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ADOPTION OF IFRS IN THE BRICS COUNTRIES – A CASE STUDY FOR RUSSIA

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Abstract

The objective of this article is to present the modern trends of adopting IFRS by the BRICS countries: Brazil, Russia, India, China and South Africa. In order to achieve this goal, the paper focuses on the analysis of the difficult process of convergence, but also on the modern trends in the development of accounting systems in these countries. Currently, each of these countries have adopted IFRSs or are doing so, but the conceptual framework of IFRS and accounting policies are fundamentally different from those that characterize Russia's financial reporting systems.

Keyword: BRICS, convergence, transparency, comparability, IFRS adoption, Russia.

JEL Classification: M41

I. Introduction

Simultaneously with the internationalization of entities, the importance of communication has grown even more, and the expansion of the economic and cultural globalization process has in time led to the homogenization and uniformization of a common language for all categories of stakeholders, facilitated and promoted primarily by international reporting standards financial.

Comparability is an important feature of improving the quality of financial reporting information that allows users to identify similarities and differences between similar and different accounting items (Ortega, 2017). Its lack can lead to difficulties in understanding the financial statements of companies in different jurisdictions. This is the

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most common situation in countries whose economies have rapidly expanded. In a study carried out by the American Accounting Association (1977: 73) it shows that ”their rapid growth, potentially combined with a very different or inadequate accounting culture, creates a barrier for those companies that would like to face the challenge of internationalization and those foreign investors who are interested in investing in these countries”.

The adoption of International Financial Reporting Standards (IFRS) by many countries has significantly altered the most-known international accounting systems, and of course at the level of each country that opted to implement these standards. The objective of IFRSs is to standardize the accounting language for companies in different jurisdictions, thus exceeding the impediment of geographical location imposed by national GAAPs. However, there are a number of known studies showing that the implementation of IFRSs is not always conducive to the achievement of the above-mentioned objective and has continued to turn to the use of different practices in the countries that have applied IFRS (Stadler & Nobes, 2014, Kvaal & Nobes, 2012; Nobes & Stadler, 2013).

In some authors' view, it is considered that accounting standards "translate" the impact of all business activities into uniform language, making the financial statements of different entities interpretable and comparable (Healy & Palepu, 2001). Application of IFRS aims at increasing the transparency of the company's business, as well as creating the opportunity to make reasonable managerial decisions, to estimate the financial position and to implement forecasts. Due to the active globalization process in global economic systems, IFRS standards are widely used in the modern financial world. The need to develop IFRS as a single set of rules for accounting and reporting systems was primarily driven by the establishment of uniform rules on the international financial market.

Literature review

Increasing transparency in accounting systems is an international desideratum, in addition to adopting minimum set of standards and good practice rules, the adoption of verification and transparency requirements applicable to all entities, especially those whose shares are quoted on the international stock exchanges. Some of the specialists (Kim Li, Zhang, 2011; Desai & Dharmapala, 2006) consider increased transparency as a measure of security against tax evasion and the creation of international opportunities by increasing visibility through countries adhering to this opportunity (Graham, Li, Qiu, 2008). Other specialists argue for the need to adhere to international standards, namely IFRS, through social opportunities, such as reducing the cost of available credit,

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increasing exchange rate quotations, increasing investor confidence (Mailyn, 2015). Mironov (2013) has focused on its economic studies in Russia, which by its specificity allows firms still anchored in a relatively tight system, a slower growth than in systems where IFRSs have already been implemented. Hasan et al. (2014) believe that strengthening the tax system is a sound instrument for creating the safety of entities and increasing the speed of lending. Regarding the quality audit role, some experts (Mironov & Strinivasn, 2013) call into question the contribution of participatory management in increasing the quality of audit and also voluntary reporting as an efficient way of transmitting information to stakeholders (Beck et al., 2014).

II. About BRICS

Emerging economies can be defined as ”low-income and fast-growing countries that use economic liberalization as the main driver of growth” (Hoskisson et al., 2000) and can generally be classified either as ”developing countries in Asia, Latin America, Africa and the Middle East, or as economies in transition in China or the former Soviet Union” (Borker, 2012: 314).

Cooperation between BRICS countries [1] is described in the literature as "an unfinished process of great economic, legal and social interest” (Scaffardi, 2014) which contributes to ”creating an economic and political block capable of interconnecting with international powers" (Grosu, 2018). Stuenkel (2015) emphasizes that the transformation of the BRICS "from a term of investment into a household name of international politics is one of the defining developments of international politics in the first decade of the 21st century”. Furthermore, BRICS as a political vector points out that "the international system is in a process of transformation towards multipolarity" (Gu et al., 2016). The views on cooperation between the five countries are shared. Some critics believe that these countries do not have the capacity to become global economic and political powers because of "excessive inequality and insufficient innovation", while others are convinced that if the proposed national reform plans are successfully implemented and the complementarities of the five economies are being implemented through concrete joint projects, weaknesses can be diminished, and BRICS have the ability to become actors of international change.

Although the risk of contamination between these countries is not very high in 2010, they were among the ”fastest growing economies in the world, contributing nearly 45 percent to global growth” (Banerjee & Vashisth, 2010; Sivramkrishna, 2016: 54). The global financial and economic crisis of 2007-2009, which continued to show at a later

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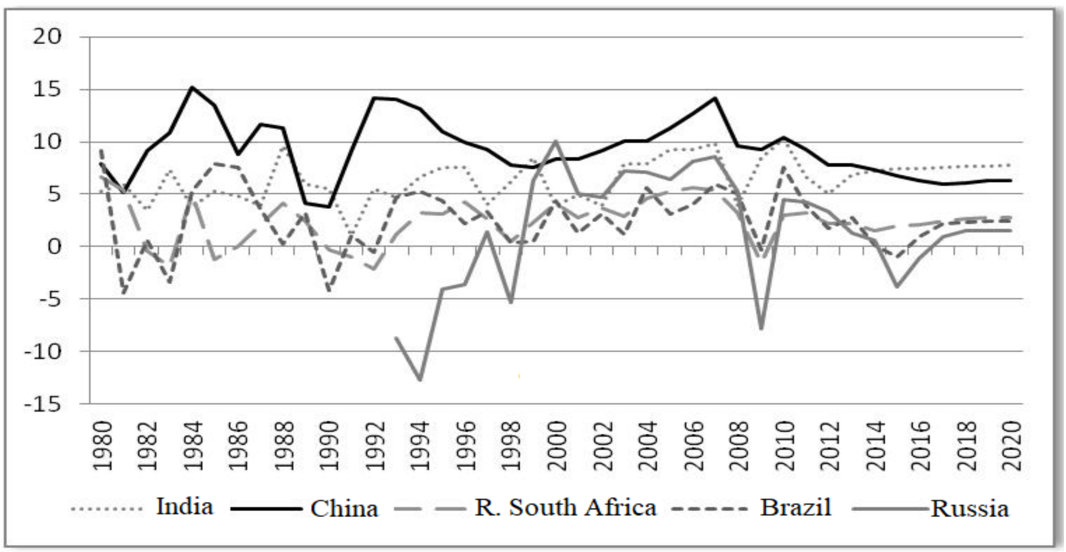
stage with different intensities ”highlighted a number of vulnerabilities, imbalances in uncertainties and risks at regional level and at the level of many world economies, including BRICS” (Oehler-Shincai, 2016; 2015).

Although the current stage of economic slowdown in BRICS countries - including even a recessionary episode for Russia (GDP decline of 3.8% in 2015 compared to 2014, followed by a further 1.1% drop in 2016) and Brazil (1% decline in GDP in 2015) - is not as severe as the previous ones (Figure 1), the general slowdown tends to be a long-term trend. The current economic conjuncture is due both to cyclical and structural factors (IMF, 2013: 42).

Figure 1- BRICS GDP Growth Rate in 1980-2020, in real terms (in %)



Source: Own representation based onTrading Economics, http://www.tradingeconomics.com

* Note: Estimate for 2017 and projections for 2018-2021.

According to Figure 1, due to factors such as the diminishing of the effects of economic stimulus packages, the diminishing global demand for goods and services, and the fall in raw materials prices, there is a slowdown in potential growth. If the fall in raw materials prices is to the detriment of Russia, Brazil and the Republic of South Africa, it is beneficial for China and India.

The World Bank's hierarchy on the easiness to make business reveals Russia on 35th position, China 78, South Africa 82, India 100 and Brazil 125. The following table highlights the most important business challenges in each of the BRICS countries.

Table 1- BRICS – the most significant challenges of doing business

Brazil	**Russia**	**India**	**China**	**South Africa**
1. Paying taxes 2. Starting a business 3. Dealing with construction permits 4. Trading across borders 5. Registering property 6. Getting credit	1. Dealing with construction permits 2. Trading across borders	1. Dealing with construction permits 2. Enforcing contracts 3. Starting a business 4. Registering property 5. Trading across borders 6. Paying taxes 7. Resolving insolvency	1. Dealing with construction permits 2. Paying taxes 3. Protecting minority investors	1. Trading across borders 2. Starting a business 3. Enforcing contracts 4. Getting electricity 5. Registering property

Source: Oehler-Șincai (2018: 44) from World Bank (2017)

According to a statement by the RISAP, gross domestic product of the BRICS countries has increased sixfold, from 2.7 trillion dollars in 2000 to over 17 trillion dollars in the year 2017. However, despite these substantial increases, the value of its members' trade fell by nearly 9 percent to $ 312 billion over the last five years, according to Johannesburg Standard Bank. Currently, each of the BRICS countries is going through a ”turbulent economic phase” with its own specific problems: ”while Brazil and Russia face a full crisis with a real contraction of GDP, China is experiencing a sharp slowdown in current account surplus and GDP growth; at first glance, India seems to be a surplus among its BRICS partners with a GDP growth rate of 7%” (Sivramkrishna, 2016: 54). However, there are several development challenges facing them - structural unemployment, stubborn food inflation, agrarian stress and poor production, and increased exports. With a controversy over beer in relation to current growth rates (Sengupta, R., 2016), India has to move more definitively and also rapidly on a larger growth path to overcome its problems of poverty.

The escalation of economic tensions and the comercial war between major global players is another problem for the BRICS and could lead to the weakening of their economies. While several initiatives have not yielded tangible results, others (such as

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previous consultations prior to key decisions on the World Bank and the IMF) have become a standard practice. While the depth of links within the BRICS remains limited (except for China's relations with everyone), it is fair to say that grouping has helped over the last decade to slowly mitigate mutual ignorance that has made ties between member countries.

III. The case of IFRS adopting in Russia

III.1 The current state of the accounting system development in Russia –

The Russian legal system is based on a concept of civil law as in many other European continental countries. In civil law countries ”the main users of financial information are not shareholders, as in the common law countries (US, UK, Australia), but government bodies and creditors; unlike the countries of common law, where representatives of professional bodies develop standards for a non-state sector, in civil law countries the state authorities draw up all accounting regulations” (Konyushkevich et. al., 2016; Grosu & Lungu, 2017: 250).

The adoption of IFRSs was carried out in four stages: in the first stage (2004-2007) were involved the major public companies, commercial banks and some business entities, and then in the second stage (2008-2010) were included all other business entities. Efforts to get closer to IFRS reporting ”have been blocked at the national level, but the transformation has continued at the firm level” (Alon, 2012: 3). At the same time, RAS (Russian Accounting Standards) did not give any legitimacy and prevented the acceptance on the foreign markets of individual companies that were hoping to attract foreign investors, and which became virtually the main *driving force* of the adoption of voluntary IFRS.

Starting with 2012 (the third stage 2010-2012), companies with consolidated accounts were required to prepare their financial statements under IFRS. Even after adopting IFRS the companies were not exempted from the requirement to prepare RAS statements, hence they had to prepare two sets of financial statements (Allan, 2012).

Although the adoption of foreign methods has been seen ”as a loss of sovereignty, the lack of legitimate institutions has accelerated the move towards transnational standards” (Susarov, 2011). Companies must either maintain parallel reporting on the basis of the reference ambulance (IFRS and RAS) or must convert RAS into IFRS at the end of the reporting periods. This process involves significant time consumption, but it may also be subject to errors (Barabanov, 2003).

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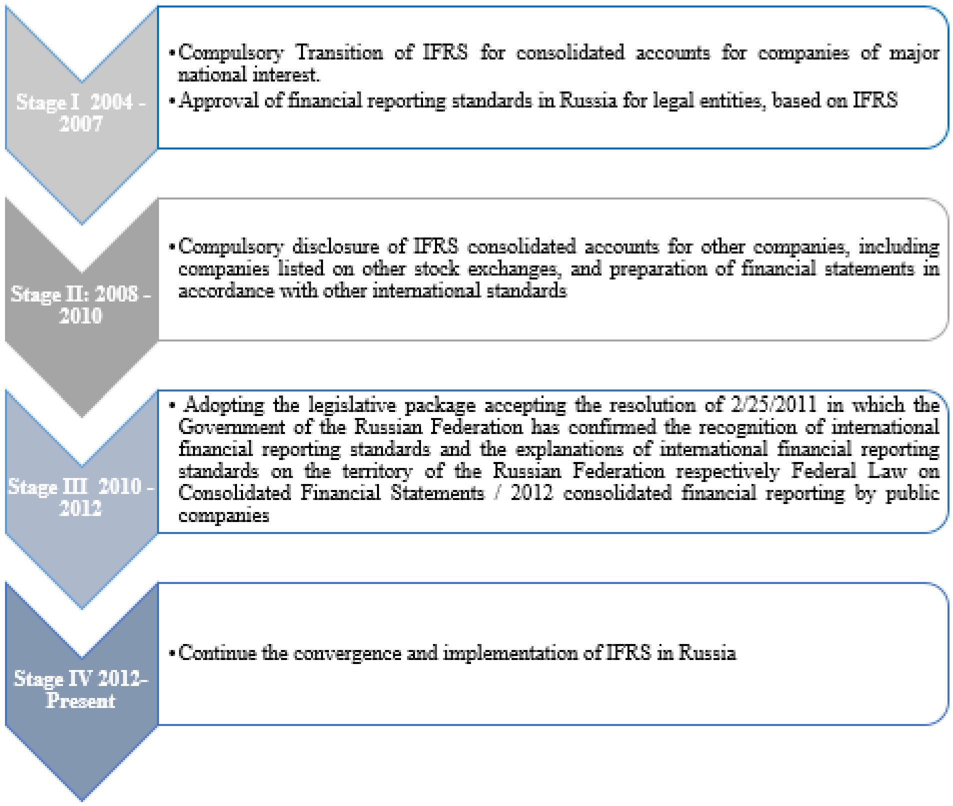
The stages of IFRS implementation in Russia are presented in Figure 2.

Figure 2 - Russia - Implementation steps for IFRS



Source: written by the author according to information published by Ernst & Young https://www.ey.com/Publication/vwLUAssets/EY-ifrs-usgaap-rap-2016-eng/$FILE/EY-ifrs-usgaap-rap-2016-eng.pdf

Russia has not yet fully implemented IFRS for all types of businesses, but has taken considerable steps to introduce IFRS into its accounting system over time, so that starting in 2012, listed companies fully adopt IFRS.

The convergence process ”has progressed slowly and there are still significant differences between the two sets of standards” (Khazimuratova, 2006). The main differences between IFRS and RAS are linked to the interests of a target group of users of financial reporting information. The main users of financial statement information

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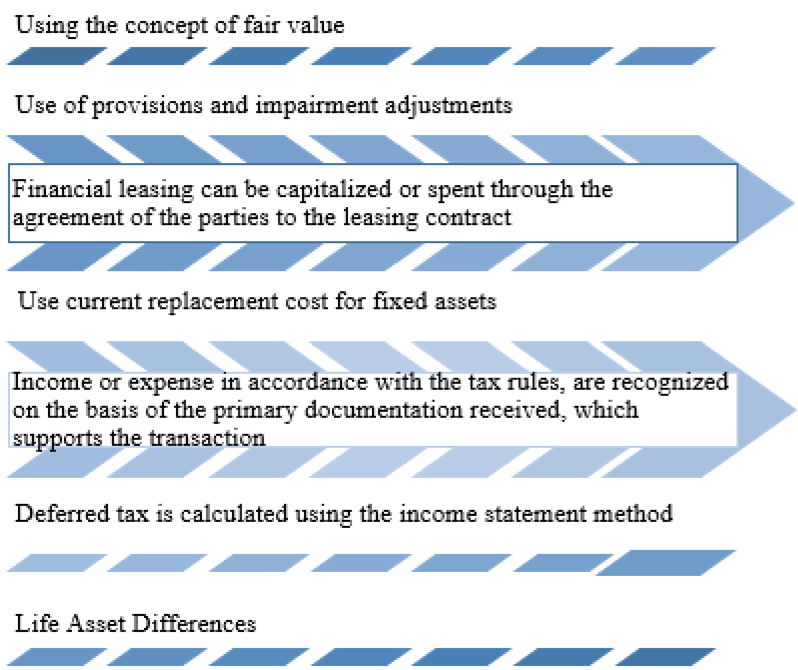
prepared under IFRS are investors, but also other companies or financial institutions, while the main users of financial statements drawn up in accordance with former RAS are the State authorities and the Bureau of the State Statistics.

Although significant progress has been made, there are still some differences between the RAS and the IFRS regarding the use of concepts or policies (see Figure 3):

Figure 3- Differences between RAS and IFRS



Source: adaptation afer Vysotskaya & Prokofieva (2013, 311)

III.2 Consequences of adopting IFRSs

The transition to international financial reporting standards ”can cause both positive and negative consequences for companies; among the positive aspects - increasing responsibility, improving grads of comparison and, as a result, increasing the scope for analyzing and simplifying access to international capital markets” (Lourenço et al. 2015: 133). However, reporting itself does not guarantee the attraction of foreign investment. For example, the size of the net profit according to international standards may be lower than according to Russian standards. The transition to IFRS will require companies to make additional effort and more consistent financial expenses; it is

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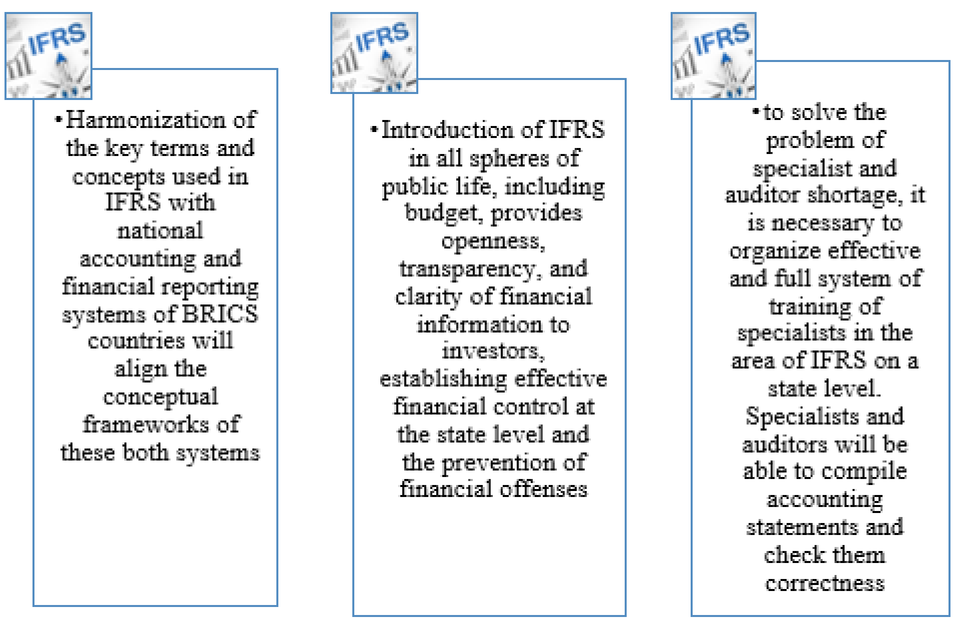
important to underline that if Russia's transition to IFRS is to be completed, this does not mean that Russia will be invaded by foreign investment. But it will certainly be an important step in the process of building mutual trust between Russia and the international community.

Increasing corporate transparency will have a positive effect on investments that will become less risky for investors, and less expensive. Practically, the transition to IFRS should not be an objective in itself, because in fact, in any industrially developed country in the world, it is not fully used IFRS as national standards, it appears as a rule that the general principles of national accounting systems and IFRS to be similar, but there are often considerable differences.

III.3 Recommendations on improving the convergence of BRICS financial reporting with IFRS

Some authors believe that the following aspects should be considered to improve the convergence of BRICS financial reporting with IFRS (see Figure 4):

Figure 4- Recommendations on improving the convergence of the BRICS financial reporting with IFRS



Source: adaptation after Dolgikh, T. (2017: 382)

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IV. Conclusion

Analyzing the current state of development of accounting systems in Russia, it should be noted that this country is proceeding in a unique way regarding the implementation of IFRS. In the current economic context, Russia is in a situation of having to adopt IFRS in order to integrate its own companies into the major international financial markets, but also to attract a foreign investment flow. This process is a consequence of users' demand for high quality, comparable, and transparent financial statements in all economic entities.

In conclusion, the implementation of the Country Accounting Standards in BRICS has contributed and will contribute to the elimination of accounting gaps and to the access to the international markets of the entities in the Member States, giving them visibility and openness in the financial markets, including from the perspective of attracting international funds and financial growth of entities by using borrowed financial capital.

Other notes

[1] The BRICS countries form an association of countries with a developing economy. The abbreviation "BRICS" comes from the first letters of the five countries that make up the association: Brazil, Russia, India, China and South Africa. The association is similar to the O5 countries that include Mexico, not Russia.

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