between the IAS and RSA balance sheets.

DISCUSS:

What are the evident differences between the assets side of the 2 balance sheets?

1. IAS balance sheet requires the comparable figures for the previous year to be shown along with the figures for the current year.

2. IAS- assets are arranged in order of decreasing liquidity, whereas in the RSA balance sheet they are arranged in order of increasing liquidity. (as indicated by the arrows)

3. The assets are also classified differently.

4. The RSA balance sheet gives a greater level of detail for some items.

5. Difference in format

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IAS and RSA Balance Sheet: Liabilities

	19X2	19X1
Current Liabilities		
Short-term bank loans		
Current portion of long-term debt		
Accounts payable		
Raw materials		
Salaries		
Tax & social secirity		
Dividends		
Other		
Current obligations under financial lease		
Total Current Liabilities		
Long-term Liabilities		
Long-term debt		
Long-term obligations under finance lease		
Notes payable		
Shareholders Equity		
Common stock		
Capital in excess of par value		
Retained earnings		
Total Long-term Liabilities and Shareholders Equity		
TOTAL LIABILITIES		

EQUITY AND LIABILITIES	Line code	Opening balance	Closing balance
1	2	3	4
I. EQUITY			
Statutory capital (85)	400	-	-
Additional capital (87)	401	-	-
Reserve capital (86)	402	-	-
Accumulation funds (88)	420	-	-
Social assets fund (88)	425	-	-
Grants and directed financing (96)	430	-	-
Lease payments (97)	440	-	-
Retained earnings (88)	460	-	-
Profit:			
Profit for the current year* (80)	470	x	-
Less appropriation of profit* (81)	471	x	-
Retained earnings for the current year	472	x	-
Total Section I	480	-	-
II. CREDITORS AND LIABILITIES			
Long term bank loans (92)	500	-	-
Other long term borrowings (95)	510	-	-
Short term bank loans (90)	600	-	-
Bank loans for employees (93)	610	-	-
Other short term borrowings (94)	620	-	-
Creditors:			
Trade creditors (60,76)	630	-	-
Bills of exchange and promissory notes (60)	640	-	-
Wages and salaries payable (70)	650	-	-
Social insurance payable (69)	660	-	-
Property and personal insurance payable (65)	670	-	-
Subsidiaries and related parties (78)	680	-	-
Non-budgetary funds contributions payable (67)	690	-	-
State budget (taxes payable) (68)	700	-	-
Other creditors	710	-	-
Prepayments from customers (64)	720	-	-
Settlements with owners (75)	725	-	-
Deferred income (83)	730	-	-
Consumption funds (88)	735	-	-
Deferred charges (expenses of future periods) (89)	740	-	-
Bad debts provision (82)	750	-	-
Other short term liabilities	760	-	-
Total Section II	770	-	-
TOTAL (add lines 480 and 770)	780	-	-

Note: Arrows indicate decrease in the liquidity across the balance sheet liabilities items

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INSTRUCTOR'S NOTES

The RSA balance sheet is inconsistent in that assets are arranged in order of increasing liquidity, while liabilities are organized with the most liquid liabilities first.

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Example on Differences between IAS and RSA

Two accountants are hired to produce the year's financial statements for AOOT Utyug. One of them has been with the company for 10 years and is perfectly versed in RSA, while the other one is new and comes from a company that used only IAS.

The two accountants started the work and soon noticed that each one arrived at remarkably different conclusions about several items.

	RSA accountant	IAS accountant
Intangible Assets	RUR 14 mln	RUR 37 mln
Long-term financial investments	RUR 30 mln	RUR 1,418 mln
Inventories	RUR 59,683 mln	RUR 63,757 mln
Revenues	RUR 140,087 mln	RUR 202,228 mln
Property, plant and equipment	RUR 106,861 mln	RUR 129,158 mln

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INSTRUCTOR'S NOTES

This example is based on the AOOT Utyug case. Handouts were given to the participants earlier.

This example does not seek to present the full set of differences in accounting, but rather to illustrate that even the simple items of accounting can be valued differently.

Instructor shall use this slide (refer to it) when presenting the rest of the session because examples used here are explained in further slides in this section.

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Balance Sheet: Fixed Assets and Depreciation Accounting

Fixed assets are valued differently because:

- The main assumption of IAS is to provide fair value of the assets
- When acquired, fixed assets are accounted for at their full historical cost
- Afterwards, only an independent professional valuation which attempts to provide fair value of an asset is allowed to adjust book value of an asset
- In case of hyper-inflation inflation adjustments should be made
- Subsequent expenditures are recognized as an asset only when the expenditures improve the condition of the asset beyond it's normal standard of performance
- If an asset was acquired in exchange for another asset, its book value is measured at the fair value of asset received

Depreciation charge in Russia is usually lower because:

- Depreciable lives depend on useful economic life, not physical life, thus depreciation rates are normally lower in RSA
- Accelerated depreciation is often used

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INSTRUCTOR'S NOTES

•Full cost of asset consists of all costs of bringing the asset into its current condition and location, i.e. delivery, installation, etc.

•Hyper-inflation can be said to exist where the cumulative inflation rate over a three year period exceeds 100%.

• Only an independent valuation is allowed for use in financial statements which attempts to provide fair value of an asset. If an item is revalued, then the entire class of property should be revalued as well.

•The assets expected useful life should be reviewed periodically and amended if necessary.

•Example from UTYUG: IAS values property, plant and equipment at RUR 129,158 mln while RSA values at RUR 96,869+2,509+7,483 Rub (Slide 8).

Balance Sheet: Capital Investments and Low Value Items Accounting

Investments in capital may be misleading because:

- IAS allows only certain expenditures to be capitalized and does not allow expenses like maintenance costs, in certain cases, interest expense, administrative workers salary, etc.
- If the project is abandoned, all costs should be written off to profit and loss account
- Actual cost to complete should be disclosed under IAS in the notes to the financial statements

Low value items is a category in RSA which is not known in IAS:

- IAS treats low value items as fixed assets if their economic life is more than one year. Thus, the differences for fixed assets accounting can be applied
- Otherwise, low value items are accounted as stock and charged directly to profit & loss account when used

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INSTRUCTOR'S NOTES

- Capital investments in Russia and in IAS are regulated. But from country to country allowable expenses differ:

    Example: In the oil & gas industry in the US, exploratory and drilling costs can be capitalized on 'successful efforts' or 'full costs' basis. Clearly, if a company has selected the first method, only when the oil field reserves are proven, will incurred expenses be treated as capital expenditures.

-

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Balance Sheet: Intangibles Accounting

Intangibles in RSA and in IAS are of a different nature:

- R & D costs are treated as intangible assets if they satisfy certain criteria
- Software should be reallocated to fixed assets
- Apartments are recognized as fixed assets under IAS
- Goodwill - separate category under IAS

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INSTRUCTOR'S NOTES

•Intangibles in IAS and in RSA are differently classified. For example, goodwill can be a large separate category in IAS.

• R&D is an intangible asset if

- all needed resources to complete the project are reasonably available in the future
- if they are classified as application research (like drugs development)
- if revenues in future are expected to cover costs

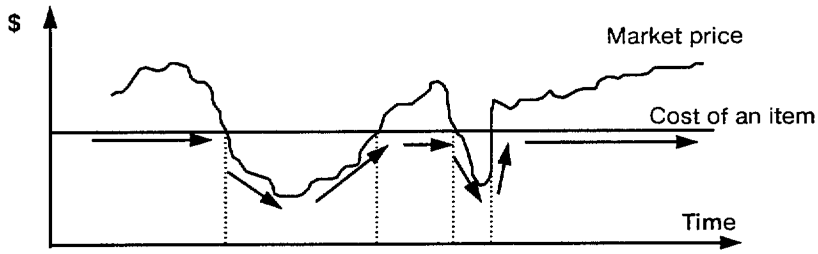
•Example from UTYUG: IAS values intangible assets at RUR 37 mln while RSA values at RUR 14 mln (Slide 8).

IAS: Lower of Cost and Market Value

Many items on the balance sheet are valued according to Lower of Cost and Market Value rule

- Costs - expenses incurred to make asset in salable condition
- Market price - a price which is established as a result of supply-demand conditions, i.e. the price at which business parties are willing to acquire goods

Lower of cost and market value means that at any time an item is valued at a minimum of: <u>market price for an item</u> or <u>incurred costs to obtain an item</u>



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INSTRUCTOR'S NOTES

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Balance Sheet: Long-term Financial Investments Accounting

Long-term financial investments in Russia may be overstated because:

- With IAS, marketable securities are carried at the lower of cost and market value
- Similarly, long-term financial investments which are classified as other than marketable securities (e.g. assets) should be carried at either cost or revalued amounts if there is a permanent decline or increase in value
- Increases or decreases in carrying amounts are recognized as income or expense. In case of long-term investments they could be credited to owner's equity as revaluation surplus
- Investments in illiquid companies should be revalued at expected net realizable value
- Bonds and coupon bonds are usually reflected at market prices and amortized over the holding period. If this is the case, a policy of revaluation should be established

To a large extent, the prudence concept governs accounting for long-term investments

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INSTRUCTOR'S NOTES

• Notes receivable (including corporate notes, treasury bills and others) should be separately accounted for

• Accounting for investments in affiliated companies also depends on a number of regulations

• In case of RSA only government bonds are brought to par value at maturity

•Example from UTYUG: IAS values long-term financial investments at RUR 1,418 mln. while RSA values at RUR 30 mln. This happens because of the inflation effect (Slide 8).

Balance Sheet: Raw Materials Accounting

- IAS values raw materials at the lower of cost and net realizable value.
  - as an option, inventories may be valued at the cost of last purchase (LIFO)
- IAS: the cost of purchase should comprise all direct costs of purchase and of bringing the inventories to their present location and condition.
  - RSA: certain costs of purchase are not allowed (#552 regulation)
  - raw materials never have overheads in them - if indirect overhead is allocated to raw materials, it should be excluded according to IAS
- Standard cost at IAS is used as a technique for the measurement of the cost of inventories only if the result approximates cost and under normal levels of activity (usually used for managerial reporting and not financial)
  - at some enterprises in Russia, standard costing is often used even if deviation is more than 10-15%
- Obsolete or damaged inventories should be valued at net realizable value (estimated selling price less estimated cost of sale):
  - although not restricted, procedures for identifying and revaluing obsolete and slow moving stock are rarely applied in Russia
- The cost of inventories in production can be determined by using FIFO, LIFO, weighted average or specific identification method.
  - Although the first three methods are allowed in Russia, majority of the companies use weighted average method only

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INSTRUCTOR'S NOTES

This slide defends the point that raw materials in Russia have the potential to be overstated.

• Example of costs not allowed to be fully included: transportation costs beyond standard costs which are based on the previous period experience

• Note: Standard cost is a predetermined estimate of what items of inventory should cost

Balance Sheet: Work-In-Progress and Finished Goods Accounting

Compared to IAS, Work-in-progress and Finished goods in Russia are treated differently because:

- IAS includes in WIP only costs directly related to the unfinished units and systematically allocated fixed and variable production overhead that was incurred in converting materials into finished goods.
  - in Russia, general and administrative expenses (plant overhead) are systematically (over) allocated
  - some direct costs, like direct labor bonus, paid in Russia from consumption fund, under IAS would be allocated to WIP
- IAS stipulates that allocation of fixed production overhead to the costs of conversion is based on the normal production level, achieved under normal circumstances.
  - no consideration of normal production level with respect to overhead allocation is required in Russia. This results in overhead 'over-allocation'

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INSTRUCTOR'S NOTES

Balance Sheet: Work-In-Progress and Finished Goods Accounting

- Unallocated overheads must be recognized as period costs. Other examples of costs excluded from the costs of inventories as required by IAS:
  - abnormal amounts of wasted materials, labor or other production costs;
  - storage costs unless they are necessary
  - administrative overheads that do not contribute to bringing inventories to their current location
  - selling costs

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INSTRUCTOR'S NOTES

•Example from UTYUG: IAS values inventories at RUR 63,757 mln, while RSA values them at RUR 59,683 mln. (Slide 8)

•(34,904+259+3,610+1,288+18,320+1,561).

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Balance Sheet: Accounts Receivable, Advance Payments and Short-Term Financial Investments Accounting

Accounts receivable in Russia are often overstated because:

- In accordance with the accruals principle under IAS all receivables expected to be realized within one year of the balance sheet date are included in their entirety
  - bad debt reserve account must include doubtful or bad accounts receivable
  - in Russia few companies create provisions for bad debts
- Accounts receivable originating from other than operating activities (notes receivable, tax recovery, etc.) should be accounted for as current if they are expected to be received within one year

Advance payments are treated under IAS as prepaid expenses. These items are expected to be expensed within one year of the balance sheet date.

Short-term financial investments are often valued differently under IAS:

- On one hand, IAS values these investments at the lower of cost and net realizable value. Thus, these investments can be overstated in RSA
- On the other hand, interest receivable should be also included in addition to face value. Thus, these investments can be understated in RSA
- Liquid assets or bank deposits can be treated as cash on the balance sheet

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INSTRUCTOR'S NOTES

• Under RSA, if accounted for on a cash basis, accounts receivable are reflected at cost of goods shipped and thus understated. They must be transferred to accrual basis and recorded at sales value .

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Balance Sheet: Bank & Cash Accounting

Although similar in definition, Bank & cash needs careful consideration in order to arrive at a reliable figure which complies with the IAS requirements listed below:

- Under IAS, cash and bank balances available for current operations should be brought to account (including those in affiliated companies) i.e.
  - If company X allows company Y to use its bank account for cash inflows (because bank account of company Y may be 'frozen') and regularly pays for company Y in cash from this account (which is often the case in Russia) this should be accounted for as cash under IAS. The nature of these relations is similar to those observed in relations of affiliated companies
- Cash and bank balances whose use for current operations is subject to restrictions should be included as current assets only if the duration of the restrictions is limited to one year
  - If tax authorities 'freeze the account' then available cash cannot be disclosed as a current asset
- Cash balance includes all payment orders issued in the accounting period even if they are paid only in the next period (cut-off problem)
  - Example: accrued interest if it is actually received in the next period

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INSTRUCTOR'S NOTES

Balance Sheet: Settlements with Owners, Losses and Share Capital Accounting

Settlements with owners - shares issued but not yet paid in should not be disclosed in the shareholders equity section of the IAS balance sheet but should be disclosed by way of an explanatory note to the balance sheet

Loss for the period should diminish shareholders equity for the corresponding amount

Although share capital is accounted for similarly, it could be different because of the revaluation surpluses from long-term investments

- IAS requires following specification:
  - Par value
  - Capital paid-in in excess of par value
  - Revaluation surplus - appears from the revaluation of long-term investments, which are recognized in the equity section under IAS
  - Reserved shares (for options, employee benefits programs, etc.)

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INSTRUCTOR'S NOTES

Balance Sheet: Retained Earnings and Funds and Reserves Accounting

The retained earnings account is typically overstated in RSA

- Figure of undistributed net income is recorded as retained earnings. However, in order to arrive at figure of undistributed net income under IAS many balance sheet and income statement items need to be revalued
- The result of the revaluation of many items on RSA balance sheet and income statement under IAS standards is often accounted for through the profit and loss account
  - Some assets may be overstated, thus IAS complying revaluation will diminish profit for the period
  - Eventually, this will influence undistributed net income, or retained earnings

Funds and Reserves is a category in RSA which is usually classified as retained earnings in IAS

- IAS treats expenses debited to funds under RSA as elements of profit and loss statement
- Credit part of some funds represents retained earnings

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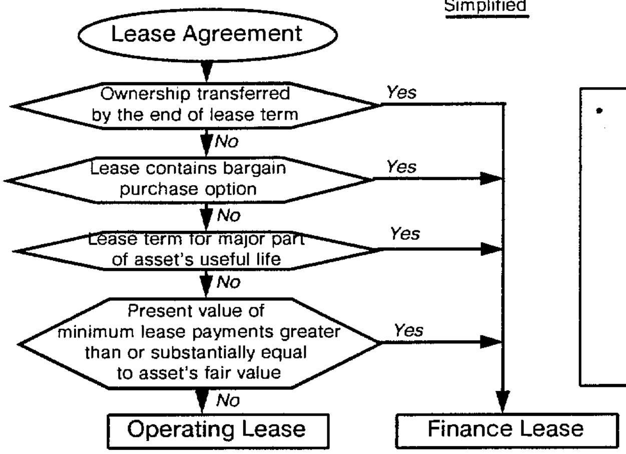
INSTRUCTOR'S NOTES

Accounting for Leases

IAS classifies lease agreements into Operating and Financial leases vs. Short-term and long-term in Russia

Simplified



Difference in accounting

- Each lease transaction should be reclassified under IAS standards in accordance with its economic substance

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INSTRUCTOR'S NOTES

Source: International Accounting Standards, page 300.

Balance Sheet: Lease Accounting

Although IAS and RSA treatment of leases have become closer, significant differences still exist both for the lessee and lessor, especially in financial leases and sale-and-leaseback agreements. In particular, IAS requires:

- Operating lease: Lessee charges rental payments to profit and loss account and recognizes expenses on a systematic basis; lessor recognizes rental income on straight-line basis over the lease term and recognizes as expenses all costs (incl. depreciation) incurred in earning rental income
- Financial lease:
  - IAS and RSA value fixed assets differently. Thus, calculation of depreciation in lease agreements is different under IAS. Additionally:
    - leased assets should be revealed to the fair value or, if lower, at the present value of minimum lease payments
    - the asset should be fully depreciated over the shorter of the lease terms or useful life
  - Certain differences exist in allocating lease costs to profit and loss account such as finance, insurance and maintenance costs
  - In IAS leases are subject to significant disclosures which must describe lease commitments of the entity

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INSTRUCTOR'S NOTES

IAS treats separately a special kind of financial leases with manufactures. This transaction is not often found in Russia and its treatment under IAS requires detailed disclosure.

Lease agreements may significantly affect balance sheet and income statement items under IAS due to differences in treatment.

Balance Sheet: Loans and Credits, Accounts Payable and Bad Debt Reserve Accounting

Loans and credits can be understated due to non-inclusion of accrued interest

- IAS specifies subdivision to short-term / long-term borrowing and accrued borrowing costs in the current period, such as:
  - interest (including overdrafts)
  - amortization of discounts or premiums related to borrowing

Accounts payable may be different under RSA because IAS requires that they be accrued in the period when incurred

- In accordance with the matching principle, all accounts payable are recognized in the period in which they are incurred, thus expenses such as for utilities should be accrued.
- Taxes and social insurance payable are disclosed in a separate line in the balance sheet. IAS requires accounting for penalties and fines payable for late tax payment in their entirety. Usually tax penalties are not accrued in RSA balance sheet
- Advance payments from customers should be disclosed on a separate line in the balance sheet

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INSTRUCTOR'S NOTES

Bad debt reserve, in accordance with the prudence concept in IAS, is supposed to assess amounts not expected to be collected and is somewhat different from RSA counterpart.

IAS and RSA Income Reporting

	For the year ended December 31, 19X2	For the year ended December 31, 19X1
Sales or other operating revenues		
Cost of goods sold		
Gross profit on sales (or gross margin)		
Other operating expenses		
Wages		
Selling expenses		
General & administrative expenses		
Depreciation		
Total operating expenses		
Operating income (EBIT)		
Other revenue and expenses		
Interest expense		
Interest revenue		
Income from investments		
Income before income taxes		
Taxes on income		
Net income		
Dividends on preferred stock		
Net income for common shareholders		
Dividends on common stock		
Retained income		
Unappropriated retained earnings, Dec. 31, 19X1		
Unappropriated retained earnings, Dec. 31, 19X2		
Earnings per common share		

Item	Line code	Profit	Loss (expenses)
1	2	3	4
Gross revenue from sales of goods and services	010	-	
VAT and Special Tax	015		-
Excise taxes	020		-
	030		-
Cost of sales (cost of goods and services sold)	040		-
Operating profit (loss)	050	-	-
Profit and loss from other sales	060	-	-
Non-operating gains and losses	070	-	-
including			
on securities and participation in joint ventures	071	-	
exchange rate gains and losses	072	-	-
	073	-	-
Total profits and losses	080	-	-
Balance sheet profit (loss)	090	-	-

Item	Line code	As at the year end
1	2	3
Budgetary payments	200	-
Appropriated to reserve capital and reserve fund	210	-
Appropriated to:		
Accumulation funds	220	-
Consumption funds	230	-
Charitable activities	250	-
Other uses	260	-

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INSTRUCTOR'S NOTES

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Recent Changes in Russian Financial Reporting

Although Russian accounting regulations are undergoing change and becoming more closer to IAS accounting significant differences still in place

Item	Line code	This year	Same period of the last year
1	2	3	4
Net revenue from sales of goods, products, works and services (less of VAT, excise duties and similar taxes and duties)	010	-	-
Cost of sales of goods, products, works and services	020	-	-
Distribution costs	030	-	-
General & administrative expenses	040	-	-
Gross margin (lines 010-020-030-040)	050	-	-
Interest received	060	-	-
Interest paid (exclusive of bank interest)	070	-	-
Income from participating interest	080	-	-
Other operating income	090	-	-
Other operating expense	100	-	-
Operating profit (loss) for the financial year (lines 050+060-070+080+090-100)	110	-	-
Other gains	120	-	-
Other losses	130	-	-
Profit (loss) for the financial year before tax (lines 110+120-130)	140	-	-
Profit tax	150	-	-
Appropriation of profit	160	-	-
Retained earnings for the financial year (lines 140-150-160)	170	-	-

≠ IAS

Time

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INSTRUCTOR'S NOTES

Income Statement: Revenue

Revenue is recorded when there is a significant assurance that economic benefits from the transaction will flow into enterprise

- Revenue should be measured at the fair value of the consideration received or receivable on accrual basis (see also accounts receivable adjustment)
- IAS recognizes barter exchange as a revenue only when it is the exchange of dissimilar goods or services and measured as a value of goods or services received (or given up, if the first measure is not available). An enterprise should disclose revenue arising from barter separately
- If an enterprise retains significant risks of ownership (for example, when the receipt of revenues is contingent on the receipt of revenue by the buyer from its sale of goods or when the probability of failure is high), the transaction is not recognized as revenue
- Services, which can be estimated reliably, should be recognized at the balance sheet date. Otherwise they are recognized to the extent of recoverable expenses. An enterprise should disclose revenue arising from the rendering of services separately
- Discounts, allowances and sales returns (interest and royalties) should be recognized and disclosed separately either on income statement or in the notes. Often, they are shown between gross revenue and net revenue

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INSTRUCTOR'S NOTES

•Example from UTYUG: IAS accounts RUR 202,228 mln in revenues while RSA only RUR 140,087 mln. (Slide 8).

Income Statement: Revenue - Industry and Segment Reporting

The enterprise should describe the activities of each industry/segment (i.e. distinguishable component of an enterprise engaged in operation of distinct feature) and indicate the composition of each reported geographical area

- Domestic operations are considered a separate geographical segment
- Industry and geographical segments may be determined in many ways for reporting purposes. Factors influencing the choice include similarities and differences in enterprise's products and activities; profitability, risk and growth of those products; the relative importance of this areas within the enterprise as a whole
- Reporting on organizational groupings such as divisions, subsidiaries or branches is not mandatory unless groupings corresponds with the segments
- It may be potentially misleading to report as separate industry segments parts of an enterprise's activities which are significantly integrated or interdependent
- Some guidelines on creating a separate segment may be 10 per cent (or more) of consolidated revenue, or operating profit or total assets or important customers

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INSTRUCTOR'S NOTES

Differences between IAS and RSA Cost Accounting Policies, Regulations and Practices

Computation of Cost of goods sold, classification of cost categories and allocation of expenses to products between IAS and RSA is not compatible

	IAS	RSA
Period costs	Selling, General & Administrative expenses are not included into COGS; written-off as period costs	Major part of Selling, General & Administrative expenses are added to COGS and not written-off
Costs inclusion	All costs which contributed to revenue generation are included into COGS	Only tax allowable expenses are included into COGS; some are only partially included (travel, marketing)
WIP	WIP includes all costs directly related to the units of production including production overhead	WIP includes only the costs of primary direct inputs without overhead portion
Reserves / provisions	Reserves are not prescribed	Tax allowable reserves / procedures are exhaustively prescribed
Bad debt expense	Included into period costs (before taxation)	Charged directly to the profit and loss account (after taxation)
Cost recognition	Matching principle determines cost recognition	Some costs are recognized in period different to when they are incurred

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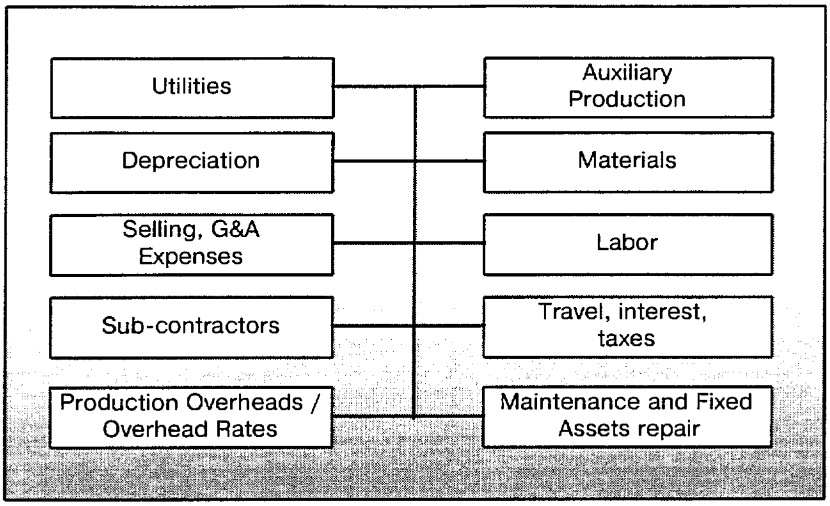
INSTRUCTOR'S NOTES

Major Areas of Differences in Cost Classification and COGS Calculation



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INSTRUCTOR'S NOTES

IAS Income Statement: Direct Labor, Materials and Manufacturing Overhead

Direct labor, materials and manufacturing overhead constitute COGS on the income statement

- Direct labor
  - Only accrual method is used for payroll accounting
  - Time record keeping for personnel is typically maintained. Labor costs are allocated on the basis of hourly rate
- Materials
  - IAS does not classify materials into categories (RSA example: low value short lived items)
  - Stock should be valued at either acquisition cost or market value
  - Handling costs are assigned to materials on individual rather than general basis
- Manufacturing/production overhead
  - Production overhead is included in Work-in-Process
  - Payroll expense is not a typical cost driver for overhead allocation (machine hours, time records of direct labor, etc. are often used)
  - Overhead allocation should be based on 'normal' and current capacity utilization. Unabsorbed overhead should be written-off as period costs

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INSTRUCTOR'S NOTES

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IAS Income Statement: Utilities and Depreciation

- Utilities
  - Electricity, heating, gas and water expenses are based (and allocated to products) on the amount actually consumed. Tariffs and utilization rates reflect actual consumption rather than arbitrary tariffs and utilization rates.
  - Utilities expenses are recognized in the period when incurred. Later they may be reallocated to the projects/orders when necessary
- Depreciation
  - IAS values fixed assets differently and requires different assets lives - thus depreciation rates and consequently expense is affected
  - Depreciation charges should take into account actual utilization of equipment and, if economically reasonable, depend not only on time
  - Method of depreciation is a subject of management judgment. Selected method should be disclosed in the notes to the statements
- Maintenance and Fixed Assets Repairs
  - Maintenance costs are treated as direct project/order costs
  - Policy of accounting for repair and overhaul costs that allows segregation of current repairs from major work or direct costs from overheads should be adopted

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INSTRUCTOR'S NOTES

IAS Income Statement: Selling and General & Administrative Expenses, Auxiliary Production, Taxes and Interest

Selling and General & Administrative expenses constitute the second biggest block of expenses on the income statement. Taxes and interest are the last expenses which are paid out of earnings

- Selling and General & Administrative expenses
  - Incurred costs for a contract that has been discontinued are written off as period expenses and should not be included in other projects
  - Selling costs are also treated as period costs. If the balance at the end of the period is significant, these expenses should be disclosed on a separate line
- Auxiliary production
  - Auxiliary production costs should be allocated to products in accordance with the actual use of auxiliary products or services
  - When material, the enterprise should account for reciprocal services
- Other expenses: taxes, interest, travel
  - Interest expense is not included in COGS and must be disclosed as a separate item on the income statement before deducting income tax
  - Taxes are also not included in COGS. Income tax is paid on net earnings after interest expense and should be disclosed on a separate line

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INSTRUCTOR'S NOTES

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Different Organizational Structures between Russia and Other Countries Influence Financial Reporting

- In many countries the accounting department defines which project should bear the costs and not the Planning department as in Russia
- Internationally, budgeting is performed with accounting input: accounting information shapes the future of the organization and thus has a significant influence on decision-making. In Russia accounting information serves the purpose of calculating taxes rather than providing meaningful input for budgeting.
- Most companies around the world use computer software for accounting and financial reporting (and managerial accounting as well)
- Many companies use standardized documents turnover and decision-making across the major operating cycles of the company: Revenue and Expenditure. This significantly increases the speed and quality of financial reporting.
- Accounting functions in foreign companies are well developed and possess the resources needed while in Russia the accounting function is not that well developed or equipped with suitable technology

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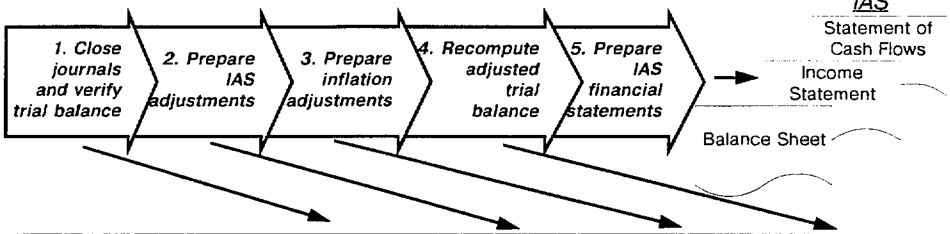
INSTRUCTOR'S NOTES

A Look on Historical Accounting Data - How to Move to IAS from RSA

Alternatively, the companies may choose to maintain IAS-based accounting



Trial Balance as of January 1, 1996					
Account No	Account name	Trial Balance in '000 RUB.	IAS Adjustments	Inflation Adjustments	IAS Trial Balance in '000 RUB
01	Fixed assets	16,368	(14,221)	19,238	21,385
02	Accumulated depreciation	(11,721)	11,108	(13,264)	(13,877)
......	....	....	....	....	....
90	Loans payable	(3,500)	0	0	(3,500)
95	Long-term non-bank loans	(1,250)	0	0	(1,250)
96	Special financing	(500)	0	0	(500)

Derived from the differences in IAS and RSA

In accordance with IAS 29

Note: Translation into foreign currency can be done as an additional independent step if required

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INSTRUCTOR'S NOTES

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Differences between Russian and International Accounting Standards: Summary

- IAS accounting principles guide accounting and financial reporting standards
  - RSA principles differ significantly in practical implications
- Financial statements for Russian companies prepared under IAS standards will generally show different net income and will value differently some assets and liabilities
- Financial reporting in Russia, regulated by the state, is gradually moving towards IAS financial reporting. However, significant differences remain
- Valuation of assets (and, hence, of depreciation), inventories and leases are the categories which require significant revaluation
- Cost accounting and calculation of Cost of Goods Sold have significantly different treatment under IAS and RSA standards
- Organizational issues impede timely and accurate financial reporting
  - process flows differences
  - reporting and decision-making authority
  - procedures and systems
- These differences necessitate the translation of the RSA financial statements into IAS as a separate exercise if required by business circumstances.

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INSTRUCTOR'S NOTES

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Moving to International Accounting Standards

Session 4: Options for moving to International Accounting Standards

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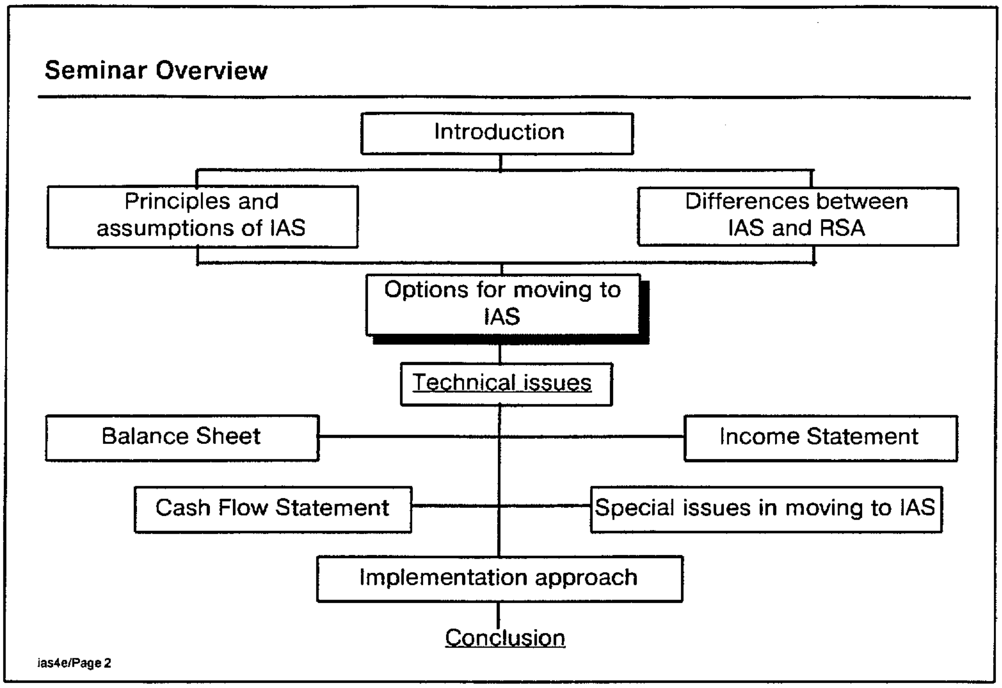
INSTRUCTOR'S NOTES



INSTRUCTOR'S NOTES

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Session Agenda and Objectives

Agenda

- Available approaches: backward vs. forward-oriented
- Backward-oriented approach: transformation of RSA statements
- Forward oriented approach
- Choice of options: strategic issues for consideration

Objectives

- To present available options of moving to IAS
- To discuss the relative benefits of each option

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INSTRUCTOR'S NOTES

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Move to IAS: Backward-Oriented vs. Forward-Oriented

Strategic consideration should be made to choose between backward- and forward-oriented approach.

Backward-oriented approach *(Ex-post approach)*	Approach that accounting professionals use to adjust and subdivide statutory account balances to produce IAS financial statements. This approach is usually referred to as Transformation. Transformation is a one-time exercise.
Forward-oriented approach *(Ex-ante approach)*	Approach that involves recording each transaction at the time of initial transaction recording with enough information to produce both Statutory and IAS financial statements. This approach is usually referred to as dual accounting.

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INSTRUCTOR'S NOTES

Backward-Oriented Approach: Available Options

The following options are available within the backward-oriented approach:

1	*Reclassification of accounts*	***Presents RSA information without adjusting for IAS requirements in a more familiar format***
2	*Basic transformation*	***Involves some basic adjustments to certain items like sales, funds, interest, bad debt, obsolete inventory, G&A expense. Gives information about financial position but can be used for informal purposes only.***
3	*Full transformation to IAS standards in local currency*	***Requires information about individual transactions. Does not comply with IAS in an inflationary environment.***
4	*Full transformation to IAS in local currency with inflation adjustments*	***Requires information about individual transactions. Comply with IAS.***
5	*Full transformation to IAS in foreign currency*	***Performed after inflation adjustments. Allows consolidation into financial accounts of foreign companies.***

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INSTRUCTOR'S NOTES

Transformation Performed by Independent Accounting Firms

A standard letter issued as a result of transformation of Russian financial statements into statements in conformity with other standards usually state:

- The period of transformation;
- Scope of documents produced (balance sheet, income statement, cash flow statement);
- Standards used (IAS, US GAAP, UK GAAP, other standards).

A separate note is added to the financial statements, which usually explains some procedures applied and a reconciliation note between the statutory accounts and the transformed statements

Important notes:

1 The responsibility for compliance with Russian accounting principles is still vested in the management of the company

2 Transformation does not substitute the audit of either local financial statements, or statements prepared in accordance with IAS

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INSTRUCTOR'S NOTES

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Backward-Oriented Approach: Advantages and Limitations

Advantages

- One-time approach
- Does not require change in the organization
- Performed by accounting professionals
- Performed when there is a well identified need for transformation
- Usually designed to meet the specific requirements of the client since the target client is known
- Relatively low-cost approach

Limitations

- One-time approach
- Can be performed only by accounting professionals
- Accuracy is limited since assumptions are used ex-post
- Accuracy is limited by the quality of source documents available
- Can be performed only at the end of accounting period based on compiled financial statements

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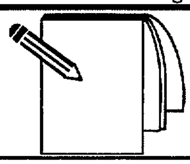
INSTRUCTOR'S NOTES

Forward-Oriented Approach: Available Options

The options available for forward-oriented approach can be viewed from two angles: level of automation and level of coverage of accounting areas.

Level of Coverage

Level of automation		Limited to one or several areas, i.e. cost accounting, marketable securities accounting	Full coverage of all aspects of accounting
	Manual		
	Automated		

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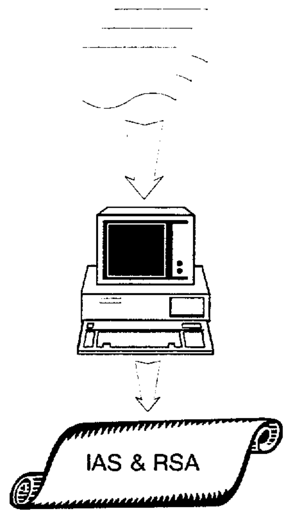
INSTRUCTOR'S NOTES

Requirements for Forward-Oriented Approach

The new system should meet the following requirements:

- To operate within the existing Statutory Chart of Accounts
- Not to cause any changes in the methods of RSA compilation and reporting
- To produce IAS reports
- To cover all or the selected areas of accounting
- To permit more detailed data collection, to reflect realistic allocation bases for overheads and other costs
- To use the same source data as the system existing at the company
- To be applicable to multiple environments
- To be operational in the manual Existing System



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INSTRUCTOR'S NOTES

The next slide is intended to provide a general appreciation on these general requirements.

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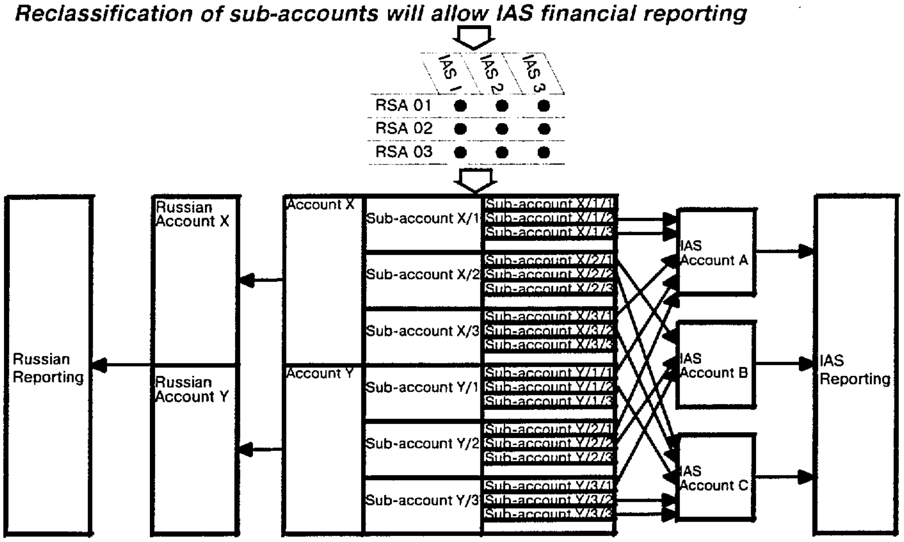
Forward-Oriented Approach

Reclassification of sub-accounts will allow IAS financial reporting



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INSTRUCTOR'S NOTES

The forward-oriented approach is basically a system that captures the transactions at the moment they are happening and records each transaction to such a level of detail that further compilation on the basis of two different sets of rules becomes possible.

This can be done differently.

The scheme illustrates how this can be done using the system of sub-accounts. However, this is not the only solution. The same idea may be realized within the software using the system codes ('sub-accounts'). It is obvious, that whatever the name, the idea stays the same.

The forward-oriented approach involves also issues like:

- cost drivers and cost parameters
- allocation based for overheads and other expenses
- timing of transactions to comply with IAS accruals principle and adopted RSA principles.

Forward-Oriented Approach: Advantages and Limitations

Advantages

- On-going approach
- Produces both RSA and IAS financial statements
- Level of accuracy much higher
- Possibility of further improvement in the future if implemented on a module basis
- Compilation according to different rules independently
- Minimal reporting lag
- Provides more comprehensive management information apart from compilation of financial statements

Limitations

- No universal solution available that would be applicable to all companies
- Involves changes in many departments of the company and not only in the accounting department
- Requires considerable staff training, both computer and accounting
- Implementation takes considerable time
- More expensive

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INSTRUCTOR'S NOTES

Strategic Issues for Consideration

- Who needs the IAS statements? Who is the ultimate user?
  - SEC or small private company or large multinational company
- For what purpose will the transformed financial statements be used?
  - acquisitions or investments or loans, etc.
- What level of materiality and detail is acceptable?
- How will the ultimate user perceive the reliability of the statements? Does he need a third-party independent opinion?
- How much time is available before the final decision on the basis of financial statements is to be made?
- What resources are available?
  - internal staff vs. external consultants
  - budget
  - support environment (hardware & software)
- What are the potential benefits from the transformation?
- Accounting department systems and procedures
  - existing data: accuracy and level of detail
  - ability to generate needed data on demand

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INSTRUCTOR'S NOTES

Implementation Options: Summary

- The company needs to make a choice between backward- and forward-oriented approach of moving towards IAS financial statements
- The decision is based on the need for moving towards IAS: one-time requirement vs. long-term IAS reporting
- The decision should be supported by the budget available, commitment of the management and personnel, and company's strategy
- The company needs to consult professionals, including accounting and system specialists when making an implementation decision
- Forward-oriented system offers more benefits compared to backward-oriented approach
- Forward-oriented system involves more changes in the company including accounting and other departments of the company, its staff and requires considerable training.

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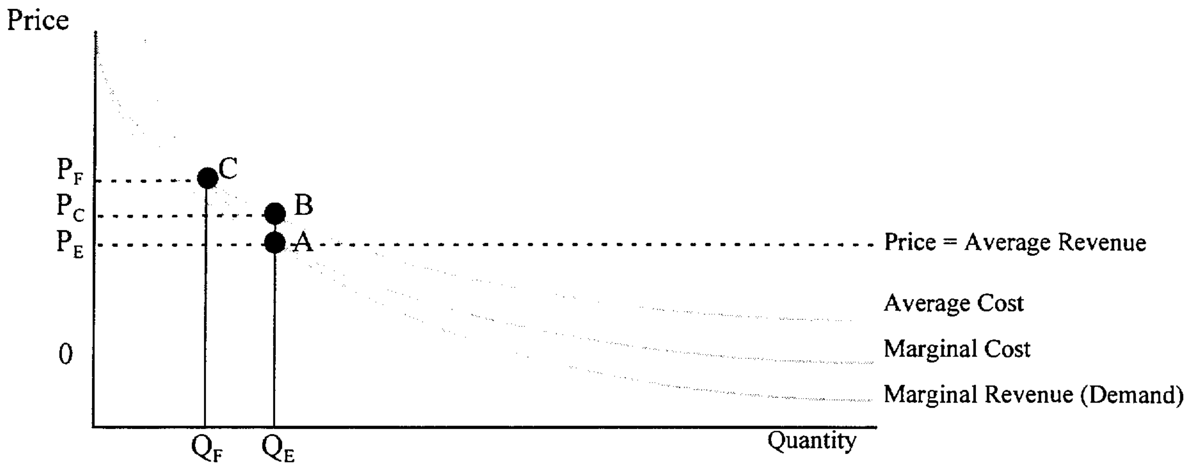
INSTRUCTOR'S NOTES

At the end of this session, if this is the end of Day 1 of the seminar, Homework 1 should be given to participants.



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B
A
Price = Average Revenue
Average Cost
Marginal Cost
Marginal Revenue (Demand)
Q_F
Q_E
Quantity

Moving to International Accounting Standards

Session 5: Balance Sheet

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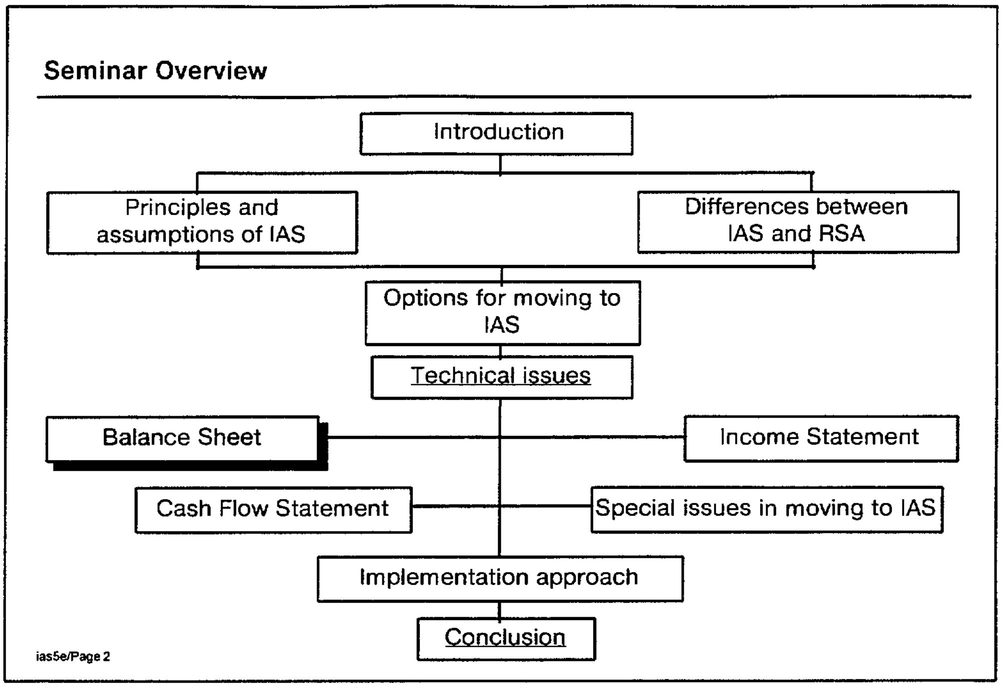
INSTRUCTOR'S NOTES

This section of the seminar discusses technical issues of the balance sheet: what are the technical differences between Russian and IAS requirements for balance sheet and what information and major adjustments are required in order to move to IAS. In a number of cases, the issues are illustrated by simple examples. For more detailed information and examples refer to the handbook.



INSTRUCTOR'S NOTES

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Session Agenda and Objectives

Agenda

- IAS general balance sheet disclosure and format requirements
- Technical issues regarding non-current assets
- Technical issues regarding current assets
- Technical issues regarding liabilities
- Technical issues regarding shareholders' equity

Objectives

- To discuss IAS requirements for content and formats of the balance sheet
- To learn what information should be maintained for IAS
- To become familiar with some technical issues of differences between Russian accounting and IAS

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INSTRUCTOR'S NOTES

At the beginning of this session, if this is Day 2 of the seminar, Homework 1 should be discussed with the participants.

IAS Disclosure and Format Requirements

- IAS sets requirements for the disclosure of information in financial statements, defined in the standard as comprising a balance sheet, an income statement, notes, and other statements and explanatory material
- IAS does not propose a specific format for the presentation of the financial statements. All material information needs, however, to be disclosed so that the financial statements are clear and understandable. Financial statements should show the corresponding figures for the preceding period. The name of the enterprise, the country of incorporation and the balance sheet date should be stated. A brief description of the nature of the activities, the legal form of the enterprise, and the currency in which the financial statements are expressed should also be disclosed
- The following disclosures should also be made:
  - information about restrictions on the title to assets,
  - security given in respect of liabilities,
  - contingent assets and liabilities, quantified if possible, and
  - amounts committed for future capital expenditure

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INSTRUCTOR'S NOTES

This slide presents general disclosure and format requirements stated in IAS.

Stress that there is no particular format for the balance sheet and that what IAS 5 'Information to be Disclosed in Financial Statements' regulates is the information that should be disclosed in the statements.

Ask participants how they think these requirements are fulfilled in in the Russian balance sheet.

IAS Balance Sheet: Assets Section

Long-term assets: The following items should be disclosed

- Property, plant and equipment
  - Land and buildings
  - Plant and equipment
  - Other categories of assets, suitably identified
  - Accumulated depreciation
- Other long-term assets
  - Long-term investments in subsidiaries and associates
  - Long-term receivables: trade receivables, receivables from directors, intercompany receivables
  - Intangible assets (goodwill, patents)

Current assets:

- Cash
- Marketable securities
- Receivables: trade receivables, receivables from directors, intercompany and prepaid expenses
- Inventories

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INSTRUCTOR'S NOTES

This slide presents a possible format for the asset section of the IAS balance sheet.

Refer participants to the corresponding part of the case study balance sheet.

Intangible Assets

In accordance with IAS, intangible assets should be valued at historic cost as at the date of acquisition

Under Russian accounting intangible assets include the following items:

- Intellectual property (patents, licenses, rights, etc.)
- Software
- Company set-up expenses
- Goodwill

In order to move to IAS:

- Estimate useful lives of the intangible assets. Intangible assets re intellectual property are amortized over the estimated useful life. For patents and licenses - over the period of their validity.
- Software expenses must be reclassified as fixed assets and added to the appropriate fixed asset account.
- Company set-up expenses must be reclassified. If incurred in this year - charged to P&L as a loss, if incurred in past years - charged against the reserve brought forward

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INSTRUCTOR'S NOTES

The purpose of this slide is to present the IAS requirements for treatment of intangible assets.

Emphasize the concept of estimated useful life of an intangible asset and how it can be determined. Possible options:

- Implied by the nature of the asset (e.g., 5 year license)
- Past experience
- Independent estimation

Tangible Fixed Assets (General)

In accordance with IAS an item of property, plant and equipment should be recognized as a fixed asset when:

- an asset has a useful economic life of over one year
- it is probable that future economic benefits associated with the asset will flow to the enterprise, and
- the cost of the asset to the enterprise can be measured reliably

According to IAS the company should disclose the following information:

- The gross carrying amount and the accumulated depreciation at the beginning and end of the period
- The depreciation method used, the useful lives and depreciation rates
- Information about additions, disposals and acquisitions through business combinations, increases and decreases resulting from revaluations
- The existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities, or other commitments

IAS contains a special standard which sets rules and requirements for accounting for tangible fixed assets

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INSTRUCTOR'S NOTES

The purpose of this slide is to introduce the tangible assets.

Compare disclosure requirements for Russian and IAS financial statements regarding fixed assets.

Emphasize the fact that all restrictions and encumbrances should be specifically disclosed.

Note that IAS 16 'Property, Plant and Equipment' sets rules and requirements for accounting for tangible fixed assets.

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Tangible Fixed Assets (Depreciation)

According to IAS the depreciable amount of a fixed asset should be allocated on a systematic basis over its useful life

- The company selects a depreciation method. The depreciation method used should reflect the pattern in which the asset's economic benefits are consumed by the enterprise
- The depreciation charge for each period should be recognized as an expense unless it is included in the carrying amount of another asset
- The useful life of a depreciable asset should be estimated after considering the following factors:
  - expected usage of the asset by the enterprise
  - expected physical wear and tear
  - obsolescence
  - legal or other limits on the use of the asset

IAS sets rules and requirements for the use of depreciation methods and accounting for them

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INSTRUCTOR'S NOTES

The purpose of this slide is to present how fixed assets are depreciated in accordance with IAS.

Explore the concept of economic useful life and net realizable (residual) value of the asset.

Introduce various depreciation methods. For more details and examples refer to the handbook.

Discuss the statement that the depreciation method should reflect the pattern of economic benefit consumption.

Note that IAS 4 'Depreciation Accounting' and IAS 16 'Property, Plant and Equipment' set the rules and requirements for the use of depreciation methods and accounting for them.

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Tangible Fixed Assets (Revaluation 1)

IAS states that revaluations should be made with sufficient regularity and in such a manner that following initial recognition as an asset the carrying amount should not differ materially from that which would be determined using fair value at the balance sheet date

IAS propose the following ways of determining fair value of fixed assets:

- The fair value of land and buildings is usually its market value for its existing use. This value is determined by appraisal normally undertaken by professionally qualified valuers
- The fair value of plant and equipment is usually its market value determined by appraisal
- When an item of property, plant and equipment is revalued, the entire class to which that asset belongs should be revalued. It is important to have fixed assets grouped in a proper manner
- The increase in value should be credited directly to equity under the heading of revaluation surplus. It may be transferred to retained earnings when the surplus is realized

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INSTRUCTOR'S NOTES

The purpose of this slide is to present how revaluations are viewed in IAS.

Emphasize the concept of fair value of the asset and possible options to determine the fair value.

Tangible Fixed Assets (Revaluation 2)

Most western companies do not revalue their plant and equipment regularly. But it is important for Russian companies for the following reasons:

- Historic cost of plant and equipment in the books of the formerly stated-owned Russian companies were determined by the state prices and do not reflect any market value
- Due to hyper-inflation in Russia during 1992-1995 historic cost of plant and equipment became irrelevant
- For mandatory revaluations of fixed assets in Russia the enterprises were provided with uniform revaluation rates which had no reference to real inflation rates and did not give the enterprises a possibility to determine fair value
- Revaluations of fixed assets have significant tax consequences since, for example, property tax is based on the revalued asset amounts
- Since depreciation rates in Russia tend to be lower than those in western countries, fixed assets remain in the enterprises' books and are depreciated over longer periods of time

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INSTRUCTOR'S NOTES

The purpose of this slide is to discuss how Russian mandatory revaluations differ from the IAS concept.

Ask participants what do they think are the purpose and effects of mandatory revaluations of fixed assets.

Ask whether any of the participants used an independent valuation for revaluation of fixed assets.

Tangible Fixed Assets (Revaluation 3)

When items of property, plant and equipment are stated at revalued amounts the following should be disclosed:

- The basis used to revalue the assets
- The effective date of the revaluation
- Whether an independent valuer was involved
- The nature of any indices used to determine replacement cost
- The carrying amount of each class of property, plant and equipment that would have been included in the financial statements had the assets been carried at cost less depreciation
- The revaluation surplus, indicating the movement for the period and any restrictions on the distribution of the balance to shareholders

Enterprises are also encouraged to have additional information (amount of temporary idle property, of fully depreciated fixed assets that are still in use, of fixed assets held for disposal, etc.)

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INSTRUCTOR'S NOTES

The purpose of this slide is to show the IAS disclosure requirements for revaluation of fixed assets.

Compare this information with information one can obtain from Russian financial statements.

Example on Tangible Fixed Assets (Revaluation)

AOOT Utyug performed a revaluation of fixed assets as at January 1, 1995. For revaluation purposes government indices were used. In accordance with Russian accounting regulations, revaluation gain on production fixed assets was recorded as additional capital.

In order to conform with IAS the enterprise's fixed assets should be recorded at fair value. Since the enterprise did not have an independent valuation, it may use historic costs adjusted for inflation. But before making an inflation adjustment, revaluation entries should be reversed:

Dr. Additional capital
    Cr. Fixed assets, and

Dr. Accumulated depreciation
    Cr. Additional capital

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INSTRUCTOR'S NOTES

The purpose of this slide is to illustrate by example how the effects of Russian mandatory revaluations should be reversed.

Tangible Fixed Assets (Conclusions)

In order to move to IAS the enterprise should analyze and obtain information re the following issues:

- Whether all tangible fixed assets conform with the definition of IAS
- Add machinery to be installed and assets under construction to tangible fixed assets
- Estimate the economic useful lives of tangible fixed assets
- Analyze whether the current depreciation method fairly corresponds to the useful lives
- Reverse Russian mandatory revaluations
- Adjust fixed assets for the effects of hyper-inflation
- Consider an independent valuation to reflect a fair value

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INSTRUCTOR'S NOTES

The purpose of this slide is to show what information and adjustments are required regarding fixed assets in order to move to IAS.

Note that in IAS there is a special standard for construction contracts which relates to assets under construction and is discussed in the special issues section of the seminar.

Long-term Investments

In accordance with IAS long-term investments are held by the company for the purpose of exercising control or influence over the investee, or for a purpose other than gaining return on investment

In order to move to IAS the enterprise should analyze its long-term investments as follows:

- If the enterprise has a clear intention to retain its investment not for a long period (less than one year), or holds this investment for the purpose of gaining return on it, such an investment needs to be reclassified as short-term
- If the enterprise holds an investment which can be easily turned into cash at any moment, such an investment needs to be classified as a monetary asset

Long-term investments can be valued at one of the following:

- Historic acquisition cost
- Current market value

Management should analyze all long-term investments and purposes of holding them. If possible, obtain information about current market value of the investments

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INSTRUCTOR'S NOTES

The purpose of this slide is to show what investments can be regarded as long-term in accordance with IAS.

Emphasize that management should regularly analyze and revise the investments.

Ask participants whether they do it and how.

Stocks

Stocks should be valued in the IAS accounts at cost of production plus any associated costs which have been incurred in bringing the stock to its current state at the end of the period, or in some cases at net realizable value.

In order to move to IAS:

- Analyze all costs included in the period end value of stock by type of
  - materials cost
  - labor costs
  - general, administrative and overheads
- Exclude all non production related overheads from the value of stock and charge them directly to the profit and loss account
- Analyze absorption rates for overheads used by the company. Absorption rates are based on the normal production levels of the plant. If the plant operates below capacity, idle time costs should be estimated and charged directly to the profit and loss account
- Determine whether stocks are valued at the lower of cost or net realizable value. If stock has been recently sold at a loss or scrapped, consider the need for a provision to write down the value of stocks

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INSTRUCTOR'S NOTES

The purpose of this slide is to introduce the concepts of IAS requirements for stocks and what information the enterprise should have.

Note that valuation of stock balances closely relates to the cost of goods sold item of the income statement. These issues will be touched in the income statement section of the seminar.

The notion of absorption rate is also only introduced in this slide and will be discussed in the income statement section.

Short-Term Investments

In accordance with IAS short-term investments are held by the company for the purpose of gaining return on surplus cash

In order to move to IAS the enterprise should analyze its short-term investments as follows:

- If the enterprise holds an investment, or has a clear intention to retain it for a long period (over one year), or holds this investment for a purpose other than for gaining return on it, such an investment needs to be classified as long-term
- If the enterprise holds an investment which can be easily turned into cash at any moment, such an investment needs to be classified as a monetary asset

Short-term investments can be valued at one of the following:

- Historic acquisition cost
- Current market value

Management should analyze all short-term investments and purpose of holding them. If possible, obtain information about the current market value of the investments

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INSTRUCTOR'S NOTES

The purpose of this slide is to show what investments can be regarded as short-term in accordance with IAS.

Ask participants how they distinguish between short-term and long-term investments for their own purposes.

Emphasize that management should regularly analyze and revise the investments.

Ask participants whether they do it and how.

Trade Receivables

In accordance with the accruals principle IAS requires that all trade and other receivables expected to be realized within one year of the balance sheet date should be accounted for in their entirety

It is important to have information about quality of receivables. This may include:

- Aging information
- Receivables turnover analysis
- Regular reconciliation of settlements with major debtors

This information is needed for making bad debt provisions and initiating further enquiries and legal actions in case of disputes

If the enterprise shows receivables at cost it should have readily available information as to corresponding sales values

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INSTRUCTOR'S NOTES

The purpose of this slide is to show what information is required for trade receivables in accordance with IAS.

Trade receivables is normally shown net of any bad debt provision. The bad debt provision can be disclosed separately. Refer participants to the IAS financial statements for an example.

Ask participants whether they have the required information readily available within their accounting departments and how much time it may take to generate this information.

Prepayments and Other Debtors

Prepayments and other receivables may represent a significant portion of all receivables

Prepayments should be classified in three groups:

- Advance payments on the purchase of current assets
- Advance payments on the purchase of fixed assets and construction
- Expense prepayments expected to be used up within one year of the balance sheet date

Quality information (aging, expected delivery) should be available

Analysis of other receivables should include:

- Nature of receivable (operating, investing, financing, tax, etc.). This information is required for preparation of cash flow statement

For major amounts - quality information (aging and reconciliation of settlements) should be available

This information is needed for making bad debt provisions and initiating further enquiries and legal actions in case of disputes

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INSTRUCTOR'S NOTES

The purpose of this slide is to show what information is required for other receivables and prepayments in accordance with IAS.

Note that irrecoverable amounts can also arise in other receivables and prepayments, and therefore a provision may be needed.

Ask the same questions as on the previous slide.

Cash and Monetary Assets

According to IAS cash includes cash on hand and current and other accounts with banks

In order to move to IAS:

- Analyze bank accounts by currency
- Obtain information about monetary documents as at the end of the period which have been issued but not processed by the bank and not included in the closing bank statement:
  - payment orders
  - cheques

  Cash and bank balances should be adjusted to include the transactions by bank
- Analyze deposits as at the end of the period. Obtain information about interest and bank charges that should be accrued but are not shown in the bank statement
- Analyze cash which is not immediately available for use, for example balances frozen in banks by exchange restrictions. They should be separately disclosed

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INSTRUCTOR'S NOTES

The purpose of this slide is to show where cash and monetary assets items can differ in Russian and IAS statements.

Emphasize the idea that according to IAS cash book, not bank statement, is used for the year end cash balances.

Cash and Monetary Assets: Example

On December 29, 1995 AOOT Utyug issued two payment orders for the total amount of RUR 70 mln and forwarded them to the servicing bank. They related to paying for raw materials. The bank processed these orders only on 5 January, 1996, therefore the year end bank statement dose not include these amounts.

An adjustment should be made because for IAS balance sheet not the bank statement but the cash book is a source document.

Dr. Trade payables/Cr. Cash	RUR 70 mln

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INSTRUCTOR'S NOTES

IAS Balance Sheet: Liabilities Section

Long-term liabilities:

- Secured and unsecured loans
- Intercompany loans and loans from associates

Current liabilities:

- Bank loans
- Current portion of long-term liabilities
- Payables: trade payables, payables to directors, intercompany payables, taxes payable, dividends payable, accrued expenses

Other liabilities and provisions

- Deferred taxes
- Deferred income
- Provisions (e.g., bad debt provision)

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INSTRUCTOR'S NOTES

This slide presents a possible format for the liability section of the IAS balance sheet.

Refer participants to the corresponding part of the case study balance sheet.

Bank Loans

IAS require much more information to be disclosed in the financial statements in respect of bank loans. This includes information about the interest rates, repayment terms, covenants, subordinations, etc.

Under IAS long-term loans should be analyzed as follows:

- Obtain information about secured and unsecured loans. This information should be separately disclosed in financial statements
- Obtain information about intercompany loans and loans from associates. This information should be separately disclosed in financial statements
- Determine the portion of long-term debt repayable within one year. It should be reclassified as a short-term debt
- Calculate, if not done, interest that should be accrued by the end of the period

Under IAS short-term loans should be analyzed as follows:

- Obtain information about secured and unsecured loans
- Obtain information about intercompany loans and loans from associates
- Calculate, if not done, interest that should be accrued by the end of the period

Information is also needed to assess possible penalties and make accruals and provisions for this purpose

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INSTRUCTOR'S NOTES

The purpose of this slide is to show participants how bank loans should be analyzed and disclosed in the IAS financial statements.

Emphasize that much more information regarding bank loans should be disclosed in accordance with IAS requirements.

Ask participants whether this information is readily available within their accounting departments and how long it may take to generate this information.

Trade Payables

In accordance with the accruals principle IAS requires that all trade payables should be accounted for in the balance sheet in their entirety. If the amount is not defined at the end of the period a liability should be recorded at estimated cost

The enterprise should have the following information available:

- Aging analysis
- Penalties and sanctions due to creditors in accordance with contracts
- Regular reconciliations with major creditors

This information is needed for initiating further enquires and legal actions in case of disputes

Prepayments from customers should be separated from genuine trade payables in order to estimate the amount of actual liabilities of the enterprise

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INSTRUCTOR'S NOTES

The purpose of this slide is to show participants what information is required to analyze and reflect trade payables in accordance with IAS.

Emphasize that all payables should be shown in the balance sheet including penalties and sanctions payable to creditors in case of late payment.

Note that aging analysis of payables can help the enterprise, especially one not in a good cash position, to prioritize its creditors and to avoid or minimize penalties.

Taxes Payable and Receivable

In accordance with IAS tax settlements are carried out in compliance with national tax legislation and corresponding amounts of taxes payable and receivables are shown in the balance sheet of the enterprise. IAS state requirements as for completeness of these items

In order to move to IAS:

- Analyze whether all taxes related to the reporting period have been accrued regardless of actual payment
- Obtain and analyze information about fines and penalties imposed on the enterprise by tax authorities
- Assess possible fines and penalties and other contingencies in respect of tax settlements
- Adjust IAS financial statements to incorporate this information

This information should be disclosed in the financial statements of the enterprise

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INSTRUCTOR'S NOTES

The purpose of this slide is to show how taxes payable and receivable should be shown in IAS financial statements.

Emphasize that Russian enterprises often do not show the total amount of tax liabilities, though it may affect significantly their financial position.

IAS Balance Sheet: Shareholders' Interests Section

Shareholders' interest:

- Share capital. For each class of share capital:
  - the number or amount of shares authorized, issued and outstanding
  - the capital not yet paid in
  - the par or legal value per share
  - the movement in share capital accounts during the period
  - the rights, preferences, and restrictions with respect to the distribution of dividends and to the repayment of capital
  - cumulative preferred dividends in arrears
  - re-acquired shares
  - shares reserved for future issuance under options and sales contracts, including terms and amounts
- Other equity, indicating the movement for the period and any restrictions on distribution:
  - capital paid-in in excess of par value (share premium)
  - revaluation surplus
  - reserves
  - retained earnings

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INSTRUCTOR'S NOTES

This slide presents a possible format for the shareholders' interests section of the IAS balance sheet.

Refer participants to the corresponding part of the case study balance sheet.

Share Capital

In accordance with IAS the enterprise should disclose in its financial statements the following information for each class of share capital:

- The number or amount of shares authorized, issued and outstanding
- The capital not yet paid in
- The par or legal value per share
- The movement in share capital accounts during the period
- The rights, preferences, and restrictions with respect to the distribution of dividends and to the repayment of capital
- Cumulative preferred dividends in arrears
- Reacquired shares
- Shares reserved for future issuance under options and sales contracts, including the terms and amounts

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INSTRUCTOR'S NOTES

The purpose of this slide is to show what information should be available in the IAS financial statements regarding share capital.

Note that IAS financial statements require much more information to be disclosed in the shareholders' interest section of the balance sheet.

Other Equity

In accordance with IAS the enterprise should have the following information available for disclosure in its financial statements regarding other equity:

- Capital paid-in in excess of par value (share premium)
- Revaluation surplus
- Reserves
- Retained earnings

Disclosure is also required of any movement for the period and of any restrictions on distribution

In order to move to IAS significant changes and reclassifications are required. They are discussed in the following slides

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INSTRUCTOR'S NOTES

The purpose of this slide is to show what information should be available in the IAS financial statements regarding other equity items.

Special Purpose Funds

The nature and use of special purpose funds in Russian accounting is a substantial departure from IAS. Russian enterprises transfer their net profit into various funds with special purpose. Some expenses are charged directly to these funds not to the profit and loss account

From the IAS viewpoint, resources accumulated in special purpose funds are, in general, a part of retained earnings.

In order to conform with IAS the enterprise should have the following analysis for the period in question:

- Total amount of profit appropriated to each fund
- Production and non-production related expenses from funds
- Operating and capital expenditures from funds
- Amounts transferred between funds

This information is needed for reclassification of expenditure from special purpose funds to appropriate expense categories

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INSTRUCTOR'S NOTES

The purpose of this slide to discuss how Russian special purpose funds are different for IAS and what information should be available to make the necessary reclassification.

Note that expenses charged to special purpose funds do not go through profit and loss account.

Ask participants what expenses can be charged to special purpose funds and how this information can be obtained.

~~Example on Special Purpose Funds~~

As per Russian statements AOOT Utyug had the following balances of the special purpose funds accounts:

	Opening balance	Transferred	Spent	Closing balance
Accumulation fund	538	5,715	1,889	4,364
Consumption fund	3,360	23,396	25,565	1,191
Social assets fund	15,082	6,529	1,494	20,117

At both balance sheet dates the enterprise had no retained earnings.

In order to have the amount of retained earnings in conformity with IAS the enterprise needs to make the following analyses and adjustments:

- Social assets fund should be regarded as a capital reserve item and not included in retained earnings
- Appropriation of profit to special purpose funds should be reversed
  Dr. Special purpose funds/Cr. Profit and loss 29,111
- Expenditures from funds should be analyzed and charged to an appropriate expense account or capitalized
  Dr. Expense/Asset account/Cr. Special purpose funds 27,454

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INSTRUCTOR'S NOTES

The purpose of this slide is to illustrate with an example how special purpose funds entries should be reversed.

Accruals

In accordance with IAS costs and expenses which have been incurred by the enterprise the exact amount of which are not defined at the end of the period need to be accrued. In some instances it may be necessary to estimate the amount of the liability. Such expenses, which are normally billed or shown in the following period, include:

- Utilities
- Telephone
- Bank interest
- Payroll
- Tax penalties

In order to move to IAS accruals should be made for all traditionally unrecorded liabilities in order to comply with the principles of completeness and prudence and to reflect in the financial statements the real financial position of the enterprise

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INSTRUCTOR'S NOTES

The purpose of this slide is to introduce the concept of accruals.

Ask participants how often they receive invoices after the balance sheet date and how they treat such invoices.

Example on Accruals

AOOT Utyug uses electricity for production purposes. Actual monthly consumption varies from month to month and is on average 180,000 kWh at the rate of RUR 200 per kWh. Electricity bills for the actual consumption of this month are received by the enterprise on the 15th of the following month.

*In order to record the liability to the electricity company the enterprise makes an accrual for the estimated amount of RUR 36 mln based on the averaged previous data (180,000 kWh * RUR 200).*

*If the consumption period differs from accounting period (e.g., electricity is billed for the period from the 15th of this month to the 15th of the following month, an accrual should reflect this fact (in our example, 180,000 kWh / 2 * RUR 200).*

The corresponding entry is:

Dr. Utilities expense	RUR 36 mln
Cr. Electricity payable	

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INSTRUCTOR'S NOTES

The purpose of this slide is to illustrate with an example how an accrual in respect of uninvoiced liability should be made.

Provisions

Some liabilities can be measured only by using a substantial degree of judgment. Such liabilities are referred to as provisions. Provisions, as accruals, are accounted for at estimated cost. As opposed to accruals, provisions focus on the economic substance rather than timing of an event.

In accordance with IAS there are two types of provisions:

- General provision is made against a balance sheet item in general (e.g., 5% of receivables balance)
- Specific provision is made against an identified amount (e.g., a particular debtor)

Examples of provisions include:

- bad debt provision
- provision against stock deterioration and obsolescence
- provision against a foreseeable loss

Provisions should be made by the enterprise in order to comply with the IAS concept of prudence

Transfers to provisions are viewed by IAS as expenses rather than appropriations of retained earnings

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INSTRUCTOR'S NOTES

The purpose of this slide is to introduce the concept of provisions.

Compare provisions allowed by Russian accounting and those required by IAS.

Discussing bad debt provision, refer participants to the slide on trade receivables and ask how the information about the quality of trade receivables should be used for making provision.

Example on Provisions

*AOOT Utyug regularly acquires various types of plastics. Recently, one type of plastics was prohibited for use in home electric appliances. As at January 1, 1996 the stock balance of this plastic was RUR 10 mln (50,000kg * RUR 200). Since the management do not see any other use for this plastic, they decide to sell 80% of it. The current price is RUR 120 per kg.*

A provision for foreseeable loss is required.

Expected proceeds from the sale:

- 50,000kg * 80% * RUR 120 = RUR 4.8 mln

Cost of stock to be sold:

- 50,000kg * 80% * RUR 200 = RUR 8 mln

Provision:

Dr. Provision expense (G&A)/Cr. Provisions RUR 3.2 mln

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INSTRUCTOR'S NOTES

The purpose of this slide is to illustrate with an example how provision should be made in accordance with IAS.

Reserves

IAS make a distinction between provisions and reserves. Transfers to reserves are viewed by IAS as appropriations of retained earnings rather than expenses

In accordance with IAS there are two types of reserves:

- Statutory reserves required by law in order to give the enterprise and its creditors an added measure of protection from the effects of losses. Russian enterprises may create a reserve fund which serves a similar purpose
- Tax reserves. Tax law grants exemptions for transfers to such reserves. An example of such a tax reserve is a tax allowance, on certain conditions, for Russian enterprises which invested in renovation and modernization

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INSTRUCTOR'S NOTES

The purpose of this slide is to introduce the concept of reserves.

Clearly distinguish between provisions and reserves.

Ask participants what reserves (in terms of IAS) exist in Russian accounting.

Exercise: Multiple Choice Questions (1)

1. Examples of receivables which would be classified as current assets on the balance sheet include

A) Accounts receivable collectible within 30 days

B) Accounts receivable collectible within 18 months for a company with an operating cycle of two years

C) Accounts receivable in respect of barter deals

D) All of the above

2. If the ending inventory is overstated by RUR 100 mln as of January 1, 1996,

A) Cost of goods sold will be overstated for 1995

B) Cost of goods sold will be overstated for 1996

C) Owner's capital will be understated as of January 1, 1996

D) Owner's capital will be understated as of January 1, 1997

3. The primary purpose of depreciation is to:

A) Show the fair market value of the plant asset on the balance sheet of the company

B) Prevent the misuse of plant assets

C) Allocate the cost of the plant over the period benefited

D) Record a decrease in the value of the plant asset based on changes in the current replacement cost of the asset

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INSTRUCTOR'S NOTES

Exercise: Multiple Choice Questions (2)

4. Retained earnings of a company as of a given date are equivalent to:

A) Net income for past years less dividends declared

B) Net income of the current year

C) Net income for all years since incorporation less losses and dividends declared

D) None of the above

5. In presenting short-term investments in shares of other companies on the balance sheet

A) Investments should always be valued at higher of cost or market

B) Investments should always be valued at cost

C) Investments, if they are marketable, should always be valued at lower of cost or market

D) Investments should always be valued at market

6. An accrual should be made on the basis of estimation as of the balance sheet date when

A) The electricity bill for the reported period has not been received

B) Bank is to accrue interest for the reported period on deposit in accordance with the deposit agreement

C) Tax authorities performed a tax audit and claim penalties of RUR 100 mln

D) All of the above

INSTRUCTOR'S NOTES

Exercise: Multiple Choice Solutions (1)

1. Examples of receivables which would be classified as current assets on the balance sheet include

A) Accounts receivable collectible within 30 days

B) Accounts receivable collectible within 18 months for a company with an operating cycle of two years

C) Accounts receivable in respect of barter deals

$\boxed{\text{D) All of the above}}$

2. If the ending inventory is overstated by RUR 100 mln as of January 1, 1996,

A) Cost of goods sold will be overstated for 1995

$\boxed{\text{B) Cost of goods sold will be overstated for 1996}}$

C) Owner's capital will be understated as of January 1, 1996

D) Owner's capital will be understated as of January 1, 1997

3. The primary purpose of depreciation is to:

A) Show the fair market value of the plant asset on the balance sheet of the company

B) Prevent the misuse of plant assets

$\boxed{\text{C) Allocate the cost of the plant over the period benefited}}$

D) Record a decrease in the value of the plant asset based on changes in the current replacement cost of the asset

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INSTRUCTOR'S NOTES

Exercise: Multiple Choice Solutions (2)

4. Retained earnings of a company as of a given date are equivalent to:

A) Net income for past years less dividends declared

B) Net income of the current year

C) Net income for all years since incorporation less losses and dividends declared

D) None of the above

5. In presenting short-term investments in shares of other companies on the balance sheet

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6. An accrual should be made on the basis of estimation as of the balance sheet date when

A) The electricity bill for the reported period has not been received

B) Bank is to accrue interest for the reported period on deposit in accordance with the deposit agreement

C) Tax authorities performed a tax audit and claim penalties of RUR 100 mln

D) All of the above

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INSTRUCTOR'S NOTES

Balance Sheet: Summary

- The Balance sheet of an enterprise presents its financial position at a particular date
- IAS do not propose a particular format for the presentation of financial statements. All information, however, should be disclosed that is necessary to make the financial statements clear and understandable
- Differences between Russian accounting and IAS require a significant volume of information to be generated in order to comply with the IAS requirements
- Some information required already exists under RSA, but needs to be reclassified to meet IAS requirements.

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INSTRUCTOR'S NOTES

Moving to International Accounting Standards

Session 6: Income Statement

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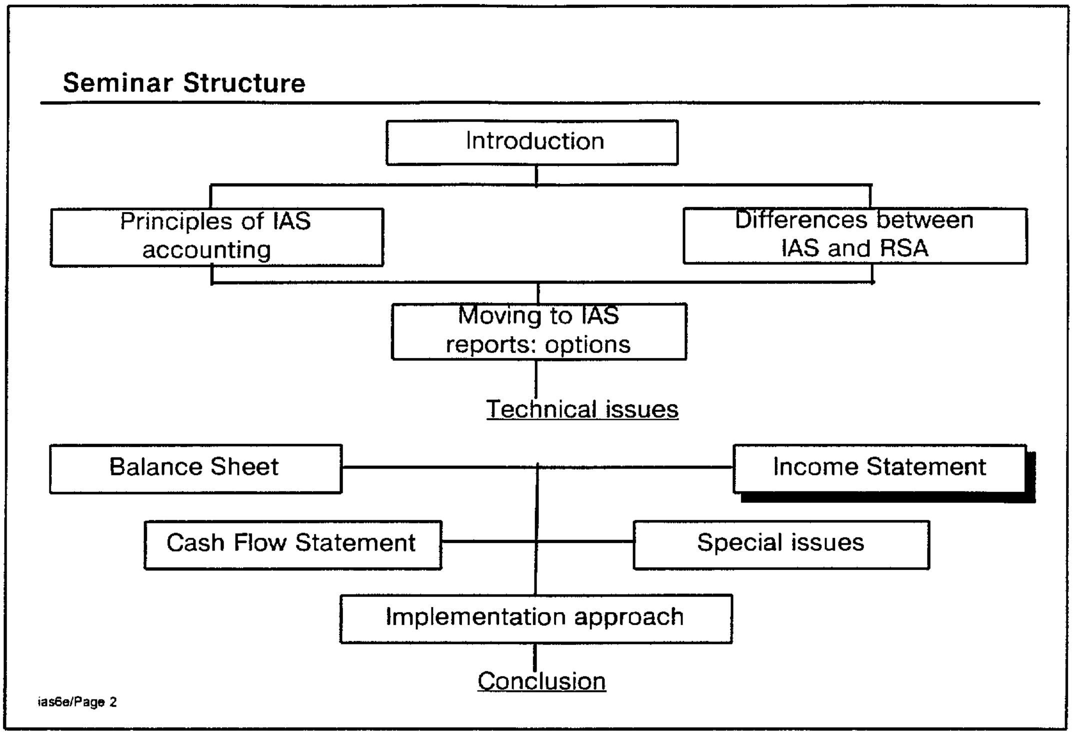
INSTRUCTOR'S NOTES



INSTRUCTOR'S NOTES

Session Agenda and Objectives

Agenda

- Revenues
- Special cases of revenue calculation
- Technical issues of recalculating some items of cost of sales
- Special issues of calculation of period expense
- Presentation of interest and taxes according to IAS
- Other gains/losses calculation
- Extraordinary expenses
- Government assistance and grants treatment under IAS
- Discontinued operations disclosure

Objectives:

- To identify issues requiring special attention when moving to IAS
- To be able to approach solution of special issues

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INSTRUCTOR'S NOTES

Contents of the Income Statement

IAS requires the following information to be disclosed in the income statement:

- sales or other operating revenues;
- depreciation;
- interest income;
- income from investments;
- interest expense;
- taxes on income;
- extraordinary charges;
- extraordinary credits;
- significant intercompany transactions; and
- net profit or loss for the period.

Note, that although it is not specifically required it is recommended that cost of sales and other elements of expenditure should be disclosed

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INSTRUCTOR'S NOTES

Income Statement of AOOT Utyug

	1995, RUR Million
Turnover	202,228
Cost of Goods Sold	(91,188)
Gross Margin	111,040
Depreciation	(5,022)
Selling, General and Administrative Expenses	(39,258)
Operating Income	66,760
Income from investments	2,600
Interest income	1,100
Other Revenues and Expenses	(33,080)
Interest Expense	(7,595)
Loss on Net Monetary Position	(34,785)
Net Gain Before Taxation	(5,000)
Taxation	(13,112)
Net Loss	(18,112)

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INSTRUCTOR'S NOTES

Revenues

$\boxed{\text{Income}} = \boxed{\text{Revenue}} + \boxed{\text{Gains}}$

Income =	Revenue +	Gains
	arises in the course of ordinary activities	other increase in the economic benefits

Revenue includes only the gross inflows of economic benefits received and receivable by the enterprise on its own account

Revenue is recognized:

Goods	Services
risks and rewards of ownership transferred; no managerial involvement and control; amount of revenue measurable; economical benefits will flow to the enterprise; costs in respect of the transaction can be measured reliably	stage of completion of the transaction can be measured reliably; costs to complete the transaction can be measured reliably; amount of revenue measurable; economic benefits will flow to the enterprise; costs in respect of transaction can be measured reliably.

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INSTRUCTOR'S NOTES

This slide is based mostly on IAS 18 "Revenue"

What types of income is revenue? - Sales, fees, interest, dividends and royalties

Revenue does not include amounts collected on behalf of third parties:

- value added taxes;
- other sales taxes;
- goods and services taxes
- amounts collected on behalf of principal in agency relations. Revenue in this case is the commission only.

When an enterprise retains the significant risks and rewards of ownership, **it is not revenue**. This may arise in a number of ways:

(1) when the enterprise retains an obligation for unsatisfactory performance not covered by normal warranty provisions;

(2) when the receipt of the revenue from a particular sale is contingent on the derivation of revenue by the buyer from its sale of the goods;

(3) when the goods are shipped subject to installation and the installation is a significant part of the contract which has not yet been completed by the enterprise;

(4) when the buyer has the right to rescind the purchase for a reason specified in the sales contract and the enterprise is uncertain about the probability of return.

Revenue cannot be recognized when the expenses **cannot** be measured reliably; in such circumstances, any consideration already received for the sale of the goods is recognized as **a liability**. This does not include warranties and other costs to be incurred after the shipment.

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What are the Peculiarities of Revenues from Services

Services sometimes present problems for the estimate of period revenues:

It is important to estimate the stage of completion. The following methods are allowed:

- surveys of work performed;
- services performed to date as a percentage of total services to be performed;
- the proportion that costs incurred to date bear to the estimated total costs of the
- progress payments and advances received from customers often do not reflect the services performed

When the outcome of the transaction cannot be estimated reliably, only recoverable expenses are included in the revenue, therefore no profit is recognized. When it is not probable that the costs incurred will be recovered, revenue is not recognized.

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INSTRUCTOR'S NOTES

How to Disclose Barter in the Income Statement

Not all barter transactions are treated as revenues under IAS:

- when goods or services are exchanged or swapped for goods or services of a similar nature and value, the exchange is not regarded as a transaction which generates revenue
  - E.g.. exchange of one type of wires for other types of wires
- an item of property, plant and equipment may be acquired in exchange for a similar asset that has a similar use in the same line of business and which has a similar fair value. Since the earnings process is incomplete, no gain or loss is recognized on the transaction. Instead, the cost of the new asset is the carrying amount of the asset given up.

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INSTRUCTOR'S NOTES

Example of barter that is not included in revenues:

When commodities like oil or milk where suppliers exchange or swap inventories in various locations to fulfill demand on a timely basis in a particular location. When goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue.

In the case of acquisition of property, plant and equipment the fair value of the asset received may provide evidence of an impairment in the asset given up. Under these circumstances the asset given up is written down and this written down value assigned to the new asset. (IAS 16)

How to Disclose Revenues

An enterprise should disclose:

- In the income statement:
  - the amount of each significant category of revenue recognized during the period including revenue arising from:
    - the sale of goods;
    - the rendering of services;
    - interest;
    - royalties;
    - dividends; and
  - the amount of revenue arising from exchanges of goods or services included in each significant category of revenue;
  - contingent gains and losses.
- In the notes:
  - the accounting policies adopted for the recognition of revenue including the methods adopted to determine the stage of completion of transactions involving the rendering of services;

Therefore, information about revenue is more detailed under IAS than under the Russian Statutory Principles

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INSTRUCTOR'S NOTES

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Exercise on Calculating Revenues

Make the necessary classification of the income statement items for the following initial RSA information:

- Revenues from sales (net of VAT) 200,000, including:
  - Revenues from services amounted in total to 50,000, including 40,000 in the form of barter;
  - Revenues from barter of goods amounted to 80,000;
  - Out of all barter operations the value of swapped goods of similar nature amounts to 10,000
  - There is a gain recognized for a construction service performed by the company (barter) in the amount of 30,000, whereas the total contract amount is 200,000 for the next two years and the costs incurred in the reported period under this contract amount to 20,000. (Assume that at this point the outcome of the transaction cannot be estimated reliably);

Present the revenue in a new format, using the following headings:

- Revenue from sale of goods;
- Revenue from barter of goods;
- Revenue from sale of services
- Revenue from barter of services

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INSTRUCTOR'S NOTES

The solution to this exercise is provided on the next slide.

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Exercise on Calculating Revenues - Solution

The solution to this problem is presented in the following table:

	Initial	Separate cash services	Separate barter services	Separate barter sales	Separate barter of similar goods	Reversal of unfinished construction gain	Final format
Revenue from sales of goods	200,000	(10,000)	(40,000	(80,000)			70,000
Revenue from barter of goods	0			80,000	(10,000)		70,000
Revenue from sales of services	0	10,000					10,000
Revenue from barter of services	0		40,000			(10,000)	30,000
Total	200,000	0	0	0	(10,000)	(10,000)	180,000

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INSTRUCTOR'S NOTES

Here:

operation 1 is the reclassification of services, both barter and cash;

operation 2, is the reclassification of barter of services

operation 3 is the reversal of sales of barter of similar goods as it is not recognized by IAS;

operation 4 is the reversal of the revenue portion of a construction contract the outcome of which is not yet certain.

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Expenses: General Approach

RSA	IAS
Some categories of expense are not accrued for Some of the expenses are not recognized	Accrue additional expenses: unaccrued underaccrued not recognized
Usually the cost of sales include general and administrative expense	Split the costs between several categories in accordance with IAS
Most of interest is not stated separately in the income statement	Segregate interest as a separate category
Some expenses are charged to reserves and not disclosed in the income statement	Reverse funds accrual and the utilization of funds, reclassifying the expense

It is necessary to get to transaction level in order to get estimates consistent with IAS

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INSTRUCTOR'S NOTES

Examples:

1. Unaccrued expense: usually the accrual of utility payments (electricity, gaz) for a portion of last month, not covered by the invoice received from utility companies is necessary. This accrual is to be added to cost of sales and/or period expense.

2. Sometimes it is necessary to get to the documents of prime entry or journals in order to split costs between cost of sales, selling, general and administrative expense, interest and taxes in order to get to the IAS classification. This classification has been in force in Russia since the adoption of the new form of quarterly reporting.

3. To segregate interest it is needed to decrease the cost of sales by the amount of interest included and to state interest as a separate line in the income statement. For interest receivable from other entities it is necessary to decrease other gains for the amount of interest received and include that in the income statement as a separate item.

4. The reversal of funds accrual and utilization is made in order to reclassify all the payments into funds as different types of revenues and gains and all utilization as different categories.

How to Restate Work in Progress

The first difficulty is calculating the portion of overheads added to the work in progress

The portion of overheads is calculated in accordance with the degree of completeness of the work in progress if there is no indication to the contrary

Example of this calculation:

- There is no opening WIP
- Total overheads incurred for the period: $100,000
- Finished units for the period: 900
- Work in progress at the end of the period: 100
- Completeness for this type of WIP: 50%
- Overheads added to WIP: $100,000 / (900 + 100 x 0.5) x 50 = $5,263

Important notice: when it is difficult to estimate completeness, it is a custom to assume completeness of 50%, but it may lead to misrepresentation if a large amount of work in progress is substantially complete or incomplete

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INSTRUCTOR'S NOTES

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Underconsumption of Overheads is often the Case in Process Costing

If a company produces a limited number of standard products and underutilized its assets, it is necessary to recalculate the consumption rate for overheads:

- it is a rule under IAS to include in the cost production the amount of overheads totally consumed under normal production levels
- if the company produces less (or more) than that, the difference is charged directly to the income statement as under (over) consumption of overheads

The following procedure may be performed:

- the absorption rate is calculated for a year when the utilization of assets under normal production levels. It is a ratio between direct expense and overheads. Usually it is calculated as a percentage;
- the same percentage is applied to other years unless normal production level or capacity changes significantly. The rest is charged to income statement as a period expense.

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INSTRUCTOR'S NOTES

Production Overheads: Reclassification of Finished Goods

It is necessary to state general and administrative expense separately, but if it was not done in time, it is still possible to estimate them after the end of accounting period

Finished goods are to be recalculated in order to exclude general and administrative expense.

Example of calculation:

- There is no opening balance of finished goods;
- The closing balance of finished goods account is $50,000
- The total charge to the finished goods account is $200,000
- The total general and administrative expenses were $40,000
- The calculation of adjustment is as follows: $40,000 x 50,000 / 200,000 = $10,000
- The adjustment must be as follows: decrease the balance of finished goods by $10,000 and increase the period general and administrative expense by $10,000

Important notice: this recalculation is not performed in order costing

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INSTRUCTOR'S NOTES

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General and Administrative Expense: Funds Accounting

The expense debited directly to funds or profit utilization is to be charged back to the income statement

Every item should be reclassified according to its nature between cost of sales, general and administrative expense, other losses and extraordinary losses

Usually the IAS rules are quite restrictive on the use of special funds, so most of the accruals of funds will be reversed and returned to retained earnings. (Described in more detail in the Balance sheet part)

The statutory revaluation cannot be admitted under IAS, therefore a reversal must be made for the amount of all revaluations

Example:

- Dr. Additional capital (revaluation reserve)
- Cr. Fixed Assets

This adjustment is made for the amount of every revaluation

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INSTRUCTOR'S NOTES

There is no general rule in the reclassification of funds expenses, so an item-by-item approach must be applied. The practice shows that most of these expenses are recognized as general and administrative charges (except interest payments and some extraordinary items).

General and Administrative Expense: Bad Debt

It is a usual practice of international accounting practices to account for bad debt. There is a similar provision in the Russian statutory rules, but most companies are too 'cautious' in applying the rules.

It is allowed either to write off the uncollectable amounts directly or to make a bad debt allowance. The accrual of the bad debt reserve has been described in the Balance sheet section.

This charge is usually included in period costs as a separate item of general and administrative costs.

Important notice: in most cases with Russian companies specific calculation of bad debt is always better than a general provision as the liquidity of debtors may vary significantly and few general rules can be applied

For example, the provision may be calculated as follows:
(1) The sales department estimated uncollectable debt in the amount of 5% of total sales, therefore, the cost of sales are increased by this amount and a provision is made as a separate line in the balance sheet;
(2) If at the end of the period the actual amount is different from the allowance, an adjustment is made

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INSTRUCTOR'S NOTES

The estimate of the bad debt allowance is usually made with two methods:

(A) The uncollectable amount is estimated as a percentage of sales, e.g. the company estimates the uncollectable amounts as 5% of the total sales;

(B) The uncollectable amount is estimated as the amount outstanding for more than a certain period of time, e.g. the company estimates the uncollectable amounts as the accounts receivable outstanding for more than 6 months. Note that this method requires the ageing analysis of accounts receivable to be performed.

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Exercise on Calculation of Costs and General and Administrative Expense

Using the following information recalculate the RSA data in IAS format:

- There are no opening balances of work in progress and finished goods. 1000 finished units have been produced during the year. The cost of goods sold disclosed (including G&A expense) was 2,900,000.
- The balance of the work in progress account at the end of the year is 200,000, including 100,000 direct materials and 100,000 direct labour; it is 100 unfinished units, 50% complete as regards production overheads. The turnover of the production overheads account for the period is 800,000.
- The portion of general and administrative expense included in the valuation of finished goods at the end of the period is 250,000.
- The turnover of the General and administrative expense account for the period is 1,100,000.
- There have been a bonus of 20,000 paid to the administration of the company and charged to funds.
- Make a provision for 300,000 of bad debt at the end of the period.

Classify the new data between the cost of sales and general and administrative expense.

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INSTRUCTOR'S NOTES

The solution of the exercise is presented on the next slide.

Exercise on Calculation of Costs and General and Administrative Expense - Solution

The solution is presented in the following table:

	Initial	Work in progress	Finished goods	General and Administrative Expense	Expense from funds	Bad debt	Final format
Cost of goods sold	2,900,000	(76,000)		(1,100,000			1,724,000
General and administrative expense	0		250,000	1,100,000	20,000	300,000	1,670,000
Total expense	2,900,000	(76,000)	250,000	0	20,000	300,000	3,394,000
Expense from funds	20,000				(20,000)		0
Total	2,920,000	(76,000)	250,000	0	0	300,000	3,394,000
For information only: balance sheet items:							
Work in progress		76,000					
Finished goods			(250,000)				
Bad debt provision						(300,000)	

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INSTRUCTOR'S NOTES

Calculation of item 1: 800,000 / (1,000 + 100 x 50%) x 100 = 76,000 (rounded). This amount is to be deducted from the cost of sales and included in the valuation of work in progress.

Item 2: 250,000 is to be charged to the General and Administrative expense account, decreasing the balance of the finished goods.

Item 3: The reclassification of expenses from funds is made

Item 4: The Charge to the Bad debt provision is accounted for as General and administrative expense in accordance with IAS.

Research and Development Costs

The question is whether Research and Development costs should be recognized as an asset or as an expense:

If R&D activities are made for another enterprise, R&D costs are accounted for as inventories

Research costs are never capitalized

Development costs are capitalized only if:

- product or process is clearly defined and costs are identifiable
- technical feasibility of the product can be demonstrated
- there is a market for the process or it can be useful internally
- adequate resources exist to complete the project and to sell/use it.

Capitalized development costs are usually amortized over a period not exceeding five years.

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INSTRUCTOR'S NOTES

This slide is based primarily on IAS 9, "Research and Development costs"

The actual treatment of capitalized R&D for IAS purposes may be to charge this expense in the full amount to Deferred charges account 31, using a special sub-account for the easy retrieval of this information and to amortize this amount for a certain period.

What to Remember about Interest Expense

All interest expense is to be charged as a separate item in the IAS income statement

Only part of the interest expense is included in the cost of sales under the Russian statutory regulations, the disallowable part is treated as utilization of after-tax profit or decrease of special funds. Therefore, it is necessary to analyze the books of account of companies before the reclassification of interest for IAS purpose.

Important note: IAS dictate that borrowing costs be charged to the income statement. The only exception to this is to allow the capitalization of borrowing costs that directly relate to the acquisition, construction or production of fixed assets.

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INSTRUCTOR'S NOTES

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Taxes

Additional income tax amount is to be calculated to account for accrual sales

The following entry must be done:

- Dr. Profit and Loss (Income tax)
- Cr. Deferred income tax

Many companies do not add the deferred income tax charge to the principal amount, but disclose it as a separate line.

In order to fulfill this requirement of IAS the company records of taxes must be examined and reclassified

It is as well a requirement of the IAS that if the tax expense for the period and the accounting income reported is not explained by the tax rates at the end of the accounting period, then additional explanation is to be provided.

- This requirement in fact means that a reconciliation of the IAS profit and the RSA taxable profit is to be provided.

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INSTRUCTOR'S NOTES

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Separate Disclosure of Items of Income and Expense

According to IAS the following circumstances may give rise to special disclosure of income and expense:

- the write-down of inventories to net realizable value or property, plant and equipment to recoverable amount, as well as reversal of such write-downs;
- a restructuring of the activities of an enterprise and the reversal of any provisions for the costs of restructuring;
- disposals of items of property, plant and equipment;
- disposals of long-term investments
- discontinued operations;
- litigation settlements; and
- other reversals of provisions.

These disclosures are usually made in the notes to the financial statements but can be shown in the income statement

As it is seen, 'other sales' and 'other gains and losses' items of the Russian income statements must have a more detailed breakdown under IAS

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INSTRUCTOR'S NOTES

This information is contained primarily in IAS 8 on the format of financial statements disclosure.

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Extraordinary Gains and Losses

Extraordinary items are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and therefore are not expected to recur frequently or regularly

The nature and the amount of each extraordinary item should be separately disclosed.

Whether an event or transaction is clearly distinct from the ordinary activities of the enterprise is determined by the nature of the event or transaction in relation to the business of the company rather than by the frequency with which such events are expected to occur.

Examples of extraordinary events:

- expropriation of assets;
- earthquake or other natural disaster;
- in Russian circumstances, the transfer of social assets to the municipality may be considered in most cases an extraordinary item.

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INSTRUCTOR'S NOTES

Extraordinary items are very rare in practice.

RSA does not make any difference between extraordinary gains/losses and 'other gains/losses'. Therefore when an extraordinary event happens, all the accounting entries relating to this event are taken out from the Other gain/loss line of RSA and disclosed separately in the income statement.

Exercise on Gains and Losses

Reclassify other gains and losses using the following information:

- Revenues from operations 400,000, cost of sales - 180,000, General and administrative expense - 160,000. Interest expense included in the general and administrative expense is 75,000
- RSA report: Other sales income - 120,000, other sales expense - 100,000; Non-sales income - 90,000, non-sales expense 280,000
- Profit utilization amounted to 25,000, including 20,000 income tax and 5,000 disallowable interest expense;
- There must be an accrual of 12,000 of deferred income tax made;
- Out of the non-sales income:
  - there is penalty received from a buyer of 10,000;
  - there is long-term investment disposal revenue of 15,000.
- Out of the non-sales expense:
  - there is penalty payable to the railway of 25,000;
  - the historic cost of disposed long-term investment of 5,000.

Reclassify these expenses in accordance with the headings provided on the previous slide

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INSTRUCTOR'S NOTES

The solution for this exercise is be presented on the next slide.

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Exercise: Other Gains and Losses - Solution

	Initial	Deduct interest	Interest and inocome tax	Accural of deferred tax	Reclassi-fication of litigation expense	Reclassi-fication of invest-ment expense	Final format
Sales	400,000						400,000
Cost of sales	(180,000						(180,000)
Operating margin	220,000						220,000
S, G & A expense	(160,000	75,000					(85,000)
Income from operations	60,000						135,000
Interest expense	0	(75,000)	(5,000)				(80,000)
Income tax payable	0		(20,000)				(20,000)
Deferred tax	0			(12,000)			(12,000)
Income from other sales	120,000					(15,000)	105,000
Expenses for other sales	(100,000					5,000	(95,000)
Income from non-sales operations	90,000				(10,000)		80,000
Expenses for non-sales operations	(280,000				25,000		(255,000)
Income from disposal of long-term investment	0					10,000	10,000
Litigation settlements loss	0				(15,000)		(15,000)
Expenses from profit	(25,000)		25,000				0
Total	(135,000	0	0	(12,000	0	0	(147,000)

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INSTRUCTOR'S NOTES

Accounting for Government Grants and Government Assistance

Government grants, subsidies, subventions or other compensations should be recognized as income over the periods necessary to match them with the related costs which they are intended to compensate.

Grants are recognized on cash basis only if no other basis (accrual) may be applied to them

Examples:

- grant related to depreciable assets: amortize over period and in proportions in which depreciation on those assets is charged;
- grant of land conditional upon the erection of a building on the site is recognizable as income over the life of the building;
- grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the enterprise with no future related costs should be recognized as income of the period in which it becomes receivable, as an extraordinary item

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INSTRUCTOR'S NOTES

This information is laid out in more detail in IAS 20 covering accounting for grants and government assistance.

Accounting for Government Grants and Government Assistance (2)

Grants related to assets may be accounted for in two ways:

- setting up the grant as deferred income
  - Example: the company bought an environment protection device for $200,000 and received a government grant of $100,000 cash for the purchase of this asset. The accounting entries will be as follows:
    - Dr. Fixed assets $200,000
    - Cr. Cash $100,000
    - Cr. Deferred income $100,000
- deducting the grant in arriving at the carrying amount of the asset:
  - Example: the same situation
    - Dr. Fixed assets $100,000
    - Cr. Cash $100,000

Grants relating to income may be accounted for in two ways:

- credit in the income statement
  - separately
  - part of 'other income' line
- deducted in reporting the related expense

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INSTRUCTOR'S NOTES

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Discontinued Operations

A discontinued operation results from the sale or abandonment of an operation that represents a separate, major line of business of an enterprise and of which the assets, net profit or loss and activities can be distinguished physically, operationally and for financial reporting purposes

The following disclosures should be made for each discontinued operation

- the nature of the discontinued operation;
- the industry and geographical segments in which it is reported;
- the date of discontinuance;
- the manner of discontinuance;
- the gain or loss on discontinuance and the accounting policy to measure it; and
- the revenue and profit or loss from these operations for the current and previous reported years.

Ordinary profit or loss ← Both variants are allowed → Extraordinary items

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INSTRUCTOR'S NOTES

This information is covering part of IAS 8 on presentation of financial statements.

The date of discontinuance is the effective date for accounting purposes.

The manner of discontinuance is whether the operations are sold or abandoned or some other method of alienation.

The results of discontinued operations are disclosed as extraordinary items in the rare circumstances that the discontinuance is the result of events or transactions that are clearly distinct from the ordinary activities of the enterprise and therefore are not expected to recur frequently or regularly.

RSA does not make special provisions for discontinued operations as they are part of the income statement of the company. Therefore, it is necessary to separate the effect of discontinued operations from other activities of the company. The most useful source may be the 'Separation balance sheet', but if it is practicable to use it (or the nature of operation did not require it), then a special analysis must be performed with the use of company's books of account.

Income Statement: Summary

- Income statement is the first document that most investors use in estimating the financial 'health' of a company
- The 1996 format of the income statement is much closer to IAS format, but some important differences still exist
- IAS require a more detailed disclosure of a company's operations than that available from Russian statutory information
- Some items, such as Work In Progress and Finished Goods may require substantial rework to comply with IAS
- Certain items disallowable (expenses from funds) or non-existant in Russian accounting (obsolescence reserves) are to be included in IAS financial statements
- Other gains and losses are to be presented in more detail in accordance with IAS.

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INSTRUCTOR'S NOTES

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Moving to International Accounting Standards

Session 7: Cash Flow Statement

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INSTRUCTOR'S NOTES

This section of the seminar discusses technical issues of the cash flow statement: what are the technical differences between Russian and IAS requirements for cash flow statement and what information and major adjustments are required in order to move to IAS. In a number of cases, the issues are illustrated by simple examples. For more detailed information and examples refer to the handbook.

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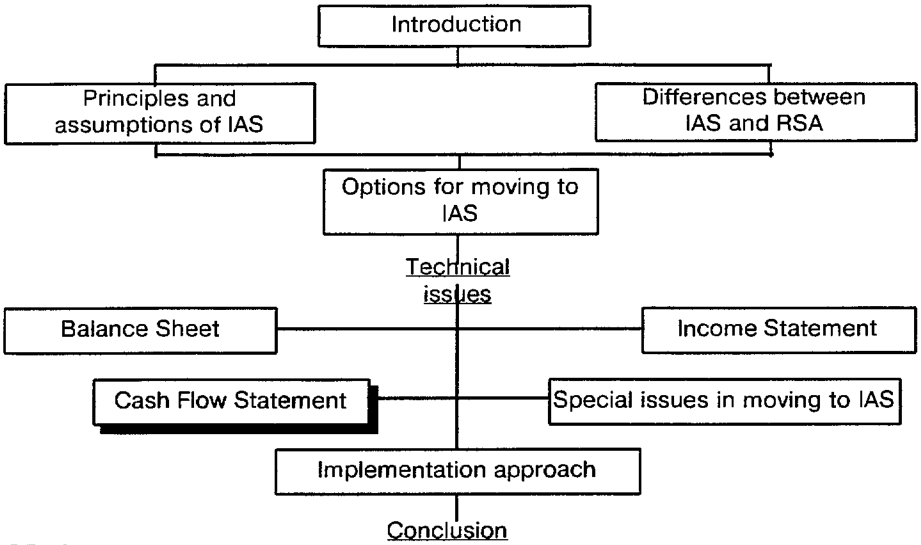
Seminar Overview



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INSTRUCTOR'S NOTES

Session Agenda and Objectives

Agenda

- Role of the cash flow statement
- Activities of the enterprise and their cash flow effects
- Direct and indirect methods of cash flow reporting
- Treatment of non-cash transactions

Objectives

- To understand the nature and role of the cash flow statement
- To become familiar with cash aspects of an enterprise's activities
- To learn IAS requirements to the content and formats of the cash flow statement

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INSTRUCTOR'S NOTES

Advantages of Cash Flow Information

Information about the cash flow of an enterprise is useful in providing users of financial statements with a basis to assess the ability of the enterprise to generate cash and the needs of the company to utilize those cash flows

- Cash flow statement should be used in conjunction with the rest of the financial statements
- Cash flow information enhances the comparability of the reporting because it eliminates the effects of different accounting treatments
- Historical cash flow information is used as an indicator of the amount, timing and certainty of future cash flows

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INSTRUCTOR'S NOTES

The purpose of this slide is to discuss what is a cash flow statement, why it is prepared by enterprises and what are its advantages and disadvantages.

History

- IAS 7 regulates how an enterprise should prepare a cash flow statement and what information should be disclosed. It states that an enterprise should present a cash flow statement as an integral part of the financial statements for each period for which financial statements are presented. The term 'cash flow statement' superseded the term 'statement of changes in financial position'
- A simple cash flow statement was introduced for Russian companies in 1995 as a part of the income statement. For the first quarter of 1996 the format of the cash flow statement was changed in order to move closer to western standards

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INSTRUCTOR'S NOTES

The purpose of this slide is to briefly discuss the history of cash flow statement.

Note that The old version of the Russian cash flow statement significantly differed from the international format. The new format is effective from the 1st quarter 1996 and is much closer to IAS, though some significant differences remain and no clear methodology is provided.

What is a Cash Flow Statement

According to International Accounting Standards, a cash flow statement contains information about inflows and outflows of:

- Cash
- Cash equivalents

Cash flows are presented and analyzed in relation to business activities of an enterprise. All business activities of an enterprise are classified in three groups:

- Operating activities. Principal revenue-producing activity
- Investing activities. The acquisition and disposal of long-term assets and other investments
- Financing activities. Activities that result in changes in the size and composition of the equity capital and borrowings of the enterprise

A single transaction may include cash flows that are classified differently (e.g., bank loan)

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INSTRUCTOR'S NOTES

The purpose of this slide is to introduce most important terms used for cash flow statement.

They are discussed in more detail in the following slides.

Emphasize that some transactions may include cash flows that are classified differently and a degree of reasonable judgment is required.

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Cash and Cash Equivalents

Cash flow statement reflects changes in cash and cash equivalents

- Cash comprises cash on hand and demand deposits
- Cash equivalents are investments which are:
  - short-term
  - highly liquid, i.e. readily convertible to known amounts of cash
  - subject to an insignificant risk of changes in value

An enterprise should disclose the components of cash and cash equivalents and should present a reconciliation of the amounts in its cash flow statement with the equivalent item reported in the balance sheet

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INSTRUCTOR'S NOTES

The purpose of this slide is to emphasize that the key issue for cash flow statement is cash and cash equivalents.

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Operating Activities

Since operating activities are the principal revenue-producing activities of an enterprise, the amount of cash arising from these activities is a key indicator of a company's financial health. These flows include:

- Cash receipts from the sale of goods and rendering of services
- Cash receipts from royalties, fees, commissions and other revenue
- Cash payments to suppliers for goods and services
- Cash payments to employees

An enterprise should report cash flows from operating activities using either the direct or indirect method

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INSTRUCTOR'S NOTES

The purpose of this slide is to discuss what is classified as operating activities of the enterprise.

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Direct Method

According to the direct method, major classes of gross cash receipts and gross cash payments are disclosed. The direct method provides information which may be useful in estimating future cash flows

Information required for the use of the direct method may be obtained:

- From the accounting records of the enterprise
- By adjusting sales, cost of sales and other items in the income statement for:
  - changes during the period in inventories and operating receivables and payables
  - other non-cash items
  - other items for which the cash effects are investing or financing cash flows

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INSTRUCTOR'S NOTES

Example on Cash Flows from Operating Activities (Direct Method)

Cash flows from operating activities	Mln RUR
Cash receipts from customers	113,567
Cash paid to suppliers and employees	(117,810)
Cash generated from operations	(4,243)
Interest paid	(3,500)
Income taxes paid	(9,291)
Net cash flow from operating activities	**(17,034)**

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INSTRUCTOR'S NOTES

Work with participants through the example line by line.

Explain that net cash flow from operating activities may differ significantly from operating profit or loss for the same period. Note that many Russian companies have operating profit on the accrual basis but at the same time net negative cash flow from operating activities due to longer collection periods of receivables and unfavorable payment terms of creditors.

Indirect Method

According to the indirect method, net profit or loss is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

The net cash flow from operating activities is determined by adjusting net profit or loss for the effects of:

- Changes during the period in inventories and operating receivables and payables
- Non-cash items such as depreciation, provisions, deferred taxes, etc.
- All other items for which the cash effects are investing or financing cash flows

Alternatively, the net cash flow from operating activities may be presented by showing the revenues and expenses disclosed in the income statements and the changes during the period in inventories and operating receivables and payables

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INSTRUCTOR'S NOTES

Example on Cash Flows from Operating Activities (Indirect Method)

	Mln RUR
Net profit before taxation	29,785
Adjustments for:	
Depreciation	8,500
Foreign exchange gain/loss	(42,614)
Investment income	-
Interest expense	7.595
Operating profit before working capital changes	3,266
Increase in trade and other receivables	(799)
Decrease in inventories	6,715
Decrease in trade payables	1.593
Cash generated from operations	(4,243)
Interest paid	(3,500)
Income taxes paid	(9.291)
Net cash from operating activities	**(17,034)**

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INSTRUCTOR'S NOTES

Comparison of Direct and Indirect Methods (Tool)

Objective: to convert each income statement item from an accrual basis amount to a cash basis amount *Step 1:* Adjust sales to get cash received from customers *Step 2:* Adjust cost of goods sold to get payments to suppliers *Step 3:* Adjust other revenues that impact cash to get cash received from other revenue sources *Step 4:* Adjust other expenses that impact cash to get cash payments for other expense items *Step 5:* Adjust for other revenues that do not impact cash *Step 6:* Adjust for other expenses that do not impact cash	*Objective:* to reconcile net income as computed on the accrual basis to net cash provided by operating activities *Step 1:* Adjust net income for noncash charges and credits to operation, such as: • Depreciation expense • Amortization of intangible assets • Gain and loss on sale of non-current assets *Step 2:* Adjust net income for operating current assets and operating current liabilities, such as: • Change in accounts receivable • Change in inventories • Change in accounts payable • Change in accruals

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INSTRUCTOR'S NOTES

Investing Activities

The cash flows arising from investing activities are important because they represent expenditures made for resources intended to generate future income and cash flows. These flows include:

- Cash payments to acquire property, plant and equipment, intangibles and other long-term assets. These payments include those relating to capitalized development costs and self-constructed property, plant and equipment
- Cash receipts from sales of property, plant and equipment, intangibles and other long-term assets
- Cash payments and receipt relating to equity and debt instruments, interests in joint ventures
- Cash loans made to other parties and cash receipts from the repayment such loans

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INSTRUCTOR'S NOTES

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Example on Cash Flows From Investing Activities

Cash flows from investing activities	Mln RUR
Acquisition of a subsidiary, net of cash acquired	(1,000)
Purchase of property, plant and equipment	(2,500)
Proceeds from sale of equipment	16,898
Interest received	1,100
Dividends received	2,600
Net cash from investing activities	**17,098**

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INSTRUCTOR'S NOTES

Financing Activities

The cash flows arising from financing activities are important because they give information for predicting claims of future cash flows by providers of capital to the enterprise. These flows include:

- Cash proceeds from issuing shares or other equity instruments
- Cash proceeds from issuing debentures, loans and other short or long-term borrowings
- Cash payments to owners to acquire or redeem the enterprise's shares
- Cash repayments of amounts borrowed
- Cash payments by a lessee for the reduction of the outstanding liability relating to a financial lease

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INSTRUCTOR'S NOTES

Example on Cash Flows From Financing Activities

Cash flows from financing activities	**Mln RUR**
Proceeds from issuance of share capital	0
Proceeds from long-term borrowings	250
Payment of finance lease liabilities	(200)
Dividends paid*	(300)
Net cash used in financing activities	**(250)**

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INSTRUCTOR'S NOTES

Dividends paid can be also shown under operating cash flow.

Example on Cash Flow Statement (Summary)

Summary cash flow statement	Mln RUR
Net cash from operating activities	(17,034)
Net cash from investing activities	17,098
Net cash used in financing activities	(250)
Net increase in cash and cash equivalents	**(186)**
Cash and cash equivalents at beginning of period	**286**
Cash and cash equivalents at end of period	**100**

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INSTRUCTOR'S NOTES

Non-Cash Transactions

Occasionally, companies enter into transactions which do not involve cash

- IAS do not have a requirement to either include or exclude non-cash operating transactions in a cash flows statement
- Investing and financing non-cash transactions should be excluded from a cash flow statement. Such transactions should be disclosed elsewhere in the financial statements. Such transactions may include:
  - the acquisition of assets by means of a financial lease
  - the acquisition of an enterprise by means of an equity issue
  - the conversion of debt to equity

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INSTRUCTOR'S NOTES

Exercise: Classification of Cash Flow Items (Multiple Choice Questions)

1 A prepayment for goods is received

2 Depreciation on fixed assets is accrued

3 Dividends are paid to shareholders

4 A supplier is paid in accordance with last month's invoice

5 In accordance with a joint venture agreement money is transferred as a contribution to a joint venture

6 A cashier received cash from the bank for salary payment to employees

7 Income tax for the previous year is paid

8 Foreign currency balances are revalued at the end of the period

9 A penalty for late delivery is paid to customer

10 Long-term bank loan, which is overdue, is repaid

O - operating, I - investing, F - financing, N - non-cash, N/A

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INSTRUCTOR'S NOTES

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Exercise: Multiple Choice Solutions

1	A prepayment for goods is received	O
2	Depreciation on fixed assets is accrued	N
3	Dividends are paid to shareholders	F or O
4	A supplier is paid in accordance with last month's invoice	O
5	In accordance with a joint venture agreement money is transferred as a contribution to a joint venture	I
6	A cashier received cash from the bank for salary payment to employees	N/A
7	Income tax for the previous year is paid	O
8	Foreign currency balances are revalued at the end of the period	N
9	A penalty for late delivery is paid to customer	O
10	Long-term bank loan, which is overdue, is repaid	F

O - operating, I - investing, F - financing, N - non-cash, N/A

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INSTRUCTOR'S NOTES

Exercise: Prepare a Simple Cash Flow Statement

Company A is a trading company. Its cash balance on January 1, 1995 was RUR 55 mln (1) and net income for 1995 was RUR 415 mln (2). Its 1995 transactions affecting income or cash were:

(3) Sales of RUR 1,600 mln, all on credit. Cash collections from customers RUR 1,500 mln
(4) The cost of items sold RUR 800 mln. Purchases of inventory totaled RUR 850 mln; inventory and accounts payable were affected accordingly
(5) Cash payments on trade accounts payable RUR 825 mln
(6) Salaries and wages paid in cash RUR 200 mln
(7) Depreciation RUR 45 mln
(8) Interest expense, all paid in cash RUR 11 mln
(9) Other expenses, all paid in cash RUR 100 mln
(10) Income tax accrued RUR 40 mln; income tax paid in cash RUR 35 mln
(11) Bought plant and facilities for RUR 435 mln
(12) Issued long-term debt for RUR 110 mln
(13) Paid cash dividends of RUR 39 mln

(A) Prepare a cash flow statement using the direct method for reporting cash flows from operating activities

(B) Prepare a statement of cash flows from operating activities using the indirect method

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INSTRUCTOR'S NOTES

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Exercise: Prepare a Simple Cash Flow Statement (Solution A)

Cash flows from operating activities	***Mln RUR***	
Cash received from customers (3)	1,500	
Cash paid to suppliers (4)	(825)	
Cash paid to employees (6)	(200)	
Other expenses paid (9)	(100)	
Interest paid (8)	(11)	
Income tax paid (10)	(35)	
Net cash from operating activities		**329**
Cash flows from investing activities		
Paid for bought plant and facilities (11)	(435)	
Net cash used in investing activities		**(435)**
Cash flows from financing activities		
Proceeds from issuance of long-term debt (12)	110	
Dividends paid (13)	(39)	
Net cash from financing activities		**71**
Net decrease in cash		***(35)***
Cash at beginning of period (1)		***55***
Cash at end of period		***20***

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INSTRUCTOR'S NOTES

Exercise: Prepare a Simple Cash Flow Statement (Solution B)

		Mln RUR
Net income after taxation (2)		*415*
Adjustments for:		
Dividends paid (13)	39	
Income tax accrued (10)	40	
Depreciation expense (7)	45	
Interest expense accrued (8)	11	
Operating profit before working capital changes		**550**
Increase in trade and other receivables (1,600-1,500) (3)	(100)	
Increase in inventories (850-800) (4)	(50)	
Increase in trade payables (850-825) (4) and (5)	(25)	
Cash generated from operations		**375**
Interest paid	(11)	
Income tax paid	(35)	
Net cash from operating activities		**329**

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INSTRUCTOR'S NOTES

Cash Flow Statement: Summary

- A cash flow statement, when used in conjunction with the rest of the financial statements, provides information that enables users to evaluate the changes in financial position of an enterprise
- The cash flow statement reflects changes in cash and cash equivalents of an enterprise
- The cash flow statement should report cash flows during the period classified by operating, investing and financing activities
- Enterprises may use either direct or indirect method to report cash flows from operating activities. The direct method shows gross receipts and payments. The indirect method is based on adjustments to the net profit or loss figure
- Non-cash transactions require special treatment.

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INSTRUCTOR'S NOTES

Moving to International Accounting Standards

Session 8: Special Issues in Moving to International Accounting Standards

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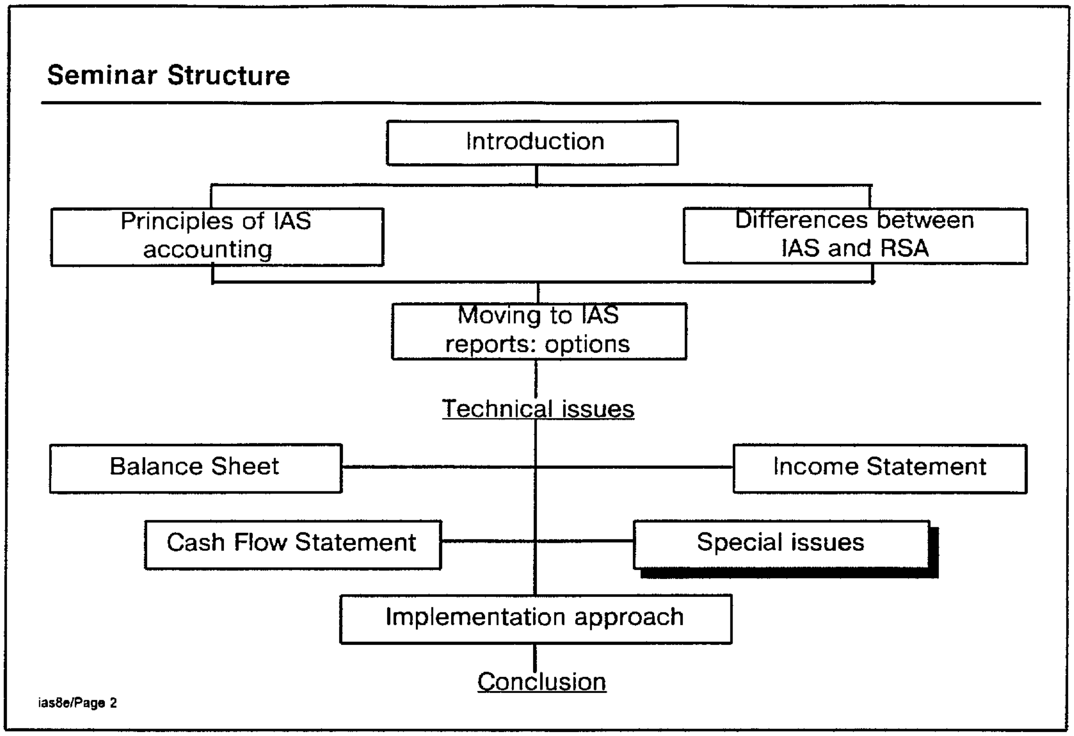
INSTRUCTOR'S NOTES

This session deals further with IAS and specifically standards such as inflation accounting and foreign currency translation not previously covered. The issues dealt with cover some special standards and rules of IAS.



INSTRUCTOR'S NOTES

Session Agenda and Objectives

Agenda:

- inflation accounting
- foreign currency translation
- consolidation of financial statements
- segmental reporting
- related parties transactions disclosure
- construction contract accounting
- accounting for leases

Objective

- To become familiar with some important issues that do not relate to all companies all the time, but may have very significant influence on financial statements

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INSTRUCTOR'S NOTES

Explain to the participants that some important issues that do not relate to all companies all the time, but may have very significant influence on financial statements if applied.

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Does Russia Qualify As Hyper-Inflationary Country?

IAS does not establish an absolute rate at which hyper-inflation is deemed to arise, but it is indicated by the following characteristics:

- the general population prefers to keep its wealth in non-monetary assets or in a relatively stable foreign currency. Amounts of local currency held are immediately invested to maintain purchasing power;
- the general population regards monetary amounts not in terms of the local currency but in terms of a relatively stable foreign currency. Prices may be quoted in that currency;
- sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period; even if the period is short;
- interest rates, wages and prices are linked to a price index; and
- the cumulative inflation rate over three years is approaching, or exceeds, 100%

It is reasonable to assume that Russia qualifies as a hyper-inflationary economy

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INSTRUCTOR'S NOTES

Inflation Accounting

It is a requirement of IAS that companies operating in a hyperinflationary environment adjust their financial statements to reflect the changes in the purchasing power of money in that environment:

- financial statements without inflation adjustments may be misleading;
- inflation does not allow the comparability of financial statements between different periods;
- the reported financial result in an inflationary environment may include a large portion of inflation gain or loss that needs to be presented separately

RSA does not have a comprehensive set of inflation adjustments, therefore additional action is needed to comply with the inflation accounting requirement

Remember, that without inflation adjustments the financial statements cannot be said to qualify with IAS

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INSTRUCTOR'S NOTES

There is a special IAS standard on accounting in hyperinflationary economies, IAS 29, that serves as the theoretical basis for this part of the presentation.

Main Principles of Inflation Adjustments Under IAS

Non-monetary items are restated by applying a general price index and monetary items are not restated

Property, plant and equipment, investments, inventories, patents and trademarks and similar assets are restated from the dates of their purchase.

If it is impossible to establish the acquisition dates of these items, it is necessary to use an independent professional assessment of their value as the basis for their restatements

Inventories of partly-finished and finished goods are restated from the dates on which the costs of purchase and of conversion were incurred.

The restated amount of a non-monetary item is reduced, when it exceeds the amount recoverable from the item's future use to net realizable value or its market value.

Owner's equity except for the retained earnings are restated from the date of their original contribution or occurrence.

Restated retained earnings are derived from all the other amounts in the restated balance sheet.

The resulting difference after all inflation adjustments is called the Monetary Gain/Loss and is disclosed as a separate item and charged to the income statement.

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INSTRUCTOR'S NOTES

Monetary items - money held and items to be received or paid in money.

Examples on Inflation adjustments (1)

Example 1: AOOT Utyug purchased a set of 10 grinding machines in August 1992 for RUR 10,000. By the end of 1995 the cumulative general inflation index was 2,336 times. The adjustment is:

Dr. Fixed assets	*100* (2,336-1) = 233,500*	
Cr. Monetary gain		*233,500*

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INSTRUCTOR'S NOTES

This may be the most important IAS that applies in the current circumstances to Russian companies, therefore it is described in more detail than any other special standard and more detailed examples than usual are provided

Examples on Inflation adjustments (2)

Example 2: The stock of inventories was purchased in the beginning of November 1995 at RUR 300 mln. The general inflation index accumulated for November and December is 1.05. The adjustment is:

Dr. Inventories	*300,000 * (1.05-1) = 15,000*
Cr. Monetary gain	*15,000*

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INSTRUCTOR'S NOTES

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Examples on Inflation adjustments (3)

Example 3: The stock of finished goods at the balance sheet date is RUR 100 million. It was produced in the beginning of November, the raw materials for it was purchased in the beginning of October. Half of cost of finished goods is raw materials. The general inflation index for December is 1.02, for October-December - 1.10. The adjustment is

Dr. Finished goods	*100,000*50%*(1.10-1) = 5,000*
	*100,000*50%*(1.02-1) = 1,000*
Cr Monetary gain	*5,000 + 1,000 = 6,000*

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INSTRUCTOR'S NOTES

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Examples on Inflation adjustments (4)

Example 4: AOOT Utyug purchased two boxes of wire in January 1994 for RUR 15,000 thousand. The wire is still kept in the warehouse. The inflated value is calculated as follows: 15,000(9.44-1)= 141,600, but the market price for these materials is now only RUR 80,000 thousand, therefore, the adjustment will be:*

Dr. Inventory	*80,000 - 15,000 = 65,000*
Cr. Monetary gain	*65,000*

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INSTRUCTOR'S NOTES

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Examples on Inflation adjustments (5)

Example 5: The inflation adjustment for the retained earning is calculated as the balancing figure in order to bring the value of the inflated opening retained earnings to the sum of inflated closing retained earnings minus the inflated income statement. For example, if the inflated closing retained earnings of AOOT Utyug equals 180,000, inflated income for the period equals 20,000, and the non-inflated opening retained earnings are 5,000, then the inflation adjustment is calculated as follows:

Dr. Monetary loss		*180,000 - 20,000 - 5,000 = 155,000*
	Cr. Retained earnings	*155,000*

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INSTRUCTOR'S NOTES

Requirements for the Information Contents for Inflation Adjustments

Fixed assets and depreciation charges:

- The company should have a register of the dates of acquisition of fixed assets
- A detailed record of the results of statutory revaluation should be kept (in order to eliminate the results of revaluation before making inflation adjustments)
- A reliable record of acquisitions and disposals of fixed assets should be kept

Inventories

- A good record of the low value short life items and their use is to be in place (these items will be reclassified as inventories, therefore, their depreciation will be reversed and there will be changes between periods)
- A reasonable record of inventory turnover should be in place (it is necessary to estimate the age of inventories to allow their cost to be hyperinflated)
- There is a similar requirement for work-in-progress and finished goods.

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INSTRUCTOR'S NOTES

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Main Sources of Information on Inflation

The main requirements for the inflation indices are:

- reliability and soundness
- long history of consistent calculation
- wide-spread use

IAS stresses the fact that it is more important to have consistency rather than precise accuracy with the calculations.

It must be a general price index, and therefore, any records of inflation applicable to specific products, however reliable and case-specific they are, cannot be used

Goskomstat indices are the most suitable for the inflation adjustments calculations

BUT! ***In the rare cases when a general price index is not available, it is acceptable to use the movement of the exchange rate between the reporting currency and a relatively stable foreign currency as an index of inflation***

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INSTRUCTOR'S NOTES

Foreign Currency Translation

Foreign currency translation - the process whereby financial data expressed in terms of one currency is restated in terms of another currency

An enterprise may carry on foreign activities in two ways:

Translation of transactions:	Translation of financials:
regulated by accounting and tax instructions	required by IAS

In transforming a set of Russian accounts into IAS it is often necessary to present the financial position in a more stable currency than Roubles

The translation can be done:

at current rate: the rate ruling at the date of the financial statement, i.e. 31 December for Russian companies

at historic rate: the rate ruling at the date of transaction according to IAS rules

IAS requires translation at current rates after inflation adjustments, but it is important to know other methods to understand the influence of them

It is important to know the basis rules for the translation as different translation methods may lead to different results

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INSTRUCTOR'S NOTES

The information on foreign currency translation is laid out in IAS 21.

Translation of transactions - recording of transactions denominated in foreign currency in the books of account of an individual company.

Translation of financial statements - preparation of financial statements where the financial statements are denominated in currency other than the reporting currency.

Example on Foreign Currency Translation

Translation of financial statements of AOOT Utyug using three possible methods (assuming no transactions happened in 1995):

Current rate:	4,553	Historic rate:	for fixed assets:	423
Closing rate 1995:	3,550		for inventories:	4,504

	Balance	Closing rate method Exchange rate	Transl. value $'000	Current/Non-current Exchange rate	Transl. value	Monetary/Non-monetary Exchange rate	Transl. value
Fixed assets	130,642	current	28,694	1 Jan 93	72,440	1 Jan 93	72,440
Inventory	63,757	current	14,003	current	14,003	1 Nov 95	14,156
Debtors and cash	52,183	current	11,461	current	11,461	current	11,461
Total assets	246,582		54,158		97,904		98,057
Current liabilities	94,559	current	20,768	current	20,768	current	20,768
Net worth end of year	152,023		33,390		77,136		77,289
Net worth opening	152,023	1 Jan 95	42,823	1 Jan 95	42,823	1 Jan 95	42,823
Gain/(loss) on translation	-		(9,433)		33,313		34,466

The difference between the methods is 42,746 thousand $ for the second method and 43,899 thousand for the third

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INSTRUCTOR'S NOTES

This example illustrate the difference between three possible ways of doing the foreign currency translation.

The rationale of the closing method: all balances are translated at the rate **current at the day of the balance sheet.**

The rationale of the current/non-current method is: if an asset is classified as current, then it is translated at the current rate , i. e. the date of the balance sheet; if an asset is classified as non-current, then it is translated at the historic rate, i.e. the rate ruling at the date of the transaction.

The rationale of the monetary/non-monetary method is: if an asset is monetary, it is translated at the current rate, if an asset is non-monetary, then it is translated at the historic rate. The difference between this method and the current/non-current method is that under this method non-monetary current assets, such as inventories, are translated with the use of historic, not current rate.

Note, that these figures assume that the inflation adjustments has already been made.

Note as well, that it is the first method that is accepted currently as standard, but the current/non-current method used to be practiced (or a version of it called temporal method) in some countries before as a generally accepted practice and is still used in many situations, especially when the foreign currency translation is performed without inflation adjustment first.

Foreign Currency Translation: Income Statement

Translation of the income statement:

	Temporal method	Closing rate method
Cash sales	date of payment	**closing rate/ average rate**
Credit sales	date of delivery	**closing rate/ average rate**
Expenses	transaction day (day when transaction was entered in the books)	**closing rate/ average rate**
Special items: depreciation	the sale as used for the translation of the underlying asset	**closing rate/ average rate**
Inventory part of cost of goods sold	at the rate of exchange applicable to this part of inventory	**closing rate/ average rate**

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INSTRUCTOR'S NOTES

Advantage of closing rate usage for the income statement translation for the closing rate method: the proportions are preserved

Advantage of average rate usage for the income statement translation for the closing rate method: there is no need to adjust interim statements.

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Foreign Currency Translation

Russian economy is classified as a highly inflationary one, therefore, if need arises, Russian accountants should translate into a more stable currency using the current/non-current method. When economy stabilizes, they should change to closing rate method.

In order to comply with the currency translation requirements it is necessary to have detailed records of the dates of transactions. It is quite difficult in case of larger enterprises, so average rates may be used if they are not misleading.

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INSTRUCTOR'S NOTES

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Exercise on Foreign Currency Translation

Translate the following simplified financial statement into US Dollars using the additional information on the next page:

	Historic (mln RUR)	Closing rate ('000 $)	Current/non-current ('000 $)
Fixed assets	1000		
Inventories	300		
Trade debtors	200		
Total assets	1,500		
Short-term loan	400		
Charter capital	600		
Sales	2,200		
Expenses	(1,600)		
Depreciation	(100)		
Gain (loss) from translation	0		
Retained earnings	500		
Total liabilities	1,500		

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INSTRUCTOR'S NOTES

The answer with the instructor's notes on the solution is provided on the slide after the next.

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Exercise on Foreign Currency Translation (2)

The applicable exchange rates are the following:

At the end of the period: 5,000

At the date of fixed assets acquisition: 2,500

At the date of inventories acquisition: 4,500

At the date when the charter capital was contributed: 2,000

Average for the period: 4,000

The average rate may be applied to both sales and expenses as they are spread evenly through the period.

For depreciation apply the same exchange rate as for the fixed assets.

Use gain (loss) from translation as a balancing item.

For the closing rate translate all the transactions at the closing rate, including the Income statement items

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INSTRUCTOR'S NOTES

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Exercise on Foreign Currency Translation - Solution

	Historic (mln RUR)	Closing rate ('000 $)	Current/non-current ('000 $)
Fixed assets	1000	200	400
Inventories	300	60	67
Trade debtors	200	40	40
Total assets	1,500	300	507
Short-term loan	400	80	80
Charter capital	600	120	300
Sales	2,200	440	550
Expenses	(1,600)	(320)	(400)
Depreciation	(100)	(20)	(40)
Gain (loss) from translation	0	0	17
Retained earnings	500	100	127
Total liabilities	1,500	300	507

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INSTRUCTOR'S NOTES

The calculation in the closing rate column is made by dividing every item by 5 (as the dollar values will be in thousand, not million).

The calculation of the current/ non-current balances:

(1) Fixed assets: 1000 / 2.5 = 400

(2) Inventories: 300 / 4.5 = 67

(3) Debtors: 200 / 5.0 = 40 (the closing rate is used as this is the current asset)

(4) Total assets: (1) + (2) + (3) = 400 + 67 + 40 = 507

(5) Short-term loan: 400 / 5.0 = 80 (the closing rate is used as this is a current asset)

(6) Charter capital: 600 / 2.0 = 300

(7) Sales: 2,200 / 4.0 = 550 (average rate is used as there is no more detail of the expense dates)

(8) Expenses: 1,600 / 4.0 = 400 (average rate is used as there is no more detail of the expense dates)

(9) Depreciation: 100 / 2.5 = 40

(10) Total retained earnings: (7) - (8) - (9) = 550 - 400 - 40 = 110

(11) Total liabilities before gain/ (loss) on translation: (5) + (6) + (10) = 80 + 300 + 110 = 490

(12) Gain/ (loss) on translation: (4) - (11) = 507 - 480 = 17

(13) Total liabilities: (11) + (12) or simply (4): = 507

Consolidation (1)

Consolidated financial statements are reports in which the assets, liabilities, revenues, and expenses of subsidiary companies are combined with those of the parent company. Consolidated financial statements present the results of operations of a parent and its subsidiary as if the group were a single enterprise. Why?

Consolidated statements are more meaningful than separate statements and they are usually necessary for fair presentation.

There is no uniformity still between countries as regards consolidation and IAS does not cover all issues, so some knowledge about the standards of individual countries is needed.

Consolidation is required in the following cases:

Majority share-holding	Majority of voting rights (together with other shareholders)	Governing financial and operating policies under statute/ agreement	Power to appoint the majority of the board of directors	Majority at meetings of the board of directors

Consolidation does not take place when:

Control is temporary: holding is for resale only	Severe long-term restrictions on transfer of funds

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INSTRUCTOR'S NOTES

First adopted in the United States (United States Steel Company in 1901), required by law in Great Britain in 1947, in West Germany in 1965 and in France in 1985.

For the sake of simplicity, the definition of consolidation was taken not from IAS but from Section C51 of US FASB Accounting standards as of June 1, 1995 (this definition does not have material differences with IAS).

Why consolidated statements appeared first in the US: (1) a wave of mergers at the turn of the century; (2) the prevalence of the holding company (which merely owns investments) as opposed to the parent company (which is one of the operating companies of the group); (3) lack of legal requirement for holding balance sheets; (4) lack of legal or other barriers to the emergence of new techniques; (5) use of consolidation for tax purposes (1917 to 1934); (6) acceptance of consolidation by the New York Stock Exchange (1919).

Publication practices in Western countries:

(1) The US companies publish consolidated balance sheets, profit and loss accounts and cash flow statements, but do not publish any parent company statements.

(2) The UK companies publish the same as the American, plus the balance sheet, but not the profit and loss account, of the parent company.

(3) The Dutch companies publish the same as the British, plus the parent company's income statement.

(4) In Germany, consolidated cash or funds statements are often published, but not as part of the financial statements.

(5) 'International' companies have chosen slightly different ways of complying with the laws and practice of their home countries.

Consolidation (2)

There are various ways to consolidate financial statements:

Pooling of interests	Equity method	Proportional	Full
equal companies usually no cash no revaluation no goodwill higher reported profits	associated companies cost + proportionate share of the retained earnings goodwill: written off against reserves (UK), amortized (US)	joint ventures line-by-line inclusion in the financial statements	100% owned subsidiaries line-by-line inclusion in the financial statements

Goodwill on consolidation arises because the amount paid by the investor company is greater or less than its proportionate share of the tangible and identifiable intangible net assets of the investee

IAS	US	UK	Germany	France
capitalized amortized < 20 years	capitalized amortized <40 years	transferred to reserves **or** amortized <economic life	difference at each balance sheet date	amortization write-off to reserves non-depreciable 'brand names'

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INSTRUCTOR'S NOTES

The higher reported profits under pooling of interest results from:

(1) depreciation is calculated on historical, not revalued cost of fixed assets;

(2) there is no goodwill to be amortized.

Detailed examples of consolidation transactions and the treatment of goodwill is laid out in the handbook provided on this topic.

Stress, that it is not necessary to know the details of these approaches, but it is important to remember that different countries have different standards and it is necessary to disclose the policy adopted for consolidation in the notes to the financial statements if there is a consolidation performed

Stress as well that the first important step for consolidation is obtaining proper financial information from subsidiaries which in Russia because of the statutory reporting environment may be difficult.

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Consolidation (3): RSA Consolidation

The first consolidation requirement in Russia: MoF Order No. 81 dated 28 July 1995.

Subsidiary - a company over which another entity has the control through shareholding, contract or other means to define business decisions.

Dependent company (associate) - a company (AO or partnership) that is controlled by 20% or more in capital by another entity.

Annual consolidated statements are required by the legislation.

The regulation requires full or proportional consolidation excluding mutual settlements and dividends from dependent entity to the parent entity.

The investment of the parent company into the subsidiary company is excluded from the consolidated reports.

Russian consolidation requirements are similar to IAS, but are rarely applied in practice

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INSTRUCTOR'S NOTES

Consolidation (4)

How to produce consolidated statements:

- obtain the financial statements of subsidiaries and related companies
- define the consolidation method in accordance with IAS principles
  - full consolidation: include line by line
  - proportionate consolidation: include a pre-established percentage line by line
  - equity method:
    - include the items of both the parent company and the subsidiary line by line;
    - decrease the investment and the retained earnings by the amount of retained earnings of the subsidiary;
    - decrease the amount of the investment and the share capital by the amount of share capital of the subsidiary;
    - make a balancing adjustment to the equity in order to eliminate investment in the subsidiary;

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INSTRUCTOR'S NOTES

The example of the equity method consolidation does not take into account the minority interest for simplicity of the exercise.

Segmental Reporting

The financial statements of large multinational companies sometimes fail to provide information to users on the make up of its business activities and need for additional segmental information arises.

Segments: line of business and geographical

IAS requirements:

- reporting by line of business and by geographical areas
- turnover split between internal and external customers
- operating results by segment
- identifiable assets (in absolute or relative terms)
- reconciliation statement
- description of each line of business and composition of each geographical segment
- basis used to determine the value of intra-group transfers

There is a similar requirement for Russian companies according to Accounting standard No. 4, para. 6.3

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INSTRUCTOR'S NOTES

Requirements for segmental reporting are presented in IAS 14

Internal customers - the customers inside the group. External customers - independent customers outside the group.

How to define a line of business (UK rules):

(1) nature of products or services;

(2) nature of production processes;

(3) markets in which products or services are sold;

(4) distribution channels used;

(5) manner in which entity's activities are organized;

(6) any separate legislative framework applying to a part of the business.

A 10% threshold must be applied to defining a segment: either 10% of total <u>external</u> sales; or 10% of combined results of all segments in profit or loss; or net assets are at least 10% of total net assets.

Related Parties Transactions

Transactions with related parties are a common business feature and it is important for them to be disclosed to allow for a full understanding of an enterprise's financial statements

Who are the related parties:

- enterprises controlled or controlling another one
- associated enterprises
- individuals having an interest in the enterprise that gives them significant influence over the enterprise
- key management personnel responsible for planning, directing and controlling the activities of the reporting enterprise, including close members of families of these individuals
- enterprises where a substantial interest in the voting power can be influenced by management or directors of the enterprise

Important exceptions when no disclosure is required:

- if there are consolidated financial statements produced
- a state enterprise does not have to disclose transactions with other state enterprises

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INSTRUCTOR'S NOTES

The requirements for related parties transactions are laid out in IAS 24.

Related Parties Transactions (2)

A price for a transaction between related parties can be determined by the comparable uncontrolled price method, but there are other methods:

- Resale price method, and
- Cost-plus method.

What is to be disclosed:

- indication of the volume of the transactions
- amounts of outstanding items
- pricing policies

Example: AOOT Utyug sold 20% of its electric irons produced in 1995 to TOO 'Udarnik' in 1995. The latter company is fully owned by the General director of Utyug and his family. The financial statements should include a note, stating, for example the following:
"In 1995 there have been sales of products worth RUR 20 bln to TOO Udarnik, a company that is fully owned by the General Director of AOOT Utyug. All transactions were at market value.

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INSTRUCTOR'S NOTES

Resale price means that there is a price at which a re-seller sells the goods obtained from the company. Therefore, the resale method means that a re-selling price is taken, then the resale margin is deducted and thus the fair price at which the re-seller obtained (and the other party sold) is obtained.

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Construction Contracts

Construction contracts may last for several months or years

Revenues and expenses relating to a contract may appear in several consecutive financial statements

Revenues and Costs are recognized as revenue and expenses by reference to the stage of completion of the contract. If there are losses expected they are recognized at once.

If there is an uncollectible amount already recognized in the income statement, it is recognized as an expense rather than as an adjustment of the amount of contract revenue.

The gross amount due from the contractor is an asset

The gross amount due to customers for contract work is a liability

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INSTRUCTOR'S NOTES

The requirements for construction contracts accounting are laid out in IAS 11.

Construction contracts include: (A) contracts for rendering of services which are directly related to the construction of the asset, e.g., those for the services of project managers and architects, and (B) contracts for the destruction or restoration of assets, and the restoration of the environment following the demolition of assets.

The construction of each asset where a contract covers a number of assets should be treated as a separate construction contract when:

(a) separate proposals have been submitted for each asset;

(b) each asset has been subject to separate negotiations;

(c) the costs and revenues of each asset can be identified.

Contract revenue comprises: (a) the initial amount of revenue agreed in the contract; (b) variations in contract work to the extent that it is probable that they will result in revenue (means that it is probable that the custom will approve the variation or that the customer will accept the claim) and they are capable of being reliably measured.

Types of contract costs: site labor costs, cost of construction materials, depreciation of plant used on the contract, cost of moving plant, equipment and materials to and from the contract site, costs of hiring plant and equipment, cost of design and technical assistance, costs of guarantee and rectification work, claims from third parties other costs attributable may include insurance, design and technical assistance that is not directly related to a specific contract and construction overheads. Depreciation of idle plant is not included.

The gross amount due from customers and due to customers is calculated as cost incurred plus recognized profit less the sum of recognized losses and progress billings.

Construction Contracts (2): How to Estimate the Amounts for Disclosure

First question to ask: can the outcome of the contract be reliably estimated?	
Yes	No:
See the second question	revenue should be recognized only to the extent of contract costs incurred that it is probable will be recoverable and contract costs should be recognized as an expense in the period in which they are incurred.

Second question to ask: what type of contract is it?	
Fixed price	*Cost plus*
- both the contract costs to complete the contract and the stage of contract completion at the balance sheet date can be measured reliably; and - the contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.	- the contract costs attributable to the contract, whether or not specifically reimbursable, can be clearly identified and measured reliably.

Third question to ask: how to establish the completion stage

- proportion of costs incurred to the estimated total contract costs
- surveys of work performed
- completion of a physical proportion of the contract work

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INSTRUCTOR'S NOTES

For both, fixed contracts and cost plus contracts the following conditions must be met

- it is probable that the economic benefits associated with the contract will flow to the enterprise;

Work in progress: a contractor may have incurred contract costs that relate to future activity on the contract. Such costs represent an amount due from the customer and are often classified as contract work in progress.

Exercise: Contract Costs Calculation Under IAS

Exercise 1: Which entry is to be made if it became known that RUR 20,000 out of the invoiced amount, already included in sales, will never be paid?

- (A) Dr. Revenue/ Cr. Accounts receivable
- (B) Dr. Expenses/ Cr. Accounts receivable
- (C) Dr. Deferred expenses/ Cr. Accounts receivable
- (D) None

Exercise 2: Engineering survey showed that a construction contract is 90% complete. There are no doubts that the contract will be paid in full. The full contractual revenue is RUR 500,000. The costs incurred up to now are RUR 300,000. No profit was recognized during previous periods. What will be recognized in the financial statements:

- (A) Revenue of RUR 450,000, cost of RUR 300,000 are recognized;
- (B) Revenue of RUR 450,000, no cost is recognized;
- (C) Revenue of RUR 500,000, cost of RUR 300,000 are recognized
- (D) No revenue is recognized, cost of RUR 300,000 is recognized

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INSTRUCTOR'S NOTES

The correct answer for the first question is (B) as this example is to repeat the statement made on slide 25.

The correct answer for the second question is (A). The exercise relate to the material covered on the previous slide.

Leases

Though RSA treatment drift to IAS as regards leasing, the differences remain

IAS: What type of lease is present at the company?

Finance lease	Operating lease
it transfers to the lessee substantially all the risks and rewards incident to ownership	any lease not classified as a financial lease

Some attributes of finance leases:
- the lease transfers ownership of the asset to the lessee by the end of lease term;
- the lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than the fair value at the date the option becomes exercisable that, at the inception of the lease, it is reasonably certain that the option will be exercised;
- the lease term is for the major part of the useful life of the asset. Title may or may not eventually be transferred;
- the present value at the inception of the lease of the minimum lease payments is greater than, or equal to substantially all of , the fair value of the leased asset, net of grants and tax credits to the lessor at that time. Title may or may not eventually be transferred.

Accounting treatment is different for these two types of leases

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INSTRUCTOR'S NOTES

The requirements for leases accounted are presented in IAS 17.

Risks incident to ownership: possibilities of losses from idle capacity or technological obsolescence and of variations in return due to changing economic conditions.

Rewards incident to ownership: the expectation of profitable operation over the asset's economic life and of gain from appreciation in value or realization of a residual value.

Leases of land and buildings are very rarely classified as finance leases.

The classification of a lease depends on the substance of the transaction rather than the form of the contract.

Leases (2): Disclosure by Lessees

Financial lease:

- disclose asset value and liability in the balance sheet of the lessee;
- at the inception of the lease, the asset and the liability for the future rentals are recognized in the balance sheet normally at the same amounts;
- in the coming periods the net asset value is diminished by the amount of depreciation charge and the liability by the decrease of liability;
- long-term and current portions of lease obligations are to be disclosed separately, as creditors. The finance charge is not shown as a liability.

Operating lease:

- disclosed in the balance sheet of the lessor;
- rental expense excludes insurance and maintenance expense
- the lease payments are charged to the income statement

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INSTRUCTOR'S NOTES

Leases (3) Disclosure by Lessors

Financial leases:

- recognized as a receivable;
- income is recognized on the basis of a pattern reflecting a constant periodic return on the lessor's net investment outstanding;
- lessors recognize profit or loss resulting from an outright sale of the asset being leased at normal selling prices and the finance income over the lease term;
- if artificially low rates of interest are quoted, selling profit should be restricted to commercial rates of interest;

Operating leases:

- recognized as property, plant and equipment in the balance sheet;
- rental income is recognized on a straight-line basis;
- costs, including depreciation, are recognized as an expense

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INSTRUCTOR'S NOTES

Examples of accounting treatment of different types of leases will be provided in the Handbook.

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RSA Regulation of Leasing Operations

The recent regulation of MoF No. 105 of 25 September 1995 provides for the following:

- Russian accounting provides for three types of leasing: financial, long-term and short-term.
- financial leasing is accounted for as operational leasing;
- long-term leasing is accounted for as financial leasing under IAS;
- interest payable (financial charge in IAS terminology) is tax-disallowable, therefore, it is a tax disadvantage for companies to use IAS-like accounting treatment;

It is necessary to make adjustments to the treatment of Russian financial leasing in order to conform with IAS

In many cases in Russia, a lease is arranged on more favorable terms than the market rates and therefore it is important to recognize the loss on it immediately upon the inception of the lease.

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INSTRUCTOR'S NOTES

Special Issues: Summary

- It is important to be aware of special issues in moving towards IAS
- Inflation accounting is applicable to Russian circumstances now and it is important to comply with IAS principles on inflation treatment
- Translation into another foreign currency is necessary especially in the case of companies with foreign operations
- Consolidated financial statements are required for companies that have controlling interest in other companies.
- Many accounting issues, such as reporting results by segments of business and related parties transactions require more detailed disclosure under IAS than is needed under the Russian statutory rules.

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INSTRUCTOR'S NOTES

Moving to International Accounting Standards

Session 9: Implementation approach

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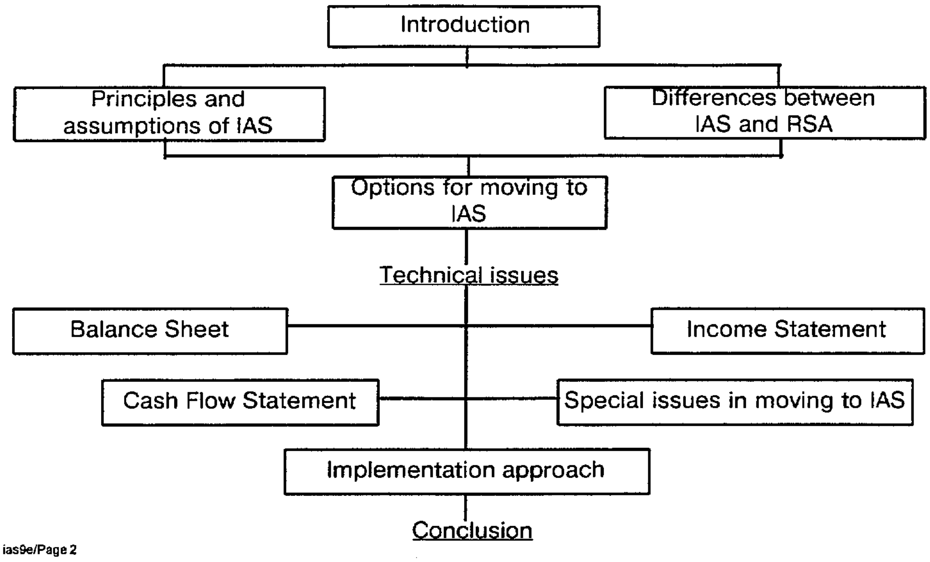
INSTRUCTOR'S NOTES

Seminar Structure



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INSTRUCTOR'S NOTES

Session Agenda and Objectives

Agenda

- General approach to implementation
- Sample implementation plan
- Special issues of implementation
- Summary

Objectives

- To learn the principles of implementation strategies
- To identify and become familiar with the key success factors in implementation

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INSTRUCTOR'S NOTES

Implementation Approach

Moving to International Accounting Standards requires a phased approach

1 Understand the need to move to IAS

- Understand requirements of financial statements users
- Understand the benefits of moving to IAS
- Agree on necessity to move to IAS
- Discuss and approve by the Board of Directors and communicate the decisions

2 Develop strategic options

- Appoint Strategy Team
- Gather all necessary information and prioritize critical issues
- Formulate acceptable options
- Discuss and approve by the Board of Directors

3 Select preferred option

- Apply cost vs. benefits criteria
- Produce implementation plan for selected option
- Discuss and approve by the Board of Directors
- Create Implementation Team, assign champions to lead the effort, delegate authority and responsibility

4 Implement Vision

- Implement changes according to implementation plan
- Empower champions to act on vision
- Monitor and facilitate implementation process

5 Provide Feedback

- Assess implementation achievements against the vision
- Refine approach on the basis of lessons learned
- Complete all planned steps

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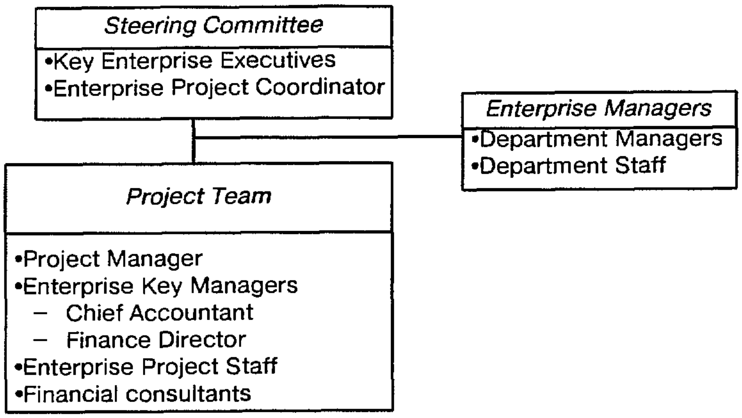
INSTRUCTOR'S NOTES

Multidisciplinary Approach to the Project

The typical project includes both organization's managers and staff from different departments and experienced consultants



Which Promotes Capabilities Transfer To The Organization

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INSTRUCTOR'S NOTES

Parties Involved in the Process of Moving Towards IAS

Who can do the work largely depends on the user's purpose and company's choice between backward and forward approaches

The most important players in moving towards IAS are:

- Management of the company
- Internal professional staff

External professionals can help the management in moving towards IAS:

- International audit firms
- Russian certified auditors
- Technical/software consultants
- External sub-contractors/part-timers

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INSTRUCTOR'S NOTES

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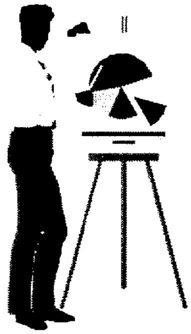
Overall Strategy for Backward-oriented IAS Financial Statements

Contract external resources for backward-oriented approach:

- Users of financial statements typically require independent opinion and assessment
- Does not require significant time:
  - experienced financial consultants
  - focused on clearly defined issues
- One-time exercise
- Less expensive than installing a system



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INSTRUCTOR'S NOTES

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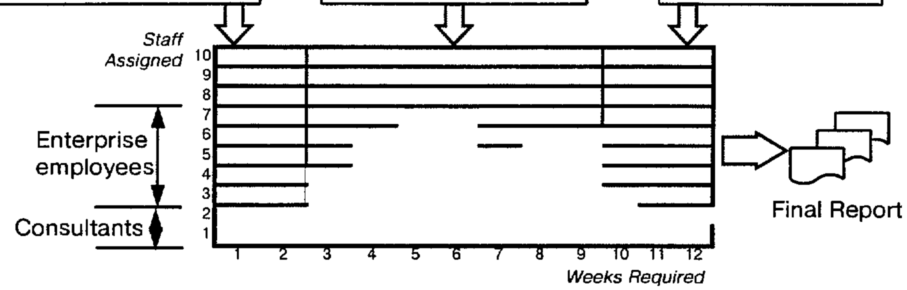
Backward-oriented Move to IAS - Sample Implementation Plan

Example: OLEKO is one of the companies which is looking for possible investments from the EBRD Regional Fund. As requested by the fund, the company decided to prepare a compilation report for the IAS financial statements for the years ended December 31, 1994 and 1995.

Stage 1	Stage 2	Stage 3
Planning	Data gathering and restatement procedures	Final assessment and preparation of report



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INSTRUCTOR'S NOTES

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Overall Strategy for Forward-looking Move to IAS

A staged approach to implementing forward-looking move to IAS is recommended

- Used for strengthening the ongoing management of the company
  - when reliable data availability is crucial
  - when it is necessary to generate IAS financial statements more than once
- Requires significant time
  - needs to be deeply integrated into companies policies and procedures
  - time-consuming decision-making is required at all stages
- Ongoing system in real time
- Requires significant effort and commitment of organization

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INSTRUCTOR'S NOTES

Need for Measurable Goals

Establish measurable goals in order to make concrete the expected value from the investment and to control the implementation

- Will clearly define what should be achieved
- Will allow smooth communication between enterprise and consultants
- Will allow measurement of the success of the implementation

Examples:

- Financial reporting frequency: at least once a month
  - ✓ major balance sheet and income statement items should be available to management on weekly basis
  - ✓ close the journals and compute major financial statements on daily basis if needed
- Make reporting lag negligible
- Use flexible (i.e. moving in time) forecasting of balance sheet, income and cash flow statements; compare planned statements against actual

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INSTRUCTOR'S NOTES

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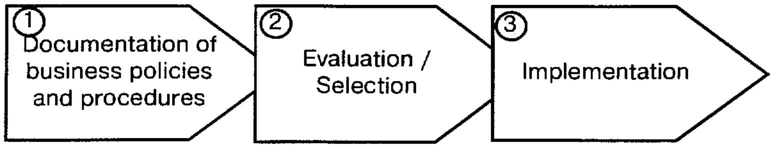
Forward-looking Move to IAS - Sample Implementation Plan

Example: Company Electromash has decided to implement IAS-type forward-looking financial systems in order to compete internationally for governmental tenders.



<u>The following actions may be taken :</u>

- final decision upon the methods and cost drivers
- finalizing requirements for the system
- the software will be purchased
- the software will be adjusted for the requirements of the company
- instructions for the use of the system will be prepared

- preparation of detailed accounting procedures for the company
- preparation of the system of data input for the cost accounting system
- creation of a set of cost drivers and parameters
- review of the existing interfaces
- preparation of interface instructions
- trial of the new interfaces

- training of personnel
- install the hardware and the software
- test the system
- input the cost parameters
- trial run the system
- adjustment of the system
- final approval and introduction of the system in the working regime

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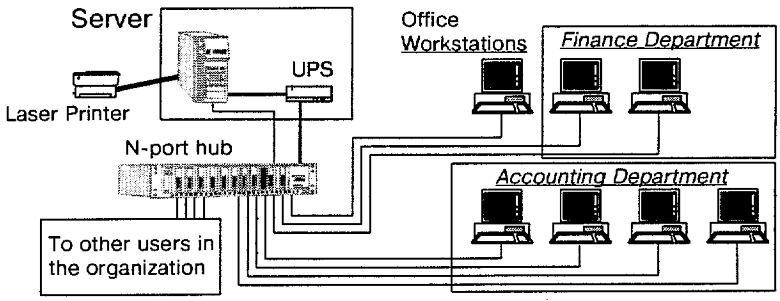
INSTRUCTOR'S NOTES

Ask participants on which Phase is of the actions listed above should be taken?

Do You Need Computers?

A majority of companies use computerized software packages to aid in accounting and financial reporting

Example



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INSTRUCTOR'S NOTES

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Is Dual Accounting Software Available?

Five major software packages

Name	Distributor Company/Tel.	Price range for software	Comments
SCALA	Scala - CIS 138-2596	Medium	• Several years of business experience in Russia • Significant client base • Used actively by foreign companies
SUN SYSTEMS	RBS 922-9292	Medium	• Several years of business experience in Russia • Established client base • Used actively by foreign companies
PLATINUM	Platinum Inc. 336-1530	Medium	• Several years of business experience in Russia •Significant client base • Used actively by foreign companies
SAP	SAP CIS 275-0454	High	• Package of choice for major multinational companies • Implementation complex / expensive • Some Russian clients
ACCPAC	Computer Associates 124-0502/956-6895	Low	• Distributed exclusively via Volgodonsk-Electronics

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INSTRUCTOR'S NOTES

Estimates for price will heavily depend on the amount of users in the network and type/quantity of hardware selected. However, some estimate - for software only - can be done:

Low: $10,000-20,000

Medium: $20,000-100,000

High: $100,000-500,000

One can take an average of a range to arrive at the rough expected cost.

Some notes on hardware:

- Scala/Sun/ACCPAC/Platinum are available in the PC DOS format

- SAP are available for UNIX only (which is much more expensive from the hardware point of view

One other package is also available - PG-400, designed by IBM. It is a package designed for trading companies and is available for the AS/400 (IBM-produced hardware)

How Much It Will Cost Me?

The implementation of the new IAS Cost Accounting System at Company Electromash will be associated with the following four major investment categories

Category	*US $*
Hardware	15,000-20,000
Software	45,000-55,000
Financial Consultants Fees	80,000-100,000
Technical consultants fees	20,000-30,000
Total Budgeted	160,000-205,000

Category	*Major cost driver*
Hardware	Type of file server, # of workstations
Software	Software module base price, # of users
Financial Consultants Fees	Amount of time spent, hourly professional rates
Technical consultants fees	Amount of time spent, hourly professional rates

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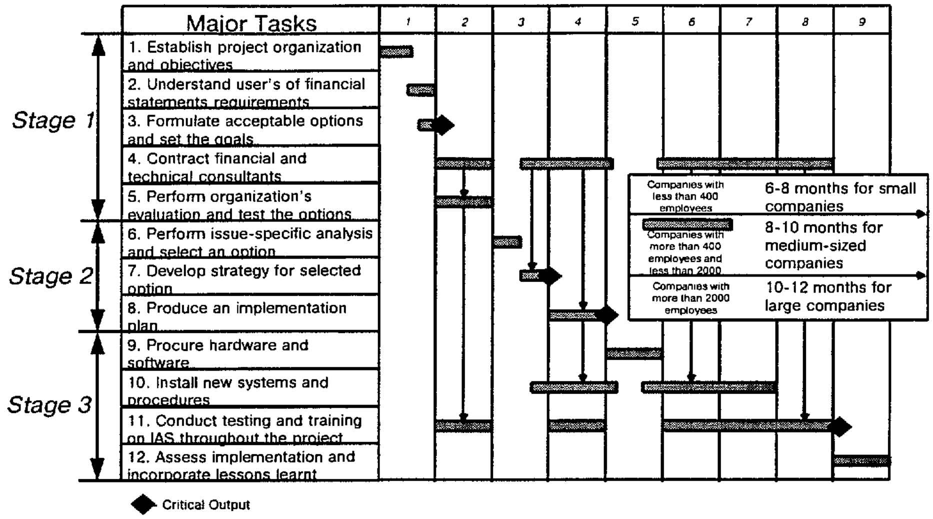
INSTRUCTOR'S NOTES

Sample Implementation Timeline

Project on forward-looking move to IAS



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INSTRUCTOR'S NOTES

It is possible to highlight to participants that the following actions are the most time consuming and important

1) Document the requirements

2) Select Hardware / Software

3) Develop Software User's Manual

4) Fine-tune the system for the particular enterprise

- Configure Chart of Accounts
- Configure the system
- Test the software
- Load historical data
- Begin initial system operation

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Key Success Factors: Computerization

Word of caution: computerization by itself is not enough

- Despite widespread opinion, an integrated computer network becomes useful only after:
  - all process flow logistics are developed and run manually
  - a system for storing information and files is established
  - all procedures are clearly defined
  - clear working relations between participants are established.
- Ideally, any computerization should be only the next step after finance function restructuring
- Computerization should be supported by clearly established goals and developed strategy

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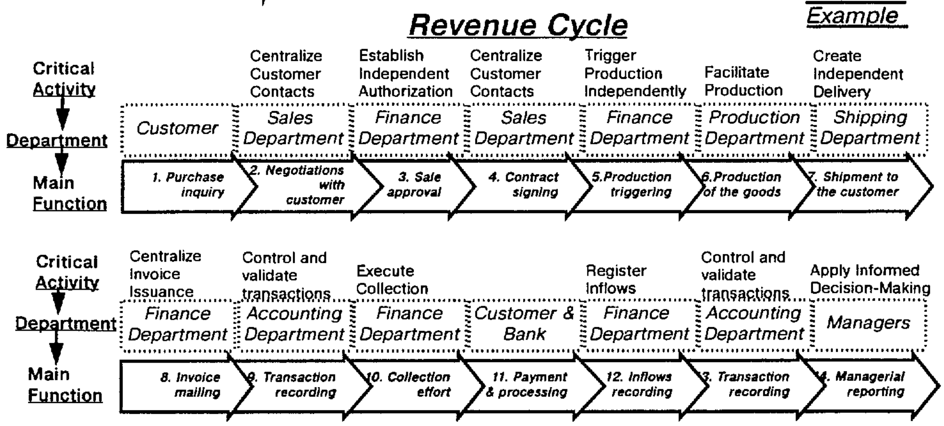
INSTRUCTOR'S NOTES

Key Success Factors: Process Flows in Revenue, Expenditures and Barter cycles

Process flows in Revenue and Expenditures cycles in many Russian companies impede accurate and timely financial reporting and need to be restructured

Logically constructed cycle can increase the speed and quality of financial reporting



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INSTRUCTOR'S NOTES

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Key Success Factors: Maintaining Accounting Records

Due to historically different objectives of the RSA system as compared to IAS, certain data essential to financial reporting under IAS is not captured in the Russian statutory accounts. Thus, organizations may need to improve the quality of the accounting data they maintain.

Examples of data to be maintained:

- Dates of recognition or realization of transactions
  - Example: Electricity bill often is accounted for in the period it was issued and not in the period when electricity cost was incurred
  - Example: Specific dates on which components of current inventory balances were acquired or average age of such items
- Values at which transactions are recorded
  - Example: Accounts receivable are often maintained at cost of goods shipped and not at full value to be received

For each category on the balance sheet or income statement the analytical accounting should be organized in such a way that the necessary data needed to prepare financial statements in IAS format would be captured

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INSTRUCTOR'S NOTES

Key Success Factors: Training

Staffing issues:

- The company simply may not currently possess the talent needed for maintaining the IAS computerized system;
- Hiring professionals can be expensive;
- Training and internal employee development programs are a better strategy than hiring;
- Training is usually less costly than hiring new employees.

Training employees on an ongoing basis is vital because ...

- Business is constantly changing, so tools and skills become obsolete.
- Skilled labor is always in short supply, so develop your own skilled labor.
- Training motivates employees, provides them with a sense of common objectives and demonstrates that you recognize their value.
- Training ensures dissemination of cumulated knowledge and information throughout the company.

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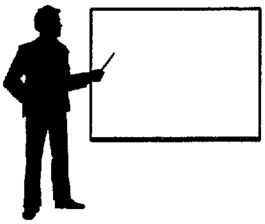
INSTRUCTOR'S NOTES

Key Success Factors: Training Strategy

Different training programs for different users should be created:

Management - key decision makers	How to use the system, how to make decisions	Quick
Chief accounting personnel	Requirements of Russian and international accounting, non-standard transactions	Intensive
Line accounting personnel	Inputting of standard transactions, creating standard reports	Intensive
System administrators	Maintenance of the system, adjusting the system for new requirements, computer training of personnel	Medium-length



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INSTRUCTOR'S NOTES

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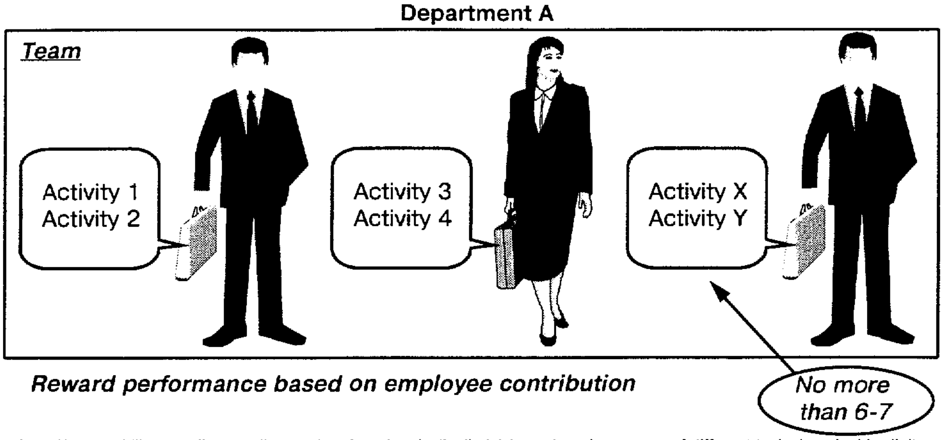
Key Success Factors: Employee Accountability and Responsibility

Assign activities to specific individuals and hold the 'owner' of the activity accountable for his work



Reward performance based on employee contribution

Note: Human ability to deliver quality results often drastically diminishes when the amount of different tasks is a double-digit number.

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INSTRUCTOR'S NOTES

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Implementation Approach: Summary

- Moving to International Accounting Standards requires a phased approach
- The typical project includes both organization's managers and staff, and experienced financial and technical consultants
- Contracting financial consultants is the best strategy for developing backward-looking IAS financial statements
- Multifunctional team approach is the best strategy for implementing forward-looking move to IAS
- Computerization is an essential part in forward-looking strategies
- Key success factors are:
  - Approach to computerization
  - Logical process flows in Revenue, Expenditure and Barter Cycles
  - Accurate accounting records
  - Training
  - Employee accountability
- The implementation work will require a lot of effort and coordination of the implementation team.

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INSTRUCTOR'S NOTES

Moving to International Accounting Standards

Session 10: Wrap-up

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INSTRUCTOR'S NOTES

This session comprises Homework 2 and Case Study on Transformation.

Session Agenda and Objectives

Agenda

- Review
- Questions
- Homework: Problem
- Homework: Case study

Objectives

- To review the material of the seminar by answering questions
- To discuss homework

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Moving to International Accounting Standards

Homework 1

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International Accounting Standards. Problem 1 (1)

Which of the following is true:

- The basic accounting equation is stated as:
  - (A) Assets = Liabilities - Owner's equity.
  - (B) Assets = Liabilities + Owner's equity.
  - (C) Assets = Owner's equity.
  - (D) Assets + Liabilities = Owner's equity
- The major asset classifications are:
  - (A) Current assets and property, plant and equipment.
  - (B) Current assets, cash and land.
  - (C) Land, buildings and equipment.
  - (D) Cash, accounts receivable and property.
- An external investor purchased a machine-tool. This causes:
  - (A) An increase in an asset and an increase in a liability.
  - (B) An increase in an asset and an increase in an owner's equity.
  - (C) An increase in an owner's equity and a decrease in a liability.
  - (D) None of the above.

International Accounting Standards. Solutions to problem 1 (1)

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  - (D) Cash, accounts receivable and property.
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  - (A) An increase in an asset and an increase in a liability.
  - (B) An increase in an asset and an increase in an owner's equity.
  - (C) An increase in an owner's equity and a decrease in a liability.
  - (D) None of the above.

International Accounting Standards. Problem 1 (2)

- The number of accounts included in a chart of accounts under IAS is determined by:
  - (A) The size of the computer system.
  - (B) The rules of the International Accounting Standards.
  - (C) Number of digits in the accounts number.
  - (D) The types and detail of the accounting information desired.
- On July 1, 1995 Utyug received rent of 36 M RUR for a two year period (from July 1, 1995 to July 1, 1997) A permanent IAS account - 'Rent creditors' is credited when the rent payment was received. What must be the entry at the end of 1995:
  - (A) A credit to Rent Earned in the amount of 27 M RUR.
  - (B) A credit to Rent Earned in the amount of 9 M RUR.
  - (C) A credit to Unearned Rent in the amount of 27 M RUR.
  - (D) A credit to Unearned Rent in the amount of 9 M RUR.
- General and Administrative expense includes:
  - (A) Advertising, office salaries and interest.
  - (B) Office salaries, interest and administrative salaries.
  - (C) Transportation out, administrative salaries and office supplies.
  - (D) Office salaries, administrative and depreciation of office building.

International Accounting Standards. Solutions to problem 1 (2)

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International Accounting Standards. Problem 1 (3)

- Making provision for bad debt is important in order to:
  - (A) Correctly state liabilities on the balance sheet.
  - (B) Correctly determine cost of goods sold on the income statement.
  - (C) Correctly determine net income on the income statement.
  - (D) None of the above
- Examples of trade receivables which would be classified as a current asset on the balance sheet in accordance with IAS include:
  - (A) Accounts receivable collectible within 30 days.
  - (B) Accounts receivable collectible within 18 months for a company with an operating cycle of two years.
  - (C) Credit card sales receivables.
  - (D) All of the above

International Accounting Standards. Solutions to problem 1 (3)

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  - (D) All of the above

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Instructors note:

The second question on this slide must initiate a discussion on the criteria of classifying an asset as current asset and must come to the conclusion that management judgment is the most important and prevalent rule for classifying assets as current and fixed. It is important to stress that the final decision of the management based upon the reality and peculiarities of the company is an important factor of IAS allowing to have flexibility and to consider substance of numerous practical cases.

International Accounting Standards. Problem 1 (4)

- On November 1, 1995 Utyug received an 110 percent, 120-day 30 M RUR note. What entry will be made at the end of the year on Accrued Interest Receivable account:
  - (A) 11 M RUR
  - (B) 33 M RUR
  - (C) 2 750 thousand RUR
  - (D) 5 500 thousand RUR
- The IAS principle that requires firms to use similar methods of accounting each year is
  - (A) Matching.
  - (B) Conservatism.
  - (C) Consistency.
  - (D) Periodicity.
- Effective comparison of financial statements requires application of the:
  - (A) Conservatism principle.
  - (B) Materiality principle.
  - (C) Consistency principle.
  - (D) Matching principle.

International Accounting Standards. Solutions to problem 1 (4)

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  - (B) Materiality principle.
  - (C) Consistency principle.
  - (D) Matching principle.

International Accounting Standards. Problem 1 (5)

RSA accounting for some costs as diminution of special funds leads to:

- lower shareholders' funds reported in the balance sheet as compared to IAS;
- lower expense reported in the income statement as compared to IAS;
- higher expense reported in the income statement as compared to IAS;
- absence of extraordinary expense in the income statement as compared to IAS.

Interest is usually reported in IAS in the amount:

- falling due under the loan contract terms;
- falling due as reported in the accounts of the servicing bank of the borrower;
- paid through the bank;
- invoiced by the lender.

International Accounting Standards. Solutions to Problem 1 (5)

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- paid through the bank;
- invoiced by the lender.

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International Accounting Standards. Problem 2

- Classify the following costs between assets, product costs and periodic expenses:
  - Cutting-machine operators' wage
  - Factory janitors
  - Factory payroll clerks
  - Safety inspectors in factory
  - Operator of a workshop lift truck
  - President of the firm's compensation
  - Traveling salespersons' compensation
  - Glue used in assembling products
  - Materials used in training production workers
  - Depreciation of office equipment
  - Purchase of a 3-year fire insurance policy beginning next year
  - Property tax for the last year
  - Stationary used
  - Wages of truck drivers who deliver finished goods to customers
  - Wages of the construction workers building a new warehouse
  - Guards at factory gate

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International Accounting Standards. Solution to Problem 2

Assets	*Product cost*	*Period cost*	*Item*
	+		Cutting Machine operators' wage
		+	Factory janitors
		+	Factory payroll clerks
		+	Safety inspectors in factory
	+		Operator of workshop lift truck
		+	President of the firm's salary
	+		Traveling salespersons' compensation
	+		Glue used in assembling products
		+	Materials used in training production workers
		+	Depreciation of office equipment
+			Purchase of a 3-year fire insurance policy beginning next year
		+	Property tax for the current year
		+	Stationary used
	+		Wages of truck drivers who deliver finished goods to customers
+			Wages of the construction workers building a new warehouse
		+	Guards at factory gate

Moving to International Accounting Standards

Homework 2. Problem

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International Accounting Standards. Problem 1

Classify the following events between the categories: (A) income from continuing operations; (B) results of discontinued operations; (C) Extraordinary gains/losses; (D) Adjustments for changes in accounting principles:

- a delivery truck was sold

- a loss of RUR 100 Mln was recognized because of switch from weighted average to LIFO

- a loss of RUR 20 Mln was recognized for the cost of warehouse destroyed by fire

- the car of the General Director was sold (no new car was bought as he now uses public transport)

- the company earned RUR 10 Mln renting out company dacha and then sold it to a local merchant because of high maintenance costs

- Utyug first applied accelerated depreciation to its new imported equipment. Previously only straight-line method was used.

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International Accounting Standards. Solution to Problem 1

A	B	C	D	*Classify the following events between the categories: (A) income from continuing operations; (B) results of discontinued operations; (C) Extraordinary gains/losses; (D) Adjustments for changes in accounting principles:*
+				*- a delivery truck was sold*
			+	*- a loss of RUR 100 Mln was recognized because of switch from weighted average to LIFO*
		+		*- a loss of RUR 20 Mln was recognized for the cost of warehouse destroyed by fire*
+				*- the car of the General Director was sold (no new car was bought as he now uses public transport)*
	+			*- the company earned RUR 10 Mln renting out the company dacha and then sold it to a local merchant because of high maintenance costs*
			+	*- Utyug first applied accelerated depreciation to its new imported equipment. Previously only straight-line method was used.*

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Moving to International Accounting Standards

Solutions

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Income Statement

For the year ended 31 December 1995

	1995 RUR Mln	1994 RUR Mln
Turnover	202,228	186,935
Cost of Goods Sold	(91,188)	(121,233)
Gross margin	111,040	65,702
Depreciation expense	(5,022)	(4,566
Selling, General and Administrative Expense	(39,258)	(22,506)
Operating Income	66,760	38,630
Income From Investments	2,600	200
Interest Income	1,100	3,530
Other Revenues and Expenses	(33,080)	15,272
Interest Expense	(7,595)	(13,718)
Loss on Net Monetary Position	(34,785)	(671)
Net Gain Before Taxation	29,785	43,243
Taxation	(13,112)	(27,436)
Net loss	(18,112)	15,807

See accompanying notes to the accounts.

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Balance Sheet

As at 31 December 1995

	1995 RUR Mln	1994 RUR Mln
Assets		
CURRENT ASSETS		
Cash and Cash Equivalents	100	286
Accounts Receivable		
Trade	34,350	37,707
Employees	832	87
Advance to a former director	250	120
Other	7,673	4,392
Advances Paid	26	-
Notes Receivable	6,502	1,142
Prepaid Expenses	142	210
VAT Recoverable	2,308	2,743
Inventories	63,757	57,042
Total Current Assets	115,940	103,729
LONG-TERM INVESTMENTS	1,447	1,418
PROPERTY, PLANT AND EQUIPMENT	129,158	133,858
INTANGIBLE ASSETS - NET	37	18
TOTAL	246,582	239,023

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	1995 RUR Mln	1994 RUR Mln
Liabilities and Shareholders' Equity		
CURRENT LIABILITIES		
Accounts Payable:		
Trade	12,134	13,727
Employees	3,831	2,574
Other	12,560	7,613
Taxes Payable	30,352	16,801
Short-term Loans	4,574	8,063
Loans payable to shareholder	2,355	-
Advances Received	7,761	8,195
Other Liabilities	19,016	8,635
Deferred Taxes Payable	1,976	3,280
Total Current Liabilities	94,559	68,888
SHAREHOLDERS' EQUITY		
Capital	184,477	184,477
Reserves	7,035	7,035
Retained Deficit	(39,489)	(21,377)
Total Shareholders' Equity	152,023	170,135
TOTAL	246,582	239,023

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Cash Flow Statement

		RUR Mln
Cash flow from operating activities		
Cash receipts from customers	113,567	
Cash paid to suppliers and employees	(117,810)	
Cash generated from operations	(4,243)	
Interest paid	(3,500)	
Income taxes paid	(9,291)	
Net cash flow from operating activities		***(17,034)***
Cash flow from investing activities		
Acquisition of a subsidiary, net of cash acquired	(1,000)	
Purchase of property, plant and equipment	(2,500)	
Proceeds from sale of equipment	16,898	
Interest received	1,100	
Dividends received	2,600	
Net cash flow from investing activities		***17,098***
Cash from financing activities		
Proceeds from long-term borrowings	250	
Payment of finance lease liabilities	(200)	
Dividends paid	(300)	
Net cash used in financial activities		***(250)***
Net increase in cash and cash equivalents		***(186***
Cash and cash equivalents at beginning of period		***286***
Cash and cash equivalents at end of period		***100***

Notes to the Financial Statements

1. Incorporation and principal activities

Utyug Joint Stock company was set up as a state enterprise on 21 February 1972 in the city of Sibirsk, Siberia and on 23 December 1992 was corporatized. The company is a producer of electric equipment for industrial and household use.

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2. Significant accounting policies

2.1. Basis of presentation

The accompanying financial statements are prepared in accordance with International Accounting Standards. The balance sheet as of December 31, 1995 and income statement for the period then ended have been restated for the effects of hyperinflation to allow comparability with the income statements and balance sheets for prior periods.

2.2. Reporting currency and foreign currency translation

Throughout the financial year of 1995 the company used Russian Roubles as its reporting currency. Revenues and expenses are translated at rates in effect at the time of the transactions. Foreign exchange gains and losses are included in earnings.

2.3. Inflation index

Although there is no official general inflation index in the Russian economy various agents of the Government of the Russian Federation monitor and report significant statistics of the Russian economy. The primary inputs to the production of Utyug are typical industrial inputs and the resulting products are generally utilized in the industrial markets. As such an appropriate index of the change in purchasing power for the Company as a whole is an estimate of the change in prices of industrial goods. An estimate has been made of the inflation in prices of industrial goods for the reporting years within the reporting period by creating a representative "basket" of such goods, evaluating the changes in the prices for the goods, as reported by GOSKOMSTAT during the period and calculating a weighted-average index. This estimate does not reflect any long-term purchase agreements that may be in effect and that may effect the prices that Utyug incurs for its non-consumer inputs. The estimate for annual industrial inflation for 1995 utilized in the report is 282%.

2.4. Net Realizable Value

No adjustments have been made to the restated amounts to reflect a lower cost or net realizable value. Management believes that the Company's pricing policies and the rapid inventory turnover are such that the payments received will be sufficient to recover the restated value of inventories. In addition, management believes that the restated value of production assets will be fully recovered through allocation of such costs to products manufactured and the sale pricing thereof.

2.5. Income taxes

Utyug uses the liability method of tax allocation, whereby the proforma tax on all accumulated net differences between book and taxable income is provided for at currently enacted tax rates. The provision for taxes payable is calculated in accordance with rules for determining taxable income established by the taxation authorities. In many circumstances these rules differ from the accounting policies applied to determine accounting income. A deferred taxes balance was established to reflect the proforma on such differences.

2.6. Research and development expenditure

Direct expenditure and related costs incurred in connection with product research and development are carried forward when the future recoverability can be foreseen with reasonable assurance. The expenditure is amortized over a period of three years from the date of commercial production.

3. Cash and cash equivalents

Cash and cash equivalents at December 31 are summarized as follows:

	(Million Roubles)	
	1995	**1994**
Cash on hand	57	54
Cash at bank	6	129
Foreign currency at bank	37	83
Other monetary items	0	20
Total	100	286

4. Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation. Costs directly related to the installation of production equipment are included in the cost of the equipment. Depreciation is provided using the following methods at annual rates over the estimated useful lives of the assets which are:

Asset	Basis	Rate
Buildings	straight-line	2-10% per annum
Machinery and equipment	straight-line	5-12% per annum
Other	straight-line	5-14% per annum

5. Investments

Investments are carried at restated cost. The management believes that the investments are fairly stated and no permanent diminution in value has occurred.

6. Inventory

The Company uses actual costs of inventories applying the weighted average costs for raw materials, work in process and finished goods valuation. The overheads are distributed between work in process and output on the basis of direct labor costs. The inflation adjustment of the cost of inventory has been made since the acquisition date. The inflation adjustment of work in progress applied to determine accounting income. A deferred taxes balance was established to reflect the proforma on such differences.

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and finished goods includes also the effect of their stay in the process of production.
Inventories at December 31 are summarized as follows:

	(Million Roubles)	
	1995	**1994**
Raw materials and components	43,120	30,374
Work-in-process	1,613	1,128
Finished goods	19,024	25,539
Total	63,757	57,041

7. Loans payable to shareholder

At 31 December, 1995 short-term loans payable include short-term advances from AOZT ElectricFinance in the amount of $500,000. These advances bear interest at LIBOR one month rate plus 15% and are repayable on 31 July 1996. Loans payable to shareholders also include 35,200 thousand Roubles to other shareholders of Utyug.

8. Advances from company related to a former director

These advances are included in other current assets balance in the assets of the balance sheet. The loans are unsecured and are due on demand. Interest is payable as negotiated (50% at 31 December 1995; 70% at 1 July 1996). During 1994 payment was demanded on a portion of the loans. Subsequent to 31 December 1995 the Company repaid in full the principal amount owing on the loans. The loans are summarized as follows:

	(Million Roubles)	
	1995	**1994**
Principal and accrued interest	250	120

9. Discontinued operations

Effective 31 December 1994, the Company adopted a formal plan to discontinue its pig farming activities, a division of Utyug. The Company sold the assets of the pig farm to its workers collective. All liabilities of the pig farming business relating to its former operations, as of the date of sale, were retained by Utyug.

10. Related party transactions

(1) A shareholder has provided Utyug with office space in Moscow free of charge.
(2) General and administrative expenses for the year ended 31 December 1995 include fees of 50 Million Roubles charged by a company related to a former officer and director of the Company for marketing and consulting services.

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11. Commitments and contingencies

(1) Utyug has guaranteed a loan obtained by TOO SuperElectra in the amount of 100 Million Roubles for the purpose of financing the purchase of certain trading equipment and related materials. Under the terms of the loan agreement, SuperElectra cannot declare or pay any dividends until the loan is repaid in full. The loan matures in March 1996.

(2) The Company is committed to lease payments of approximately 1,300 Million Roubles over the next 10 years on vacant office space.

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Moving to International Accounting Standards

Homework 2. Case Study

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Reversal of Revaluation

In accordance with Russian regulations AOOT Utyug performed several revaluations of its fixed assets, machinery to be installed and construction in progress. Mandatory revaluation rates were used for this purpose. The following information exists:

- Before revaluation acquisition cost of fixed assets was RUR 33,766 mln, accumulated depreciation was RUR 14,897 mln. After revaluation acquisition cost of fixed assets was RUR 173,345 mln, accumulated depreciation was RUR 76,476 mln
- Before revaluation cost of machinery to be installed was RUR 777 mln; after revaluation RUR 5,509 mln
- Before revaluation cost of construction in progress was RUR 550 mln; after revaluation RUR 4,483 mln

Revaluation gain was treated in the Russian statements as part of additional capital.

Task: reverse effects of revaluation

Reversal of Revaluation: Solution

The following calculations should be made:

- Fixed assets: RUR 173,345 mln-RUR 33,766 mln = RUR 139,579 mln
- Accumulated depreciation: RUR 76,476 mln-RUR 14,897 mln = RUR 61,579 mln
- Machinery to be installed: RUR 5,509 mln-RUR 777 mln = RUR 4,732 mln
- Construction in progress: RUR 4,483 mln-RUR 550 mln = RUR 3,933 mln

The following entry should be made:

- DR. Revaluation reserve/CR. Fixed assets RUR 139,579 mln
- DR. Accumulated depreciation/CR. Revaluation reserve RUR 61,579 mln
- DR. Revaluation reserve/CR. Machinery to be installed RUR 4,732 mln
- DR. Revaluation reserve/CR. Construction in progress RUR 3,933 mln

Sales

AOOT Utyug accounted for sales on a cash basis, i.e. goods are recognized as sold when they are delivered and paid for. Cash sales for the year as per Russian statements were RUR 114,672 mln (net of VAT and special tax). During 1995 the value of goods delivered but not yet paid for was RUR 14,957 mln. In 1995 RUR 3,976 mln was received for the goods delivered in 1994.

***Task:* calculate sales on the accrual basis. In accordance with the accrual basis sale is recognized when goods are delivered and invoiced. In order to move from cash to accrual basis you need to make the following adjustments:**

- Add to the cash sales figure the sales value of the goods delivered but not paid for in the reporting year
- Deduct from the cash sales figure the sales value of the goods delivered in the prior year but paid for in the reporting year. For the sake of simplicity these proceeds may be added to retained earnings of previous years

Sales: Solution

Adjust for the sales value of the goods delivered but not paid for in the reporting year:

- DR. Trade receivables/CR. Sales RUR 14,957 mln

Adjust for the sales value of the goods delivered in the previous year but paid for in the reporting year:

- DR. Sales/CR. Retained earnings of the previous years RUR 3,976 mln

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Cost of Sales

AOOT Utyug accounted for sales on a cash basis, i.e. goods are recognized as sold when they are delivered and paid for. Cash sales for the year as per Russian statements were RUR 114,672 mln (net of VAT and special tax). During 1995 the cost of goods delivered but not yet paid for was RUR 9,341 mln. In 1995 the cost of the goods delivered in 1994 but paid for in 1995 was RUR 2,014 mln.

Task: calculate cost of sales on the accrual basis. In accordance with the accruals concept, cost of sales should include costs attributable to the goods for which sale is realized in the reporting year.

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Cost of Sales: Solution

Adjust for the cost of goods delivered but not paid for in the reporting year (these goods are recognized as sold in accordance with the accruals concept)

- Dr. Sales/Cr. Goods shipped

Adjust for the cost of goods delivered in the previous year but paid for in the reporting year (these are considered to be sold in the previous year)

- Dr. Retained earnings of previous years/Cr. Sales

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Reclassification of Funds

In the Russian balance sheet consumption fund is shown as a part of current liabilities section. The balance as at January 1, 1996 was RUR 1,191 mln.

Task: reclassify the balance of the consumption fund to an appropriate section of the balance sheet

Reclassification of Funds: Solution

In accordance with IAS special purpose funds (of which consumption fund is a part of) should be reclassified as retained earnings

Reclassification entry:

Dr. Liabilities/Cr. Retained earnings RUR 1,191 mln

Reclassification of Expenditure from Funds

AOOT Utyug transferred its after tax profit to several special purpose funds: consumption and accumulation funds.

Some of the expenses were charged to the special purpose funds, specifically consumption fund. These expenses include:

- Expenses relating to an advertising campaign to promote a new model of irons (RUR 11,561 mln)
- Training course for senior management 'International Accounting Standards' (RUR 4,447 mln)
- Entertainment expenses in excess of state limits (RUR 7,009 mln)
- Material aid for some workers (RUR 7,894 mln)

Task: ***reverse appropriation of profit and reclassify these expenses into appropriate expense categories***

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Reclassification of Expenditure from Funds: Solution

Reverse appropriation of profit to special purpose funds:

- Dr. Special purpose funds/Cr. Retained earnings RUR 30,911 mln

First three categories of expenses should be reclassified as general and administrative:

- Dr. G&A expense/Cr. Retained earnings RUR 23,017

Last category should be classified as a part of direct labor expense and included in the cost of goods sold:

- Dr. Cost of goods sold/Cr. Retained earnings RUR 7,894 mln

Reclassification of Capital

In 1995 AOOT Utyug obtained some funds from the government as a grant for development of a new model of iron. This money was accounted for as directed financing (part of the capital). The amount of the grant was RUR 22,756 mln

Task: make an appropriate adjustment to account for the grant in accordance with IAS

Reclassification of Capital: Solution

In accordance with IAS grants received should be accounted for in the income statement as a part of other revenue. The following adjustment should be made:

- Dr. Capital (Directed financing)/Cr. Other revenue RUR 22,756 mln

Deferred Taxes

Since AOOT Utyug adjusted its sales for the accrual basis, a new amount of income tax should be calculated and recorded as deferred income tax. The amount of deferred tax is RUR 1,976 mln

Task: Make appropriate adjustments to record deferred income tax

Deferred Taxes: Solution

This difference between the new and old amount of income tax should be recorded as deferred tax by the following entry:

- Dr. Taxation expense/Cr. Deferred income tax RUR 1,96 mln