UNIVERSITY OF JYVÄSKYLÄ

Jyväskylä School of Business and Economics

THE EFFECT OF IFRS'S AND RUSSIAN GAAP'S REVENUE RECOGNITION DIFFERENCES ON ACCUMULATION AND TIMELY ALLOCATION OF PROFIT TAX IN RUSSIA – case Andritz Russia

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Abstract

The case company of this study encounters problems in Russian taxation because of the loss it makes in certain periods. These losses are mostly born due to differences in revenue recognition methods between IFRS that the Russian company must follow in group reporting, and local accounting, Russian GAAP that acts as the basis for profit taxation.

The aim of the research was to find out whether it is possible to reach a situation in which revenue of projects is recognised in Russian financial accounting, and consequently in taxation, simultaneously and at the same amount with revenue recognition according to IFRS and in which IFRS's project accounting would act as a basis for taxation in the case company also in Russia. In addition, my purpose was to clarify in which ways this kind of situation could be reached if laws and standards make it possible. The factors underlying the differences between accounting systems were taken into consideration to deepen the analysis and highlight the cultural aspect of the problem. Within a case study research strategy, data were collected through documentary and participant observation and analysed through qualitative analysis methods. Three project scenarios were built to provide comprehensive enough answers for research questions.

The results of the research indicated that firstly, the harmonisation between IFRS and Russian GAAP is possible. Project revenues in Russia can be recognised simultaneously and at the same amount than under IFRS but the expense side including formation of provisions is the one to generate the differences. Secondly, Russian financial and tax accounting were discovered congruent with each other concerning revenue recognition but divergent due to the non-deductible character of some expenses. Thirdly, because of the two previous points, IFRS can not act as a basis for profit taxation in Russia where the overall tax influence of projects is higher than in accounting under IFRS. Furthermore, taxation was found to have a strong effect on financial accounting mainly due to the aim of Russian companies to minimise their tax expense. Thus, mindset of accountants dominated by form over substance and tax-based thinking shows resistance to change that may complicate Russia's road towards IFRS.

Key Words

Revenue recognition, Profit tax, Russian accounting, IFRS, Differences between Accounting Systems

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ABBREVIATIONS

CCM	Completed Contract Method
CON	FASB Concepts
FAS	Finnish Accounting Standards
FASB	US Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IFRIC	International Financial Reporting Interpretations Committee
IFRS	International Financial Reporting Standards (with reference to the accounting system)
IFRSs	International Financial Reporting Standards (with reference to standards)
LLC	Limited Liability Company
POC	Percentage-of-Completion
SIC	Standing Interpretations Committee
US GAAP	United States Generally Accepted Accounting Principles

CONTENTS

1 INTRODUCTION

1.1 Background of the Research

Taxation can have a significant impact, positive or negative, on current business operations and future investment plans. In Russia, companies often encounter difficulties with tax authorities. It is even stated that companies will ultimately have disputes with tax authorities, and, therefore, they should be prepared to manage them. Outside the formal audit process, a significant amount of companies are yearly invited to discuss tax matters, especially regarding profit tax, with tax authorities. These difficulties to comply with existing tax rules result mainly from ambiguity and uncertainty in the Russian tax legislation. In addition, in 2001 started tax reform still continues causing constant changes in Russian tax legislation and tax administration. Unfavourable features of the tax climate in Russia has led to situation where a plenty of time is spent on routine and administrative tasks, such as tax reporting, tax audit and tax litigation, leaving less time for tax planning and internal reporting on tax risk management matters. (Ernst & Young 2010, 3-7, 18, 28.) Hence, there is significant room for improvement in tax efficiency for a lot of companies operating in Russia.

Taxation has a close connection to financial accounting, at least in most of the countries in Europe. It is an apparent consequence that due to the differences concerning tax-induced accounting, the figures of profit may differ considerably by country even when reporting the exact same items. (Eberhartinger 1999, 95, 111.) The influence of tax issues on financial reporting is, therefore, notable.

In Russia, where financial reporting has been prepared mainly for the purpose of taxation, though from 1.1.2002 onwards financial and tax accounting were officially separated, it is no wonder that taxation affects the way revenue is recognised or expenses entered (Hellevig & Usov 2006, 38). A specific particularity that the tax authority eagerly touches is the loss of a company. Article 1 of Federal Law No. 129–FZ "On Accounting" states that one of the main purposes of accounting is the prevention of negative results of organization's economic activities. As tax authorities tend to pay attention to losses of companies, companies have to sometimes struggle to organise their books so that profit instead of loss is presented. The principle behind this is almost like "if the company affords to make a loss, it also affords to pay taxes". Goncharov and Zimmermann (2006) affirm that Russian firms do have a tendency to manage earnings downwards in the sphere of financial accounting in order to minimise the income tax burden.

The case company of this study, Andritz, encounters problems in Russian taxation because of the loss it makes in certain periods. These losses are mostly born due to differences in revenue recognition methods between IFRS and local accounting, Russian GAAP. The focus of this study is directed at Andritz LLC, a

100% owned Russian subsidiary of Andritz AG, the Austrian parent company of the group that is listed in Vienna Stock Exchange. Andritz Group is a global supplier of plants and services for hydropower, pulp and paper, metals and other specialised industries. Its structure is organised through five corresponding strategic business areas: Hydro, Pulp & Paper, Metals, Environment & Process and Feed & Biofuel. Andritz classifies itself as a growth company with a turnover of 3,554 billion Euros, a net income of 177 MEUR and with about 14 700 employees in the end of 2010.

Andritz LLC belongs to the Pulp & Paper business area, is situated in St. Petersburg and has a turnover of approximately 4 million roubles. Based on the regulation of European Union No 1606/2002 that came into force 14.9.2002, starting from year 2005, all publicly traded companies registered within the European Union must prepare their consolidated financial statements in accordance with IFRS (Haaramo & Räty 2009, 17). That is why also Andritz LLC must follow IFRS in its group reporting which is, however, only converted from the local bookkeeping in the end of every month. Day-to-day operative accounting is handled according to local rules which naturally act as the basis for taxation.

The relationship between Russian financial accounting complying with Russian GAAP and Russian tax accounting primarily regulated in the Tax Code constitutes already as such a challenge for companies. The picture becomes even more complicated when IFRSs are taken into account. Compliance with IFRS is required only from the banking sector, whereas an increasing number of Russian companies have to comply with the standards in order to meet the reporting requirements of the foreign parent or a foreign stock exchange, or to fill the information needs of western banks and lenders (Deloitte 2009, 14). For companies preparing their financial reporting in accordance with IFRS alongside with Russian GAAP and a separate tax accounting system, this in the worst case means a third set of books to be kept. (Hellevig & Usov 2006, 36-39.) Furthermore, the connection between IFRS and Russian taxation is not widely known. At least IFRS does not have a similar bond to taxation as Russian GAAP still, regardless of the separation of these two, has. For now, no plans for converging IFRS as the basis of tax reporting have been announced (PwC 2010a, 109).

The complexity in keeping books stems partly from the fact that IFRS and Russian GAAP by no means match with each other. The difference that this study is interested in concerns revenue recognition because this is the point where a major gap between IFRS and Russian GAAP reporting emerges. Under IFRS the mainly used method for accounting of projects of the scope conducted in Andritz LLC is percentage-of-completion method (IAS 11:25, IAS 18:20) while under Russian GAAP revenues are recognised using the completed contract method or an own version of the percentage-of-completion method that does not fully correspond with the definitions of IAS 11 and IAS 18 (Ernst & Young 2009, 29). Departures from these commonly used practices are, however, seen. Since a big part of the case company's operations are organised as long-term projects, under IFRS named as construction contracts, the difference in recognition methods inevitably leads to a situation where the Russian company is not able to show profit in local bookkeeping in periods in which contracts are not completed. In group reporting prepared in accordance with IFRS profit is made due to the different method of revenue recognition. Hence, profit tax is accumulated and allocated unfavourably from the viewpoint of Andritz LLC. A serious taxation problem it becomes when the tax authorities intervene in the situation.

Furthermore, it should be noted that taxation affects financial reporting of the projects also otherwise than just by demanding positive results from companies. Namely, as all expenses are not deductible in the taxation, they are not necessarily entered into the costs of the project at all, which again affects the formation of taxable profit (or loss) (Ernst & Young 2010, 25).

One of the main problems underlying this situation is the communication gap between the Russians and employees in other countries. No one knows if the problem in Russia is solvable or not because no one is truly aware of the complicated regulations of Russia's accounting and tax legislation. Straight answers from accountants or tax experts from Russia are difficult to receive, partly because parties talk about different issues with vague definitions. IFRS understood in Finland is not necessarily understood the same way in Russia. McGee and Preobragenskaya (2004, 13) even claim that Russian GAAP will never be identical to international standards because at the point of interpretation Russian culture and mindset come into play. According to Nobes and Parker (2004, 19-20), in its narrow meaning culture has influence on accounting but the measures of cultural attributes are rather vague and indirect. If understood more widely, culture includes also the history, legal system, enterprise financing and taxation system that are already better able to explain financial reporting in a country. I consider it important to understand the ground from which the problem of this research emerges. That is why differences between accounting systems can not be passed when trying to find explanations and solutions to the situation.

With all of these fascinating details the problem of the case company becomes quite a massive whole that this research tries, with some limitations, to solve. The ground for this research topic arises straight from the needs of the case company and is, therefore, extremely relevant. In addition, the subject matter has not been studied in this scope ever before. As I work in the case company, the viewpoint of the research will focus on the issues related to the specific characteristics of the company. However, it can be assumed that also other multinational companies operating in long-term project business face the same challenges in Russia and simply do not have time to investigate the matter thoroughly in order to be able to develop some proposed settlements. For me this is a great chance to enhance my knowledge of accounting and taxation in Russia that can be applied into practice later in working life.

1.2 Aim of the Research and Research Problem

The requirement for the research to have some practical implications is one of the things to make business research a distinctive focus for research (Easterby-Smith, Thorpe & Lowe 2002 cited in Saunders, Lewis & Thornhill 2007, 5). This research has a strong practical value for the case company within which the research is undertaken. The purpose of the research is to find out if it is possible to reach a situation in which revenue of projects is recognised in Russian accounting, and consequently in taxation, simultaneously and at the same amount with revenue recognition according to IFRS and in which IFRS's project accounting would act as a basis for taxation in the case company also in Russia. In addition, my purpose is to clarify in which ways this kind of situation could be reached if laws and standards make it possible. In this dissection the factors underlying the differences between accounting systems deepen the analysis. Thus, the practical contribution of the research is to suggest appropriate action for the company on the basis of the findings.

The research aims at answering the question:

- How is it possible to solve the case company's taxation problem in Russia resulting from the revenue recognition differences in IFRS and Russian GAAP?

In the process of trying to answer the research question, solutions for the following sub-problems need to be defined:

- How does the revenue recognition according to IFRS and Russian GAAP differ from each other?
- Why do these differences occur?
- Is it all just about differences in written legislation and standards or, from Russian viewpoint, has the problem something to do with underlying differences between Russian GAAP and IFRS, including slowly changing beliefs and traditions, that is, cultural dimension?
- How do the revenue recognition differences affect the profit taxation of the case company in Russia?
- How are projects treated in Russian taxation?
- Does the treatment of projects in Russian tax accounting differ from the treatment in Russian financial accounting?
- Which expenses can be included in the project both in financial accounting and in tax accounting?
- Which expenses are non-deductible in taxation and why?
- What is the connection between previous questions, in other words, are there expenses that are not included in the project costs because they are non-deductible?

The basis for examining the problem of the research is a sales contract, which equals to a project in accounting of the case company. That is why those terms are used simultaneously during the research.

1.3 Limitations of the Research

This thesis is written purely from a Russian point of view combined with some comparisons with IFRS. That is why Finnish legislation does not concern this case at all and is excluded from the study.

The geographical dimension of the research covers only the area of St. Petersburg. Thus any peculiarities in legislation or other regulations concerning other areas of Russia are not discussed in this research. As the case company is organised in Russia in the form of a resident legal entity (limited liability company) as distinct from a foreign legal entity, the specific issues related to the taxation of the latter one are only briefly mentioned.

Because of scope problems, only a narrow description of the general principles of Russian accounting and taxation is presented in order to give the reader a somewhat clear picture of the field the research is related to. Furthermore, only issues concerning profit tax are covered in this study; other Russian taxes including VAT are not taken into account. Also profit taxation is introduced rather briefly; among others depreciation, transfer pricing and dividends are left without consideration as they do not touch the case company's situation and the research problem. Similarly, Russian accounting is presented thoroughly only concerning revenue recognition and that of construction contracts. The same principle applies to IFRS. Comparisons between the accounting systems generally are made mainly on a very basic level with a focus on cultural factors.

Case company's revenue recognition within projects using percentage-of-completion method is not questioned and different alternatives to recognise revenue under IFRS are only briefly touched. In addition, the joint project initiated by IASB and FASB to clarify the principles of recognising revenue and to develop a common revenue standard for IFRS and US GAAP is mainly not taken into account. The developed draft standard *Revenue from Contracts with Customers* exposed in June 2010 (ED 2010/6) and its possible influence on project accounting of the case company are presented merely as estimates since there is no certainty of how the draft is still going to evolve before completion of the new standard.

One has to also keep in mind that the present research is based on the accounts of one particular company, and thus does not give a universal picture of the effects of IFRS's and Russian GAAP's revenue recognitions differences on accumulation and allocation of profit tax in Russia and of solutions to the problem. The special characteristics of the case company may also affect the results of the empirical part, especially because so far also the accounting principles and tax planning opportunities of the parent company have had their impact on the financial reporting of the case company.

Though I try to remain objective of the problem in question, the fact that I at the same time work for the case company may subconsciously affect the implementation of the research. Disadvantages of the practitioner-researcher role, such as incapability of asking "basic" questions and knowing the organization too well are, however, diminished because I have just started working for the company and my main task is to conduct the research (Saunders et al. 2007, 143-144). Thus, my background as a student of Russian language and culture, as well as several working and exchange periods in Russia may be much stronger factor that moves the research towards a more subjective direction. Subjectivity is emphasised by taking into account also the cultural factors of accounting systems and by analysing the data partly from the viewpoint of these factors.

1.4 Previous Research

As I have already mentioned, there is no research of the topic in this scope made before. This is mainly because the research is firmly attached to a real world problem which brings along quite a many details to discuss. However, in the following I present studies that have touched the topic at least to some extent and may help in conducting this particular research.

A general model of reasons for international differences in accounting practices is proposed by Nobes (1998). He classifies two major explanatory factors for the differences: equity-outsider market and cultural influence, the first being also dependent on the culture of the country. Nobes' model is an extension of the model of Doupnik and Salter's (1995). Culture as a reason for international differences is examined by Gray (1988) who uses Hofstede's societal values to explain differences in accounting values and thus, in accounting systems between countries. Gray's framework is criticised and revised by Doupnik and Tsakumis (2004). Evans (2004), Evans, Baskerville and Nara (2011), Doupnik and Richter (2003, 2004) and Doupnik and Riccio (2006) concentrate on language and translation as keys to different interpretations by accountants of accounting concepts and in consequence, as hindering factors in convergence and comparability of IFRS with national accounting systems.

Implementation of IFRS and the cultural factors related to it have influenced the emergence of the case company's problematic situation in Russia. McGee and Preobragenskaya (2004) debate some problems of IFRS implementation in Russia and several background factors that affect them. Russian cultural values are further studied by Bollinger (1994), Elenkov (1997) and Ardichvili and Kuchinke (2002).

Eva Eberhartinger (1999) examines the influence of tax rules on the financial statements of a company. The paper states that different approaches to the connection between financial accounting and taxation may lead to distortion concerning the comparability of statements of companies from different countries and distortion concerning the true and fair view. Zeff (2007) takes this view further by concluding that the cultural value of fixation on the minimisation of the income tax burden has still, in many countries, effect on financial reporting. With regards to Russia, this view is supported by Goncharov and Zimmermann (2006). The article reveals that Russian companies manage earnings downwards to reduce tax expense, public companies do it to a lesser extent because of their incentive to produce high-quality financial information and that at least in private companies, financial and tax accounting are still tightly aligned.

There are a couple of master's theses that concern the subject matter of international differences between accounting systems, revenue recognition and percentage-of-completion method. Molotova (2007) in her thesis draws a comprehensive explanatory framework for differences between FAS and Russian GAAP. In particular, she then concentrates on current assets and revenue recognition according to percentage-of-completion method under both FAS and Russian GAAP. A more detailed comparison between FAS and Russian GAAP is presented by Konochevitch (2004). Tiainen (2008) in his thesis ”Kansainvälisten tilinpäätösstandardien mukainen osatuloutus rakennusliiketoiminnassa Venäjällä” studies how a developer reports the result of a financial period and which factors are the most critical for the result of the financial period, when the result is based on the percentage-of-completion. The main results of the research, received through quantitative analysis, emphasise the role of the percentage-of-completion as a key driver of financial result variation. This study can be used to understand the revenue recognition according to IFRS in Russia, as well as the costs and the revenue that fall for a certain project. Haataja's (2007) thesis "Revenue recognition of developer contracting projects under IFRS in Finland and Sweden", on the other hand, initiates into the concept of contracting project in a more familiar environment, Finland.

1.5 Key Concepts

I will use the abbreviation *IFRS* to describe current international accounting principles – both international financial reporting standards (IFRSs) and the earlier international accounting standards (IAS) - promulgated by the IASB (International Accounting Standards Board) and its predecessor, the IASC. In addition, interpretations of the International Financial Reporting Interpretations Committee (IFRIC) preceded by the Standing Interpretations Committee (SIC), and IASB's Conceptual Framework functioning as the basis for both the interpretation of current rules and the construction of new rules are included in the concept IFRS. (Epstein & Jermakowicz 2008, 1 – 22; IFRSs 2005.)

Russian Generally Accepted Accounting Principles (*Russian GAAP*, sometimes RAS – Russian Accounting Standards or RAP – Russian Accounting Principles) is the term used unofficially to indicate the whole body of Russian regulatory documents governing accounting and reporting (KPMG 2005). As it is easier to refer to one concept instead of listing all the laws, decrees, standards, orders and instructions controlling Russian accounting and reporting, I will use Russian GAAP throughout the work. Russian GAAP establishes the rules for the Russian financial accounting, whereas the Tax Code regulates Russian tax accounting (taxation).

Accounting system refers to the set of financial reporting *practices* used by a company for an annual report. In a country, it is possible that different companies may use different accounting systems. *Rules* of financial reporting are usually similar to the accounting practices but sometimes a company may depart from rules or make choices in the absence of rules. A set of detailed and well enforced rules exhibits an accounting system. (Nobes 1998, 164.)

Convergence, also known as *harmonisation*, is characterised as a process of increasing the compatibility of accounting practices by setting bounds to their degree of variation (Nobes & Parker 2004, 8).

Revenue is defined as income resulting from the ordinary activities of an entity. Revenue refers to gross amount of among others sales, fees, interest, dividends and royalties and excludes amounts collected on behalf of third parties, such as sales tax or value added tax. (IASB Conceptual Framework 74 §.)

Construction contract is a contract specifically entered into for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology, and function or their end use or purpose (IAS 11:3). Because of the nature of the activity undertaken in construction contracts, the date at which the contract activity is entered into and the date when the activity is completed usually fall into different accounting periods (IAS 11 Objective).

Percentage-of-completion method (POC-method) is one of several methods used to reliably measure stage of completion of contract work completed. It recognises revenue and expenses by reference to the stage of completion of a contract by matching contract revenue with contract costs incurred and thus, reports revenue, expenses and profit that can be attributed to the proportion of work completed. (IAS 11:25; Epstein & Jermakowicz 2008, 230.)

Under *completed contract method (CCM),* revenues, costs, and gross profit are recognised only after the project is fully completed.

1.6 Structure of the Research Report

This study consists of seven main chapters. The first chapter, introduction, sheds light into the background of the research and presents the research problem, limitations, keys concepts and the relationship of this study to previous research in the field. In the second chapter, methodological considerations and background assumptions of the research are discussed.

In order to form a wider theoretical framework for the study, the third chapter discusses differences of accounting systems relying largely on culture as a major contributing factor to differences. In the same chapter, basic principles of both IFRS and Russian GAAP are presented. The motivation for this chapter arises from the fact that Russian accounting is quite an unfamiliar subject for many of the readers. To understand the details, first the big picture needs to be understood. In the fourth chapter are pointed out the revenue recognition differences between IFRS and Russian GAAP. The different methods are compared and differences analysed. The fifth chapter concentrates on Russian taxation and the treatment of projects within it. In addition, comparisons of treatment in financial accounting and taxation are made.

The sixth chapter reports and analyses the results based on the data collected. At the same time, the research question is answered. Finally, in the seventh chapter conclusions of the research are drawn and practical implications suggested.

2 METHODOLOGY

In this study I use the term *method* to refer to techniques and procedures used to obtain and analyse data. In contrast, the term *methodology* refers to the theory of how research should be undertaken. *Research design* is in this study understood as a logical plan for getting from "here" to "there", where "here" may be defined as the initial set of questions to be answered, and "there" is some set of conclusions (answers) about these questions (Yin 2003, 20). As parts of the research design are counted the choice of the *research strategy*, purpose of the research as well as more detailed data collection and analysis techniques, also known as *research tactics*.

Placed on a continuum presented by Saunders et al. (2007, 7 - 8) this research moves towards *applied research*. Research is of practical relevance to the case company and addresses issues that the company sees as important. At the same time it improves understanding of a particular business problem and results in a solution to the problem. Robson (2002) characterises this type of research as *real world research* that tends to have emphasis on solving problems in an outside organisation and that is oriented to the client who has also initiated the topic.

The terms quantitative and qualitative are used widely in business research to differentiate both data collection techniques and data analysis procedures. Quantitative is used as a synonym for techniques and procedures generating or using numerical data, while qualitative concentrates on non-numerical data. This research adopts *mixed-methods approach* which is increasingly advocated within business research and which uses quantitative and qualitative techniques and procedures in combination with primary and secondary data. (Saunders et al. 2007, 145.) This is also referred to as *flexible* design of research (Robson 2002, 5). During the research both qualitative data through personal notifications and participant observation and quantitative data through documentary are collected, but the data are analysed only through qualitative procedures. Hence, the use of qualitative/quantitative ways of labelling the research design is not entirely logical. In traditional sense, the research would follow the qualitative research approach. This statement leans on the following characteristics of qualitative research:

- The starting point for qualitative research is description of real life.
- Data are collected in a natural situation and analysed in detail.
- The subject of the research is being studied in comprehensive manner.
- The aim is to understand the subject, which means that only a small amount of cases can be chosen for examination.
- The quality, rather than quantity, of the data is in centre so size of the data does not directly affect success of the research. (Hirsjärvi, Remes & Sajavaara 2009, 160-164.)
- In qualitative research an inductive approach concentrating on the generation of theories is emphasised (Bryman & Bell 2007, 28).

The choice between qualitative and quantitative research does not concern only narrow considerations of research methods – it can be extended also to epistemological and ontological considerations. Hence, the next sub-chapter discusses the background assumptions of the research.

2.1 Background Assumptions of the Research

Guba and Lincoln (1994, cited in Saunders et al. 2007, 100-102) claim that questions of research methods are of secondary importance to questions of which paradigm is applicable to the research. By the paradigm they mean the basic belief system or world view that guides the investigation and is also called *research philosophy.* It contains important assumptions that underpin the research strategy and the methods chosen as part of that strategy. There are two major ways of thinking about research philosophy: *epistemology* and *ontology*.

Assumptions on epistemology are concerned with how and where information can be acquired and what constitutes acceptable knowledge in a field of study. Epistemological considerations encompass the choice between positivist, realistic and interpretivist research philosophies. Ontology, on the other hand, is concerned with nature of the reality in which the studied phenomenon takes place. The positions of ontology are referred to as objectivism and subjectivism. (Bryman & Bell 2007, 16-25.) Despite acknowledging the fact that overall paradigm is seen as important for conducting the research, within this research the choice between one position and the other can be considered somewhat unrealistic in practice. Saunders et al. (2007, 110) reminds that it is sometimes more appropriate for the researcher to think of the philosophy adopted as a continuum rather than opposite positions. This view is called *pragmatism.* Thus, the most important determinant of the research philosophy adopted is the research question.

The pragmatic philosophy is applicable for this research for one main reason. Namely, the research question divides into several sub-questions that each sheds light to the topic from a different angle. For the most part, research question is answered from a realist, objectivist angle, but a subjectivist and critically realist view is emphasised when considering the differences between accounting systems and their effect on the actual birth of the problem in question. The combination of *critical realism* and *subjectivism* argue that the researcher will only be able to understand what is going on in the social world if the social structures that have given rise to the phenomena being studied are understood, and if social phenomena are seen to be created from the perceptions and consequent actions of social actors. This way, what is seen is only part of the bigger picture instead of just relying on *direct realism* stating that what you see is what you get and *objectivism* believing that social entities exist in reality external to social actors. (Saunders et al. 2007, 105, 108.)

Consistently with the choice of the pragmatic philosophy, from Burrel's and Morgan's four research paradigms connecting epistemological and ontological assumptions, functionalist, interpretive, radical humanist and radical structuralist, a combination of *functionalist* and *interpretive* paradigms is chosen to describe this research the most accurately (Saunders et al. 2007, 112-113). While the regulatory perspective aiming at explaining and changing organisational problems within the existing state of affairs remains in place, the objectivist and subjectivist views alternate in compliance with the phase of the research. Hence, in addition to providing practical solutions to practical problems, the research tries to understand and explain what is going on in the case company.

Closely related, though not always unambiguously attached, to research philosophies are the research approaches: *induction* and *deduction*. This research follows the inductive approach that emphasises a close understanding of the research context, a realisation that the researcher is part of the research process, and a more flexible research structure to permit changes as the research progresses. With induction, data are generated first and by analysing and reflecting upon what theoretical themes the data are suggesting, the theory is developed. Inductive working method is appropriate especially with research into a topic that is new and on which there is little existing literature. (Saunders et al. 2007, 117-121.) Although the development of theory is not in the focus of this research, empirical and theoretical parts are so intertwined together that the approach can be referred to as induction.

2.2 Research Strategy

Research strategy is understood as the whole of methodical decisions of research which is always chosen on the grounds of the research problem (Hirsjärvi et al. 2009, 132). Hirsjärvi et al. (2009, 134-135) divides the traditional research strategies into three types: survey research, experimental research and case study. This research is conducted as a *case study*. Yin (2003, 13-15) has defined a case study as an empirical inquiry that

- investigates a contemporary phenomenon in its real-life context; when
- the boundaries between phenomenon and context are not clearly evident; and in which
- multiple sources of evidence are used, with data needing to converge in a triangulating fashion.

Hence, the case study as a research strategy is an all-encompassing method covering the logic of design, data collection techniques and specific approaches to data analysis. The studied case can be almost anything from individual behaviour to organisations or organizational processes. In this study the case is Andritz LLC, the Russian subsidiary of the Andritz Group and, to be exact, its finance organization. Contrary to the common belief of a case study as a solely qualitative research, case studies can be based on any mix of quantitative and qualitative evidence. This study relies on both quantitative and qualitative evidence that are, however, analysed only with qualitative procedures.

Case study is a preferred research strategy especially when the research is intended to answer questions "how" or "why". Along with these *explanatory* case studies there are also *exploratory* ones conducted in order to answer question "what" and *descriptive* case studies. Actually each research strategy can be used for all three purposes; it is the substance and form of the research question that primarily affect the choice of the research strategy. All of these purposes have their special characteristics but significant overlap among them can in some cases be discovered. In other words, a single case study research can contain characteristics from all of these types. (Yin 2003, 1-7.)

Firstly, explanatory case studies aim to identify cause-effect relationships but also relationships between aspects of the phenomenon without causal connection. After examining the existing literature or empirical examination, the formed preconceptions and findings from the case are compared, and consistency between them is evaluated. Secondly, the case is exploratory when there is little or no prior information available and the research problem may not be explicitly defined. In an exploratory study multiple cases can be examined in order to compare findings between them or even build new theory on the phenomenon studied. The phenomenon may be assessed in a new light and often at the same time ideas and hypotheses for future research are generated. Lastly, in a descriptive case study the researcher aspires to describe a complex real-life phenomenon in its context and to identify connections between the case and existing theory. It may be an extension, or a forerunner, to a piece of exploratory or explanatory research. (Robson 2002, 59-60; Saunders et al. 2007, 133-134; Yin 2003, 1-9.)

This research includes characteristics of all three purposes. It is explanatory as it tries to find reasons for the differences in IFRS and Russian GAAP revenue recognition procedures and clarify their effect on profit taxation in Russia. This is done by comparing the formed preconceptions based on literature with the findings from data. On the other hand, the research is exploratory because the research topic is quite new with only little prior information available. In addition, multiple subunits, IFRS and Russian GAAP, within the case are studied and compared to each other in order to even build new theory if findings are comprehensive enough. Descriptive purposes are fulfilled by forming an extensive picture of the current situation as well as of the possible scenarios for the future. These descriptions act as a forerunner to further analysis.

The design of this study according to Yin's categories (2003, 39-46) is an embedded single-case study. Rationales for conducting a single-case study include situations when the case represents

- a critical case in testing a well-formulated theory,
- an extreme or unique case,
- a representative or typical case, or when the case serves a
- revelatory or
- longitudinal purpose studying the same single cases at different points in time.

In this research the case represents a typical case among global companies operating in Russia. It can be assumed that there are difficulties in interpreting

IFRS regulations also in other subsidiaries in Russia, and revenue recognition of surely constitutes a problem when comparing IFRS to Russian GAAP. This study creates at least one solution to the common problem. As within this case study there are several subunits of analyses, IFRS, Russian GAAP and taxation, incorporated, an embedded design over a holistic one was chosen. A comparative approach between IFRS and Russian GAAP combined with considerations about taxation is followed throughout the research.

Despite the fact that case study is an extremely popular research strategy in the business field, harsh criticism is also posed to the method. Yin (2003, 10-11, 33) mentions three problems that often occur when discussing a case study. The first of them is the lack of rigor in case study research. In many cases the investigator has been negligent when trying to follow systematic procedures, or has allowed ambiguous evidence or biased views to affect the direction of the findings and conclusions. The researcher should always report all evidence fairly. I have become aware of this problem, which already as such increases the rigor in conducting the research. The second problem is that case studies are seen to provide little basis for scientific generalization. This prejudice can be overruled by the view that case studies are generalisable to theoretical propositions – not to populations or universes. The goal is to generalise theories (analytic generalisation) and not to enumerate frequencies (statistical generalisation). In analytic generalisation a previously developed theory is used as a template with which to compare the empirical results of the case study. Although the research studies only one case, the nature of the research problem as a common for also other companies operating in Russia enhances its ability to be generalised more widely. Statistical generalisation is not needed as the problem deals with a very practical and multidimensional issue. Yin's third concern is that often case studies take too long and result in massive, unreadable documents. This can be prevented with enough focusing and planning.

2.3 Data Collection Methods

A major strength of case study data collection is the opportunity to use multiple sources of evidence. Any finding or conclusion in a case study is likely to be much more convincing and accurate if it is based on several different sources of information. (Yin 2003, 97-99.) This data triangulation is only one of the four types of triangulation in doing evaluations. Besides triangulation of data sources (data triangulation), there are triangulation among different evaluators (investigator triangulation), triangulation of perspectives to the same data set (theory triangulation), and triangulation of methods (methodological triangulation) (Denzin 1970, cited in Yin 2003, 97-99). In this research data triangulation is the only one met, although there are also some signs of theory and methodological triangulation. However, within this research it is not possible, or even expedient, to reach saturation of the data with multiple sources of evidence because of the type of the research problem. In all researches the satisfaction of saturation is not considered necessary (Tuomi & Sarajärvi 2009, 87).

Yin (2003, 83) has listed six types of data sources for case studies: documents, archival records, interviews, direct observation, participant observation and physical artefacts. The two main data sources in this study are *documentation* of case company's bookkeeping systems and tax reporting related to projects, and *participant observation*. Personal notifications or small interviews with the people working at the company are included under participant observation. The main source from personal notifications is the chief accountant of Andritz LLC, Irina Krasilnikova, with whom meeting were arranged 14.2.2011, 15.2.2011, 21.4.2011 and 22.4.2011 and email conversation carried out whenever necessary. In addition, laws and standards act as a basis for understanding the information collected from these sources and are also by definition interpreted as a part of the analysis. Thus, they are a significant source of information when formulating answers to the research questions.

2.3.1 Documentary

Documentation used in this research is by nature quantitative, secondary and compiled data because it is already collected for some other purpose, in this case for calculating the profit/loss and tax base of the company, and has received some form of selection or summarising. Documentary analysis is an obtrusive measure which is non-reactive, in that the document is not affected by the fact that you are using it. (Robson 2002, 349; Saunders et al. 2007, 246-253.)

The strengths of documentation as presented by Yin (2003, 86) are its stableness, unobtrusiveness, exactness and broad coverage over time, events and settings. In addition, for researches requiring national or international comparisons, using secondary documentary data can sometimes be almost necessary. In weaknesses of the method can be included retrievability, biased selectivity if collection is incomplete, reporting bias reflecting the mistakes made by author, and difficulties in accessing the data. In this research, incompleteness of the collection does not occur. Reporting biases in the figures of bookkeeping and taxation are always possible but the company has quite accurate checking tools for assuring that deviations are corrected. The access problem does not exist as the investigator is working in the case company. All in all, documentary in this research is precisely suitable for meeting the objectives of the research.

2.3.2 Participant Observation

Participant observation, and particularly the role of participant as observer, is a special mode of observation in which the investigator is not merely a passive observer but instead, may assume a variety of roles within a case-study situation and actually participate in the events being studied. Interviews are connected also to this data collection method but they are likely to be informal discussions. (Robson 2002, 314-325.)

The method's strengths encompass orientation to reality and actual context of events as well as insightfulness into interpersonal behaviour and motives. On the other hand, the method may be time-consuming and costly, and problems may occur due to selectivity and reflexivity issues: event may proceed differently because it is being observed. In addition, the investigator has the ability to manipulate minor events which potentially produces bias. Finally, closeness of the researcher to the situation being observed can lead to significant observer bias. (Yin 2003, 86, 94.)

Within this research it is hardly relevant to believe that events could proceed differently due to observation or that the investigator could manipulate the whole function of accounting in the company. Furthermore, observer bias results mainly from the background and former experience of the investigator, not from the closeness to the situation.

Participant observation method is used every time when discussing the company's problems in Russia with parties involved. Especially interesting and useful this method becomes when being physically in the office of Andritz LLC and getting acquainted with the Russian way of working. A record of observation is written in connection with, or straight after, the observation situation. The method is not expected to produce the most significant results of the research, but is rather seen as a good instrument to deepen the understanding of the problem and the fundamental reasons that has led to the situation.

2.4 Analysis of the Data

Analysing case study evidence is an especially difficult task because the strategies and techniques have not been well defined. In addition, in qualitative studies the process of data analysis and data collection is necessarily an interactive one. For example in participant observation, it is difficult to separate out the data collection and analysis phases of an enquiry. Analysis takes place in the middle of collection and is used to help shape its development. (Robson 2002, 315.) In this research, the documentation, figures from accounting systems according to IFRS and Russian GAAP are first compared to each other by conducting some calculations that present the differences in revenue recognition methods. First, the current situation is presented in the form of calculations and detailed by accounts. Furthermore, possible scenarios for bringing closer the local and group reporting practices are introduced related to three different situations (projects). Then, the effect of these differences on profit taxation in Russia is similarly illustrated through profit and loss statements. Finally, with help of information from law and standard texts, calculations, participant observation and conversations, a thorough clarification of the problem is formed, explanations for the situation built and proposals for a solution suggested. The aim is, therefore, to understand the phenomenon, which in most cases requires the use of qualitative analysis procedures (Hirsjärvi et al. 2009, 224). The understanding is enhanced by making illustrative comparisons between practices of IFRS and Russian GAAP throughout the study.

The analysis method of the research is closely linked to the twofold purpose of the research and the exact sub-question that is being answered at a time. Exploratory purposes are reached through *content analysis*, while explanatory purposes require also use of *explanation building* technique.

Content analysis is a research technique for making replicable and valid inferences from data to their context. This context encompasses the purpose of the data as well as institutional, social and cultural aspects. It is codified common sense, a refinement of ways that might be used by laypersons to describe and explain aspects of the world around them. Content analysis is especially used to analyse documents which form a significant part of the collected data in this research. The purpose of the document is important in understanding and interpreting the results of the analysis. (Robson 2002, 350-357.) With help of content analysis documents can be systemically analysed by describing the contents verbally. The aim is to produce a description of the phenomenon being researched in a condensed and general form and organise the data for conclusions. Content analysis can be divided into deductive and inductive content analysis. In this research, an inductive one is applied as the analysis gets off the ground from the data, not from the theory. However, also an abductive stance towards the analysis can be detected. It relies on inductive analysis of the data but still, theory guides the principles of the analysis. The research follows also abductive method as it tries to analyse the situation and the factors leading to the situation also based on the theory on differences between accounting systems. (Tuomi & Sarajärvi 2009, 99-100, 105-108.)

Close to content analysis is *content itemisation*, one of the ways to analyse data according to Hirsjärvi et al. (2009, 224). Other popular ways to analyse data are thematising, classification by type, discourse analysis, conversation analysis and, naturally, statistical techniques. Content itemisation can be used as an extension to content analysis and it often includes quantification of the data. Originally content analysis, or content itemisation, was firmly rooted in the quantitative research strategy aiming to produce quantitative accounts of the raw material in terms of predetermined rules. Later on, the analysis method became applicable also in the field of qualitative research. (Bryman & Bell 2007, 303.) In this research, content analysis is understood as Tuomi and Sarajärvi (2009) see it, separately from more structured content itemisation.

According to Yin (2003, 109, 120-122), case studies can be analysed by means of five specific techniques: pattern matching, explanation building, time-series analysis, logic models and cross-case synthesis. From these techniques a part of this study mostly relies on explanation building. It is relevant for explanatory studies but a similar procedure for exploratory case studies, commonly cited as a hypothesis-generating process, has also been formed. To "explain" a phenomenon corresponds to stipulating a presumed set of causal links about it. The eventual explanation in this research is likely to be a result of a series of iterations:

- Making an initial theoretical statement or an initial proposition about policy or social behaviour
- Comparing the findings of an initial case against such a statement or proposition
- Revising the statement of proposition
- Comparing other details of the case against the revision
- Repeating this process as many times as needed.

Explanation building is used as an analysis method specifically when trying to find explanations to the problem arising from the cultural aspects of Russian accounting and taxation.

3 DIFFERENCES BETWEEN ACCOUNTING SYSTEMS – IFRS AND RUSSIAN GAAP

The importance of studying comparative international accounting can be justified by four main reasons: historical, multinational, comparative and harmonisation. While several countries have in the past made important contributions to the development of accounting, nowadays multinational corporations govern the field and receive their finance from global financial markets. Comparison of accounting practices enlightens the way accounting is handled in other countries and may lead to improvements in country's own practice. Finally, the knowledge of different accounting practices is vital in the attempt to harmonise accounting systems, a goal that has gained attention in recent years as the business world has become more and more international. (Nobes & Parker 2004, 4-9.)

In the following sub-chapters, I present some underlying reasons for differences in accounting systems and highlight culture as one of the most important. Furthermore, I introduce some basic guidelines of IFRS and Russian GAAP and discuss the most significant differences between the practices. The differences are examined on a rather basic, principle-based level; for example issues such as measurement and valuation are not touched.

3.1 Reasons for Differences between Accounting Systems

3.1.1 Culture

Culture and external environment are traditionally considered to largely explain the differences between accounting systems. Hofstede and Hofstede (2005, 4, 7, 11) define culture as "the collective programming of the mind that distinguishes the members of one group or category of people from others". Culture is learned, not innate, and it is formed around slowly-changing core values. Practices such as symbols, heroes and rituals, are the visible, and faster changing, part of culture but their cultural meaning lies only in the way they are interpreted by the representatives of a certain culture.

Hofstede (1980) studied in his original research cultures of organisations in a variety of countries and divided cultures according to four dimensions, also known as societal values: power distance (PD), individualism versus collectivism (IND), masculinity versus femininity (MASC) and uncertainty avoidance (UA). The first dimension, power distance, is defined as the degree of distance between different hierarchical levels. Individualism is characterized by a preference for a loosely knit social network wherein individuals are the object of attention. On the contrary, collectivist societies are more tightly knit and expect people to take care of each other. The third dimension stands for a division between masculine values like achievement orientation or competition and feminine values such as nurturance or importance of personal relationships. Uncertainty avoidance, the fourth dimension, measures the level of anxiety that people feel about their futures. Hofstede and Bond (1988) add also a fifth cultural dimension, Confucian dynamism, later renamed as long-term orientation versus short-term orientation (LTO). Long-term oriented cultures are concerned with long-term influence of their actions, whereas short-term oriented cultures concentrate more on the past and present (Hofstede & Hofstede 2005, 210).

Culture affects the way individuals structure their society and interact with its substructure. One of those substructures is accounting. Gray (1988) incorporates Hofstede's societal values into his theory of cultural influence on the development of accounting systems internationally. With the model (Figure 1) he develops a mechanism by which societal values become related to accounting systems through values at the accounting subcultural level. Those accounting values, the values systems and attitudes of accountants, are seen to be related to and derived from societal values and thus, to have an impact on the nature of accounting practices. Naturally, different societal values lead to differences in accounting values and consequently, in accounting systems internationally. Gray created the following pairs of accounting values:

- professionalism versus statutory control;
- uniformity versus flexibility;
- conservatism versus optimism (in measurement);
- secrecy versus transparency (in disclosure).

In the model, Hofstede's societal values are determined by ecological influences and modified by external factors. In addition, they have institutional consequences in the form of legal and political systems, capital markets and so on.

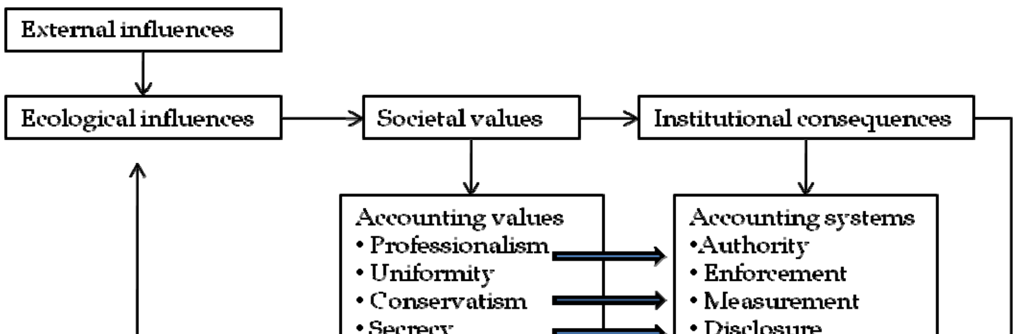

FIGURE 1 Culture, societal values and the accounting sub-culture (adapted from Gray 1988, 7)

Based on the framework, Gray formulates four hypotheses on the relationships between societal and accounting values. First of all, the higher IND and the lower UA and PD figures a country has, the more likely it is to rank highly in terms of professionalism. Instead, with opposite figures (high UA and PD, low IND), a country is more likely to rank highly in terms of uniformity. Furthermore, high UA figures and low figures of IND and MASC predict high rank in terms of conservatism. If high PD is added to the previous hypothesis, a country is about to have a tendency also towards secrecy of disclosure information. As it can be noticed, individualism and uncertainty avoidance seem to be of the greatest importance at the level of the accounting subculture.

Doupnik and Tsakumis (2004) introduce studies that have tested Gray's theory and conclude that a rather massive amount of variations have occurred in the attempt to empirically prove Gray's hypotheses. Critics towards the framework are directed especially at the validity of Hofstede's cultural values, the exact examination of linkages between the factors and at the notion that even if the set of financial reporting rules was identical in every country, culture would still be relevant in explaining the differences in interpretation and application of those rules by individual accountants. It is suggested that 'accounting system' should be replaced with 'accountants' application of financial reporting rules'. Hence, accountants are expected to apply financial reporting rules in consistence with their cultural values.

Accounting can be considered as a medium for communicating economic information – an economic language. Hence, it is a 'social construct' reflecting the society in which it has been developed. (Walton, Haller & Raffournier 1998, 1-3.) Doupnik and Richer (2003) link culture to interpretations of accounting concepts via language, an essential part in shaping cultures. It is suggested that people speaking different languages perceive and think about the world differently and in consequence, they also perceive and interpret accounting concepts in different ways (Evans 2004). Thus, accountants' application of financial reporting rules should be highly dependent on the interpretation of accounting concepts and consequently, on language and culture. Doupnik and Richer (2003) divide the explanations for differing interpretations of accounting concepts into two groups: language-culture and translation. While language-culture concentrates on the cultural values of accountants, translation is seen as a more technical reason. Evans, Baskerville and Nara (2011) conclude that since there is no formal correspondence of accounting concepts and terms between different languages and cultures, translation inevitably leads to shifts in meaning. Studies of Doupnik and Richter (2003, 2004) and Doupnik and Riccio (2006) find significant evidence that both language-culture and translation affect the interpretation by accountants of uncertainty and verbal probability expressions of IFRSs. Based on the results, doubt is casted on whether IFRS can be applied consistently in different countries having different language-cultures. The question is further examined by Zeff (2007) who recognizes some problems in convergence of accounting systems. Those problems are mainly related to interpretation, language and terminology. As an example, 'true and fair view' is originally a British concept but may be understood entirely differently in other countries adopting IFRS.

The following sub-chapters examine environment of accounting by identifying some more direct influences, such as legal systems, corporate financing and tax systems, as explaining factors. However, it has to be remembered that these factors interact with culture in many ways as already seen in Gray's framework and thus, can not be entirely separated from the concept of culture. Hence, it is not unambiguous to define exact reasons for differences between accounting systems. (Nobes & Parker 2004, 17-19.) Though Nobes (1998) sees the measures of cultural attributes and the influence of culture on accounting rather vague and indirect, he, however, defines culture as one of the background factors leading to more direct causes of accounting differences

3.1.2 Legal System and Source of Financing

Western legal systems can be divided into common law originating from England and codified law based on Roman civil law. Common law relies on case law to supplement the statues. It is less abstract than codified law, and rules seek to provide an answer to a specific case rather than to create a general rule for the future. Similarly, accounting is generally not dependent on commercial law but accountants themselves establish rules for accounting practice, written down as recommendations or standards. The English system has influenced the legal systems of countries such as the US, Australia, Ireland and so on. Other countries, such as Germany, France, Spain and Japan have legal systems based on codified law in which rules are linked to ideas of justice and morality and become doctrine. Within the system, rules for accounting and financial reporting are established by company or commercial law. (Nobes & Parker 2004, 20.)

Furthermore, Nobes and Parker (2004, 21-24) identify as the key cause for international differences the differentiation between 'equity' countries where equity providers, usually outsiders of the entity, put a pressure for disclosure, audit and fair, transparent information and 'credit' countries where companies are dominated by debt providers, government or family holdings. In the latter case, because of the insider status of the owners and a concentrated ownership structure, there is no market demand making fair presentation preferable for the companies. Instead of fair information, they are interested in more careful and conservative information, whereas external financial reporting is aimed at protecting creditors and for government's purposes to collect taxes and control the economy. This financing-related classification of countries strongly corresponds with the earlier categorisation of legal systems. For example La Porta, Lopez-de-Silanes, Shleifer and Vishny (1997) find a connection between common law countries and strong equity capital markets with good investor protection and a scattered ownership structure. In 'equity' countries, accountants are more eager to work out their own technical rules as accounting profession is usually running ahead of government in providing unbiased, up-to-date information about the success of a business. La Porta et al. (1997) also state that there is a link between codified law system and weak equity-outsider position.

On the grounds of the observation that different financing systems and purposes of reporting lead to different financial reporting systems, Nobes (1998) classifies countries into Class A with important equity markets and many outside shareholders and Class B with credit-based financing system and rather unimportant outside shareholders. Class A corresponds with Anglo-Saxon accounting and Class B – continental European accounting. However, in the case of countries that have been strongly culturally influenced from outside (especially former colonies), the accounting system is usually similar to the system of the former colonial power regardless of, for example, the financing system of the country (Nobes 1998, 170).

Nobes (1998) does not see culture as a direct cause for differences in accounting system. However, he admits that culture explains the different types of capital markets and this way affects the classification model. His simplified model of reasons for international accounting differences (Figure 2) bases on the model of Doupnik and Salter (1995) on accounting development in which accounting practice is considered to be the result of the complex interaction between external environment, cultural norms and values, and institutional structures.

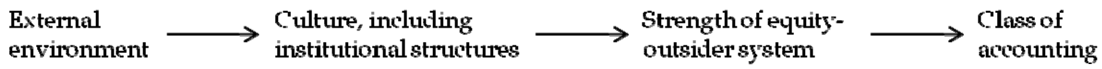

FIGURE 2 A model of reasons for international accounting differences (Nobes 1998, 177)

Although classifications help understanding complex phenomena, there are obvious flaws in the attempt to classify countries or accounting systems according to differing accounting principles, objectives of financial reporting or cultural and other environment-related factors. Reality is always so complex that classifications risk giving a very misleading view of the world.

3.1.3 Other Reasons

The classification of Nobes contains a linkage to taxation. Concerning financial reporting, it is essential to determine the degree to which taxation regulations affect accounting practice. Generally, in Class A countries accounting and tax rules are separated whereas in Class B countries taxation dominates accounting rules in practice although officially a legal separation could have been written in the law. However, whether the tax rules really belong to the causes rather than results of international accounting differences can be argued. (Nobes 1998, 171.)

In addition, Nobes (1998) and Doupnik and Salter (1995) mention the accounting profession, inflation, theory, accidents and external influences as causes for international differences. Others that might have effect include history, language, geography, religion, education, stage of economic development and political systems. However, like taxation, many of these are seen rather as results or covariants than causes for differences or as too vague or broad concepts to have a direct influence on accounting systems (Nobes 1998, 175-176).

A major external influence on accounting systems is now the IASB and the adoption, or convergence with, IFRS. Zeff (2007) examines the global financial reporting comparability and convergence further. Zeff discovers four cultures, and thus, reasons for differences between accounting systems, able to affect comparability of financial reporting between countries. Those are business and financial culture, accounting culture, auditing culture and regulatory culture. As it can be noticed, Zeff's perception of culture is wider than that of Nobes, Gray or Hofstede in sub-chapter 3.1.1. However, many common characteristics are also found.

3.1.4 Framework of Differences between Accounting Systems

The following framework of Walton et al. (Figure 3) summarises the reasons for differences in accounting systems. It illustrates accounting as a language; differences can occur due to information sent but also because of the perception and interpretation of the information by the receiver. Accounting rules of a country have evolved over time and are fundamentally attached to the basic environmental circumstances of that country. Country-specific social, economic and cultural environment encompasses factors such as capital markets, legal system, fiscal system and naturally, culture, that affect the objectives of financial reporting and thus, accounting principles within an accounting system. Accounting objectives include considerations, among others, of the decision-usefulness of accounting information including the primary users of financial statements and the scope of disclosure, calculation of distributable income and the interconnection between taxation and financial accounting. (Walton et al. 1998, 3-8.)

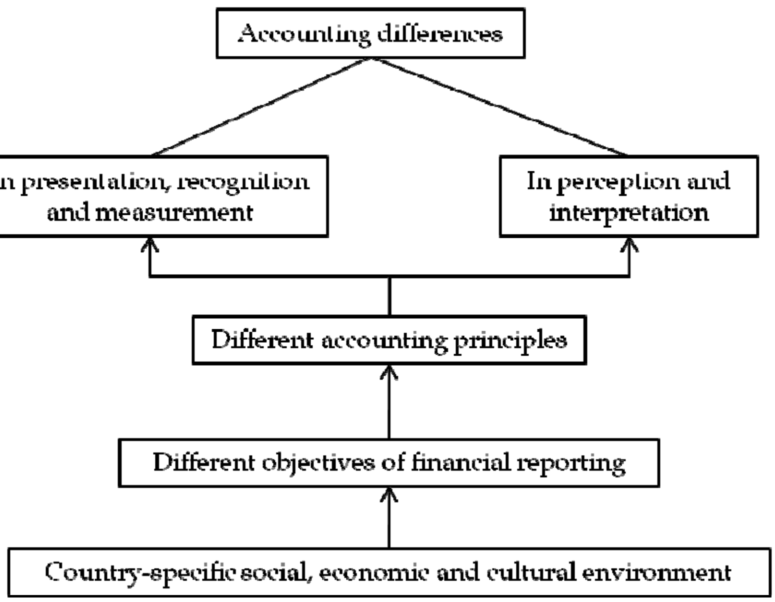

FIGURE 3 Framework of differences between accounting system (Walton et al. 1998, 2)

3.2 IFRS

The IASC, now the IASB, was formed in 1973 by the professional accounting organisations of the US, UK, France, Germany, Mexico, Canada, Japan, the

Netherlands and Australia. The dominance of countries with Anglo-Saxon accounting approach has significantly influenced the formation and content of the standards in which priority is given to Anglo-Saxon concepts of accounting, such as 'fair presentation' or 'true and fair view'. This is further reinforced by the shared value of the key members of the IASB: the view of accounting as oriented towards the needs of capital markets. (Walton et al. 1998, 11, 36.) According to the Preface for the Conceptual Framework, the objective of the IASB along with the formulation and publication of accounting standards is to harmonise regulations, accounting standards and procedures related to the preparation and presentation of financial statements in order to narrow down the differences in accounting systems of countries deriving from different social, economic and legal circumstances (IFRSs 2005, 23-27).

As Anglo-Saxon accounting system is based on common law and characterised by strong equity-outsider market and a separation between financial and tax accounting rules, according to Nobes' (1998) categorisation, IFRS as a system can be classified into Class A. Principle-based private sector standards form the legal basis of accounting regulation, and accountants' professional judgement is needed in applying the principles in practice. A doubt has, however, emerged that IFRS would be inevitably moving in the direction of more rules away from the principles-based focus. This view is suggested by the increasing length and greater detail of standards and other IASB's pronouncements. (Zeff 2007, 293.)

The IASB Conceptual Framework (later "Framework") forms the theoretical basis of the issued IFRSs by defining the main overall objectives and characteristics of financial information as well as the elements of financial statements and their recognition (Framework 5 §). The framework functions as the basis for both interpreting the current rules and constructing new rules. The introduction of key concepts underlying the preparation and presentation of financial statements is directed towards users of the information, such as investors, employees, customers, suppliers and governments (Framework 9 §). The IASB Framework is very little more than a summary of the first six Concepts Statements of the FASB Framework forming the base for US GAAP regulations (Troberg 2003, 21).

A set of financial statements consists of a balance sheet, a profit and loss statement, a statement of changes in financial position and notes, other statements as well as explanatory material needed in interpreting the statements (Framework 7 §). As for the objective of financial statements, it is to provide information about entity's financial position, performance and changes in financial position that can be used by a wide range of users, mainly investors, in making economic decisions (Framework 12 §). With help of the disclosed information, the user should be able to evaluate and predict the activities and financial status of the organisation (Framework 15-18 §).

IFRS contains two underlying assumptions for preparing the financial statements: *accrual basis* of reported information, meaning that the effects of transactions and other events are recognised in accounting records when they occur and reported in the financial statements in the periods to which they relate, and *going concern* signifying that an entity will continue operating for the foreseeable future (Framework 22-23 §).

In order to be useful for the users, information in financial statements needs to fulfil certain qualitative criteria. Under IFRS, those characteristics comprise of understandability, relevance, reliability and comparability. First of all, information has to be understandable for the users. Secondly, it has the quality of relevance, affected by its nature and materiality, if it helps the users to evaluate actions, predict the future and confirm the past evaluations. Furthermore, information is considered reliable if it is free from material bias and can be depended on by the users. To be reliable, information has to be faithfully represented, neutral, complete in terms of materiality and cost, and produced by following the principles of substance over form and prudence when preparing the financial statements. Lastly, the users have to be able to compare financial information of an entity not only with information of the previous years, but also with other entities. In this respect, the accounting policy of the organisation plays a significant role. (Framework 24-42 §.)

Thus, the key requirement of IFRS is for the financial statements to give a true and fair view of the financial position, performance and changes in financial position of an entity. If the financial statements fulfil all the above mentioned criteria, this situation is highly likely to be reached. (Framework 46 §.)

3.3 Russian GAAP

Contemporary Russian accounting system began to shape in the early 1990s as the Soviet Union collapsed and the need for a more developed system was stressed by market forces. A change was required also in the legal system. The Russian legal system is based on statutory, codified law rather than case law. (McGee & Preobragenskaya 2006, 9-10, 14.) The main legal acts are the Constitution, federal constitutional laws, federal laws, presidential decrees, governmental regulations, and laws of regional constituents of the Russian Federation. The Constitution recognises the norms of international law and international treaties and agreements with Russia as part of the domestic legal system. (PwC 2010b, 7.)

Accounting is regulated in Russia by state authorities, and detailed accounting rules are provided by law. The legal framework for Russian accounting consists of four levels: legislative, normative, methodical and organisational. The first one includes federal laws, governmental acts and presidential decrees. The main laws concerning accounting are Federal Law No. 129–FZ of November 21, 1996 “On Accounting” and the new Federal Law No. 208-FZ of July, 27, 2010 “On Consolidated Financial Statements”. In addition, draft laws “On Official Accounting” and “On the Regulation of Accounting and Financial Reporting” have been introduced and should come into effect in the near future. Seppänen (2010, 18) reminds, that the actual accounting laws represent only the tip of the iceberg of the regulations affecting accounting; among others the Civil Code and The Tax Code have a major regulative impact on Russian accounting. The second, normative, level refers to Provisions on Accounting, also known as PBUs or Russian accounting standards, set by the Ministry of Finance for all companies except banks that belong to the sphere of influence of the Central Bank. The methodical level consists of other normative acts on accounting, including Accountancy Decree confirmed by the order No. 34n of Ministry of Finance in July, 29, 1998, and of methodical manuals, whereas the last level concentrates on regulations, for example accounting policies and internal documents developed based on the preceding levels, inside organizations. (McGee & Preobragenskaya 2006, 10-11; PwC 2010b, 43.)

Russian Generally Accepted Accounting Principles (later Russian GAAP) is the term used in this research to describe the whole array of laws, decrees, standards, orders and instructions defining accounting and financial reporting in Russia. The following chapters are mostly based on official sources, which signifies a number of references to laws, decrees and standards. When a reference to a law is made, only the number and article of the law are mentioned. A reference to the Accountancy Decree goes as follows: (Accountancy Decree 2 §). When referring to the PBU standards, only the number and article of the standard are presented similarly to references to IFRS.

3.3.1 Key Principles of Russian GAAP

The main purposes of Russian accounting are introduced in Article 1 of the Law "On Accounting" 129-FZ. They comprise of

- forming reliable and complete information on the activities and financial position of an organisation required by the users of accounting information;
- providing information needed by the users of accounting reports to monitor the compliance of organisation's economic operations with the Russian legislation; and
- preventing negative results from economic activities and identifying the internal resources needed to secure the financial stability of an organisation (129-FZ 1 §).

Besides the regulations binding for everybody, every organisation is obliged to adopt its own accounting policy in the due form. The accounting policy gives a company some freedom in adjusting the accounting procedures to the company's own needs. (129-FZ 5 §.) It can be changed only once in a year, in connection with the financial statements, and new accounting procedures can not be applied retrospectively (Seppänen 2010, 21). Though management is officially responsible for the organisation of accounting in organisations, in day-to-day bookkeeping Russian accounting relies strongly on the institution of Chief Accountant. He is, for example, responsible for the formation of the accounting policy, the maintenance of accounting records and the timely presentation of reliable and complete accounting reports. (129-FZ 7 §.)

The basic principles of Russian GAAP encompass accrual principle and going concern assumption similarly to IFRS. Likewise, qualitative characteristics such as materiality, reliability, neutrality, prudence and comparability are incorporated into the Russian accounting system although they are not clearly assembled into a framework in the manner of IFRS. Understandability and relevance, however, are not mentioned anywhere. (McGee & Preobragenskaya 2006, 16-17.) The key requirement of GAAP, like IFRS, is for the financial statements to give a "reliable and complete" or a "true and fair" view of the company's capital and financing position, their changes and also of the financial results of its operations (Accountancy Decree 32 §). However, "reliable and complete" as well as "true and fair" do not mean the same under these two accounting systems. The main reason for the situation is the fact that until 1 January 2002, the adoption of the new Profit Tax Law, Russian accounting and taxation were tightly bound together. The significant change of separating these two indicated the end of the interest for developing financial accounting regulations (Seppänen 2010, 18). Despite companies' release obligations, accountants have not been motivated to issue other information about the company than what the authorities have required and thus, there has been no need to develop accounting procedures into a more explicit direction. The step from tax-based to true and fair view has at least so far been a bit too big to handle. (Matilainen 2010.)

True and fair view is clearly not rooted in the minds of Russian accountants. Accounting entries can be done only based on vouchers, which indicates difficulties regarding, for example, provisions. Hence, in order to achieve the requirements for true and fair view, chief accountant must hold an independent grasp of the accounting. (Matilainen 2010.) One of the biggest obstacles to the true and fair view is the fact that transactions are often accounted for in accordance with their legal form rather than their substance. Hellevig & Usov (2006, 29) even state that the fixation of all Russian legal, administrative and court practices to form is "a great tragedy for the Russian society and a major reason for the Russian economy not being able to realise its full potential".

TABLE 1 The main sections of the Chart of Accounts (PwC 2010b, 45)

Account Section	**Number**
Non-current assets	01-09
Inventories	10-19
Cost of production and work-in-progress	20-39
Finished goods and goods for resale	40-49
Cash and investments	50-59
Accounts receivable and payable	60-79
Equity	80-89
Financial results	90-99
Off-balance sheet accounts	001-011

The first eight sections are called balance-sheet accounts and used in double-entry accounting. The ninth section consists of off-balance sheet accounts for various kinds of transactions that can not be made within the double-entry system. Most of the accounts are divided into sub-accounts because of their complexity. In addition, every account and sub-account can be divided into analytical accounts according to, for example, material categories. Based on the Chart of Accounts and its instructions, each organisation should approve its own working chart of accounts appropriate for its accounting purposes. (PwC 2010b, 45.)

Furthermore, form over substance –principle can be seen in the necessity of compiling acts. Contract parties have to prepare a mutual act of the fulfilment of the contract and thus ensure that they have no more claims towards each other. Both parties should sign the act and stamp it with official marks. The act then functions as a prerequisite for recognising revenues and expenses. Although in principle transactions should be recorded also in Russia on accrual basis, in practice a transaction can not be recorded without the required documents and the mutual act that confirms the delivery and on the other hand, the receipt of goods or service in question. As a conclusion, it is obvious that Russian accounting is formally extremely high-level, although in practice many central principles of accounting do not come true. Thus, the Russian financial statements do not necessarily give a reliable and complete view of the financial result and position of a company according to international accounting regulation. As a matter of fact, the obsession with form is a main reason why Russian accounting practice is so slow to adapt to IFRS rules where subjective judgment is often needed. However, in order to write a clear audit report, Russian auditors require only that the financial statements give a reliable and complete view in compliance with Russian legislation. (Seppänen 2010, 18, 20-21.)

3.3.2 Financial Statements

By the reform process of Russian accounting system, the focus of financial accounting has changed from merely making entries to reporting and disclosure of information (McGee & Preobragenskaya 2006, 15). Russian financial statements consist of balance sheet, profit and loss statement, normative appendices to both of them, audit report for companies belonging to the scope of obligatory audit and explanatory notes (129-FZ 13 §). Notes must include announcement of any changes in the accounting policy for the following year, as well as an explanation for any cases of non-compliance with the accounting rules (129-FZ 13 §). The profit and loss statement in Russia resembles the functional form of profit and loss statement known in IFRS meaning that expenses must be analysed by function on the face of the profit and loss statement. By nature they are analysed in the explanatory notes. (Ernst & Young 2009, 2.)

The presentation, structure and other aspects of statutory financial statements are regulated in PBU 4/99 Accounting Reports of an Organisation (Бухгалтерская отчетность организации). All entities must have an annual balance sheet date of 31 December; the reporting year is the calendar year. The financial statements must be presented in the local language, Russian and always in roubles. Recommended formats for the financial statements are used practically in every company. The annual statutory financial statements should be submitted to the shareholders of the company, the state statistics authorities and to the state tax authorities, and they must be accessible to also all other interested users. Open joint-stock companies must also publish their statutory financial statements. Generally, the scope of disclosure in financial statements under Russian GAAP is lower than in financial statements under IFRS, although in many respects the GAAP rules of disclosure are comparable with IFRS. For example, according to Russian GAAP, financial statements are required to be prepared on an accrual basis for accounting, and similar concepts as under IFRS regarding the materiality and consistency of the requirements have to be followed. Small businesses are exempted from the responsibility of the heavy reporting burden and a simplified set of accounting rules is available for them. (129-FZ 8 §, 13-16 §; PwC 2010b, 43-45.)

3.3.3 Development and Convergence of Russian GAAP with IFRS

In the Soviet Union, financial accounting was made solely for the benefit of the State for statistical purposes. As the collapse of the CCCR created the need for taxation, financial accounting was next closely bound to taxation and done for the purposes of taxation and statistics. It was not until in the year 2002 that financial accounting was given an independent status as it was separated from taxation by the new Profit Tax Law in the Tax Code. However, taxation still affects the choices made under financial accounting, and tax authorities are seen as the primary user of accounting information (McGee & Preobragenskaya 2006, 32). Now Russian financial accounting is catching influences from international accounting and converging towards the International Financial Reporting Standards. This tendency was further reinforced with the separate statutory requirements introduced on tax accounting. (Hellevig & Usov 2006, 36-39.)

In Russia, only the banking sector is obliged to prepare their financial reporting in compliance with IFRS. However, an increasing number of Russian companies have to comply with the standards in order to meet the reporting requirements of the foreign parent or a foreign stock exchange, or to fill the information needs of western banks and lenders. (Deloitte 2009, 14.) A new amendment of the standard PBU 1/2008 Accounting Policies of an Organisation (Учетная политика организации) allows all companies to use directions of IFRS for situations in which there are no established methods of accounting in local GAAP with regard to a particular issue. In developing a relevant accounting method for the issue, a company should take into consideration both the requirements of other PBUs and the requirements of the International Financial Reporting Standards. (PBU 1:7.) In case IFRS is used, however, there should always be a mention of the use in the accounting policy of the organisation. More recently, the Government of the Russian Federation issued an Order No. 107 of 25.02.2011 "On approval of the provisions on the recognition of International Financial Reporting Standards and interpretations of International Financial Reporting Standards for use in the Russian Federation" establishing the procedure for applying the standards and their instructions in Russia. Hence, IFRS seems to be now an essential part of the Russian accounting legislation.

For now, IFRS and Russian GAAP still differ from each other in some cases even radically. A programme to reform accounting in accordance with IFRS was adopted already in 1998 and another project in the form of Order No. 180, Concept of Mid-Term Development of Accounting and Financial Reporting in Russian Federation, in 2004. As a result of the first development project, PBU standards were introduced. There are now 22 PBUs (presented in Appendix 1). They, however, did not quite manage to bring GAAP closer to IFRS as they were much shorter than the corresponding standards of IFRS and thus left many issues unsolved. (Matilainen 2010.) In addition, standards are weakly followed in cases they do not affect tax accounting and thus enforced by tax authorities (Matilainen 2006, 34). Furthermore, a variety of new concepts and terms, never before known to Russian accountants, were introduced hindering the proper interpretation of the standards (McGee & Preobragenskaya 2006, 15). In any case, the standards regulate major aspects of Russian financial accounting and the new amendments made in years 2008-2010 after a five-year stagnant period in the development of financial accounting have somewhat succeeded in the task of converging the Russian and international practices. The convergence was also the main goal of the second development plan at the beginning of which IFRSs were finally officially translated into Russian and named as MSFO standards. However, practical interpretation of the assumptions and regulations under Russian GAAP, due to basic principles of Russian accounting and the absence of a suchlike conceptual base as under IFRS, may long prevent the two practices from meeting each other. (PwC 2010b, 41; Seppänen 2010, 18.) Detailed list of differences between IFRS and Russian GAAP can be found in Appendix 2.

The Concept of Mid-Term Development of Accounting and Financial Reporting introduced the need for the mandatory preparation of consolidated financial statements by public and other public interest companies in compliance with IFRS. In 2010, the new federal law “On Consolidated Financial Statements” finally came into force. According to the law, consolidated financial statements of public companies are to be prepared solely under IFRS from January 1, 2012 onwards and are subject to audit and publication. Before the adoption of the law, consolidated financial statements were treated as secondary to stand-alone statutory financial statements and were seldom prepared regardless of their obligatory nature stated in the Accountancy Decree 91 § and Order No. 112 (Aggregated Financial Statements). Though the procedural framework of consolidation rules of Russian GAAP is similar to IFRS, specific rules and practical issues may differ. (PwC 2010b, 41-42, 44.) Other than public companies can still prepare consolidated financial statements either in compliance with IFRS or Russian GAAP. However, Finance Minister Alexei Kudrin assures that also all other companies will have to switch to IFRS during the transition period, that is, in the near future (Filatova 2011). Federal Law “On Accounting” does not mention consolidated financial statements.

3.4 Summary of the Differences between IFRS and Russian GAAP

With regard to social-economic environment, differences between accounting systems can be traced on the level of capital markets, legal system, fiscal system and culture. IFRS is based on common law system in the sphere of which accounting rules are developed by private standard setting bodies. Russian GAAP, on the contrary, has its legal base in codified law, and government is the main body in setting law-based accounting rules. Law prescribes the accounting rules in detail, and professional judgement typical for IFRS remains in the shadow. Furthermore, IFRS is based on Anglo-Saxon accounting system that is characterised by strong equity-outsider market, whereas in Russia, capital has been traditionally provided by the banking sector. This division is seen in the primary users of accounting information: under IFRS they are investors but under Russian GAAP, tax authorities and only secondly, investors. Respectively, under IFRS there is no mutual influence between financial and tax accounting rules, while Russian GAAP applied in practice, despite of the separation between taxation and financial accounting, takes in many cases also the tax rules into consideration.

On the cultural level, IFRS is based on Anglo-American value system. According to Hofstede and Hofstede (2005, 43-44, 78-79, 120-121, 168-169, 211), the US and UK, major influencers in the IASB, are characterised as highly individualistic and rather masculine societies with low power distance, a capability to cope with uncertainty and a tendency towards short-term orientation. In compliance with Gray's hypotheses, IFRS should thus rank highly in terms of professionalism, flexibility, optimism and transparency. Russia, on the other hand, shows high figures of power distance and uncertainty avoidance with a feminine approach and medium level of individualism. Elenkov's (1997) and Bollinger's (1994) studies support these findings. Ardichvili and Kuchinke (2002), however, override some of these arguments by discovering a high level of masculinity and a low level of power distance in the society. In addition, they describe Russia as a more long-term than short-term oriented country. Leaning on the most recent findings about Russian societal values presented by Salmi and Sharafutdinova (2008), the original findings of Hofstede hold, and Russian accounting system can be characterized by values of statutory control, uniformity, conservatism and secrecy. In respect of Hofstede's dimensions and Gray's framework, it has to be remembered that culture is not static – it is adaptive and dynamic, influencing and being influenced by the environment. Conceptualisations of cultural values and their relationships with accounting values represent a quite simplified picture of the whole of country's culture and its influence on accounting systems. In addition, it is rather questionable to associate IFRS with only Anglo-American values of the US and UK.

The objective of financial accounting to provide information to the capital markets is tightly connected to IFRS's theoretical base - the conceptual framework stating the underlying assumptions and qualitative characteristics for preparing financial statements. Despite of the objective of Russian GAAP to rather calculate distributable income for the purposes of taxation than to fill the information needs of investors, those assumptions and characteristics are quite similar to IFRS, although instead of a framework they are scattered in several laws, decrees, orders and standards. However, some basic principles, such as substance over form, are missing and some, such as true and fair view, are understood differently to IFRS. While under IFRS true and fair view is understood as such and applied by professional accountants, under Russian GAAP it is always linked to compliance with the rules that the law provides. As a consequence, financial statements prepared under Russian GAAP are more uniform than under IFRS. Furthermore, in Russia the decision usefulness of financial statements is hindered by the dominance of the conservatism principle intended to minimise taxable profits. Along with the fixation to form over substance, conservatism leads to less transparency and lower quality of disclosed information compared to IFRS under which more optimistic choices are made to emphasise profitability. As a conclusion, the linkages between societal and accounting values according to Gray (1988) seem to be valid when comparing them with the accounting objectives and principles of both IFRS and Russian GAAP.

In addition to differences in legal foundations, objectives and basic principles of accounting, McGee and Preobragenskaya (2004) summarise some reasons why the implementation of IFRS in Russia is seen as a rather difficult task. First of all, the preference of tax rules over financial accounting rules hinders the adoption of IFRS because in most of the cases, the alternative complying with tax rules is chosen over an option suggested under IFRS. Minimisation of the tax liability overcomes all the other objectives of accounting, and accountants consider the tax authorities as the primary user of accounting information. Secondly, concerning other than public and internationally financed companies, there is a clear absence of demand from the big audience for more transparent and fair information. Benefits of IFRS are not yet widely understood. Thirdly, accountants face difficulties in implementing IFRSs due to the lack of knowledge in understanding and interpreting the rules. New terms and concepts are understood differently than intended by the IASB, and the problems of translation does not ease the situation. In addition, Russian accountants were taught to follow rules, not to exercise professional judgement. McGee and Preobragenskaya (2004) claim that Russian GAAP will never be identical to international standards, even if every word of every standard was translated directly into Russian. That is because at the point of interpretation, Russian culture and accountants' mindset come into play. Russian accountants will always interpret the rules of standards differently than their colleagues for example in the UK. Thus, a change in the mentality of the whole accounting profession is first demanded. Finally, Russian accounting and the standards are now legislated by the government. This results in a time lag between the work of the IASB and the adoption of standards in Russia, and many inefficiencies related to, for example, translation. However, the accounting profession in Russia is rather underdeveloped compared to many other countries in the world. An aim of the Concept of Mid-Term Development of Accounting and Financial Reporting from year 2004 was to change this situation and delegate the development of accounting standards to professional organisations, while leaving the state authorities merely to decide whether to adopt them or not (PwC 2010b, 41). By now, any changes to the rulemaking process have not been made. However, lots have changed in Russia since McGee and Preobragenskaya's studies, which leads to a conclusion that not all impediments for adopting the IFRSs necessarily take place anymore.

4 REVENUE RECOGNITION IN FINANCIAL ACCOUNTING

The way of recognising revenue is usually controlled by the type of the contract between seller and buyer in question, depending on facts such as what kind of object the contract is about, how long is the contract term and what other elements does the contract include. The chapter presents revenue recognition both from the point of view of IFRS and Russian GAAP and seeks to find the most important differences between the standards. The comparison is made in the sub-chapter 4.3.

4.1 According to IFRS

Besides the IASB Framework, the main regulations covering the area of revenue recognition under IFRS are standards IAS 11 (Revenue) and IAS 18 (Construction Contracts). In addition, some rules regarding the matter are presented in IAS 10 (Events After the Balance Sheet Date), IAS 23 (Borrowing Costs) and IAS 37 (Provisions, Contingent Liabilities, and Contingent Assets), as well as in interpretations SIC-31 (Revenue-Barter Transactions Involving Advertisement Services), IFRIC 13 (Customer Loyalty Programmes) and IFRIC 15 (Agreements for the Construction of Real Estate). From the underlying assumptions of IFRS presented in the Framework, accrual basis, materiality, substance over form and the call for true and fair view are the ones relating closely to revenue recognition (Anttila et al. 2010, 85).

In every case it is not simple to define if a contract should be treated as a construction contract according to IAS 11 or a contract according to IAS 18. Anttila et al. (2010, 102-103) present some principles for the situation when a contract belongs to the scope of application of IAS 11. First of all, a binding, detailed agreement should be made before the work starts. The content of the contract is tailored and requirements of the customer are taken into account. The good, service or property item produced is designed and developed individually for the purposes of the customer; the contract is not about a standard model ordered in advance. The contract is capable of being executed, and it includes substantial terms of cancellation. If the contract can be cancelled without a contractual penalty, it belongs rather to the scope of application of IAS 18.

4.1.1 Revenue Recognition

As explained in the introduction, *revenue* is defined as income resulting from the ordinary activities of an entity. Income, on the other hand, is defined in the Framework 70 § as follows.

> "Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants."

Income encompasses both revenue and gains. Revenue refers to gross amount of among others sales, fees, interest, dividends and royalties and excludes amounts collected on behalf of third parties, such as sales tax or value added tax. The standard concerning revenue recognition principles in general terms is IAS 18 covering only recognition of revenue and leaving out recognition of gains. The standard encompasses three categories of transactions producing revenue: the sale of goods, the rendering of services and the use by others of the reporting entity's assets, and establishes criteria for recognising revenue from each category. (Epstein & Jermakowicz 2008, 215 – 217.) Outside the scope of application of IAS 18 are left, among others, lease agreements regulated in IAS 17, insurance contracts within the scope of IFRS 4 and changes in fair values or disposal of financial instruments that belong to the scope of IAS 39 (Anttila et al. 2010, 87). In this research, revenue from the use by others of the reporting entity's assets is not discussed.

Under IFRS revenue is recognised only if it is probable that future economic benefits will flow to the entity and these benefits can be measured reliably (Framework 92 §). This is the base for recognising all revenues. Furthermore, IAS 18 sets additional criteria recognising revenue from the sale of goods and services. Revenue from the normal sale of goods is recognised when the entity has transferred the significant risks and rewards of ownership to the buyer and it no longer retains control or managerial involvement in the goods. In addition, the company should be able to reliably measure costs incurred or to be incurred in respect of the transaction. For most of the transactions this is the situation when the goods have been delivered to the customer. Revenue should be measured at the fair value of the consideration received, net of any trade discounts and volume rebates allowed by the entity. However, usually the quantum of revenue is dependent of the contract between parties in question. (IAS 18:9-10, 14.)

Revenue recognition for service transactions requires the use of percentage-of-completion method unless certain defined conditions are not met. Originally reporting entities had the opportunity to choose between percentage-of-completion or completed contract method. Current standards for revenue arising from the rendering of services closely parallel those for long-term construction contracts. That is, the recognition of revenue should be with reference to the stage of completion of the transaction at the date of the statement of financial position if revenues, costs and the stage of completion of the transaction can be measured reliably and if it is probable that economic benefits will flow to the company. (Epstein & Jermakowicz 2008, 215 – 216, 220, IAS 18:20-21.)

Revenue arising from an element of a transaction is recognised separately if that element has commercial substance on its own. Otherwise the multiple elements are combined and accounted for as a single transaction. IAS 18 does not present any specific criteria for making the decision. (Ernst & Young 2009, 28.)

4.1.2 Construction Contract Accounting

The definition of a *construction contract* in IAS 11:3 goes as follows:

> "specifically negotiated contract for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose of use."

Typically a construction contract is a project work that can concern the making of a single property item like a building, ship or bridge, service or a certain intangible asset like a tailored information system. The contract can also relate to a combination of assets, such as a pulp factory. (Anttila et al. 2010, 102.) In addition, construction contracts encompass contracts for rendering of services that are directly related to the construction of the asset including for example services of project managers and architects, contracts for destruction or restoration of assets, and contracts for restoration of the environment following the destruction of assets (IAS 11:5). Because of the nature of the activity undertaken in construction contracts, the date at which the contract activity is entered into and the date when the activity is completed usually fall into different accounting periods (IAS 11 Objective). The standard is meant to be applied, particularly, in the accounting of contractors.

The timing of revenue recognition is one of the main concerns regarding accounting for long-term construction contracts. If revenue recognition was deferred until completion of a project, like in the case of normal sale of goods, the level of activity of the company in that reporting period would come out totally wrong. Even if the company operated at a constant rate of production, in some periods no apparent activity would be presented in the financial statements. This is why percentage-of-completion method was developed. It reports the revenues proportionally to the degree to which the projects are being completed by matching contract revenue with contract costs incurred. (Epstein & Jermakowicz 2008, 228.)

Already in December 1984, FASB issued Concepts Statement 5 (later CON) discussing revenue recognition in more detail. As an application of the principles presented in the issue it is concluded in CON 5 84c § that

> "if a product is contracted before production, revenues might be recognized by a percentage-of-completion method as earned – as production takes place – provided reasonable estimates of results at completion and reliable measures of progress are available" (FASB Concepts Statement 5).

Thus, percentage-of-completion method is not a new invention, and was eventually transferred from US GAAP to IFRS world. Currently it is recognised under IAS 11 as the only valid method of accounting for construction contracts. Hence, the completed-contract method is not an option anymore although in many national GAAP the practice varies significantly. US GAAP prefers the use of percentage-of-completion method, when estimates of costs to complete and extent of progress toward completion of contracts are reasonably dependable. Otherwise, completed-contract method is preferable. (Epstein & Jermakowicz 2008, 231.)

The idea behind the percentage-of-completion method is that both the seller (contractor) and the buyer have certain rights. The buyer has the right to require specific performance from the contractor, whereas the contractor has the right to require the buyer to make progress payments during the construction period. Combining of these rights results in a continuous sale that occurs as the work progresses. In the standard IAS 11 the method is defined as follows:

> "Under this method contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expenses and profit which can be attributed to the proportion of work completed. …Contract revenue is recognised as revenue in the income statement in the accounting periods in which the work is performed. Contract costs are usually recognised as an expense in the accounting periods in which the work to which they relate is performed. However, any expected excess of total revenue for the contract is recognised as an expense immediately." (IAS 11:25-26.)

The basic rules for recognising revenue and expenses stem from the IASB Framework. (Epstein & Jermakowicz 2008, 230-231.)

When using the percentage-of-completion method for recognizing revenue, the construction-in-progress (CIP) account is used for accumulation of costs and recognized income. If CIP exceeds billings, the difference is posted as an asset. On the contrary, if billings exceed CIP, the difference is reported as a liability. Thus, income is not based on advances and progress billings. In fact, progress payments and advances from the customer generally do not measure the work performed but are based on contract terms to generate cash flow for the company. The calculation of the periodic profits must be sensitive to the terms of the underlying contract, and companies must carefully assess the ability to actually bill for the work done. (Epstein & Jermakowicz 2008, 228, 232, 237.)

The ability to bill is also dependent on the type of the contract. There are two types of construction contracts: fixed-price contracts and cost-plus contracts. In the first type the price is not subject to adjustments, while the latter one usually includes a fee over the reimbursable expenditures. Costs are invoiced from the customer according to a plan and the additional fee constitutes the profit margin of the contract. A contract can also be a combination of the two types presented. (Epstein & Jermakowicz 2008, 235; IAS 11:3.) Nevertheless, even a fixed-price contract can not contain clauses on all the possible matters occurring during a project. Thus, the final contract revenue usually consists of the amount defined in the original contract added with the changes made to the contract, incentive payments and with requirements for additional charges to the extent that they are likely to become materialised as revenue and reliably measurable. (Anttila et al. 2010, 105.)

Contract costs consist of costs that can be identified with a specific contract, attributed to contracting activity in general, allocated to the contract and that can be charged from the customer according to the contract. Accounting for contract costs is, in principle, similar to accounting for inventory according to IAS 2. The contract costs include:

- costs of materials,
- wages and other labour costs,
- subcontractor costs,
- depreciation charges of plant and equipment used in the contract,
- lease rentals of hired plant and equipment for the purpose of the contract,
- cost incurred in shifting materials, plant and equipment to and from the construction site,
- cost of design and technical assistance,
- estimated costs of any work done under a warranty or guarantee, and
- claims from third parties.

Contract costs may be reduced by incidental income, for example from the sale of plant and equipment at the end of the contract, if that income is not included in contract revenue. Interest income from investing advance payments is either included in contract revenue or offset against contract costs, depending on the contract terms and negotiations. Indirect costs or overhead expenses including construction overhead, cost of insurance, cost of design and technical assistance should be included in the contract costs if they are attributable to the contracting activity in general and can be allocated to specific contracts in a systematic and rational way, even if they are not directly related to the contracts. As well, costs of preparing payroll of employees engaged in construction activity and borrowing costs that are capitalised under IAS 23 should be allocated to contract costs. On the contrary, costs that are specifically excluded from allocation to construction contracts may include

- general and administrative costs that are not reimbursable according to the contract,
- marketing and selling costs,
- research and development costs that are not reimbursable according to the contract, and
- depreciation of plant and equipment that is not used in any specific contract. (IAS 11:16-21.)

IAS 11 does not contain any advice on how to treat exchange rate differences. Anttila et al. (2010, 105) claim that the most simple option is to show the differences in financing yields and costs, which, however, misrepresents the project profitability. That is why exchange differences should be rather treated as a part of the costs and revenues of the project.

Contract costs can be divided into two categories: costs incurred to date and estimated costs to complete. Estimates of costs to complete should be frequently examined to keep the revenue recognition of the contract in balance. Especially upcoming price fluctuations and possible future problems should immediately be taken into consideration and respectively, the estimates changed to correspond with the new situation. (Epstein & Jermakowicz 2008, 232-235.)

A major challenge of the method is to accurately estimate the extent to which the project is being finished. The stage of completion of a project may be determined in many ways, depending on the nature of the contract. The most reliable, also referred to as input measure, is cost-to-cost method which measures the proportion that contract costs incurred bears to estimated total contract cost. In measuring the stage of completion, however, contract costs that relate to future activity and advance payments to subcontractors prior to performance are to be excluded. The two other ways, also known as output measures, are survey of work performed –method and completion of a physical proportion of contract work –method also known as the milestone method. The percentage-of-completion method is used under the principle that "recognised profit (should) be that percentage of estimated total profit…that incurred costs to date bear to estimated total costs", that is, under cost-to-cost method. The formula that the method exploits in determining the percentage of revenue to recognise is presented in Figure 4. (Epstein & Jermakowicz 2008, 237-238; IAS 11:25, 30.)

$$\frac{\text{Cost to date}}{\text{Cumulative costs incurred} + \text{Estimated costs to complete}} \times \text{Contract price} - \text{Revenue previously recognised} = \text{Current revenue recognised}$$

FIGURE 4 The formula of cost-to-cost method (Epstein & Jermakowicz 2008, 237-238)

Cost-to-cost method is theoretically clear but in practice it may be difficult to compare costs and real process if the company does not have detailed enough specifications of the costs incurred to date and estimated costs to complete. The completeness of the cost-to-cost method is a reason why some companies have instead started to apply the milestone method in which the project is divided into different stages, often according to the completion of a physical proportion of a contract work. (Anttila et al. 2010, 107.)

Recognition of contract revenue and expenses, and furthermore, the possibility to use percentage-of-completion method demand a reasonable level of accuracy of information in the financial reporting process. The principle is that the outcome of the construction contract should be reliably estimated. In fixed-price contracts, in addition to IASB Framework's criteria presented above (p. 44), one should be able to measure reliably both all contract costs, the contract cost to complete and the stage of completion, as well as identify properly the contract costs attributable to the contract in order to compare actual contract costs with estimates. In cost-plus contracts only the criteria that economic benefits will in all probability flow to the entity and that the contract costs can be identified and measured reliably, are to be fulfilled. In case outcome of the contract can not be estimated reliably, revenue should be recognised only to the extent of the contract costs incurred that are probably recoverable, and contract costs should be recognised as an expense in the period in which they are incurred. (IAS 11:22-24, 32.) In practice this means that no profit margin is recognised to the project until the outcome of the contract can be again reliably estimated. In the most extreme case the profit can be recognised only upon the final delivery. Also in this case, any expected losses should be recognised immediately. (Anttila et al. 2010, 108-109.)

IAS 11 presents a number of disclosure requirements for construction contracts. Concerning all contracts, aggregate amounts of revenue recognised from the contracts in the period should be disclosed, as well as methods used in determination of that revenue. For contracts in progress, disclosures about methods used in determination of stage of completion, aggregate amount of costs incurred and recognised profits to date, amounts of advances received and amount of retentions are demanded. As it comes to financial statement presentation requirements, the principle is that gross amounts due from customers should be reported as an asset, and vice versa, gross amounts due to customers should be reported as a liability. (IAS 11:39-40, 42.)

It is presumed that each individual contract forms an own profit centre for accounting purposes. However, construction contracts are combined or segmented if certain criteria are met. A group of contracts may be combined and treated as a single contract if the group of contracts is negotiated as a single whole, the contracts are so closely related that, in fact, they are a part of a single project with a joint profit margin and if the contracts are performed concurrently or immediately one after another. On the contrary, a contract may cover a number of assets. The construction of each asset should be treated as a separate construction contract if a separate offer is made for the separate components of the project, every asset has been separately negotiated for and both the contractor and the customer have been able to accept or reject part of the offer relating to a single asset, and if the costs and revenues incurred from each asset can be separately identified. Furthermore, a contract can include an option for an additional asset or it can be amended to include the construction of an additional asset. The construction of the additional asset is treated as a separate construction contract if the additional asset significantly differs from the asset encompassed by the original contract and if the original contract price is not taken into account in negotiating the price for the additional asset. (Anttila et al. 2010, 104; IAS 11:8-10.)

IFRIC issued on 3rd July 2008 an interpretation, IFRIC 15 Agreements for the Construction of Real Estate concerning revenue recognition. The Interpretation provides guidance on how to determine whether an agreement for the construction of real estate is within the scope of IAS 11 Construction Contracts or IAS 18 Revenue and when revenue from the construction should be recognised. The main expected change in practice is a shift for some entities from recognising revenue using the percentage-of-completion method to recognising revenue at a single time at completion upon or after delivery because the definition of a construction contract as in IAS 11 is not met. (Deloitte 2008.) This interpretation, however, is not taken into account in this study as the case company is extremely rarely involved in the construction of real estates. The construction service is usually bought from an independent contractor by the customer of Andritz, that is, apart from the service provided by Andritz.

4.1.3 Future Changes

Based on a Memorandum of Understanding (MOU) published in 2006, IASB and FASB are currently pursuing a joint revenue recognition project that rests on an idea of revisiting revenue recognition through an analysis of assets and liabilities, instead of the existing approach focusing on completed transactions and realised revenue. According to IASB, the current approach focuses on the occurrence of critical events and may result in the creation of debits and credits that do not meet the definition of assets and liabilities under IFRS, and which in principle should not be recognised. In addition, IAS 18 does not give sufficient guidance on multiple-element revenue arrangements, meaning contracts that include more than one good or service delivered or performed possibly at different times. (Epstein & Jermakowicz 2008, 15, 226 - 227)

The new approach would have major implications for the timing of earnings recognition and potentially would lead to revenue recognition in stages throughout the transaction cycle. In this asset and liability model a reporting entity would recognise revenue on the basis of changes in assets and liabilities arising from an enforceable arrangement with a customer. For the entity to be able to identify the separate liabilities ("performance obligations") arising from a contract, the *fair value model* and the *customer consideration model* were further distinguished. The new model recognises the principle that earning is a gradual process and that the value of executory contracts is sometimes a significant indication of profits. In practice this would mean that revenue is not recognised until a performance obligation is satisfied. (Epstein & Jermakowicz 2008, 15, 226 – 227.) According to Anttila et al. (2010), this could mean that revenue from long-term contracts would be recognised at the stage of delivery, unless it could be proven that control over the goods or services has transferred to the client already during the project. In addition, warranty obligations related to a contract are perhaps to be treated as a part of the original sales transaction, which indicates postponement of the revenue recognition. A draft version of the standard *Revenue from Contracts with Customers* was exposed in June 2010 (ED 2010/6).

4.2 According to Russian GAAP

Besides Federal Law on Accounting and Accountancy Decree of Russian Federation, under Russian GAAP revenue recognition is regulated by the standard PBU 9/99 Income of an Organisation (Доходы организации) and construction contracts by the standard PBU 2/2008 Construction Contracts (Учет договоров строительного подряда). In addition, expenses are regulated under Russian GAAP by the own standard PBU 10/99 Expenses of an Organisation (Расходы организации).

In the Russian accounting, the choice of the used standard seems to be slightly more complicated than under IFRS. Even though a construction contract is in principle defined the same way as under IFRS, difficulties arise especially related to pure service contracts that do not include actual building of an asset (Krasilnikova 2011). In the following sub-chapters I present the regulations of Russian GAAP on revenue recognition and construction contract accounting. In case the Russian standards correspond with IFRS, they are not explained once again but a reference to the IFRS standard is made. As it appears, expense recognition is under Russian GAAP strictly tied to project accounting matters and thus, explained further in sub-chapter 4.2.3.

4.2.1 Revenue Recognition

Under Russian GAAP, as under IFRS, revenue is recognised in accordance with the accrual method, that is, in the reporting period in which it occurred, regardless of the actual receipt of funds or other assets (services). PBU 9/99 differs from IAS 18 mainly due to structure of the standard and classification of revenue recognition principles. However, the same basic principles of revenue recognition can be found also from the Russian standard. PBU 9:2 defines income as follows:

> "As income of the organisation is recognised increase in economic benefits resulting from inflow of assets (funds, other property) and (or) decrease of liabilities that lead to increase in equity of the organisation, except for those resulting from contributions of participants (owners of property)."

PBU 9:4 divides income depending on its nature, conditions of receipt and course of activity into two categories: income from the ordinary activities of an organisation and other income. Unlike IAS 18, PBU 9/99 discusses both of these categories, which can be understood as revenues and gains in accordance with IFRS, within one standard. Income from the ordinary activities of an organisation (revenue) is simply defined as revenue from sale of goods, completion of works or rendering of services (PBU 9:5). The standard excludes from the scope of application amounts like value-added tax, sales tax, export duties, income from commission or agency contracts in favour of the principal, advance payments and deposits (PBU 9:3). Other income is not discussed within this research.

PBU 9:12 defines five conditions that have to be met in order to be able to recognise revenue from both sale of goods and rendering of services. First of all, the entity should have the right, based on a contractual arrangement or supported by other means, to receive revenue. Secondly, the amount of revenue should be reliably measurable. Thirdly, as under IFRS, it should be probable that economic benefits will flow to the entity as a result of the transaction in question. The requirement of probability is satisfied when the entity received an asset as settlement or there is no uncertainty that the asset will be received. Fourthly, revenue should not be recognised until the legal title (right of ownership, use and disposal) for the goods is transferred from the entity to the buyer or when the service provided is accepted by the customer. Due to the form over substance -principle dominant in Russian accounting, often the ability to recognise revenue requires only the fulfilment of contract terms despite the fact that the seller could still have rights or obligations concerning the object of the agreement. However, the seller should be left with only a minor risk of the title when revenue is recognised. Documents attesting to the transfer of legal title or acceptance of the service are in most of the cases prerequisite for recognising revenue. (Matilainen 2010.) Lastly, the costs incurred or to be incurred regarding the transaction should be reliably measurable. If at least one of the conditions above is not met, the entity should recognise payables instead of revenue. (PBU 9:12.)

Due to the different categorisation of the situations producing revenue, PBU 9/99 does not differentiate conditions for revenue recognition between sale of goods and rendering of services. Revenue from rendering of services is recognised similarly to the recognition of revenue from the sale of goods. The only obvious deviation occurs in the transfer of legal title that is considered to take place when work has been accepted by the buyer. Originally the moment of the transfer of legal title is derived from the Civil Code. With regard to services, article 702:1 states that the contractor is obliged to complete the work ordered by the other party and deliver the result of the work to the client. The client is, respectively, obliged to accept the result of the work and pay for it. As the work is first accepted and only then paid, the moment of acceptance is considered to state for the transfer of legal title (Davydova 2010). Transfer to temporary use of entity's assets and rights resulting from intellectual property or income from equity investments in other entities constitutes an exception to the general rule. In these cases, only the first three conditions presented above have to be simultaneously met. (Ernst & Young 2009, 28.) Furthermore, small companies are able to recognise revenue without the official transfer of legal title or without acceptance of the work by the customer (PBU 9:12).

The standard PBU 9/99 contains an own Article for recognising revenue from sale of goods, rendering of services and completion of work with a long production cycle. In this case, revenue can be recognised in compliance with percentage-of-completion method the same way as construction contracts. If the stage of completion of the product, service or work can not be determined, completed contract method should be used for these long-term contracts the same as for all other (short-term) contracts. In addition, the Article states that with respect to different in nature and conditions of work performed, services rendered and products manufactured, the organization may apply in one reporting period at the same time different methods of recognizing revenue. (PBU 9:13.) With regard to all contracts under PBU 9/99, if the amount of revenue can not be determined, revenue is recognised only to the extent of the expenses recognised that are recoverable (PBU 9:14).

Long production cycle, however, has under Russian tax accounting and respectively, under Russian GAAP, a somewhat extended meaning as distinct from IFRS. Namely, the letters from the Federal Tax Service 28.11.2008 N 19-12/111003 and from the Ministry of Finance of the Russian Federation 13.10.2006 N 03-03-03/4/160 attest that a contract with long production cycle encompasses also situations in which the start and end dates of the contract fall into different tax periods. Krutjakova (2011) broadens the principle to cover also financial accounting side. Basically this means that also a regular 3-months-project concerning sale of goods or rendering of services can under Russian GAAP be accounted for in compliance with the percentage-of-completion method of PBU 9/99.

Revenue is generally measured at the amount stated in the contract and recognised in accounting equal to cash receipts, other property received and (or) magnitude of receivables. If the price is not stated in the contract and can not be established based on the terms of the contract, the value of revenue is determined by taking the price at which in comparable circumstances a similar good, work or service would be sold. (PBU 9:6.) PBU 9:6 also determines the possibility to recognise revenue even in case no cash is exchanged in the transaction but does not mention anything about exchange of goods similar in nature and value. There is no guidance under Russian GAAP about multiple elements accounting. In practice, however, the general conditions for revenue recognition are applied to every element of a transaction based on the contractual prices. (Ernst & Young 2009, 28.)

4.2.2 Construction Contract Accounting

In Russia, the definition for construction contract can be found in the Civil Code of the Russian Federation. Article 740:1-2 § states that according to a construction contract, the contractor is obliged at the date set in the contract to build in compliance with the orders of the customer a specific object or perform other construction work, and the customer agrees to create necessary conditions for the contractor to perform the work, accept the results and pay the due price. Construction contract includes construction or reconstruction of enterprises, buildings (including residences) or other objects, as well as performing installation, commissioning and other projects closely related to the object under construction. Rules concerning the contract for construction work shall also apply to major repair works of buildings and structures, unless otherwise stipulated in the contract. In the cases stipulated by the contract, the contractor takes on the obligation to ensure operation of the facility after its adoption by the customer within a stretch of time specified in the contract.

The standard PBU 2/2008 does not itself define construction contract any further but relies on the definition of the Civil Code. Similarly to IAS 11, it, however, extends the construction contract to encompass contracts for architectural services, engineering design and other services closely associated with projects under construction, contracts for restoration and destruction of buildings, structures, ships, and contracts for restoration of the environment following the destruction of assets (PBU 2:2). The standard highlights strongly that only those construction contracts that are to be fulfilled in a period longer than a year or contracts whose start and end dates fall into different accounting periods can be regulated by the standard 2/2008. Interestingly, the standard thus provides for its application also to those short-term contracts that start on one but end on another period. As regarding PBU 9/99, also here the analogy for defining a long-term contract is drawn from the tax legislation. In addition, the standard is meant to be applied, particularly, in the accounting of contractors or subcontractors. (PBU 2:1.)

The PBU standard 2/94 was amended in 2008, clearly to match better with IFRS, and the renewed standard 2/2008 came into force in 1 January 2009. Though the standard is quite new, changes to it have already been made a few times. For now, the amount of companies that are obliged to apply the standard is growing constantly. (Zdorovenko 2010.) According to the standard, revenue from construction contracts shall be recognised using the percentage-of-completion method, or if the outcome of the contract can not be estimated reliably, to the extent of contract costs incurred that will be probably recoverable. The old standard did not know revenue recognition in compliance with the stage of completion, whereas the new standard approves it in cases when the amount of costs to complete the contract and costs attributable to the contract, amount of total contract revenue and the stage of work completed at the end of the reporting period can be reasonably measured and identified, and when it is probably that economic benefits will flow to the entity. In the case of a cost-plus contract, only contract costs attributable to the contract should be reliably identified and measured, and it should be probable that economic benefits will flow to the entity in order to be able to recognise revenue. (Ernst & Young 2009, 29; PBU 2:17, 23.) Revenue is, thus, recognised at the end of every accounting period irrespective of the signing of the act by the client and of the payments received or receivable from the client. The method for defining the stage of completion of the contract has to be stated in the accounting policy of the company (Krutjakova 2011). Hence, the conditions for percentage-of-completion method are exactly the same as under IAS 11 and therefore, are more thoroughly presented in the sub-chapter 4.1.2. The few differences between PBU 2/2008 and IAS 11 are discussed in the sub-chapter 4.3.

In practice, revenue recognition of long-term construction contracts has been based on implementation of stages specified in the original contract, and on invoicing that takes place according to these stages when agreed in the contract. The state of affairs arises mainly from profit taxation legislation which has preferred the use of defined stages in the contract and furthermore, recognition of revenue according to these stages. In some cases, percentage-of-completion method as understood under IFRS has been accepted as a revenue recognition method if it is specifically defined in the accounting policy of the company. (Matilainen 2010.) This opportunity, most likely, derives from the fact that Russian legislation does not specifically prohibit the use of percentage-of-completion method as understood under IFRS, and from the revised PBU 1/2008 that allows the creation of own accounting methods if Russian GAAP does not contain any specific guidance on the issue. Actually, currently Russian GAAP, like IFRS, require the use of percentage-of-completion method in accounting of construction contracts, so the situation seems to be changing. However, according to Matilainen (2010), the possibility to use percentage-of-completion method should always be clarified with local authorities. The biggest problem that authorities would probably easily touch concerning the method is the low verification of stage of completion of project and the costs incurred.

4.2.3 Expense recognition

PBU 10:18 states that costs are recognised in accordance with the accrual method, that is, in the reporting period in which they occurred, regardless of the actual payment of funds or other assets. Similarly to PBU 9/99, PBU 10/99 divides costs into costs from the ordinary activities of an organisation and into other costs. In Russia, expense recognition has a somewhat more significant role in project accounting than under IFRS because a company does not usually allocate or attribute to direct contract costs all the expenses that it is able to. Namely, within costs from the ordinary activities of an organisation, a company is able to create itself the classification of costs into different groups, for example into those that are to be count among direct expenses, that is, among the account 20 and into those that rather belong to the group of overhead expenses. (Krasilnikova 2011; PBU 10:8.)

The reason for the current situation is taxation: the important aim to show less profit in the financial statements and minimise the company's tax expense. Expenses posted to overhead expenses account 26 or accounts such as 44 and 91 can be recognised in profit and loss statement immediately in the period in which they occur, whereas expenses posted to the main production unit account 20 or accounts 41 and 44 (in specific cases) taken into consideration in the project accounting are able of being acknowledged only when the revenue concerning the contract is recognised Also overhead expenses and other expenses related to contracts can be entered to a sub-account of account 20 but they behave in the end of a period the same way as expenses on account 26 - that is, overhead expense accounts are always closed in the end of every period. (The Chart of Accounts for Bookkeeping for the Financial and Economic Activities of Organisations and the Instruction on the Application thereof 2000, later The Chart of Accounts 2000.) As a conclusion, it is to be noticed that companies tend to prefer posting expenses to overhead expense accounts, which leads to a situation in which a project under Russian GAAP in most of the cases includes fewer direct expenses and shows a bigger gross margin, than it does when accounted for under IFRS (Krasilnikova 2011).

Another specific feature regarding expenses in project accounting is the fact that project related expenses can incur even months after the final act is signed and the project closed. Especially difficult the situation is if there is a yearend between the closure of the project and occurrence of the new expenses. The problem could be solved in Russian accounting by making provisions of the missing expenses as it is done under IFRS. As provisions, however, are still a slightly vague concept for Russian accountants mainly because of the difficulty in assessing them and thus are rarely made, even the possibility for provisions does not always dispose of the issue. (Matilainen 2010.) In fact, neither

Russian GAAP nor the Tax Code acknowledges a provision for late project costs, apparently because when the act is signed and the project closed, it is not seen as possible to accumulate more costs to the project. In this respect, the accrual principle in recognising revenues and expenses does not come true in Russian accounting. Instead, instructions on bookkeeping (The Chart of Accounts 2000, 100) concerning account 96 "Reserves for future expenses" allow the formation of reserves for future holiday pay of organisation's employees, for payment of an annual bonus for length of service, for costs of preparatory work in connection with seasonal nature of production activity, for repair of fixed assets, for future expenditures on recultivation of land and for warranty repairs and services. Thus, in case late project costs incur, they are acknowledged as expenses in the current period on respective accounts 20/26/44 etc. without the possibility to deduct them in tax accounting in the previous or current period. (Krasilnikova 2011.)

Sometimes a Russian company is not able to recognise expenses relating to a previous period until in a new period. The situation results partly from the strict documentation requirements of Russian accounting: it can take a while until all documents of the project expenses are at hand and postings can be made. The problem is to define which of the expenses are actually associated with the previous period and which are considered as expenses of the current period. The deciding factor is the date at which documents are issued. If costs are dated in the previous period, they are entered to account 91.2 in the current period and included in the profit tax calculation of the previous period as deductible expenses. If costs are dated in the current period but related to a project closed in the previous period, they are treated as late project costs described above. If costs are dated in the current period and do not relate to a certain project, they are considered as expenses of the current period both in financial and tax accounting. (Krasilnikova 2011; Matilainen 2010.)

4.2.4 Future Changes

Some amendments have been planned to the existing revenue recognition standard PBU 9/99 by the Ministry of Finance, but the time of issuance of the new standard is not yet known. The new standard is supposed to bring revenue recognition practices of Russian GAAP closer to IFRS especially with regard to revenue recognition for an operating cycle longer than one year. (Ernst & Young 2009, 29.) However, it seems that the development of IFRSs is too fast for Russian legislators. Namely, IFRS is already transferring closer to the principle of recognising revenue at completion of the contract (see IFRIC 15) when the client receives control over the goods or services rather than according to stage of completion during the project's lifetime.

4.3 Comparison of Revenue Recognition under IFRS and Russian GAAP

Revenue recognition criteria under IFRS and Russian GAAP are basically similar, though not identical. In both systems revenue recognition is based on the transfer of risks and the attempt to determine when the earnings process is complete. Hence, revenue is not recognised until it is both realised (or at least realisable) and earned, though under Russian GAAP form over substance is emphasised in determining the criteria.

IAS 18 and PBU 9/99 contain general principles and illustrative examples of revenue recognition practices. The standards differ mostly by their structure: PBU 9/99 discusses recognition of both revenue (income from ordinary activities of an organisation) and gains (other income) whereas IAS 18 concentrates on purely revenue recognition. Furthermore, PBU 9/99 does not specifically divide revenue into categories (sale of goods, rendering of services and use of organisation's assets) as IAS 18 does but discusses them all at the same time. PBU 9/99, however, does make a slightly vague division between short-term and long-term contracts and defines for them different revenue recognition methods. As discussed in sub-chapter 4.2.1, the definition for long-term is due to the influence of taxation, moreover, extended from what usually is used to consider as long-term. Basically, this difference occurs only with regard to contracts that are under IFRS short-term: under Russian GAAP, they might also be perceived as long-term. The division between long- and short-term combined with the choice between sale of goods and rendering of services is exactly the point where IFRS and Russian GAAP mostly diverge with regard to revenue recognition, as it is seen from Figures 5 and 6. Under Russian GAAP, the key factor for being able to use percentage-of-completion method is, namely, the longevity of the contract, not the fact what kind of object the contract concerns. Under IAS 18, percentage-of-completion method can be used only in recognising revenue from rendering of services, not from the sale of goods, irrespective of whether the contract is long-term or not. In addition, according to IAS 18, completed contract method can not be used for recognising revenue from rendering of services whereas it is the only valid method for acknowledging revenue from sale of goods. According to PBU 9/99, completed contract method can be used for all contracts and especially for long-term contracts when the stage of completion of the project can not be determined. From the abovementioned differences derives also the following deviation between wordings of the standards: PBU 9/99 suggests the revenue recognition only to the extent of expenses incurred that are recoverable in every situation in which *revenue* of the contract can not be reliably estimated; IAS 18, on the other hand, requires it in connection with rendering of services and the use of the percentage-of-completion method if the *outcome* of the contract can not be reliably estimated. Other differences occur because of differing levels of specificity between the standards.

In general, it can be stated that under Russian GAAP transfer of legal title and documentation of the transfer play a more crucial role in determining the time of revenue recognition as under IFRS. Percentage-of-completion method can be used to recognise revenue from the sale of goods, rendering of services and completion of work with a long production cycle in accordance with PBU 9:13. However, the general conditions of PBU 9:12 for revenue recognition may prohibit the use of the method as the documentation attesting to the transfer of the legal title or acceptance of the service is, in general, demanded before it is possible to show revenue. In these cases, it is usually the contract that determines the accounting procedure. In addition, Krutjakova (2011) claims that normative documents of the financial accounting allow the company to treat also all other contracts the same way as construction contracts are treated, that is, to apply the percentage-of-completion method. Basically this possibility derives from the concession that the source accounting documents for recognising revenues, expenses and financial result can under percentage-of-completion method be formed by the company unilaterally, whereas the final act is written only once, at the end of the project. An enormous effect has also the accounting policy of the company: for example percentage-of-completion method can not be applied at all if it is not mentioned in the accounting policy. In principle, the accounting policy of the company determines how contract revenues are divided between accounting periods (The letter from the Ministry of Finance of the Russian Federation 5.2.2010 N 03-03-06/1/50).

The construction contract standards IAS 11 and PBU 2/2008 do not in principle differ from each other with regard to the basic guidelines, as it comes clear from the Figures 5 and 6. Both standards demand the use of the percentage-of-completion method in recognising revenue and if the outcome of the contract can not be estimated reliably, revenue should be recognised only to the extent of contract costs incurred that will be probably recoverable. However, the Russian standard does not describe all the matters as thoroughly as IAS 11 does and in addition, leaves certain points unmentioned. First of all, PBU 2/2008 does not provide with any definitions of fixed price and cost-plus contracts although they are later mentioned in the standard. In addition, construction contract is not specifically divided into these two categories. Concerning combining and segmenting of contracts, slightly shortened conditions are required and the parts mentioning negotiations are entirely excluded from the Russian standard. Interestingly, as the starting point for revenue and expense recognition under a contract are mentioned the standards regulating organisation's income (PBU 9/99) and costs (PBU 10/99), although revenue may be recognised under PBU 2/2008 quite differently from PBU 9/99. Some differences to IFRS may occur from the rather incoherent specification of costs that relate directly to the specific contract and from the fact that PBU 2/2008 does not classify at all costs that can not be attributed to contract activity or allocated to a contract. Furthermore, PBU 2/2008 does not discuss the treatment of losses at any point.

All in all, the most interesting difference between the standards PBU 2/2008 and IAS 11 relates to the definition for the word long-term, that is, to a key concept of construction contract accounting. Under IFRS, construction contracts are long-term contracts in which the date at which the contract activity is entered into and the date when the activity is completed usually fall into different accounting periods. Under Russian GAAP, construction contracts are long-term contracts *or* contracts in which the date at which the contract activity is entered into and the date when the activity is completed fall into different accounting periods. Basically this does not change the conditions based on which a construction contract is defined because also IAS 11 Objective contains the word *usually* in discussing the longevity of the contract and because in practice, the object and nature of the contract activity is a much more important indicator of whether a contract belongs to the scope of construction contract accounting.

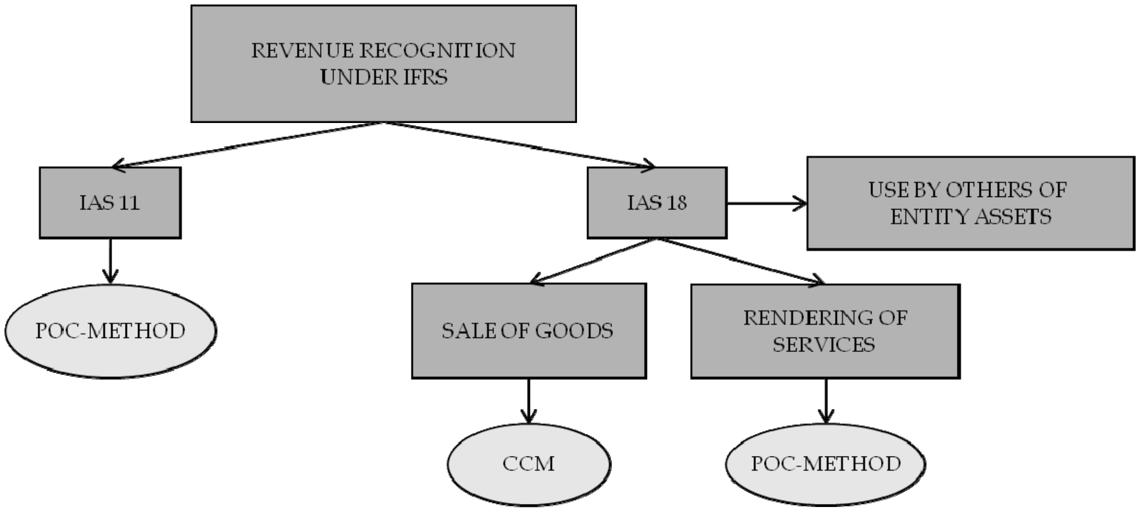

FIGURE 5 Revenue recognition under IFRS

One challenge between Russian GAAP and IFRS is the timing difference in recognising revenues and expenses into a right accounting period. Group reporting should usually be ready already in January whereas in Russia the books can be closed only in March. The gap results partly from the strict documentation requirements of Russian accounting: it can take a while until all the vouchers of the year's expenses are at hand and postings can be made. This can lead to a situation where revenues and expenses of the accounting period in group reporting and local accounting do not match with each other. In terms of expenses, the situation is described in the sub-chapter 4.2.3. The same challenge can be related to revenues, especially from rendering of services if the Russian company uses cash basis in recognising them. (Matilainen 2010.)

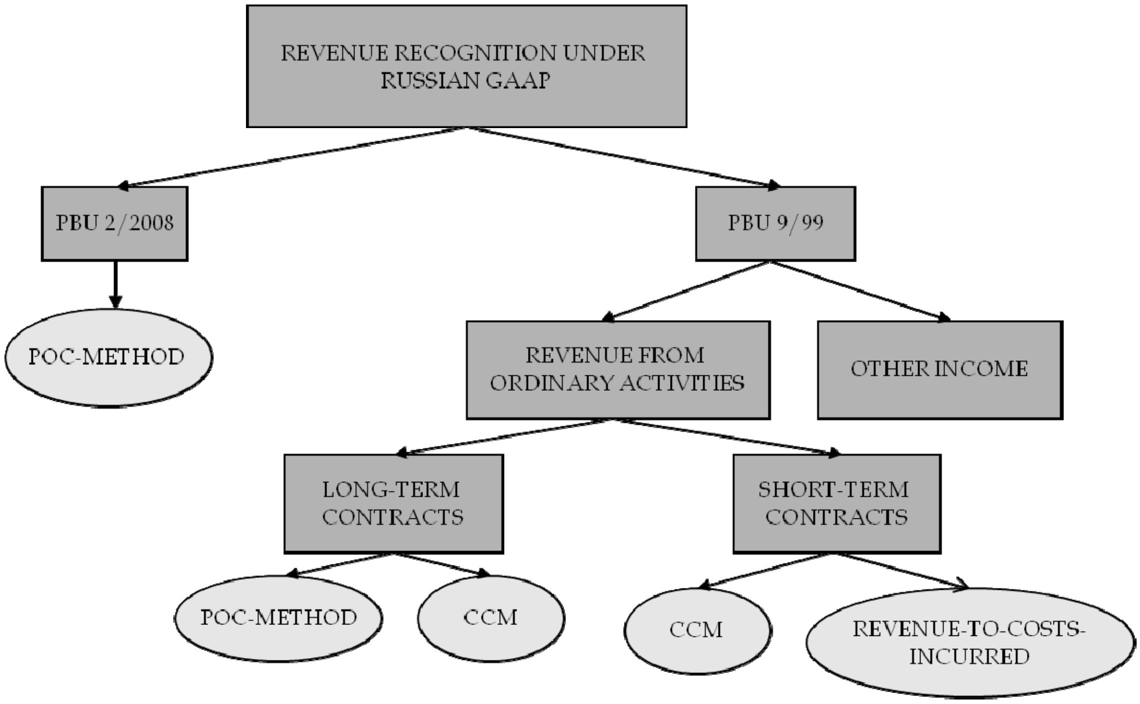

FIGURE 6 Revenue recognition under Russian GAAP

However, maybe the trickiest problem with regard to revenue recognition deals with the definition whether a contract belongs to the scope of application of PBU 9/99 or PBU 2/2008, how the treatment of long-term contracts actually differs between these two standards and how do these regulations connect with IFRS. These questions are reviewed closer in the empirical part, chapter 6 of the research.

5 RUSSIAN TAX ACCOUNTING

5.1 Overview of the Russian Taxation

In the Soviet Union, the predecessor state to Russia, economy was based on state ownership and administrative planning. The USSR with its centrally planned economy was meant to be the first state ever without taxes, thus there existed in practice no real taxation system. Companies were not actually taxed; they rather transferred certain residual amounts of financing back to the centre. (Hellevig & Usov 2006, 11.)

Due to this historical background, the first taxation system created in the Russian Federation in the early 1990's – after the downfall of the USSR – took shape through ad hoc adoption of laws and regulations, not within a unified system. In 1990's the laws regulating taxation kept changing frequently. Lack of clear provisions for norm hierarchy and of statutory rules defining the authority of various governmental bodies led to serious flaws in the legal protection of the taxpayer. However, the need for a tax system suitable for a market economy was so strong that in less than ten years, Russia has managed to establish a fairly transparent and modern taxation system based on the Russian Tax Code, and at the same time to abolish a mass of unnecessary and unprofitable taxes. (Hellevig & Usov 2006, 11-12, 18.)

As some of the advantages of the Russia tax laws can be counted a flat 13% personal income tax rate, Corporate Profit Tax rate of 20%, wide benefits for small and medium businesses and the fact that burden of proof lies with the tax authorities, not with the tax payer. Among improvements for investors, Russia now has the lowest corporate tax rate of any G8 or BRIC country (PwC 2010b, 20). Furthermore, in most of the cases courts have ruled in the favour of the taxpayer. The biggest problems related to the Soviet past are the heavy administrative burden, red tape and bureaucracy that the taxpayers are subjected to. As for implementation of the tax laws, the major obstacle for long has been the underdeveloped judicial system. Even the judges in the Constitutional Court seem to lack knowledge and experience of the market economy in order to be able to provide for needed justice and fair decisions. (Hellevig & Usov 2006, 12-14; PwC 2010b, 69.)

5.1.1 The Tax Code

The Russian Constitution states that "all are obliged to pay legally established taxes and duties". Besides this highest norm on taxation, the Constitution sets that new taxes and adverse changes to taxes can not be applied retrospectively. Taxation is further regulated in the Tax Code which is intended to become the only piece of legislation regulating taxation issues. (Hellevig & Usov 2006, 15.)

The Tax Code of the Russian Federation consists of two parts. The first one was promulgated in 1998 and entered into force on 1 January 1999. During the transition period, until 2005, the old Law "On the Fundaments of the Taxation System in Russia" acted as a concurrent regulation. The first part of the Tax Code presents the general tax principles, as well as rights and obligations of tax payers and tax authorities, taxes payable and other rules. The second part of the Tax Code introduces and describes all the individual taxes separately and completely. First taxes under Part II, including the Value Added Tax and the Personal Income Tax, were adopted in 2000 and entered into force in 2001. Today basically all taxes are included in the Tax Code, though amendments are still introduces at a high frequency. The Tax Code defines with relation to each separate tax, at least, the object of taxation, the tax base, the tax period, the tax rate, the rules for calculating the tax and the procedure and time for payment of the tax. (Tax Code; Hellevig & Usov 2006, 15, 21-22.)

The Tax Code introduces the legal principles for Russian taxation. Some of them are quite valuable for the protection of the taxpayer, even compared to the principles of other tax systems in Europe. In principle, at the legal level the taxpayer is better protected than for example in Finland. The taxpayer has, among others, the right to receive from the Ministry of Finance and subordinate financial agencies explanations and instructions on implementation on tax laws and rules not to mention the fact that the burden of proof in relation to tax offences is left to the tax authorities. Altogether, the improved legal protection of the taxpayer has been a major factor in establishing a transparent tax system in Russia. (Hellevig & Usov 2006, 20, 25.)

5.1.2 Tax System and Administration

The Russian tax system is relatively new and therefore a rapidly developing area with new concepts and issues emerging in a constant manner. The danger is that the new concepts introduced are often understood and interpreted differently from other countries and thus, the tax system may cause challenges to especially foreign organisations that are starting their operations in Russia. The tax reform is today almost completed as regards to the codification and simplification of regulative structure. The new transfer pricing legislation and concepts like profit tax consolidation are still at the planning stage. Furthermore, the fight against the aggressive tax evasion of companies continues. (PwC 2010b, 48.)

The Ministry of Finance controls the taxation; it has the overall responsibility for collecting state budget revenues and for setting tax policy, while its subordinate, the Federal Tax Service is responsible for collecting taxes. The Federal Agency for Economic and Tax Crimes under the Ministry of Internal Affairs also belong to the tax enforcement bodies by being responsible for investigating tax crimes. (Hellevig & Usov 2006, 23-24.) The Tax Code specifically mentions that the tax authorities have an obligation to follow the law and to treat the taxpayers with respect. In addition, the taxpayers are reminded of having the right to insist on the authorities' compliance with the law. (Tax Code 21-

23 §, 32-33 §.) These rather odd clauses describe the former lawlessness on the part of the authorities and the fact that those times have come to an end.

Each legal entity must register with the tax authorities in the place where the entity, its branch, representative office, other subdivision, immovable property or transport vehicles are located within one month after founding the branch or subdivision. A foreign legal entity is required to do the same in every location in which it operates through a subdivision if the period of its activity exceed 30 days cumulatively in a year. (Tax Code 83-84 §.) However, it should be remembered that the obligation to register presence does not necessarily equate the obligation to pay taxes, as registration itself does not create a taxable status of a Permanent Establishment (Hellevig & Usov 2006, 27).

The Russian tax system consists of three levels: federal, regional and local. All taxes are legislated at the federal level, but regional and local authorities have the power to set the rates and establish procedures for the taxes bringing revenues for their own budgets (Tax Code 12-15 §.). The set of Russian taxes are introduced below.

TABLE 2 Russian taxes (Tax Code 13-15 §)

Federal taxes	• Corporate profit tax • Value-added tax (VAT) • Excise taxes • Personal income tax and Obligatory Social Insurance Contributions (that formally remain outside the Tax Code) • Mineral resources extraction tax • Payments for the use of natural resources • Water tax
Regional taxes	• Property tax • Transport tax • Tax on gambling
Local taxes	• Land tax • Individual property tax

Taxes, duties and fees are enacted by law and must be changed by new legislation signed by the President. Thus, the law can not be changed and nothing can be added to it by any other norms unless the Code itself allows for this kind of subordinate legislation. The tax authorities' power extends only to the ability to issue forms for tax registrations, calculation of taxes and tax returns, as well as for determining the procedure for calculating certain items for the correct computation of taxes. Case law is not included in the Russian legal system, meaning that court rulings in principle do not bind companies in general. However, rulings and guidance issued by the Supreme Arbitrazh Court and the Constitutional Court have a significant influence on the approaches taken by taxpayers and tax authorities. There are a couple of special tax regimes in force; for example small companies are allowed to comply with the simplified system of taxation (Hellevig & Usov 2006, 16, 19; PwC 2010b, 49.)

By the end of 2009, Russia had signed and ratified 78 double taxation treaties that typically decrease withholding taxes on interests, dividends and royalties. Under the Tax Code, subject to withholding income tax is the income received by a foreign legal entity and not attributed to a Permanent Establishment in Russia. For example, instead of 15% tax rate on dividends from participation in Russian enterprises with foreign investments, the double taxation treaty with Finland defines a tax rate for dividends of either 5% or 12%. Furthermore, interest and royalties from Russian sources are, according to the treaty, tax-exempt contrary to 20% withholding tax without the bilateral treaty. In addition, the treaty between Finland and the Russian Federation specifies construction site duration of 12 or, for particular types of construction work, 18 months in which the constructor does not fall subject to taxation in Russia. (PwC 2010b, 49-50, 69-70.)

Tax returns are to be filed with the tax authorities separately in respect of each tax payable on a monthly, quarterly or annual basis depending on the tax in question and the company's field of business (Tax Code 80 §). The taxes due are calculated and paid independently by the taxpayer. Tax returns are desk-audited by the tax authorities when submitted. The authorities also have the right to regularly perform field audits of companies. They should not last more than two months (in some cases four or six months) and may cover only three years prior to the year of audit. (Tax Code 87, 89 §.)

Penalties for a variety of tax violations including underpayment of taxes, late filing of a tax declaration and failure to supply tax authorities with the required information are, as well, established by the law. If the taxpayer applies for clarification of Tax Code rules to the Ministry of Finance or the tax authorities and follows the clarifications, it will be relieved of fines or late tax payment interests. Tax disputes that most of the companies operating in Russia face at some point can be resolved either at pre-trial (administrative) stage or in court. Starting from 2009, it came mandatory to first appeal to a higher tax authority before going to court. If dispute is not solved at the first stage, a taxpayer can file a claim with an arbitrazh court within three months after a decision comes into force or after the taxpayer discovers that his rights were violated. (Hellevig & Usov 2006, 35; PwC 2010b, 50-51.)

5.1.3 Situation in 2010

During tax audits of the financial year 2009, the main focus was pointed on activities of company's counterparties. In particular, the application of the bona fide taxpayer concept to contractors was an issue of particular interest to the tax authorities. (Ernst & Young 2010, 8.) Ernst & Young Russia's Tax Survey 2010 (2010, 3-6, 25) showed that 63 % of the companies participating in the survey were charged with additional tax liabilities as a result of tax audits performed during 2009, mostly related to profit tax and VAT. The reasons for these additional charges were mainly insufficient economic justification and documentation of transactions. Other grounds for additional profits tax charges were deduction of expenses in the "wrong period", deduction of expenses over the limits established by tax legislation, deduction of expenses that did not relate to the business of the company and non-inclusion of income in the profit tax base. The deductibility of expenses can be thus seen as one of the most challenging issues of Russian tax legislation and tax administration. Currently Russian tax legislation provides for a rather long list of limited and/or non-deductible expenses, which is considered to be unreasonable and outdated.

On the other hand, there was also a significant decrease in the number of tax disputes and tax-related litigation cases, presumably because of the change in tax law introduced starting from 1 January 2009, according to which a taxpayer is required to appeal to a higher tax authority before going to court. However, of the decreased number of tax-related cases in the court, now a significantly smaller part (67% in 2009 in comparison with 89% over the prior three years) resolved in the favour of the taxpayer. (Ernst & Young 2010, 3-6)

Generally the Russian tax regime is seen to have a negative impact on investment. The most undeveloped areas in tax authorities' performance are, according to respondents of Ernst & Young Russia's Tax Survey, form over substance -oriented approach and lack of independence. In this respect, a constant concern is that sometimes political factors dictate the tax authorities' actions and court rulings. The most wanted measures to be taken in the sphere of Russia's tax regime were simplification of tax laws and tax accounting, as well as improvement of tax administration. In particular, simplification of the procedure of VAT calculation, simplification of documentation requirements, extension of the list of deductible expenses and clarification of transfer pricing rules were pointed out as major development areas. (Ernst & Young 2010, 3, 15. 24-25.)

Russian tax legislation and tax administration are still in constant motion. One of the biggest changes in tax legislation to come in the near future is the new transfer pricing law. The new law is expected to have a major influence on transfer pricing policies and documentation of companies operating in Russia. (Ernst & Young 2010, 20.) As a conclusion it can be stated that companies face increased attention to taxation matters not only due to the ambiguity of tax legislation and scrutiny by tax inspectors, but also as a result of constant changes in tax legislation and changes in the interpretation of tax law by the tax authorities. Also the fact that businesses in Russia are still growing rapidly may contribute to an organization's tax risk as an internal factor. Interestingly, the compliance of tax accounting with Russian GAAP and international accounting requirements was not seen anymore as a major challenge, even though companies in Russia often have difficulties in adopting the tax accounting requirements of international standards. (Ernst & Young 2010, 32-33.)

5.2 Profit Taxation

In the Russian corporate tax system, corporations and their shareholders are taxed separately. The profit tax rate is, at maximum, 20% but it can be reduced to 15,5% by regional authorities. The rate is applicable to all types of income except for dividends and interest from state securities. (Tax Code 284 §.) As a Russian tax resident is considered every company incorporated in compliance with the laws of the Russian Federation. There stands a distinction between resident legal entities which pay tax on their worldwide income and foreign legal entities which pay profit tax on income attributable to a Permanent Establishment (PE) in Russia and which are subject to withholding tax on other income from Russian sources not related to a Permanent Establishment. (Tax Code 246 §; PwC 2010b, 52, 54.) The object of profit taxation is the realised income reduced by the amount of economically justified expenses (Tax Code 247 §).

Tax accounting was separated from financial accounting in 2002 when the new Profit Tax Law (Chapter 25 of the Tax Code) was adopted. Before that, the object for taxation was the residual profit calculated according to financial accounting rules and directed towards the narrow interests of tax authorities. Now the law is in terms of basic concepts and rules in line with Western practice. From the year 2002 onwards, separate tax ledgers have been required to be maintained as taxable income has differed from the income shown in statutory accounts. (Hellevig & Usov 2006.)

Profit tax liability is to be defined in connection with every financial statement in which it should also be documented (Matilainen 2010). The accounting period is the calendar year. As reporting periods for profit tax are recognised every quarter of the calendar year unless the company calculates monthly advance payments, in which case the reporting period is every month of the calendar year. (Tax Code 285 §.) Profit tax is paid in monthly, quarterly or annual instalments, with a final adjustment made when annual tax returns are filed. The choice is of the company: profit tax may be calculated monthly (with monthly advance payments calculated based on the actual profit received) or quarterly with equal monthly advance payments calculated from the profit received during the previous quarter. (Tax Code 287 §.) The final payment of the year is due by 28 March of the following year (Tax Code 289 §).

The tax base is calculated on an accrual basis, though small companies are still allowed to use the cash basis. It is defined as the amount taxable or deductible for tax purposes according to the Tax Code (Ernst & Young 2009, 23). The total profit tax expense is the sum of current tax expense (or recovery) plus all of the changes in deferred tax liabilities and assets during the period. Current tax represents only the amount of profit tax payable in respect of the taxable profit for a period. Any profit taxes recoverable are recognised but can not be included in current tax. (KPMG 2005, 85.)

5.2.1 Revenue recognition

In defining the tax base for profit taxation, taken into account are income from sales and non-sale income. Incomes are defined on the basis of source and other accounting documents as well as tax accounting records. (Tax Code 248:1 §.) Income from sales, in other words, revenue, includes revenue from sale of commodities (works, services) of both own manufacture and of those acquired from elsewhere, and sale of property. These revenues shall be recognised in compliance of either Article 271 (accrual method) or 273 (cash method) depending on the choice made by the taxpayer. (Tax Code 249:1 §.) Article 250 contains a list of receipts subsumed under non-sale income.

There are certain types of income that are exempt from the profit tax. The purpose of the closed list in Article 251 of the Tax Code is to especially exclude financing items from the group of taxable income. The list comprises, for example, of:

- income in the form of property from a parent company that owns over 50% of shares in the receiving party, or from a subsidiary of which the recipient owns over 50% of shares;
- advances received (under accrual method);
- loan receipts or repayments;
- income from revaluation of fixed assets and securities;
- income in the form of property received as a contribution to the charter capital;
- special-purpose financing and other special-purpose receipts such as grants, funds received from the state budget, ownership contributions, donations. (Tax Code 251 §.)

In Russian taxation, revenues are recognised in accordance with accrual method, that is, in the reporting (tax) period in which they occurred, regardless of the actual receipt of funds or other assets (services) (Tax Code 271:1 §). Small companies are allowed to use the cash method for tax accounting purposes (Tax Code 273 §). Tax Code requires, along with financial accounting, transfer of legal title or transfer of results of work or service performed to take place before realisation of goods, works or services and subsequently, revenue recognition can happen. Place and date of actual sale of goods, works or services is determined in accordance with the second part of the Tax Code in connection with each individual tax. (Tax Code 39:1-2 §.) The Article 271:3 concerning revenue recognition within the profit tax law states that for the income from the sales, unless otherwise provided by the chapter, the date of receipt of income is the date of the sale of goods, works or services, as determined in accordance with paragraph 1 of Article 39 of the Tax Code. Basically, this signifies that without relevant documents attesting to the transfer of legal title, the company has no grounds for recognising revenue from sale of goods or rendering of services, except in case of products and services of long technological cycle as told in the next paragraph. As a relevant document is accepted an act that proves the delivery of the good or service and that is signed by both the company and the client. Hence, revenue can be recognised only in the period in which the act was signed by the client regardless of the actual completion of the sale of goods, work or rendering of services. (Krutjakova 2010.)

Revenue from long-term contracts is recognised as follows:

> "For long technological cycle (over one tax period) production facilities, if contract conditions do not require delivery of work (service) in phases, income from the sale of the said works (services) shall be distributed by the taxpayer at the taxpayer's own discretion in compliance with the principle of expense formation for the said works (services)." [Translated from Russian]

The clause seems to correspond with the percentage-of-completion method described earlier. Furthermore, it is stated that if the relationship between income and expenditure concerning a long-term contract can not be clearly defined or it is determined by an indirect method, revenue related to multiple reporting (tax) periods is distributed independently by the taxpayer, taking into account the principle of uniformity in the recognition of revenues and expenses (Tax Code 271:2 §). Thus, the latter method corresponds to revenue-to-costs-incurred method introduced in chapter 4 in connection with construction contract accounting. Furthermore, the principle of even income recognition seems to be universally applicable concerning long-term contracts based on Article 316 of the Tax Code. As a matter of fact, for example the letter from the Ministry of Finance of the Russian Federation 5.2.2010 N 03-03-06/1/50 attest that with regard to contracts with long production cycle, the company is obliged to divide revenue recognition into all of the tax periods the contract touches if there are no stages defined in the contract, irrespective of the timing of actual payments received from the client.

As already mentioned in sub-chapter 4.2.1, the letters from the Federal Tax Service 28.11.2008 N 19-12/111003 and from the Ministry of Finance of the Russian Federation 13.10.2006 N 03-03-03/4/160 state that a contract with long production cycle comprises also situations in which the start and end dates of the contract fall into different tax periods regardless of the amount of actual days the project has lasted. The principles and methods according to which contract revenues are divided between accounting periods are to be defined by the accounting policy of the organisation. In addition, the demand for this division touches works and services of all kind. (Tax Code 316 §; The letter from the Ministry of Finance of the Russian Federation 5.2.2010 N 03-03-06/1/50.)

In practice, revenue recognition of construction and other long-term contracts seems to take place in stages: revenue is recognised as a detailed part of the contract is delivered from contractor to customer (Seppänen 2010, 20). This corresponds with the clause 271:2 and shows that in general, contracts include some kind of division of phases according to which completed work or service is then delivered and revenue recognised. When phases are included in the contract, there is no possibility to use percentage-of-completion method in acknowledging revenue.

To conclude, there is one method to recognise revenue from short-term contracts and three possible methods to recognise revenue from long-term contract (Figure 7). If the contract includes stages, that is the obvious choice for revenue recognition. Percentage-of-completion method is used if there is the possibility to identify contract expenses for the period, but not necessarily the contract revenue. Presumably, the company should also be able to define the stage of completion of the contract. If the relationship between revenues and expenses and thus, the outcome of the contract, can not be clearly defined, the contract revenue is divided over the contract period by a method defined by the taxpayer independently. In this case, the most appropriate way is to recognise revenue to the extent of expenses incurred. Lastly, the principle of even recognition of revenue is applied if expenses of the contract are expected to incur evenly over the contract period, for example, with regard to some maintenance contracts or public services. (Davydova 2010.)

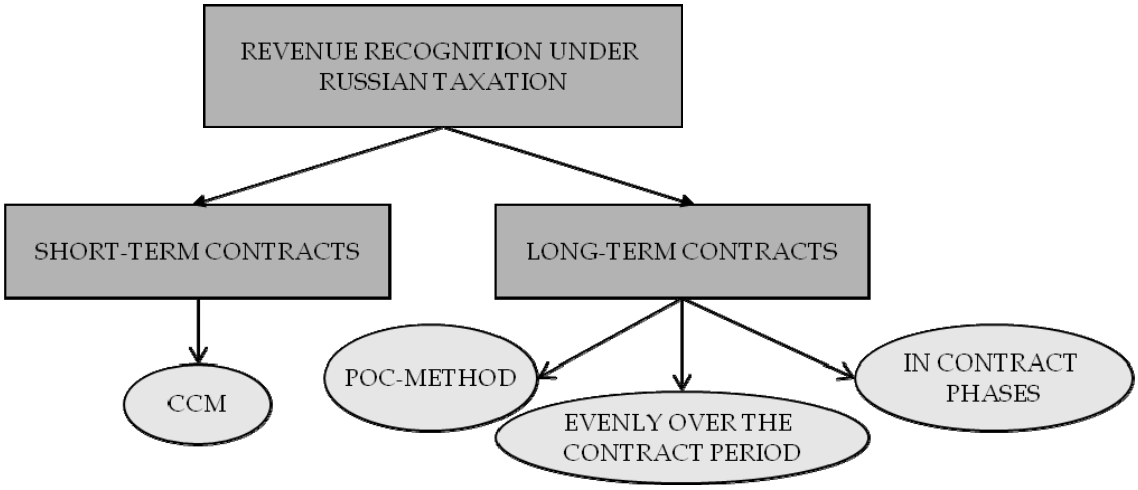

FIGURE 7 Revenue recognition under Russian taxation

5.2.2 Expense recognition and deductibility

Expenses are, in general, recognised on the accrual basis. As for revenues, small-scale business is able to recognise expenses also according to the cash method (Tax Code 273 §). The deductibility of expenses requires that the expense is

- incurred in the course of an activity that generates income,
- properly documented, and
- not defined as non-deductible for tax purposes in the Tax Code. (Tax Code 252:1 §.)

Expenses can be divided into expenses involved in production and sales, and into non-sale expenses. If certain expenses could be included on equal ground in several groups of expenses, the company should self decide among which group expenses are to be counted. (Tax Code 252:2, 4 §.) In expenses related to production and sales are included material expenses, labour expenses, depreciation charged and other expenses (Tax Code 253:2 §). The quite extensive list of other expenses is presented in Article 264.

In addition to expenses intentionally committed by the company as deductible, also losses such as those of past tax periods identified in the current reporting period, bad debt losses, those due to stoppages in the production and many others brought about by unfortunate circumstances are considered deductible (Tax Code 254:7 §, 265:2 §). The Tax Code introduces also the possibility to form reserves for at least bad debts (266 §), warranty costs (267 §), devaluation of securities (300 §), expenses on repair of fixed assets (324:2) § and for future holiday pay of employees (324.1 §). Losses from previous tax periods can be carried forward for ten years meaning that they can be used to offset the taxable profit before a loss carry-forward deduction (Tax Code 283 §).

The list of non-deductible expenses in the Tax Code contains, for example, the following items:

- cost of assets transferred free-of-charge;
- penalties paid to the Russian state budget;
- allowance accrued in financial accounting for revaluation of fixed assets and securities;
- negative margin between nominal and market prices of securities;
- certain types of insurance expenses;
- voluntary membership fees or contributions to unions, associations and organisations;
- any types of employee remunerations not mentioned in employment contracts;
- travel expenses by public transport to and from a place of work unless stipulated in employment contract or considered as expenses of production and sales of goods, works, services;
- expenses for personal services or goods for the use of employees;
- some other expenses. (Tax Code 270 §.)

Noticeable is that many of the non-deductible expenses are associated with employees. Hellevig and Usov (2006, 102) claim that the fact that almost all deductible employee-related expenses are still to be stipulated specifically by employment agreements, instead of being just properly supported by documents in the form accepted by the Tax Code, is just a hangover of the earlier Russian tax legislation. Furthermore, expenses like representation expenses, certain types of advertisement expenses and interest on loans are only restrictedly deductible. (Tax Code 270 §.)

In Russia there are still quite a lot non-deductible expenses that increase the effective tax rate and lead to the situation in which the calculation formulas of tax liabilities do not work. Thus, a company pays more taxes than could be expected just on the grounds of the profit in statutory accounts. (Matilainen 2010.) Hellevig and Usov (2006, 84) claim that the remaining restrictions in the deductibility of expenses tend to be of an anti-avoidance nature, that is, in place to prohibit the withdrawal of profit in the form of expenses or payment of salary and other related compensation in the form of other business expenses.

The Tax Code (252:1 §) states that expenses recognised in taxation should be justified and documented. A connection between the expense and corresponding income is stressed. It should, however, be noted that the Tax Code does not require to prove the linkage between income and expenses in order to be able to deduct the expenses; that is, the sources of income and expenses may differ from each other. (Hellevig & Usov 2006, 84, 89.) As documented expenses are seen expenses, confirmed by documents executed in accordance with the Russian legislation, by documents in accordance with business practice applicable in a foreign country in whose territory the expenses were incurred or by documents confirming the incurred expenses in a collateral way (including among others customs declaration and travel documents) (Tax Code 252 §). Hence, documentation plays a crucial role in the deductibility of expenses. For example, employee remunerations such as salary payments and bonuses are deductible only if they are mentioned in employment contracts. Incorrectly prepared documents can lead to the denial of the right to deduct expenses or to the imposition of sanctions. The expense deductibility can be jeopardised even with inexact wording in an agreement or invoice. (Hellevig & Usov 2006, 30.) Considering that tax authorities are easily able to disqualify improperly recorded transactions, it should not be wondered that accounting is claimed to be done merely for the purposes of taxation.

5.3 Comparison of Revenue and Expense Recognition between Financial and Tax Accounting

Treatment differences concerning contracts in financial and tax accounting derive mainly from two sources: different methods of revenue recognition and non-deductibiliy of certain expenses in taxation.

Both financial and tax accounting demand recognition of revenue in accordance with the accrual method. Furthermore, both PBU 9:12 and Article 271:3 of the Tax Code state that the transfer of legal title or acceptance of the service performed plays a significant role in the ability to recognise revenue and actually, without relevant documents, the company has no grounds for recognising revenue from sale of goods or rendering of services. As a relevant document is accepted an act that proves the delivery of the good or service and that is signed by the client. Hence, it seems that both in financial and tax accounting revenue can be recognised only in the period in which the act was signed by the customer regardless of the actual completion of the works. (Krutjakova 2010.) This, also considered as a normal, way of recognising revenue applies especially to short-term contracts both in financial and tax accounting.

An exception is formed by PBU 2/2008 regarding construction contracts combined with Article 271:2 of the Tax Code concerning contracts of long production cycle. PBU 2:17 accepts percentage-of-completion method congruent with IFRS as the revenue recognition method with regards to construction contracts if certain conditions are met. Respectively, Article 271:2 of the Tax Code allows a company to recognise revenue for long-term contracts in compliance with the principle of expense formation for the works (services) performed, that is, in compliance with percentage-of-completion method, unless the work or service is to be delivered according to specific phases stated in the contract. The principle of even recognition of expenses over the contract period is also allowed but not seen here as the most appropriate method due to its different recognition logic to percentage-of-completion method. Therefore, a difference between financial and tax accounting in recognising revenue occurs if stages are included in the contract. Namely, in tax accounting percentage-of-completion method can be used only if there are no stages mentioned in the contract, whereas in financial accounting, the method is obligatory for contracts of all kinds.

A slightly more complicated situation arises from the sale of goods, rendering of services and completion of work with a long production cycle in accordance with PBU 9:13. The article of the standard allows the company to choose between completed contract method and percentage-of-completion method in financial accounting. On the other hand, Article 271:2 of the Tax Code lets us understand that revenue under any kind of long-term contract, in other words, under also other than construction contracts has to be recognised in compliance with the percentage-of-completion method if the contract does not include specifically defined stages for signing of the acts and if the relationship between income and expenditure concerning the long-term contract can be clearly defined. Applicable is also the even method for revenue recognition over the contract period but as with regard to construction contracts, it is not seen as the most reasonable way to recognise revenue as it deviates remarkably from the methods introduced in financial accounting. However, the general conditions of PBU 9:12 for revenue recognition may prohibit the use of the percentage-of-completion method as the documentation attesting to the transfer of the legal title or acceptance of the service is, in general, demanded before it is possible to show revenue. With this situation correspond the stages stated in the contract defining the transfer of the legal title or acceptance of the service and thus providing for the revenue recognition. Despite the small inconsistencies regarding this case, Krutjakova (2011) claims that normative documents of the financial accounting allow the company to treat also all other contracts the same way as construction contracts are treated, that is, to apply the percentage-of-completion method.

To conclude, there are two options for harmonising the financial and tax accounting of a project in respect of PBU 9/99, PBU 2/2008 and Article 271:2 of the Tax Code:

- To require in the contract monthly or quarterly delivery of the work completed based on acts (forms KC-2 and KC-2 regarding construction contracts) that indicate the stage of completion of the work;
- Not to use stages in the contracts, but to define in the accounting policy uniform methods for revenue recognition in financial and tax accounting.

In the first option, under PBU 2/2008 the requirement to use percentage-of-completion method is fulfilled by the fact that revenue is recognised in compliance with the stage of completion defined in the contract and thus, shown in financial and tax accounting at the same amount. In the second option, the uniform method refers to percentage-of-completion method as understood under IFRS. (Krutjakova 2011.) Naturally, it is possible to use completed contract method in financial accounting (under PBU 9/99, not PBU 2/2008) and then be obliged to calculate the tax base using percentage-of-completion method as there are no stages defined in the contract, or apply percentage-of-completion method in financial accounting (both under PBU 9/99 and PBU 2/2008) and recognise revenue in stages in tax accounting if the contract terms require so. However, these kinds of combinations, if anything, just complicate the accounting procedure and are thus rarely suggested.

In financial accounting, all regular expenses are taken fully into account when calculating the profit/loss for the reporting period. These expenses include among others business travel expenses, advertisement expenses and payments made under insurance contracts which may, however, under the Tax Code be defined as non-deductible. Hence, in order to calculate profit for tax purposes, adjustments to some of the expenses are needed as taxation does not accept certain expenses as deductible. Same principles apply to project accounting. In financial accounting, a company is self able to define in its accounting policy which expenses belong to direct and which to indirect expenses on account 20. Thus, all the expenses on the account are automatically part of project expenses, while expenses on accounts 91.2, 26 and 44 (if certain criteria are not met) are included in overhead expenses. These divisions, however, have, or should have, no connection with deductibility of expenses under tax accounting. Thus, even direct expenses on account 20 could basically be non-deductible in tax accounting. In practice, this kind of situation would hardly come true. This conclusion stems from the history of Russian accounting. Namely, account 20 used to contain only absorption costs that were always deductible in taxation. (Takala 1999.) Entering other than deductible costs to the account may still be a difficult task for accountants.

6 CASE ANDRITZ RUSSIA

6.1 Andritz

Andritz Group is a global supplier of customized plant, systems and services. The Group, with approximately 14 700 employees worldwide, focuses on the following business areas: Hydro, Pulp & Paper, Metals, Environment & Process and Feed & Biofuel. It develops and makes its high-tech systems at production and service sites all around the world. The parent company of Andritz Group, Andritz AG, is a publicly held company headquartered in Graz, Austria. It usually owns its subsidiaries fully with 100 % holding. The group produces financial statements in compliance with IFRS, as listed companies are required to do in the European Union.

Andritz OY is a 100 % owned Finnish subsidiary of Andritz AG. Its business area is limited to Pulp & Paper. Pulp & Paper provides technology and services that enable the industry to produce practically all grades of pulp for the manufacture of paper, board and fibreboard, and also specialised machines for tissue production. On the Russian market Andritz OY collaborates quite a lot, especially during big projects, with the Russian company Andritz LLC that is also 100 % owned by Andritz AG. LLC was founded in 2001 as an extended arm of Andritz OY, is managed by a Finnish President and it also has other Finnish employees, which further explains the link between the companies.

LLC in the name refers to a limited liability company, a form of business entity in Russia. Basic requirements for foundation documents, name, location, governance and state registration of legal entities are governed in the Civil Code of the Russian Federation; the limited liability company is further detailed in the Federal Law No. 14-FZ of February 8, 1998 "On Limited Liability Companies". The limited liability company is established by one or several persons whose charter capital is divided into shares according to the formation documents. The liability of each participant is limited to the value of its contribution. (14-FZ.) With regard to this research, the limited liability company is not discussed more thoroughly. Moreover, in the research the abbreviation LLC states for Andritz LLC, OY for Andritz OY and AG for Andritz AG.

Andritz LLC is situated in St. Petersburg but has some branch offices dealing with capital equipment orders and plant service also in other locations of Russia. The company consists basically of two separate sections: Capital Equipment providing support for sales and order processing in the Pulp & Paper segment of the Russian market, and Service. Thus, it hosts two types of activities: on one hand it supports other group companies in the form of, for example, marketing services and on the other hand, executes projects as an independent company. Andritz LLC employs approximately 45 people. Both OY and LLC prepare their group reporting according to IFRS in which OY also assists LLC. Contrary to OY, LLC handles its day-to-day operative accounting in

1C-programme according to local rules instead of IFRS. IFRS reporting done in SAP for the group is converted from the local bookkeeping in the end of every month.

6.2 Project Accounting

The problem of the research is examined through projects. Basically this means that only project accounting is taken into account when considering the tax consequences of revenue recognition; all other revenues and expenses are ignored. The basis for a project is a contract between the seller (contractor) and the buyer (client), so basically the two terms of project and contract in the scope of the research correspond to each other. Thus, project accounting encompasses everything (revenue, costs) that has been specified in the contract concerning the object to be built or service to be rendered. All project related costs and revenues are connected to projects with a WBS-number created in SAP.

Andritz Group follows regulations of IFRS. Those regulations are articulated, as applied by the Group, in the IFRS Accounting Policy and Annual Financial Report. With regard to revenue recognition of projects not defined as construction contracts, the group accounting principles state the following:

> "Revenue [except for construction contracts] is recognized when it is probable that the economic benefits associated with the transaction will flow to the enterprise and the amount of the revenue can be measured reliably. Sales are recognized net of sales taxes and discounts when delivery has taken place and transfer of risks and rewards has been completed." (Andritz Annual Financial Report 2010, 39.)

> "Contracts other than construction contracts are valued at production costs. For these contracts, the revenue is recognized when the ownership of the goods is transferred ('completed contract method')." (Andritz Annual Financial Report 2010, 36.)

Respectively, construction contract accounting and hence, the percentage-of-completion method is explained as follows:

> "Receivables from construction contracts and the related sales are accounted for using the percentage of completion method. The construction contracts are determined by the terms of the individual contract, which are agreed at fixed prices. The extent of completion ('stage of completion') is established by the cost-to-cost method. Reliable estimates of the total costs and sales prices and the actual figures of the accumulated costs are available on a monthly basis. Estimated contract profits are recorded in earnings in proportion to recorded sales. In the cost-to-cost method, sales and profits are recorded after considering the ratio of accumulated costs to the estimated total costs to complete each contract. Changes to total estimated contract costs and losses, if any, are recognized in the income statement in the period in which they are determined. For remaining technological and financial risks which might occur during the remaining construction period, an individually assessed amount is included in the estimated contract costs. Impending losses out of the valuation of construction contracts are recognized immediately. Impending losses are recognized when it is probable that the total contract costs will exceed the contract revenues. For possible customer warranty claims, provisions are accounted for according to the profit realization. At the completion of a contract, the remaining warranty risk is reassessed." (Andritz Annual Financial Report 2010, 36.)

The importance of estimations is also recognised:

> "The accounting for construction contracts is based on estimations for costs and recoverable earnings. Although these estimations are based on all information available on the balance sheet date, substantial changes after the balance sheet date are possible. These changes could lead to adjustments of assets and may influence earnings in subsequent periods." (Andritz Annual Financial Report 2010, 41.)

Andritz Group has its own strategy for dividing construction contracts (and thus the use of percentage-of-completion method) from other contracts that demand the use of completed contract method. According to Andritz Group's internal policy, every project that has estimated revenue of over 1 million Euros has to be recognised in compliance with percentage-of-completion method. Revenue from other projects is recognised in compliance with the completed contract method.

> "In the Andritz Group, a contract is recognised as a construction contract applying the POC-method if its expected order value at the moment of order intake exceeds the equivalent of **1 Mio EUR**. A minimum duration to execute the order (from order intake to final acceptance) is not a criterion to apply the POC-method or not.
>
> If the contract value is below 1 Mio EUR but it is expected that it will be increased above this limit it is shown as POC-contract from the beginning (i.e. if an engineering order is expected to be increased to an equipment order).
>
> An order originally classified as a POC contract must be reclassified and accounted for under the completed contract method only if the expected order value materially declines to an order value below 1 Mio EUR by 30% or more.
>
> The limit of 1 Mio EUR is valid per customer contract: If a customer contract is split to various divisions only the total order value of the single contract is relevant for the application of the POC-method. For orders which are composed of several separate external contracts (delivery of different parts or by different reporting entities and each one having separate contracts) the 1 Mio EURO-limit per contract has to be applied strictly per contract." (Andritz Group IFRS Accounting Policy 2009, 29.)

As a matter of fact, the policy does not fully correspond with the regulations of IFRS and is done just to simplify the accounting procedure and the choice of the recognition method. It has to be remembered that in this case, the Group's regulations outdo what is written in the IFRS standards. The Group Accounting Policy is, in spite of all, accepted by the auditors and thus, minor deviations from the standards can be seen as acceptable. The examples of the following calculations are chosen in the way that does not create inconsistency between IFRS and the group policy. Diverging situations are, though, explained in an own subchapter 6.2.5.

In the following sub-chapters of the research, the project accounting of Andritz LLC is introduced both at local (1C) and group (SAP) level, that is, both in compliance with Russian GAAP and with IFRS. First, the current situation is presented in the form of calculations and detailed by accounts. Furthermore, possible scenarios for bringing closer the local and group reporting practices are introduced related to three different situations (projects). The tax consequences of each situation are discussed by reviewing the profit and loss statement on a yearly basis. Under IFRS, earnings before tax -figure basically corresponds with the amount of tax base from which the profit tax expense is calculated. The idea is to aim at the similar situation also under Russian GAAP. Balance sheet is not presented as the yearly tax base is calculated only through the profit and loss statement. This is the reason also for the fact that not all the accounts related to the project accounting, for example Accounts Payable, are necessarily showed in the calculations. In the calculations of Russian GAAP, usually no sub-account, except for accounts 90 and 91, or analytical records for the accounts are detailed. All long-term projects are determined to last for three years, during which the costs incur by the principle 15% / 50% / 30%, that is, 15% of the costs incur during the first year, 50% during the second year and 30% during the third year. 5% of the costs are to be realised in future periods. Forecasts for project costs do not change during the periods. As stage of completion and outcome of the projects is in every case definable, percentage-of-completion method in recognising revenue can be applied and is always an option both under IFRS and Russian GAAP and in Russian tax accounting. Furthermore, as project costs do never incur evenly over the contract period, except for maintenance contracts that are not discussed here, recognition of revenue in Russian tax accounting evenly over the contract period is not considered an option.

6.2.1 Project #1

The first project portrays the situation of project accounting of Andritz LLC at the moment. The long-term contract (3 years) in question relates to plant services within a pulp mill in Russia. Revenue of the contract is in the local financial accounting recognised according to the act that is signed by both the seller and the buyer. Usually the point of time of the recognition and the amount to be recognised as revenue is defined by the contract terms, the project manager and the actual proportion of the work completed. Russian GAAP does not consider the project as a construction contract but just as normal sales of services, which thus justifies the use of the revenue recognition in stages defined by the company itself. Likewise, the contract is not understood as a construction contract under IFRS. On the other hand, IFRS requires the use of percentage-of-completion method also concerning service projects and thus, in the group reporting, revenue of the project is recognised according to the percentage-of-completion method. The Group Accounting Policy defines projects such as this as construction contracts due to the sales price of over 1 million EUR. However, in this case the minor inconsistency between IFRS and Group Accounting Policy does not make any difference as the final outcome is the same. The standards reviewed in this case are IAS 18 and PBU 9/99. To summarise, the methods applied in the calculations are:

TABLE 3 Methods applied in Project 1

Service contract	Long-term over 1 Mio EUR
IFRS	POC
Group	POC
Russian GAAP	CCM/POC
Tax Code	STAGES/POC

The terms of payment of the contract are the following:

- 10% down payment on signing the contract,
- 60% progress billing on arrival of the site supervisor, and
- 30% on final acceptance.

Furthermore, the following budget has been specified for the project:

- Sales price 80 000 KRUB (approximately 2 000 KEUR)
- Planned costs 60 000 KRUB, including
  - working hours (engineering, supervision, management, assistant) 35 000 KRUB
  - subcontracting costs 11 000 KRUB
  - travel expenses 5 000 KRUB
  - materials for the work 4 000 KRUB
  - rents (office and apartments) 3 000 KRUB
  - office supplies 100 KRUB
  - external services (post, other) 1 850 KRUB
  - exchange losses 50 KRUB

There are no warranty costs estimated for the project. Only exchange losses, no gains, are born.

The project accounting in SAP is presented in Table 6. The principle is that accounts starting with number 1 belong to the assets of the balance sheet and accounts starting with 2 – to the liabilities of the balance sheet. Number 3 in the beginning of the account indicates a sales/income account and 4 – a cost/expense account. Calculations for the POC-sales and the IFRS part of the project look like this (amounts in kRUB, as in all the tables from now on):

TABLE 4 POC-calculations related to Projects 1 and 4

IFRS	YEAR 1		YEAR 2		YEAR 3		YEAR 4	
Incurred costs during the period	9 000	(15%*60 000)	30 000	(50%*60 000)	18 000	(30%*60 000)	3 000	(5%*60 000)
Reserve for unrealised costs	-		-		3 000	(5%*60 000)		
Received payments from the client	8 000	(10%*80 000)	48 000	(60%*80 000)	24 000	(30%*80 000)		
Stage of completion	15 %	(9 000/60 000)	50 %	(30 000/60 000)	35 %	(21 000/60 000)		
POC-sales	12 000	(15%*80 000)	40 000	(50%*80 000)	28 000	(35%*80 000)		
POC-receivable	4 000	(12 000-8 000)	0		0			
POC-liability	0		4 000	(56 000-52 000)	0			

The project starts in 2008. First of all, a down payment request for the first instalment (10% on signing the contract) is sent to the client. A note is created in the sales ledger but no G/L posting is yet made. 13.12.2008 the first down payment is received from the client and also G/L postings are created. In the end of the period, project costs on account 410000 encompass 9 000 KRUB (15%*planned contract costs) following the plan for the accrual of costs. Note that no A/P account is used in the calculations. Thus, project costs are always presented at the end of the period on account 410000, and the bank account shows only the cash flow from the client to the company.

SAP comprises POC-sales by comparing planned and actual costs. First, the stage of completion has to be calculated by dividing incurred costs of the period by planned costs of the project (9 000 KRUB/60 000 KRUB). The amount of POC-sales is then formed by multiplying the stage of completion percentage with the planned sales price of the project (15%*80 000 KRUB), which leads to the posting deb 310000 "POC-method adjustment to sales" cr 115000 "A/R (Revenue) from POC contracts". The profit and loss statement shows 3 000 KRUB profit before taxes. Now, as the amount of POC-sales (costs incurred plus gross margin recognised) exceeds received payments (progress billings) from the client, POC-receivable is created and shown on accounts 115000, 115300 and 115400. In the example, POC-receivable is the difference between the accounts 115000 and 115300/115400 (12 000 KRUB - 8 000 KRUB).

In the year 2009, the stage of completion and POC-sales are calculated similarly as in the previous period. However, it has to be noticed that calculations are based on period-specific numbers meaning that the total stage of completion is achieved by adding up the stages of completion in periods 2008 and 2009 (15%+50%). Now the progress billings from the client exceed costs incurred plus gross margin recognised (the total amount of POC-sales until the end of the period), and POC-liability, 4 000 KRUB, is shown on account 270000 "Revenue from POC contracts, liability, correction entry". The balance of account 115400 "A/R Progress Billing from POC contracts, liability, correction entry", corresponds with the balance of account 110900 "A/R External – Advance Payment Received". The period 2009 has EBT (Earnings before taxes) figure of 10 000 KRUB.

In the third period, year 2010, the client accepts the work and final billing is thus made possible. The total contract price is posted deb 110000 "Accounts Receivable" cr 300010 "Third Party Sales Revenue". Then received payments are allocated to the final invoice. Payment of the final invoice produces the same kind of postings as each earlier payment does, except for the use of Accounts Receivable -account instead of Advance payment received -account. Project is now considered finished and thus, no POC-sales are defined anymore but earlier postings are reversed as the project revenue is already shown directly on account 300010. The idea is that no balance is left on the accounts showing POC-sales during the lifetime of the project. In addition, a reserve for late project costs (deb 411330 "Change in late project costs" cr 250004 "Reserves for unrealised costs") has to be formed as it is known that 5% of the project costs are to be incurred in the next period and as the profit influence of the costs, because of the final acceptance of the project, fall to the period 2010, not to 2011. The reserve is reversed when the actual costs incur in the year 2011. Profit and loss statement of the year shows 7 000 KRUB profit before taxes.

In Russian accounting introduced in Table 7, no percentage-of-completion method is in use. Sales are produced only when an act is signed. The signature moment of the act is usually defined by the contract and/or the project manager.

The project starts by invoicing the client and by receiving the payment that is posted deb 51 "Bank account" cr 62 "Accounts Receivable". Next, project costs are debited to a variety of accounts that behave differently from each other in the end of an accounting period. The costs of the project are divided between accounts in following manner (slightly rounded):

TABLE 5 Division of costs between accounts in Project 1

	KRUB	Account Russian GAAP	% of the cost	YEAR 1	YEAR 2	YEAR 3	YEAR 4
Sales price	80 000						
Contract costs	60 000						
- Working hours	35 000	20	58,33 %	5 250	17 500	10 500	1 750
- Subcontracting costs	11 000	20	18,33 %	1 650	5 500	3 300	550
- Travel expenses	5 000	26	8,33 %	750	2 500	1 500	250
- Materials	4 000	20	6,67 %	600	2 000	1 200	200
- Rents	3 000	26	5,00 %	450	1 500	900	150
- Office supplies	100	26	0,17 %	15	50	30	5
- External services	1 850	26	3,08 %	278	925	555	93
- Exchange losses	50	91.2	0,08 %	8	25	15	3

Russian GAAP **Costs by account**	**YEAR 1**	**YEAR 2**	**YEAR 3**	**YEAR 4**
20	7 500	25 000	15 000	2 500
26	1 492	4 975	2 982	500
91.2	8	25	18	0
Incurred costs during the period	**9 000**	**30 000**	**18 000**	**3 000**

Account 20, "Main production unit", is used to summarise information on expenditures of the production unit whose products (works and services) constitute the purpose for which the organisation in question was established. Among these expenditures are counted mainly direct expenses associated directly with the manufacture of products, the performance of work and the rendering of services and indirect expenses associated with the management and support of main production. The balance on account 20 in the end of the month indicates the value of work-in-progress. (The Chart of Accounts 2000, 32-33.) Within this project, working hours, subcontracting costs and materials are defined as those direct expenses debited to account 20. At the end of the year 2008, they are, however, not yet written out of the account 20 because no sales are born, but left there to indicate the value of work-in-progress.

Travel expenses, rents, office supplies and external services are debited to account 26 “General business expenses”. The account is used to summarise information on expenses for management needs not directly associated with the production process. In particular, expenses such as administrative and management expenses, the maintenance of general business staff, rental payments for premises of a general business nature and expenses associated with auditing, consulting and other similar services belong to the scope of the account. At the end of a period, period expenses are debited from account 26 to account 90. (The Chart of Accounts 2000, 38.) The sub-account for period end postings from account 26 is 90.8 representing the final amount of administrative expenses at the end of the period. The debit amount of 90.8 is still debited to account 90.9 “Profit/loss from sales” from which the profit/loss from sales of the period is transferred to account 99 “Profits and losses”.

Exchange rate differences, as well as, among others, interest expenses, losses of previous years recognised in the accounting year and amounts of bad debts are recorded on sub-account 91.2 “Miscellaneous expenses”. The debit balance of account 91.2 is compared monthly with the credit balance of sub-account 91.1 “Miscellaneous income” to determine the balance of miscellaneous income and expenses for the accounting month. The balance is then through final entries written out of sub-account 91.9 “Balance of miscellaneous income and expenses” to account 99 “Profits and losses”. The balance of account 99 shows the final financial result, and in this case, the profit before tax of the period. It is noticeable that the profit and loss statement of the year 2008 shows a gross profit of 0 RUB but loss from sales and before tax of 1 500 KRUB. This is directly connected with the different sub-accounts of the account 90. Only account 90.2 is included in the “Cost of sales”, whereas accounts 90.7 and 90.8 are shown under the gross profit constituting profit (loss) from sales. Miscellaneous expenses of account 91.2 are shown only right before the line “Profit before tax”. After the accounting year has ended, account 99 is closed by writing out the amount of net profit (loss) for the accounting year and crediting (debiting) it to account 84 “Undistributed profit (uncovered loss)”. (The Chart of Accounts 2000, 95-96, 104.) In these examples, this final entry is not made.

The year 2009 begins with the similar payment posting as the previous year. Now, however, the project manager considers the project to be ready to produce some revenue. An act is signed mutually by the seller and the buyer and revenue of amount of the received payment 48 000 KRUB is recognised deb 62 “Accounts Receivable” cr 90.1 “Sales”. In the end of the period, more project costs have again been incurred. The project manager decides to close the account 20; apparently all costs on the account incurred so far can be associated with the revenue recognised. This is not necessarily the case. For example, if the account includes costs to be realised in future periods or costs related to a part of the project to be completed only in the future, account would be left with a debit balance showing work-in-progress. The closing of account 20 is executed with posting deb 90.2 cr 20 and with the transfer from account 90.2 to account 90.9. The sales amount is similarly credited from account 90.1 to 90.9. Furthermore, the balance of accounts 90.9 and 91.9 constitutes the profit of the period on account 99. Now, the gross profit of the year is 15 500 KRUB and profit before tax 10 500 KRUB.

The third year postings correspond with the previous period. Final acceptance from the client is received, the second act signed and the project closed. Account 20 is, naturally, also closed. Gross profit of the period shows 17 000 KRUB and profit before tax – 14 000 KRUB. However, a part of the project costs are still to be incurred in 2011. Under Russian GAAP it is impossible to form a reserve for late project costs as the act has already been signed. Thus, costs incurred in 2011 can not be included in the profit and loss statement or profit tax calculation of the year 2010, but are debited to the respective accounts 20 and 26 in the year 2011. Hence, the profit and loss statement indicates a loss of 3 000 KRUB in 2011.

From the tax accounting point of view, the tax base for profit tax calculation more or less corresponds with the amount of profit before tax of financial accounting, expect for in 2011. Concerning the contract in question, revenue recognition method of tax accounting refers to the use of contract stages in which the act is signed and in consequence, revenue recognised. Thus, no difference regarding revenue recognition is born between financial and tax accounting. However, a difference between financial and tax accounting may occur due to some expenses that are non-deductible in taxation. Late project costs are non-deductible in tax accounting of the year 2011 meaning that the result of tax accounting in 2011 is 0 RUB. In the scope of an ordinary project, other expenses that are considered non-deductible in compliance with 270 § of the Tax Code usually comprise of hotel accommodation costs for a person that is not employed by a Russian company, taxi and other transport costs in leisure time, voluntary medical insurance outside the company's health insurance contract, things bought for an employee's own use at home and some other travel expenses, for example flights not related to business activities and not defined in the employee contract (Krasilnikova 2011). In this example, the possible non-deductible expenses are not detailed in particular. If a part of the project costs, for example some of the travel expenses, is non-deductible in taxation, the amount of them has to be added to the amount of profit before tax. Hence, the tax base, and profit tax expense, increases. In practice, 1C keeps books also separately for tax accounting purposes and calculates the tax base from the beginning. The most critical period of the project is the year 2008 which produces no tax revenue for the government at all due to the negative result of the accounting year. However, it has to be remembered that the stages for the definition of revenue are detailed individually for each contract; this solution presents only one option of many to choose from.

IFRS

	Sales ledger		A/R External - Advance Payment		Interim acc. - Incoming payments		Bank account		Accounts Receivable		Third Party Sales Revenue		Costs		Change in late project costs		Reserves for unrealized costs		POC-method adjustment to sales		Rev. from POC contracts, liability, corr.		A/R (Rev) from POC contracts		A/R Rev from POC contr., liability, corr.		A/R Prog Billing POC contr., liability,	
SAP account	NOT a G/L account!		110900		150108		171101		110000		300010		410000		411330		250004		310000		270000		115000		115300		115400	
Opening balance 1.1.2008																														
15.11.2008 Down Payment Requ	8 000																													
13.12.2008 Payment						8 000	8 000																							
		8 000		8 000	8 000																									
31.12.2008 Project costs													9 000																	
31.12.2008 POC-sales																				12 000			12 000			8 000	8 000			
Total	0	8 000	0	8 000	8 000	8 000	8 000	0	0	0	0	0	9 000	0	0	0	0	0	0	12 000	0	0	12 000	0	0	8 000	8 000	0		
Opening balance 1.1.2009		8 000		8 000			8 000						9 000							12 000			12 000			8 000	8 000			
10.10.2009 Down Payment Requ	48 000																													
12.11.2009 Payment						48 000	48 000																							
		48 000		48 000	48 000																									
31.12.2009 Project costs													30 000																	
31.12.2009 POC-sales																				40 000		4 000	40 000			44 000	48 000			
Total	0	56 000	0	56 000	48 000	48 000	56 000	0	0	0	0	0	39 000	0	0	0	0	0	0	52 000	0	4 000	52 000	0	0	52 000	56 000	0		
Opening balance 1.1.2010		56 000		56 000			56 000						39 000							52 000		4 000	52 000	0		52 000	56 000			
9.9.2010 Final invoice	80 000								80 000			80 000																		
9.9.2010 Allocation of 1. paymer	8 000	8 000	8 000							8 000																				
9.9.2010 Allocation of 2. paymer	48 000	48 000	48 000							48 000																				
3.11.2010 Payment						24 000	24 000																							
		24 000			24 000					24 000																				
31.12.2010 Project costs													18 000																	
31.12.2010 Reserve for unrealized costs															3 000			3 000												
31.12.2010 Reverse postings																			52 000		4 000			52 000	56 000	4 000		56 000		
Total	136 000	136 000	56 000	56 000	24 000	24 000	80 000	0	80 000	80 000	0	80 000	57 000	0	3 000	0	0	3 000	52 000	52 000	4 000	4 000	52 000	52 000	56 000	56 000	56 000	56 000		
Opening balance 1.1.2011							80 000					80 000	57 000		3 000			3 000												
15.1.2011 Project costs													3 000																	
31.1.2011 Reversal of the reserve																3 000	3 000													
Total	0	0	0	0	0	0	80 000	0	0	0	0	80 000	60 000	0	3 000	3000	3 000	3 000	0	0	0	0	0	0	0	0	0	0		
Balance							80 000					80 000	60 000																	

TABLE 6 Project 1 under IFRS

Russian GAAP

	Sales ledger		Bank account		Accounts Receivable		Sales		Main production unit		General business expenses		Miscellaneous expenses		Balance of misc. income and expenses		Cost of production of sales		Administrative expenses		Profit/loss from sales		Profits and losses	
1C account	NOT a G/L account!		51		62		90.1		20		26		91.2		91.9		90.2		90.8		90.9		99	
Opening balance 1.1.2008																								
13.12.2008 Payment of the invoice		8 000	8 000			8 000																		
31.12.2008 Project costs									7 500		1 492		8											
31.12.2008 Period end postings												1 492							1 492					
														8	8					1 492	1 492			
																8						1 492	1 500	
Total	0	8 000	8 000	0	0	8 000	0	0	7 500	0	1 492	1 492	8	8	8	8	0	0	1 492	1 492	1 492	1 492	1 500	0
Opening balance 1.1.2009		8 000	8 000			8 000			7 500														1 500	
12.11.2009 Payment of the invoice		48 000	48 000			48 000																		
15.12.2009 Act					48 000			48 000																
31.12.2009 Project costs									25 000		4 975		25											
31.12.2009 Period end postings										32 500		4 975					32 500		4 975					
							48 000							25	25			32 500		4 975	37 475	48 000		
																25					10 525		25	10 525
Total	0	56 000	56 000	0	48 000	56 000	48 000	48 000	32 500	32 500	4 975	4 975	25	25	25	25	32 500	32 500	4 975	4 975	48 000	48 000	25	10 525
Opening balance 1.1.2010		56 000	56 000			8 000																		10 500
3.11.2010 Payment of the final invoice		24 000	24 000			24 000																		
15.12.2010 Act					32 000			32 000																
31.12.2010 Project costs									15 000		2 982		18											
31.12.2010 Period end postings										15 000		2 982					15 000		2 982					
							32 000							18	18			15 000		2 982	17 982	32 000		
																18					14 018		18	14 018
Total	0	80 000	80 000	0	32 000	32 000	32 000	32 000	15 000	15 000	2 982	2 982	18	18	18	18	15 000	15 000	2 982	2 982	32 000	32 000	18	14 018
Opening balance 1.1.2011		80 000	80 000																					14 000
15.1.2011 Project costs									2 500		500													
31.1.2011 Period end postings										2 500		500					2 500		500					
																		2 500		500	3 000	3 000	3 000	
Total	0	80 000	80 000	0	0	0	0	0	2500	2500	500	500	0	0	0	0	2 500	2 500	500	500	3 000	3 000	3 000	0
Balance		80 000	80 000																			#	3 000	

TABLE 7 Project 1 under Russian GAAP

IFRS

PROFIT AND LOSS STATEMENT 2008		
Sales		
Third party sales revenue		0
The change of POC		
- value 1.1.2008	0	
- value 31.12.2008	12 000	
POC-method adjustment to sales	12 000	12 000
Total sales		12 000
Cost of sales		-9 000
GROSS PROFIT		3 000
Financial income/expenses		0
EARNINGS BEFORE TAXES		3 000

PROFIT AND LOSS STATEMENT 2009		
Sales		
Third party sales revenue		0
The change of POC		
- value 1.1.2009	12 000	
- value 31.12.2009	52 000	
POC-method adjustment to sales	40 000	40 000
Total sales		40 000
Cost of sales		-30 000
GROSS PROFIT		10 000
Financial income/expenses		0
EARNINGS BEFORE TAXES		10 000

PROFIT AND LOSS STATEMENT 2010		
Sales		
Third party sales revenue		80 000
The change of POC		
- value 1.1.2010	52 000	
- value 31.12.2010	0	
POC-method adjustment to sales	-52 000	-52 000
Total sales		28 000
Cost of sales		-21 000
GROSS PROFIT		7 000
Financial income/expenses		0
EARNINGS BEFORE TAXES		7 000

Russian GAAP

PROFIT AND LOSS STATEMENT 2008	
Sales	0
Cost of sales	0
GROSS PROFIT	0
Trade expenses	0
Administrative expenses	-1 492
PROFIT FROM SALES	-1 492
Other expenses	-8
PROFIT BEFORE TAX	-1 500

PROFIT AND LOSS STATEMENT 2009	
Sales	48 000
Cost of sales	-32 500
GROSS PROFIT	15 500
Trade expenses	0
Administrative expenses	-4 975
PROFIT FROM SALES	10 525
Other expenses	-25
PROFIT BEFORE TAX	10 500

PROFIT AND LOSS STATEMENT 2010	
Sales	32 000
Cost of sales	-15 000
GROSS PROFIT	17 000
Trade expenses	0
Administrative expenses	-2 982
PROFIT FROM SALES	14 018
Other expenses	-18
PROFIT BEFORE TAX	14 000

PROFIT AND LOSS STATEMENT 2011	
Sales	0
Cost of sales	-2 500
GROSS PROFIT	-2 500
Trade expenses	0
Administrative expenses	-500
PROFIT FROM SALES	-3 000
Other expenses	0
PROFIT BEFORE TAX	-3 000

TABLE 8 Profit and loss statements regarding Project 1

6.2.2 Project #2

The next three projects represent the ideal scenarios on how project accounting according to local and group accounting could be brought closer to each other. The second situation describes a short-term project (duration less than a year) concerning spare part delivery. First, LLC buys the parts from OY and then sells and delivers them to the customer with a certain gross margin. Under IFRS, completed contract method is used as the project concerns sale of goods and does not belong to the scope of construction contract. From the Group's point of view, congruence with regulations of IFRS is ensured by setting the contract price under 1 Mio EUR. Under Russian GAAP, short-term contracts are always treated in compliance with the completed contract method. However, as the date at which the contract activity is entered into and the date when the activity is completed fall into different accounting periods, Russian GAAP considers the project to be long-term and provides for the use of either completed contract or percentage-of-completion method. The Tax Code, on the other hand, accepts only the recognition of revenue evenly or in compliance with expense formation, that is, according to the percentage-of-completion method, over the project lifetime so that the profit influence of the project would fall over all taxation periods. Another option is to include stages in the contract and recognise revenue whenever the act is signed. Hence, in local accounting, two options are introduced: the first one encompasses contract stages (only one act in 2010) and revenue recognition when the contract is completed, and the second one uses percentage-of-completion method and produces sales already in 2009 although the final act is signed only in 2010. The standards concerning the case are IAS 18 and PBU 9/99. The summary of the used methods is presented in Table 9.

TABLE 9 Methods applied in Project 2

Sale of goods contract	IFRS: Short-term under 1 Mio EUR	Russian GAAP: Long-term under 1 Mio EUR
IFRS	CCM	
Group	CCM	
Russian GAAP		CCM/POC
Tax Code		STAGES/POC

The budget for the project is planned as follows:

- Sales price 20 000 KRUB (approximately 500 KEUR)
- Planned costs 15 000 KRUB, including
    - materials 12 000 KRUB
    - customs 2 000 KRUB
    - freights 200 KRUB
    - exchange losses 50 KRUB
    - working hours 400 KRUB
    - travel expenses 350 KRUB

Only exchange losses, no gains, are born.

Under IFRS, the project accounting for Project 2 introduced in Table 12 turns out to be quite simple. Most of the project costs incur in 2009 and are shown on account 410000. As the costs form also the work-in-progress of the project, the same amount has to be posted deb 101000 "Work In Process" cr 320200 "Change in WIP". Thus, both the change in work in process on account 320200 and cost of sales on account 410000 show 14 950 KRUB, resulting in a gross profit of 0 RUB.

In the next period, the final invoice is sent to the customer creating a sales posting deb 110000 "Accounts Receivable" cr 300010 "Third Party Sales Revenue". The payment then closes the Accounts Receivable -account. In the end of the period, exchange losses from the payment are realised and the WIP accounts closed with reverse posting deb 320200 "Change in WIP" cr 101000 "Work In Process". The gross profit of 5 000 KRUB is shown in the profit and loss statement solely in the year 2010.

The first version (Table 13) of the project accounting under Russian GAAP, as said, employs the completed contract method and the defined stage of the contract in recognising revenue. In 2009, like under IFRS, only contract costs are incurred. They are divided to accounts as follows:

TABLE 10 Division of costs between accounts in Project 2

	KRUB	Account Russian GAAP
Sales price	20 000	
Contract costs	15 000	
- Materials	12 000	41
- Customs	2 000	41
- Freights	200	44
- Working hours	400	20
- Travel expenses	350	20
- Exchange losses	50	91.2

Russian GAAP **Costs by account**	**YEAR 1**	**YEAR 2**
20	750	0
41	14 000	0
44	200	0
91.2	0	50
Incurred costs during the period	**14 950**	**50**

Currently in the real life, account 20 would not be used regarding project of this kind, but working hours and travel expenses would be entered to account 26. However, as the object is to harmonise the local and group accounting, account 20 is taken into use in this scenario. This is made possible by the article 8 of PBU 10/99 that enables the classification of costs into direct and indirect costs by the company itself, as long as the classification is explained in the accounting policy of the company. In this case, working hours and travel expenses are considered as direct costs.

For materials and customs duties, account 41 has to be taken into use as the project concerns the sale of goods. Account 41 “Goods” is used to summarise information on the existence and movement of goods and materials acquired as goods for sale by mainly trade organisations but also by production and industrial organisations in those instances where particular articles, materials and products are acquired specially to be sold. The account resembles to account 20: the value of the goods shall be written out of account 41 and debited to account 90.2 only when receipts from the sale of goods are recognised in accounting records. (The Chart of Accounts 2000, 43-44.) Thus, in principle the account shows the amount of work-in-progress together with account 20.

Freights are posted to account 44 “Sale expenses”. The account is used to summarise information on expenses associated with the sale of products, goods, work and services and can include expenses associated with, among others, packing and packaging of articles, transportation of goods, loading into means of transport and advertising. Usually expenses on account 44 shall be included in the cost of production of products sold on a monthly basis. However, as in the example the freight costs are related to the materials sold in the next period and kept in the stock until the delivery, the amount on account 44 is debited to account 90 in connection with the sales of those materials. (The Chart of Accounts 2000, 48-49.) Hence, no sales, cost of sales nor gross profit are shown in the profit and loss statement in 2009.

The year 2010 starts with sending the final invoice to the client and receiving the payment, which produces the posting deb 51 “Bank account” cr 62 “Accounts Receivable”. In the end of the period, the act is signed and sales created. Some exchange losses occur due to the payment on account 91.2. Period end postings consist of closing all the expense accounts 20, 41, 44 and 91.2 to the respective accounts 90.2, 90.7 and 91.9, closing account 90 to 90.9 and finally, the transfer of balances from accounts 91.9 and 90.9 to account 99. The gross profit of the project shows 5 250 KRUB and profit before tax – 5 000 KRUB, the same amount as EBT under IFRS does.

The second variant (Table 13) under Russian GAAP portrays the situation in which POC-method is used both in financial and tax accounting to produce revenue for the project. The POC-calculations are presented in Table 11.

TABLE 11 POC-calculations related to Project 2

Russian GAAP				
	YEAR 1		**YEAR 2**	
Incurred costs during the period	14 950		50	
Received payments from the client	0		20 000	
Stage of completion	99,67 %	(14 950/15 000)	0,33 %	(50/15 000)
POC-sales	19 933	(99.67%*20 000)	67	(0.33%*20 000)
POC-receivable	19 933	(19 933-0)	0	
POC-liability	0		0	

Now all expenses, except for exchange losses, are entered to account 20. Thus, it is assumed that the company has in its accounting policy defined the expenses to belong to account 20. This kind of entry instruction is also provided by Zdorovenko (2010) who reminds that contract costs under POC-method are recognised as costs from ordinary activities primarily on account 20, whether they are by nature direct, indirect or even other expenses. The accrual of costs follows the IFRS example and situation 2a, whereas the logic of POC-calculations is equivalent to the IFRS side of Project 1. To show the POC-sales, account 46 "Completed stages of work-in-progress" corresponding, in principle, with account 115000 "A/R (Revenue) from POC contracts" in SAP has to be added to the table. According to The Chart of Accounts (2000, 51), account 46 is used to summarise information on stages of work that have been completed in accordance with contracts concluded and that have an independent value. The account is in use, when necessary, in organisations which perform long-term work where the dates of commencement and completion usually fall into different accounting periods. The value of stages of work (in 2009 19 933 KRUB) which have been completed by the organisation are, thus, debited to account 46 in correspondence with account 90.1. At the same time, account 20 is closed to account 90.2 at the amount of expenditures on the completed and accepted stages of work, and further to account 90.9 together with sales account 90.1. The profit of the period is shown on account 99.

As the amount of POC-sales (account 46) exceeds the amount of received payments from the client (account 62), POC-receivable is born. In local accounting it is not shown on a specific account, but just in the assets of the balance sheet of the period.

In principle, under POC-method it makes no difference if the costs were defined as direct or indirect ones on account 20, as the account 20 is anyway closed in the end of every period producing POC-sales. However, in order to keep the project calculation as simple as possible, it would be better if account 26 (and similarly, account 44) was not used to recognise indirect expenses but all project related expenses would be acknowledged on account 20. An argument supporting this statement is the fact that the choice between accounts 20 and 26 affects also the order of the costs in profit and loss statement: account 20 is closed to "Cost of sales" above gross profit, whereas account 26 is closed to "Administrative expenses" under gross profit. Exchange losses can only be recognised on account 91.2 and shown in profit and loss statement in other expenses under Profit from sales.

In 2010, payment of the final invoice produces cash flow and signing of the act creates the final sales posting for the amount of 67 KRUB deb 62 cr 90.1. As a consequence of signing the act, the amounts on accounts 46 and 62 reverse each other. The last project expenses, exchange losses, are entered to account 91.2 and at the end of the period, accounts 90.1 and 91.2 are closed via the necessary accounts creating profit of 17 KRUB for the period.

As the outcome of the profit and loss statement demonstrates (Table 14), there is a big difference between situations 2a (and thus, IFRS accounting) and

2b due to the fact that POC-method recognises revenue earlier than CCM does. As such, it is actually more profitable for the tax authorities to demand the use of percentage-of-completion method because the tax revenue flows to the pockets of authorities earlier than with other methods. Actually, it has to be noticed that if the contract of situation 2a does not include stages or a mention of the act as the only requirement for revenue recognition, for tax accounting purposes the profit before tax has to be formed in a manner of the situation 2b. The financial accounting, however, accepts the completed contract method introduced. Again, minor adjustments may have to be done in calculation of the tax base if some of the project expenses are defined as non-deductible for tax purposes. Now, there are no late project costs to create differences between financial and tax accounting and therefore, between the overall tax influence between Russian tax accounting and IFRS.

IFRS

	Sales ledger		Interim acc. - Incoming payments		Bank account		Accounts Receivable		Third Party Sales Revenue		Costs		Change in WIP		Work In Process	
SAP account	NOT a G/L account!		150108		171101		110000		300010		410000		320200		101000	
Opening balance 1.1.2009																
1.12.2009 Project costs											14 950					
31.12.2009 Change in WIP														14 950	14 950	
Total	0	0	0	0	0	0	0	0	0	0	14 950	0	0	14 950	14 950	0
Opening balance 1.1.2010											14 950			14 950	14 950	
13.1.2010 Final invoice	20 000						20 000			20 000						
25.1.2010 Payment				20 000	20 000											
		20 000	20 000					20 000								
31.1.2010 Exchange losses											50					
31.1.2010 Change in WIP													14 950			14 950
Total	20 000	20 000	20 000	20 000	20 000	0	20 000	20 000	0	20 000	15 000	0	14 950	14 950	14 950	14 950
Balance					20 000					20 000	15 000					

TABLE 12 Project 2 under IFRS

Russian GAAP 2a

	Sales ledger		Bank account		Accounts Receivable		Sales		Main production unit		Goods		Sale expenses		Miscellaneous expenses		Balance of misc. income and expenses		Cost of production of sales		Trade expenses		Profit/loss from sales		Profits and losses	
1C account	NOT a G/L account!		51		62		90,1		20		41		44		91,2		91,9		90,2		90,7		90,9		99	
Opening balance 1.1.2009																										
1.12.2009 Project costs									750		14 000		200													
Total	0	0	0	0	0	0	0	0	750	0	14 000	0	200	0	0	0	0	0	0	0	0	0	0	0	0	0
Opening balance 1.1.2010									750		14 000		200												0	
25.1.2010 Payment		20 000	20 000			20 000																				
30.1.2010 Act					20 000			20 000																		
31.1.2010 Exchange losses															50											
31.1.2010 Period end postings										750		14 000		200					14 750		200					
							20 000									50	50			14 750		200	14 950	20 000		
																		50					5 050		50	5 050
Total	0	20 000	20 000	0	20 000	20 000	20 000	20 000	750	750	14 000	14 000	200	200	50	50	50	50	14 750	14 750	200	200	20 000	20 000	50	5 050
Balance		20 000	20 000																							5 000

2b

	Sales ledger		Bank account		Accounts Receivable		Completed stages of work-in-progress		Sales		Main production unit		Miscellaneous expenses		Balance of misc. income and expenses		Cost of production of sales		Profit/loss from sales		Profits and losses	
1C account	NOT a G/L account!		51		62		46		90,1		20		91,2		91,9		90,2		90,9		99	
Opening balance 1.1.2009																						
1.12.2009 Project costs											14 950											
31.12.2009 POC-sales							19 933			19 933												
31.12.2009 Period end postings												14 950					14 950					
									19 933									14 950	14 950	19 933		
																			4 983			4 983
Total	0	0	0	0	0	0	19 933	0	19 933	19 933	14 950	14 950	0	0	0	0	14 950	14 950	19 933	19 933	0	4 983
Opening balance 1.1.2010							19 933															4 983
25.1.2010 Payment		20 000	20 000			20 000																
30.1.2010 Act					67					67												
					19 933			19 933														
31.1.2010 Exchange losses													50									
31.1.2010 Period end postings									67					50	50					67		
																50			67		50	67
Total	0	20 000	20 000	0	20 000	20 000	19 933	19 933	67	67	0	0	50	50	50	50	0	0	67	67	50	67
Balance		20 000	20 000																			17

TABLE 13 Project 2 under Russian GAAP

IFRS

PROFIT AND LOSS STATEMENT 2009			PROFIT AND LOSS STATEMENT 2010		
Sales			**Sales**		
Third party sales revenue		0	Third party sales revenue		20 000
Total sales		0	**Total sales**		20 000
Change in WIP			Change in WIP		
- value 1.1.2009	0		- value 1.1.2010	14 950	
- value 31.12.2009	14 950		- value 31.12.2010	0	
Total	14 950	14 950	Total	-14 950	-14 950
Cost of sales		-14 950	Cost of sales		-50
GROSS PROFIT		0	**GROSS PROFIT**		5 000
Financial income/expenses		0	Financial income/expenses		0
EARNINGS BEFORE TAXES		0	**EARNINGS BEFORE TAXES**		5 000

Russian GAAP 2a

PROFIT AND LOSS STATEMENT 2009		PROFIT AND LOSS STATEMENT 2010	
Sales	0	**Sales**	20 000
Cost of sales	0	Cost of sales	-14 750
GROSS PROFIT	0	**GROSS PROFIT**	5 250
Trade expenses	0	Trade expenses	-200
Administrative expenses	0	Administrative expenses	0
PROFIT FROM SALES	0	**PROFIT FROM SALES**	5 050
Other expenses	0	Other expenses	-50
PROFIT BEFORE TAX	0	**PROFIT BEFORE TAX**	5 000

Russian GAAP 2b

PROFIT AND LOSS STATEMENT 2009		PROFIT AND LOSS STATEMENT 2010	
Sales	19 933	**Sales**	67
Cost of sales	-14 950	Cost of sales	0
GROSS PROFIT	4 983	**GROSS PROFIT**	67
Trade expenses	0	Trade expenses	0
Administrative expenses	0	Administrative expenses	0
PROFIT FROM SALES	4 983	**PROFIT FROM SALES**	67
Other expenses	0	Other expenses	-50
PROFIT BEFORE TAX	4 983	**PROFIT BEFORE TAX**	17

TABLE 14 Profit and loss statements regarding Project 2

6.2.3 Project #3

The third project is a classic example of construction contract accounting in compliance with IAS 11 and PBU 2/2008. The scope of the long-term project (3 years) covers delivery of a part of a pulp mill, installation and site supervision. Both IFRS and Russian GAAP require the use of percentage-of-completion method in recognising project revenue. As the estimated sales price of the project exceeds 1 Mio EUR, also Andritz Group classifies the project among construction contracts.

The following payment terms are agreed upon:

- 10% down payment on signing the contract,
- 60% progress billing on delivery,
- 20% on final acceptance, and
- 10 % after warranty period (2 years).

In addition, the budget of the project has been specified as follows:

- Sales price 100 000 KRUB (approximately 2 500 KEUR)
- Planned costs 80 000 KRUB, including
    - working hours (engineering, supervision, management, assistant) 40 000 KRUB
    - subcontracting costs 10 KRUB
    - materials 15 000 KRUB
    - travel expenses 5 000 KRUB
    - freights 200 KRUB
    - customs 2 000 KRUB
    - rents (office and apartments) 3 000 KRUB
    - office supplies 100 KRUB
    - external services (post, other) 2 850 KRUB
    - exchange losses 50 KRUB

In addition, the amount of estimated warranty costs is 1 800 KRUB. Now also warranty costs are calculated as the project is officially counted among the scope of construction contract accounting. The Group Accounting Policy states:

> "The estimated costs to be incurred during the warranty period are included in the project costs (as warranty cost accrual), but are excluded from the calculation of the stage of completion. Recognition of the warranty cost accrual is based on the stage of completion of the contract." (Andritz Group IFRS Accounting Policy 2009, 33.)

Only exchange losses, no gains, are born.

Calculations and postings of Project 3 under IFRS presented in Tables 15 and 17, for the most part, correspond with Project 1. The differences can be seen in the magnitude of the project and thus, in higher amounts of sales price and planned contract costs. As mentioned, now also warranty costs are included in the project calculation. Furthermore, 10% of the sales price is paid only after the warranty period, in the year 2012.

TABLE 15 POC-calculations related to Project 3

	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5
Incurred costs during the period	12 000 (15%*80 000)	40 000 (50%*80 000)	24 000 (30%*80 000)	4 000 (5%*80 000)	
Reserve for unrealised costs	-	-	4 000 (5%*80 000)		
Received payments from the client	10 000 (10%*100 000)	60 000 (60%*100 000)	20 000 (20%*100 000)		10 000 (10%*100 000)
Stage of completion	15 % (12 000/80 000)	50 % (40 000/80 000)	35 % (28 000/80 000)		
POC-sales	15 000 (15%*100 000)	50 000 (50%*100 000)	35 000 (35%*100 000)		
POC-receivable	5 000 (15 000-10 000)	0	0		
POC-liability	0	5 000 (70 000-65 000)	0		
Warranty cost accrual	270 (15%*1 800)	900 (50%*1 800)	630 (35%*1 800)		

The project is launched in 2008. The stage of completion and POC-sales are calculated as in relation with Project 1, only the figures differ slightly from each other. The first difference to Project 1 emerges when the warranty cost accrual is formed in the end of the periods. It is calculated by multiplying the stage of completion percentage with the estimated warranty costs and then posted to accounts 411350 ″Change in warranty cost accrual″ and 231100 "L-T Warranty Cost Accrual″. The gross profit and thus, earnings before taxes of the first and second period differ from the amounts of Project 1 by the amount of warranty cost accrual incurred during the period.

The final invoice is created as a result of the final acceptance from the client in the third period. The last instalment (10% after warranty period) is included in the final invoice with payment term "within 720 days due net" and shown as a receivable on Accounts Receivable. Now the reverse postings extend also to warranty cost accrual accounts. The final acceptance, however, creates a new WBS-element, a warranty project from the current construction contract project and hence, a warranty reserve is formed with the posting deb 411360 "Change in warranty reserve" cr 231200 "L-T Warranty Provision". The difference in the cost accounts 411350 and 411360 is recognised as expense. When warranty costs incur in the future, the amount of the reserve decreases respectively. If no warranty costs during the warranty period have been incurred or the whole amount of the reserve is not used, as in this example, the rest of the reserve is reversed in the end of the warranty period and shown in the profit and loss statement as income in 2012. The rest of the project costs incur in 2011, and in 2012, after the warranty period, the last instalment is paid. The profit and loss statement shows also in the year 2010 profit that differs from Project 1 by the amount of the warranty cost accrual.

Percentage-of-completion method under Russian GAAP was already introduced in a small scale Project 2b. Now (Table 18) the scope is slightly larger and the costs of the project are divided between accounts and project periods in the following manner:

TABLE 16 Division of costs between accounts in Project 3

	KRUB	Account Russian GAAP
Sales price	100 000	
Contract costs	80 000	
- Working hours	40 000	20
- Subcontracting costs	10 000	20
- Materials	15 000	20
- Travel expenses	5 000	20
- Freights	200	20
- Customs	2 000	20
- Rents	3 000	20
- Office supplies	100	20
- External services	2 850	20
- Exchange losses	50	91.2
- Estimated warranty costs	1 800	20

Russian GAAP **Costs by account**	**YEAR 1**	**YEAR 2**	**YEAR 3**	**YEAR 4**	**YEAR 5**
20 (incl. warranty cost reserve)	12 000	40 000	25 750	5 800	1 800
91.2	0	0	50	0	0
Incurred costs during the period	**12 000**	**40 000**	**25 800**	**5 800**	**1 800**

Account 20 is used to acknowledge all other project related costs except exchange losses, provided that the list of expenses of account 20 in the accounting policy includes all of them. Costs incur by the same principle as under IFRS. In addition, POC-calculations presented in Table 15 apply in this case also to accounting under Russian GAAP, apart from warranty cost accrual.

The project starts in 2008 by sending an advance payment invoice and receiving the payment from the client. Project costs are shown on account 20. In the end of the period, POC-sales of the amount 15 000 KRUB are posted deb 46 cr 90.1, and accounts 20 and 90.1 are closed so that account 99 portrays a profit of 3 000 KRUB. Similarly to IFRS, also POC-receivable is born. It is calculated from accounts 46 and 62 (15 000 KRUB – 10 000 KRUB) and displayed in assets of the balance sheet of the period. During the year 2009, the postings correspond with the previous period. However, as received payments from the client exceed POC-sales, POC-liability is born on accounts 46 and 62 (70 000 KRUB – 65 000 KRUB) and shown in liabilities of the balance sheet of the period. In 2008 and 2009, the profit and loss statements of IFRS and Russian GAAP come very close to each other. The only difference occurs due to the warranty cost accrual that Russian GAAP does not form during the project's lifetime.

In the third period, the final invoice is made and paid. The final act is signed by the contract parties, which creates the sales posting deb 62 cr 90.1 and the reversal of balances on accounts 62 and 46. Period end postings do not differ from the previous periods. The difference to IFRS occurs due to the warranty cost accrual and treatment of late project costs. In Russian accounting, it is impossible to form a reserve for unrealised project costs as the act has already been signed and the project closed from all other income and expenses except warranty costs. Hence, only 24 000 KRUB of costs (excluding warranty cost accrual) are shown in profit and loss statement in 2010 whereas the rest, 4 000 KRUB, are left to be presented in profit and loss statement of the year 2011. As a consequence, Russian GAAP profit and loss statement presents a profit of 11 000 KRUB in 2010 compared to IFRS's 6 370 KRUB, and a loss of 4 000 KRUB in 2011 while under IFRS, the project does not have a profit influence anymore. The final payment is received in 2012 after the warranty period.

Although a reserve for late project costs is not accepted, Russian GAAP and taxation enable the formation of warranty cost reserve for the future warranty costs. Warranty cost accrual is not followed during the project the same way as in SAP, but the reserve is formed similarly to IFRS when the project closes. The reserve is debited in the end of the period to account 20, credited to account 96 "Reserves for future expenses". When actual warranty costs incur, they are credited from account 96 to accounts corresponding the nature of the expenses. If no warranty costs during a period have been incurred or the whole amount of the reserve is not used, the rest of the reserve is cleared in the end of every period from account 96 to account 90.1 "Miscellaneous income". Respectively, account 20 is closed to account 90.2. Interestingly, the "cost posting" affects the gross profit of the profit and loss statement while the "income posting" is taken into account only in the profit before tax. As in the example, no warranty costs actually incur, the general effect of the warranty reserve in the profit and loss statement is zero. In the beginning of the next period, warranty cost reserve for the estimated remaining warranty costs is accrued all over again monthly (1/12 every month). In Table 18, to simplify the calculations, the whole reserve is formed in 2011 and 2012 at once. As in 2010, it does not influence the final profit (loss) of the periods, which leads to a difference between IFRS's and Russian GAAP's profit and loss statements in 2012 when under IFRS, the reserve is cleared. In Russian tax accounting, it is possible to carry forward the unused warranty reserve. The profit influence would, in this case, seem the same as under financial accounting.

Besides financial accounting, percentage-of-completion method is accepted as a method to recognise revenue for long-term contracts also in tax accounting. The only exception prohibiting the use of POC-method in tax accounting covers the situation in which defined stages are written in the contract. In this case, the contract does not include stages and thus, profit before tax acts as the base for profit tax calculation. Once more, if some of the expenses are considered non-deductible according to the Tax Code, minor adjustments to the tax base may have to be made. Furthermore, the result in tax accounting of the year 2011 is 0 RUB, the same as under IFRS, due to the impossibility to deduct late project costs. This leads to higher overall tax influence in Russian tax accounting than in accounting under IFRS.

IFRS

	Sales ledger		A/R External - Advance Payment		Interim acc. - Incoming payments		Bank account		Accounts Receivable		Third Party Sales Revenue	
SAP account	NOT a G/L account!		110900		150108		171101		110000		300010	
Opening balance 1.1.2008												
15.11.2008 Down Payment Request	10 000											
13.12.2008 Payment						10 000	10 000					
		10 000		10 000	10 000							
31.12.2008 Project costs												
31.12.2008 POC-sales + warr. cost accr.												
Total	0	10 000	0	10 000	10 000	10 000	10 000	0	0	0	0	0
Opening balance 1.1.2009		10 000		10 000			10 000					
10.10.2009 Down Payment Request	60 000											
12.11.2009 Payment						60 000	60 000					
		60 000		60 000	60 000							
31.12.2009 Project costs												
31.12.2009 POC-sales + warr. cost accr.												
Total	0	70 000	0	70 000	60 000	60 000	70 000	0	0	0	0	0
Opening balance 1.1.2010		70 000		70 000			70 000					
9.9.2010 Final invoice	100 000								100 000			100 000
9.9.2010 Allocation of 1. payment	10 000	10 000	10 000							10 000		
9.9.2010 Allocation of 2. payment	60 000	60 000	60 000							60 000		
3.11.2010 Payment						20 000	20 000					
		20 000			20 000					20 000		
31.12.2010 Project costs												
31.12.2010 Reserve for unrealized costs												
31.12.2010 Reverse postings												
Total	170 000	160 000	70 000	70 000	20 000	20 000	90 000	0	100 000	90 000	0	100 000
Opening balance 1.1.2011	10 000						90 000		10 000			100 000
15.1.2011 Project costs												
31.1.2011 Reversal of the reserve												
Total	10 000	0	0	0	0	0	90 000	0	10 000	0	0	100 000
Opening balance 1.1.2012	10 000						90 000		10 000			100 000
14.12.2012 Payment						10 000	10 000					
		10 000			10 000					10 000		
31.12.2012 Reversal of the reserve												
Total	10 000	10 000	0	0	10 000	10 000	100 000	0	10 000	10 000	0	100 000
Balance							100 000					100 000

	Costs		Change in late project costs		Reserves for unrealized costs		POC-method adjustment to sales		Rev. from POC contracts, liability, corr.		A/R (Revenue) from POC contracts	
SAP account	410000		411330		250004		310000		270000		115000	
Opening balance 1.1.2008												
15.11.2008 Down Payment Request												
13.12.2008 Payment												
31.12.2008 Project costs	12 000											
31.12.2008 POC-sales + warr. cost accr.								15 000			15 000	
Total	12 000	0	0	0	0	0	0	15 000	0	0	15 000	0
Opening balance 1.1.2009	12 000							15 000			15 000	
10.10.2009 Down Payment Request												
12.11.2009 Payment												
31.12.2009 Project costs	40 000											
31.12.2009 POC-sales + warr. cost accr.								50 000		5 000	50 000	
Total	52 000	0	0	0	0	0	0	65 000	0	5 000	65 000	0
Opening balance 1.1.2010	52 000							65 000		5 000	65 000	0
9.9.2010 Final invoice												
9.9.2010 Allocation of 1. payment												
9.9.2010 Allocation of 2. payment												
3.11.2010 Payment												
31.12.2010 Project costs	24 000											
31.12.2010 Reserve for unrealized costs			4 000			4 000						
31.12.2010 Reverse postings							65 000		5 000			65 000
Total	76 000	0	4 000	0	0	4 000	65 000	65 000	5 000	5 000	65 000	65 000
Opening balance 1.1.2011	76 000		4 000			4 000						
15.1.2011 Project costs	4 000											
31.1.2011 Reversal of the reserve				4 000	4 000							
Total	80 000	0	4 000	4000	4 000	4 000	0	0	0	0	0	0
Opening balance 1.1.2012	80 000											
14.12.2012 Payment												
31.12.2012 Reversal of the reserve												
Total	80 000	0	0	0	0	0	0	0	0	0	0	0
Balance	80 000											

	A/R Rev from POC contr., liability, corr.		A/R Prog Billing POC contr., liability,		L-T Warr. Cost Accr.		Change in warr. cost accual		L-T Warranty Provision		Change in warranty reserve	
SAP account	115300		115400		231100		411350		231200		411360	
Opening balance 1.1.2008												
15.11.2008 Down Payment Request												
13.12.2008 Payment												
31.12.2008 Project costs												
31.12.2008 POC-sales + warr. cost accr.		10 000	10 000			270	270					
Total	0	10 000	10 000	0	0	270	270	0	0	0	0	0
Opening balance 1.1.2009		10 000	10 000			270	270					
10.10.2009 Down Payment Request												
12.11.2009 Payment												
31.12.2009 Project costs												
31.12.2009 POC-sales + warr. cost accr.		55 000	60 000			900	900					
Total	0	65 000	70 000	0	0	1 170	1 170	0	0	0	0	0
Opening balance 1.1.2010		65 000	70 000			1 170	1 170					
9.9.2010 Final invoice												
9.9.2010 Allocation of 1. payment												
9.9.2010 Allocation of 2. payment												
3.11.2010 Payment												
31.12.2010 Project costs												
31.12.2010 Reserve for unrealized costs												
31.12.2010 Reverse postings	70 000	5 000		70 000	1 170			1 170		1 800	1 800	
Total	70 000	70 000	70 000	70 000	1 170	1 170	1 170	1 170	0	1 800	1 800	0
Opening balance 1.1.2011										1 800	1 800	
15.1.2011 Project costs												
31.1.2011 Reversal of the reserve												
Total	0	0	0	0	0	0	0	0	0	1 800	1 800	0
Opening balance 1.1.2012										1 800	1 800	
14.12.2012 Payment												
31.12.2012 Reversal of the reserve									1 800			1 800
Total	0	0	0	0	0	0	0	0	1 800	1 800	1 800	1 800
Balance												

TABLE 17 Project 3 under IFRS

Russian GAAP

	Sales ledger		Bank account		Accounts Receivable		Completed stages of work-in-progress		Sales		Main production unit		Reserves for future expenses		Miscellaneous income		Miscellaneous expenses		Balance of misc. income and expenses		Cost of production of sales		Profit/loss from sales		Profits and losses	
1C account	NOT a G/L account!		51		62		46		90.1		20		96		91.1		91.2		91.9		90.2		90.9		99	
Opening balance 1.1.2008																										
13.12.2008 Payment		10 000	10 000			10 000																				
31.12.2008 Project costs											12 000															
31.12.2008 POC-sales							15 000			15 000																
31.12.2010 Period ens postings												12 000									12 000					
									15 000													12 000	12 000	15 000		
																							3 000			3 000
Total	0	10 000	10 000	0	0	10 000	15 000	0	15 000	15 000	12 000	12 000	0	0	0	0	0	0	0	0	12 000	12 000	15 000	15 000	0	3 000
Opening balance 1.1.2009		10 000	10 000			10 000	15 000																			3 000
12.11.2009 Payment		60 000	60 000			60 000																				
31.12.2009 Project costs											40 000															
31.12.2009 POC-sales							50 000			50 000																
31.12.2010 Period end postings												40 000									40 000					
									50 000													40 000	40 000	50 000		
																							10 000			10 000
Total	0	70 000	70 000	0	0	70 000	65 000	0	50 000	50 000	40 000	40 000	0	0	0	0	0	0	0	0	40 000	40 000	50 000	50 000	0	10 000
Opening balance 1.1.2010		70 000	70 000			70 000	65 000																			10 000
3.11.2010 Payment of the final invoice		20 000	20 000			20 000																				
31.12.2010 Project costs											23 950						50									
31.12.2010 Act + warranty cost reserve					35 000					35 000																
					65 000			65 000			1 800			1 800												
31.12.2010 Period end postings												25 750	1 800			1 800					25 750					
									35 000						1 800			50	50	1 800		25 750	25 750	35 000		
																			1 750				9 250			11 000
Total	0	90 000	90 000	0	100 000	90 000	65 000	65 000	35 000	35 000	25 750	25 750	1 800	1 800	1 800	1 800	50	50	1 800	1 800	25 750	25 750	35 000	35 000	0	11 000
Opening balance 1.1.2011		90 000	90 000		10 000																					11 000
15.1.2011 Project costs + warranty cost reserve											5 800			1 800												
31.1.2011 Period end postings												5 800	1 800			1 800					5 800					
															1 800					1 800		5 800	5 800			
																			1 800					5 800	5 800	1 800
Total	0	90 000	90 000	0	10 000	0	0	0	0	0	5 800	5 800	1 800	1 800	1 800	1 800	0	0	1 800	1 800	5 800	5 800	5 800	5 800	5 800	1 800
Opening balance 1.1.2012		90 000	90 000		10 000																				4 000	
14.12.2012 Payment + warranty cost reserve		10 000	10 000			10 000					1 800			1 800												
31.12.2012 Period end postings												1 800	1 800			1 800					1 800					
															1 800					1 800		1 800	1 800			
																			1 800					1 800	1 800	1 800
Total	0	100 000	100 000	0	10 000	10 000	0	0	0	0	1 800	1 800	1 800	1 800	1 800	1 800	0	0	1 800	1 800	1 800	1 800	1 800	1 800	1 800	1 800
Balance		100 000	100 000																							

TABLE 18 Project 3 under Russian GAAP

IFRS

PROFIT AND LOSS STATEMENT 2008		
Sales		
Third party sales revenue		0
The change of POC		
- value 1.1.2008	0	
- value 31.12.2008	15 000	
POC-method adjustment to sales	15 000	15 000
Total sales		15 000
Cost of sales		-12 000
Warranty cost accrual		-270
GROSS PROFIT		2 730
Financial income/expenses		0
EARNINGS BEFORE TAXES		2 730

PROFIT AND LOSS STATEMENT 2009		
Sales		
Third party sales revenue		0
The change of POC		
- value 1.1.2009	15 000	
- value 31.12.2009	65 000	
POC-method adjustment to sales	50 000	50 000
Total sales		50 000
Cost of sales		-40 000
Warranty cost accrual		-900
GROSS PROFIT		9 100
Financial income/expenses		0
EARNINGS BEFORE TAXES		9 100

PROFIT AND LOSS STATEMENT 2010		
Sales		
Third party sales revenue		100 000
The change of POC		
- value 1.1.2010	65 000	
- value 31.12.2010	0	
POC-method adjustment to sales	-65 000	-65 000
Total sales		35 000
Cost of sales		-28 000
Warranty cost accrual		-630
GROSS PROFIT		6 370
Financial income/expenses		0
EARNINGS BEFORE TAXES		6 370

PROFIT AND LOSS STATEMENT 2011		
Sales		
Third party sales revenue		0
The change of POC		
- value 1.1.2010	0	
- value 31.12.2010	0	
POC-method adjustment to sales	0	0
Total sales		0
Cost of sales		0
Warranty cost accrual		0
GROSS PROFIT		0
Financial income/expenses		0
EARNINGS BEFORE TAXES		0

PROFIT AND LOSS STATEMENT 2012		
Sales		
Third party sales revenue		0
The change of POC		
- value 1.1.2010	0	
- value 31.12.2010	0	
POC-method adjustment to sales	0	0
Total sales		0
Cost of sales		0
Warranty cost accrual		1 800
GROSS PROFIT		1 800
Financial income/expenses		0
EARNINGS BEFORE TAXES		1 800

Russian GAAP

PROFIT AND LOSS STATEMENT 2008	
Sales	15 000
Cost of sales	-12 000
GROSS PROFIT	3 000
Trade expenses	0
Administrative expenses	0
PROFIT FROM SALES	3 000
Other income	0
Other expenses	0
PROFIT BEFORE TAX	3 000

PROFIT AND LOSS STATEMENT 2009	
Sales	50 000
Cost of sales	-40 000
GROSS PROFIT	10 000
Trade expenses	0
Administrative expenses	0
PROFIT FROM SALES	10 000
Other income	0
Other expenses	0
PROFIT BEFORE TAX	10 000

PROFIT AND LOSS STATEMENT 2010	
Sales	35 000
Cost of sales	-25 750
GROSS PROFIT	9 250
Trade expenses	0
Administrative expenses	0
PROFIT FROM SALES	9 250
Other income	1 800
Other expenses	-50
PROFIT BEFORE TAX	11 000

PROFIT AND LOSS STATEMENT 2011	
Sales	0
Cost of sales	-5 800
GROSS PROFIT	-5 800
Trade expenses	0
Administrative expenses	0
PROFIT FROM SALES	-5 800
Other income	1 800
Other expenses	0
PROFIT BEFORE TAX	-4 000

PROFIT AND LOSS STATEMENT 2012	
Sales	0
Cost of sales	-1 800
GROSS PROFIT	-1 800
Trade expenses	0
Administrative expenses	0
PROFIT FROM SALES	-1 800
Other income	1 800
Other expenses	0
PROFIT BEFORE TAX	0

TABLE 19 Profit and loss statements regarding Project 3

6.2.4 Project #4

The last project example corresponds to a large extend with Project 1, the current situation. The difference is that in this case I make a proposal on how to bring the two practices closer to each other. Russian GAAP and PBU 9/99 are examined further and a conservative new model based on the use of percentage-of-completion method also in Russia is suggested for the project accounting. The standards used in this example are IAS 18 and PBU 9/99. As the expected revenue of the contract exceeds 1 Mio EUR, also the Group Accounting policy requires the use of the percentage-of-completion method and in practice, no difference to IFRS regulations occurs. The methods applied are:

TABLE 20 Methods applied in Project 4

Service contract	Long-term over 1 Mio EUR
IFRS	POC
Group	POC
Russian GAAP	POC
Tax Code	POC

The payment terms of the contract are the following:

- 10% down payment on signing the contract,
- 60% progress billing on arrival of the site supervisor, and
- 30% on final acceptance.

Furthermore, the following budget has been specified for the project:

- Sales price 80 000 KRUB (approximately 2 000 KEUR)
- Planned costs 60 000 KRUB, including
    - working hours (engineering, supervision, management, assistant) 35 000 KRUB
    - subcontracting costs 11 000 KRUB
    - travel expenses 5 000 KRUB
    - materials for the work 4 000 KRUB
    - rents (office and apartments) 3 000 KRUB
    - office supplies 100 KRUB
    - external services (post, other) 1 850 KRUB
    - exchange losses 50 KRUB

Again, no warranty costs are estimated for the project, as the contract is not classified as a construction contract. Only exchange losses, no gains, are born.

IFRS/SAP accounting of Project 4 equals to the situation of Project 1 and is shown in Table 6. The local accounting procedure (Table 22) seems for the most part the same as Project 3. Costs are divided between accounts and periods as follows. The same POC-calculations are employed as under IFRS accounting in Project 1 (Table 4). As the contract does not include specific stages for revenue recognition, POC-method is acknowledged as the only relevant method for revenue recognition also in tax accounting.

TABLE 21 Division of costs between accounts in Project 4

	KRUB	Account Russian GAAP
Sales price	80 000	
Contract costs	60 000	
- Working hours	35 000	20
- Subcontracting costs	11 000	20
- Travel expenses	5 000	20
- Materials	4 000	20
- Rents	3 000	20
- Office supplies	100	20
- External services	1 850	20
- Exchange losses	50	91.2

Russian GAAP **Costs by account**	**YEAR 1**	**YEAR 2**	**YEAR 3**	**YEAR 4**
20	9 000	30 000	17 950	3 000
91.2	0	0	50	0
Incurred costs during the period	**9 000**	**30 000**	**18 000**	**3 000**

Table 23 introduces the profit and loss statements regarding the project. As it can be seen, years 2008 and 2009 match fully with each other under IFRS and Russian GAAP. The difference in the year 2010 derives from the late project cost reserve that is not possible to be done under Russian GAAP. Hence, the rest of the project costs, 3 000 KRUB, are shown in the profit and loss statement in 2011. However, in profit taxation, no difference between IFRS and Russian taxation in 2011 is born as late project costs are considered as non-deductible ones. As in the previous examples, regarding other years, profit before tax –figure acts also as the basis for profit tax calculation, unless some of the expenses are considered as non-deductible. Therefore, the overall tax influence is higher in Russia than in countries adopting IFRS.

Russian GAAP

1C account	Sales ledger		Bank account		Accounts Receivable		Completed stages of work-in-progress		Sales		Main production unit		Miscellaneous expenses		Balance of misc. income and expenses		Cost of production of sales		Profit/loss from sales		Profits and losses	
	NOT a G/L account!		51		62		46		90.1		20		91.2		91.9		90.2		90.9		99	
	Dr	Cr	Dr	Cr	Dr	Cr	Dr	Cr	Dr	Cr	Dr	Cr	Dr	Cr	Dr	Cr	Dr	Cr	Dr	Cr	Dr	Cr
Opening balance 1.1.2008																						
13.12.2008 Payment		8 000	8 000			8 000																
31.12.2008 Project costs											9 000											
31.12.2008 POC-sales							12 000			12 000												
31.12.2008 Period end postings												9 000					9 000					
									12 000									9 000	9 000	12 000		
																			3 000			3 000
Total	0	8 000	8 000	0	0	8 000	12 000	0	12 000	12 000	9 000	9 000	0	0	0	0	9 000	9 000	9 000	12 000	0	3 000
Opening balance 1.1.2009		8 000	8 000			8 000	12 000															3 000
12.11.2009 Payment		48 000	48 000			48 000																
31.12.2009 Project costs											30 000											
31.12.2009 POC-sales							40 000			40 000												
31.12.2009 Period end postings												30 000					30 000					
									40 000									30 000	30 000	40 000		
																			10 000			10 000
Total	0	56 000	56 000	0	0	56 000	52 000	0	40 000	40 000	30 000	30 000	0	0	0	0	30 000	30 000	40 000	40 000	0	10 000
Opening balance 1.1.2010		56 000	56 000			56 000	52 000															10 000
3.11.2010 Payment of the final invoice		24 000	24 000			24 000																
31.12.2010 Project costs											17 950		50									
31.12.2010 Act					28 000					28 000												
					52 000			52 000														
31.12.2010 Period end postings												17 950					17 950					
									28 000					50	50			17 950	17 950	28 000		
																50			10 050		50	10 050
Total	0	80 000	80 000	0	80 000	80 000	52 000	52 000	28 000	28 000	17 950	17 950	50	50	50	50	17 950	17 950	28 000	28 000	50	10 050
Opening balance 1.1.2011		80 000	80 000																			10 000
15.1.2011 Project costs											3 000											
31.1.2011 Period end postings												3 000					3 000					
																		3 000	3 000	3 000	3 000	
Total	0	80 000	80 000	0	0	0	0	0	0	0	3 000	3 000	0	0	0	0	3 000	3 000	3 000	3 000	3 000	0
Balance		80 000	80 000																		3 000	

TABLE 22 Project 4 under Russian GAAP

IFRS

PROFIT AND LOSS STATEMENT 2008			PROFIT AND LOSS STATEMENT 2009			PROFIT AND LOSS STATEMENT 2010		
Sales			**Sales**			**Sales**		
Third party sales revenue		0	Third party sales revenue		0	Third party sales revenue		80 000
The change of POC			The change of POC			The change of POC		
- value 1.1.2008	0		- value 1.1.2009	12 000		- value 1.1.2010	52 000	
- value 31.12.2008	12 000		- value 31.12.2009	52 000		- value 31.12.2010	0	
POC-method adjustment to sales	12 000	12 000	POC-method adjustment to sales	40 000	40 000	POC-method adjustment to sales	-52 000	-52 000
Total sales		12 000	**Total sales**		40 000	**Total sales**		28 000
Cost of sales		-9 000	Cost of sales		-30 000	Cost of sales		-21 000
GROSS PROFIT		3 000	**GROSS PROFIT**		10 000	**GROSS PROFIT**		7 000
Financial income/expenses		0	Financial income/expenses		0	Financial income/expenses		0
EARNINGS BEFORE TAXES		3 000	**EARNINGS BEFORE TAXES**		10 000	**EARNINGS BEFORE TAXES**		7 000

Russian GAAP

PROFIT AND LOSS STATEMENT 2008		PROFIT AND LOSS STATEMENT 2009		PROFIT AND LOSS STATEMENT 2010		PROFIT AND LOSS STATEMENT 2011	
Sales	12 000	**Sales**	40 000	**Sales**	28 000	**Sales**	0
Cost of sales	-9 000	Cost of sales	-30 000	Cost of sales	-17 950	Cost of sales	-3 000
GROSS PROFIT	3 000	**GROSS PROFIT**	10 000	**GROSS PROFIT**	10 050	**GROSS PROFIT**	-3 000
Trade expenses	0	Trade expenses	0	Trade expenses	0	Trade expenses	0
Administrative expenses	0	Administrative expenses	0	Administrative expenses	0	Administrative expenses	0
PROFIT FROM SALES	3 000	**PROFIT FROM SALES**	10 000	**PROFIT FROM SALES**	10 050	**PROFIT FROM SALES**	-3 000
Other expenses	0	Other expenses	0	Other expenses	-50	Other expenses	0
PROFIT BEFORE TAX	3 000	**PROFIT BEFORE TAX**	10 000	**PROFIT BEFORE TAX**	10 000	**PROFIT BEFORE TAX**	-3 000

TABLE 23 Profit and loss statements regarding Project 4

6.2.5 Other situations

A bunch of situations are left uncovered in the examples above. First of all, Project 2 can encompass also other kinds of variations if the project is considered long-term under IFRS while it still does not fulfil the criteria for construction contract. IFRS and the Group Accounting Policy both treat the long-term contract concerning sale of goods with estimated revenue of less than 1 Mio EUR as a contract acknowledged in compliance with the completed contract method. Russian GAAP, nevertheless, may recognise the project revenue also using the percentage-of-completion method. However, as in Russia the completed contract method seems to be a valid option in financial accounting almost in every situation, the question arises, what sense it makes for the Russian company to recognise project revenue differently from the Group's policy. Also the Russian tax accounting bends to the use of completed contract method by defining suitable stages in the contract and recognising revenue according to them. Presumably, the outcome would thus be the same from the viewpoint of both IFRS, Group's policy, Russian GAAP and Russian taxation.

Another problem occurs if the sales price of a long-term contract under IFRS concerning sales of goods exceeds 1 Mio EUR. In this case, the Group would probably treat the project as a construction contract in compliance with IAS 11 although IFRS would require the use of the completed contract method instead of the percentage-of-completion method in compliance with IAS 18. As both Russian GAAP and the Tax Code allow the use of the percentage-of-completion method when it comes to long-term contracts, in this situation, once again, the practices of the Group and the Russian company would correspond to each other. The third possible point of deviation is a short-term contract with estimated revenue of more than 1 Mio EUR. There, it seems, no common outcome is possible to be reached. Table 24 summarises the different situations concerning sale of goods. It should be noted that as mentioned in sub-chapter 6.2., the outcome and thus, the stage of completion of the contract can always be defined meaning that percentage-of-completion method instead of revenue-to-costs-incurred method can be used both in financial and Russian tax accounting. Furthermore, costs do never incur evenly over the contract period, which excludes recognition of revenue evenly over the contract period in Russian tax accounting.

TABLE 24 Revenue recognition of sales of goods contracts

Sale of goods contract	Short-term under 1 Mio EUR	Short-term over 1 Mio EUR	Long-term under 1 Mio EUR	Long-term over 1 Mio EUR
IFRS	CCM	CCM	CCM	CCM
Group	CCM	POC	CCM	POC
Russian GAAP	CCM	CCM	CCM/POC	CCM/POC
Tax Code	CCM	CCM	STAGES/POC	STAGES/POC

Under Project 4, the example was chosen in order to avoid any deviations between IFRS and the Group Accounting Policy. However, contracts that are either not long-term or do not have estimated revenue of more than 1 Mio EUR, create some inconsistencies between the practices. Different options for revenue recognition of service contracts are presented in Table 25. As it can be seen, quite a few variations are present.

TABLE 25 Revenue recognition of service contracts

Service contract	Short-term under 1 Mio EUR	Short-term over 1 Mio EUR	Long-term under 1 Mio EUR	Long-term over 1 Mio EUR
IFRS	POC	POC	POC	POC
Group	CCM	POC	CCM	POC
Russian GAAP	CCM	CCM	CCM/POC	CCM/POC
Tax Code	CCM	CCM	STAGES/POC	STAGES/POC

6.3 Findings

Project 1 represents the current situation; how project accounting is done both in SAP under IFRS and in 1C under Russian GAAP. The differences between the accounting systems derive basically from three reasons: the timing of revenue and expense recognition, the division of expenses to more than one cost account and the impossibility to create a reserve for late project costs. Project revenue is recognised according to acts which are usually defined in the contract beforehand. Thus, revenue may be forced to be recognised totally randomly irrespective of the actual proportion of the work done. Noteworthy is also the completely different mentality in recognising revenue compared to IFRS: there are no strict internal policies for the matter but each project is reviewed individually and the project manager has a huge responsibility in governing the project accounting.

As for the expense side, the cost account 20 is strictly connected to the revenue recognition: costs on the account can be recognised as expenses in profit and loss statement only when sales occur. This leads to a cumbersome situation in which, for example, project-related travel expenses on account 26 are recognised as expenses in the end of every period whereas account 20 is activated as work-in-progress. Costs different by nature are, thus, by no means treated equally. While under IFRS, the project costs are always counted among the gross profit of the period, under Russian GAAP they can be shown either in gross profit, in profit from sales or only in profit before tax of the period depending on the account in which they are entered. This difference is illustrated in Figure 8: under IFRS the gross profit (gross margin) and profit before tax (earnings before taxes) correspond to each other, whereas under Russian GAAP, the gross profit always contains less expenses than profit before tax. Furthermore, the fact that Russian GAAP does not allow the creation of reserve for late project costs causes a crucial deviation between IFRS and Russian GAAP and an extension of the project's profit influence to further periods. The following Figure 8 compares the results of the accounting periods.

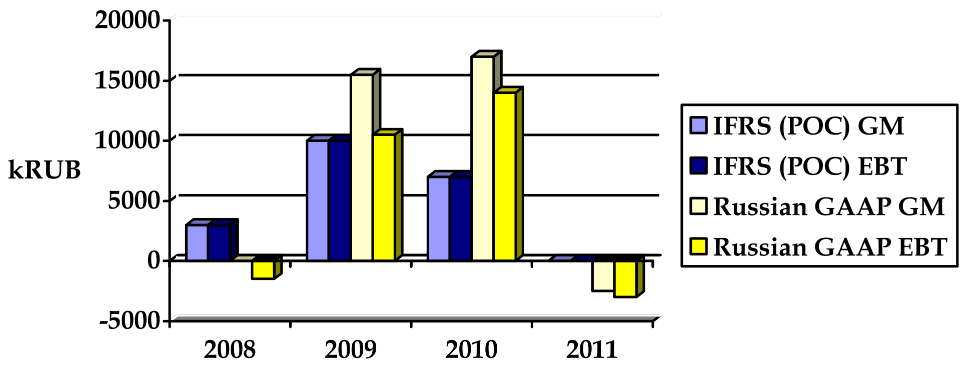

FIGURE 8 Comparison of results of Project 1

As the figure shows, under Russian GAAP the rhythm of revenue recognition does not seem to be too even. Compared to the current revenue recognition method of Russian GAAP, POC-method acknowledges revenue earlier and more evenly. Under Russian GAAP, periods 2008 and 2011 produce losses because sales do not occur, whereas in years 2009 and 2010 the profits exceed those under IFRS, in 2010 even significantly. Thus, the application of percentage-of-completion method also in Russian accounting would be a perfectly arguable idea, both from the point of view of profit taxation and of the harmonisation wishes between IFRS and Russian accounting.

Projects 2, 3 and 4 portray possible scenarios on how IFRS and Russian accounting, both financial and tax, could be brought closer to each other and at the same time, on how the tax problem due to negative results in some periods could be solved. Project 2 introduces an interesting mix of recognition methods between the Group, IFRS, Russian GAAP and the Tax Code resulting from differences in interpreting concepts short-term and long-term. Hence, under IFRS the project is seen as short-term, while Russian Tax Code considers it as long-term and requires the use of stages in the contract or percentage-of-completion method in dividing the contract revenue to both of the accounting periods the project touches. If deviations between Russian financial and tax accounting are wanted to be avoided, Russian GAAP is forced to adjust to the rules of the Tax Code. Interestingly, PBU 9/99, the standard concerning Project 2, does not itself define the term long-term contract. The analogy is here drawn from the standard PBU 2/2008 and interpretations of the Tax Code that both define long-term contracts as contracts that are to be fulfilled in a period longer than a year or contracts whose start and end dates fall into different accounting periods. It is, thus, strongly but inconspicuously suggested that financial accounting adapts to regulations of taxation.

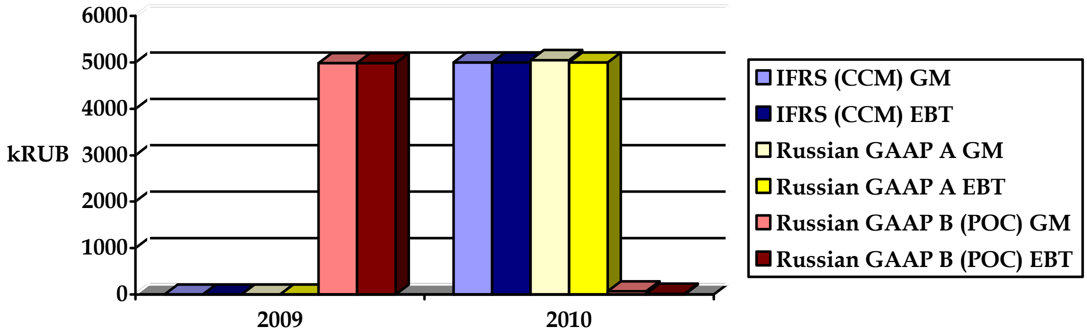

FIGURE 9 Comparison of results of Project 2

Projects under IFRS's completed contract method and Russian GAAP A show in both years the same profit before tax -figure. This is made possible by excluding account 26 from the calculations and listing in the accounting policy certain expenses traditionally belonging to account 26 as direct expenses on account 20. The minor differences in gross profits between IFRS and Russian GAAP in 2010 are due to GAAP's expenses on accounts 44 and 91.2 that are taken into account only in the profit before tax of the period. Russian GAAP B applying the percentage-of-completion method turns out to be the exact opposite: POC-method recognises revenue according to the incurred costs and almost the entire gross margin of the project is born already in 2009. Thus, it is clear that for harmonisation purposes, the company should use the method A (in principle completed contract method introduced already in Project 1) in Russian financial accounting and include stages in contracts such as this. However, for taxation purposes the more even revenue recognition method, POC-method, would probably suit better. Furthermore, the method for recognising revenue should always be mentioned and explained in the accounting policy of the organisation, which may pose some problems. Namely, if percentage-of-completion method is stated as the method for recognising revenue from long-term contracts, it is questionable if stages and thus, completed contract method can be used at all. Article 13 of the standard PBU 9/99 seems to provide an answer to this problem but its applicability to tax accounting remains doubtful.

Project 3 concerns a construction contract demanding the use of POC-method both under IFRS and Russian GAAP. As the Tax Code also allows the use of the method, in principle no differences between the accounting systems should appear. However, as Figure 10 proves, slight deviations between practices occur due to warranty cost accrual of IFRS during the project in 2008, 2009 and 2010, reversal of warranty cost reserve under Russian GAAP in 2010, 2011 and 2012 and under IFRS in 2012, as well as due to reserve for late project costs that can not be created in Russian accounting in 2010. Year 2011, however, does not create a difference between IFRS and Russian tax accounting since late project costs are non-deductible in taxation.

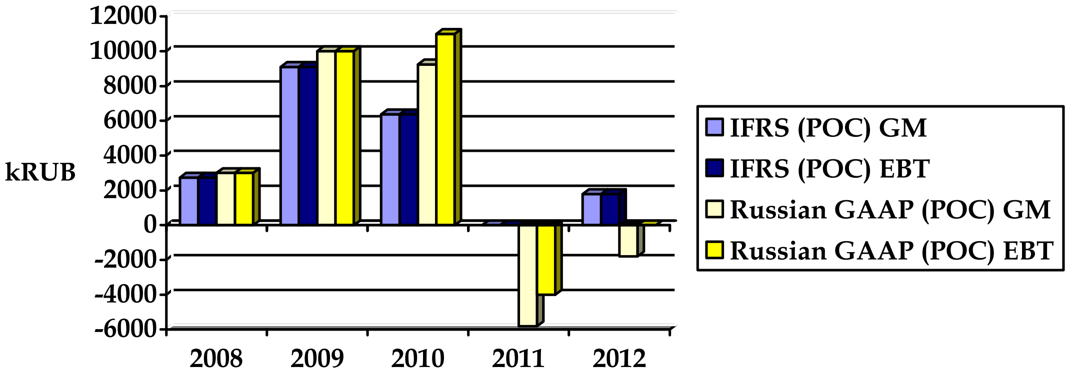

FIGURE 10 Comparison of results of Project 3

Years 2008 and 2009 go pretty much hand in hand, except for IFRS's warranty cost accrual. In 2010, Russian GAAP shows more profit than IFRS and in 2011, a loss due to the impossibility to form a reserve for late project costs. Differences in GAAP's gross profits and profit before tax –figures derive from the reversal of warranty cost reserve in the end of periods 2010, 2011 and 2012; now the gross profit is actually lower than the profit before tax –figure. In addition, exchange losses on account 91.2 can never be counted among account 20 and hence, can not be shown in the gross profit in 2010. Though the effect of warranty cost reserve is divided differently between periods under IFRS and Russian GAAP, the general influence over the period of time is the same. In 2012, the warranty cost reserve is reversed also under IFRS producing the same amount of income that was accrued as warranty costs during the project. Under Russian tax accounting, the reserve is carried forward the same way as in IFRS and thus, no difference between the amounts of gross profit and profit before tax of years 2010, 2011 and 2012 would arise. Naturally, if warranty costs would actually incur, no reversals of the whole amount of estimated warranty costs were needed to be made. To conclude, it can be noticed that POC-method per se is applied similarly in IFRS and Russian accounting, and project accounting done according to percentage-of-completion method acts as such as the basis for profit taxation. Deviations stem from regulations of Russian GAAP and the Tax Code mainly related to reserves that were already beforehand known to be a somewhat difficult subject in Russian accounting. In conclusion, the tax influence of the whole project is in Russia higher than it would be under IFRS accounting since late project costs are non-deductible in taxation in 2011.

Project 4 was meant to be a revised version of Project 1 aiming at harmonising the practices between IFRS and Russian accounting. PBU 9/99 allows a right, but not an obligation as PBU 2/2008, to use the percentage-of-completion method. As already known, the Tax Code demands the recognition of revenue in all accounting periods the project touches unless specific stages are included in the contract. Figure 11 condenses the results.

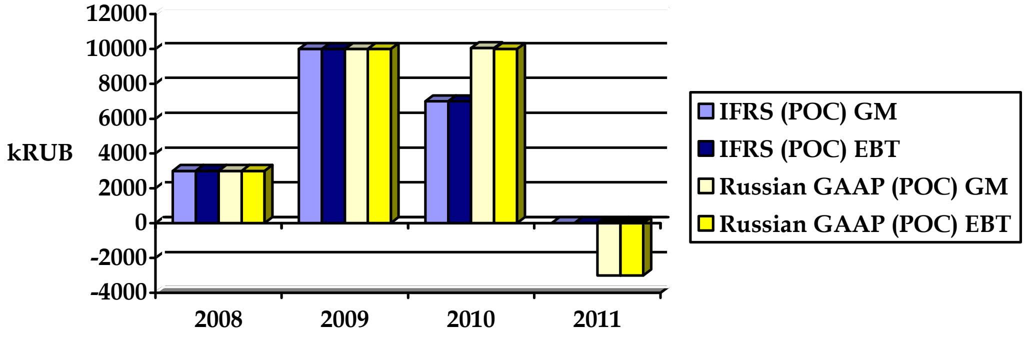

FIGURE 11 Comparison of results of Project 4

As it can be seen, with regard to service projects with an estimated sales price of over 1 Mio EUR, the harmonisation is possible almost in full scale. The two differences that can not be eliminated concern the reserve for late project costs not permitted under Russian GAAP and exchange losses that can not be included in the gross profit but only to the profit before tax of the period. Between IFRS and Russian tax accounting there is no difference in 2011, but in 2010 the tax base is higher in Russia leading to a higher tax influence of the whole project.

In financial accounting, differences between IFRS and Russian GAAP can be entirely eliminated though late project costs and warranty cost accruals and reserves create some deviations between the years. The overall results, however, are the same. In the figures above, profit before tax –amount of Russian GAAP basically equals to the tax base calculated according to the Tax Code with regard to every project. That was the aim also when building the projects and thus, no contradictory combinations of revenue recognition methods between Russian GAAP and the Tax Code were even introduced. The only difference between the profit before tax of financial accounting and the tax base of tax accounting may be due to some expenses not deductible in taxation. In the scope of these projects, those constitute mainly of late project costs. Since they are non-deductible in 2011, the tax bases under IFRS and Russian accounting correspond with each other in that year but create a situation in which the overall tax influence of projects is higher in Russia than in accounting under IFRS. As it became evident, other non-deductible expenses constitute only a surprisingly minor part of the overall project expenses and hence, were not detailed more thoroughly in connection of the projects.

Lastly, it should be remembered that in respect of project accounting, the contract technique plays a huge role in determining when revenue should be recognised. If the contract includes stages according to which acts should be signed, it automatically prohibits the use of percentage-of-completion method in tax accounting regardless of the method used in financial accounting. If the company wants to apply percentage-of-completion method both in financial and tax accounting, it should always attend to that the accounting policy is updated and that the contract is written without any reference to specific stages requiring the signing of acts.

Data acquired through the participant observation method corresponds highly with the already existing assumptions of the underlying reasons for the case company's problem. Zeff (2007) argues that cultural values and the way of thinking about financial reporting, that is, accounting culture, define the choice of financial reporting practices and is a slowly-changing area. Mindset of accountants has in many countries, for example, kept up the tendency to minimise the income tax burden and delayed the introduction of percentage-of-completion accounting as a method for recognising revenue. Consistent with Goncharov and Zimmermann's (2006) propositions, it became evident that Russian accountants truly consider the aim to minimise the tax base for profit taxation as the most important. This is also a reason for the tendency to avoid the use of percentage-of-completion method in project accounting. Another cause is related to form over substance -principle of accounting. The proper preparation of acts for tax purposes is essential, even insomuch that though a clause clearly states that recognition of revenue is perfectly possible without an act, the form-over substance –thinking automatically rejects that kind of interpretation. It seems that the more even recognition of revenue through the project's lifetime is seen as a burden rather than a benefit. Russian accountants' mindset shows resistance to change. Financial and tax accounting were separated already in 2002, but taxation is still always taken into consideration when preparing financial accounting records. Partly this is, naturally, due to the fear that the company ends up having a tax dispute with the tax authorities unless tax matters are not properly handled. The easiest and most efficient way to keep separate records for financial and tax accounting is to harmonise them. As financial accounting is not particularly inspected by any authorities and the quality of Russian auditors can sometimes be suspected, the bond between financial and tax accounting continues to hold and true and fair view to suffer.

Resistance to change can be seen also in the reluctance to learn to understand the IFRSs and speak the same language with colleagues from other countries. Evans (2004) reminds that understanding may even be entirely impossible since people from different cultures speaking different languages perceive and interpret accounting concepts in different ways. For Russians, form over substance and tax-based thinking surely prevent the understanding of concepts of a system basically quite different to Russian GAAP. Professional judgement is not familiar to them as the profession of a bookkeeper has not involved making independent decisions. Within the study, the attitude towards provisions was a good example of this tradition. Accountants felt it extremely intimidating to enter a transaction without any supporting documents, substance over form in mind. However, it may be too simplified to argue that Russian accounting values inevitably indicate more statutory control than professionalism, rather uniformity than flexibility, more conservatism than optimism or secrecy over transparency compared to IFRS. For example, the avoidance of provisions can be seen as a sign for optimism rather than conservatism, although concerning some other aspects, this statement could be overruled. Practices change and in the course of time, also values.

Surely also other underlying differences between IFRS and Russian GAAP affect the case company's situation and the harmonisation attempt of the two practices. The fact that IFRS bases on Anglo-Saxon accounting model and Russian GAAP is closer to the continental European model already as such weakens the possibilities for proper convergence. Differences in legal systems and functioning of the capital markets are, however, factors that can not be changed in a year. Many countries with different systems have succeeded in transferring to IFRS. However, an existence of de-jure harmonisation on the level of laws and rules does not necessarily lead to concurrent de-facto harmonisation, that is, harmonisation in practice (Ali 2005; Murphy 2000). In this respect, in my opinion it is not overstated to claim that culture-related mindset of accountants not eager to change the good old practice is the most significant barrier on Russia's road towards compliance with IFRS. Thus, a change of mindset is needed. Consequently, as no proper professional organisations have emerged in the country to take responsibility for the preparation of IFRSs, government continues to do a bad job: the Russian versions of standards (PBUs) do not match with the IFRSs and lag always behind in time. Central concepts of IFRS are not properly explained and translation problems may lead to shifts in meaning. In addition, to harmonise Russian financial accounting with IFRS it is not enough to only harmonise the standards. Differences can occur due to other accounting-related rules in laws, decrees, acts, orders or other regulations, as it became clear during this research. For example, although PBU 2/2008 in principle matches fully with IAS 11, differences between IFRS and Russian GAAP in the treatment of provisions and specialities related to certain expenses prevent the full congruence. Hence, Russian GAAP's compliance with IFRS may still be far away.

7 CONCLUSIONS

The aim of the research was to find out whether it is possible to reach a situation in which revenue of projects is recognised in Russian financial accounting, and consequently in taxation, simultaneously and at the same amount with revenue recognition according to IFRS and in which IFRS's project accounting would act as a basis for taxation in the case company also in Russia. In addition, my purpose was to clarify in which ways this kind of situation could be reached if laws and standards make it possible. The factors underlying the differences between accounting systems were supposed to deepen the analysis and highlight the cultural aspect of the problem. Inevitably, it became also necessary to discuss the overall harmonisation attempt of Russian GAAP with IFRS, and factors affecting it. Several research questions were set to solve the case. Within a case study research strategy, data were collected through documentary and participant observation and analysed qualitatively through content analysis and explanation building. Three project scenarios were built to provide comprehensive enough answers for research questions. Furthermore, the current situation was first described in order to understand the starting point for the research. Findings from both quantitative and qualitative data were discussed in chapter 6.3.

7.1 Main Findings

The main finding of the research is the proven fact that it is possible to harmonise the revenue recognition of long-term projects between IFRS and Russian GAAP. With right choices of methods and careful planning IFRS and Russian GAAP go hand in hand, as it was seen in Project 4, but there are still deviations between the practices. The most significant of them are related to the concept of long-term contract, the impossibility to form a reserve for late project costs, differences in the treatment of warranty cost accrual and warranty cost reserve, and the strictly defined structure of posting certain expenses to certain accounts without the possibility to include them among project costs. Hence, it was surprising to notice how much project expenses and their treatment affect the differences between IFRS and Russian GAAP. Except for Project 2 in which the concept of long-term creates some difficult considerations, however, the idea of project accounting and the overall results of the projects under Russian GAAP and IFRS correspond to each other though deviations between years can occur.

When considering the effect of differences between IFRS and Russian GAAP on Russian profit taxation, two main points were discovered. First, rules concerning revenue recognition can be harmonised between Russian GAAP and Russian tax accounting. However, the deductibility of expenses creates deviations between profit before tax in financial accounting and the tax base of tax accounting. Secondly, due to the previous point and the fact that it is not possible to form certain provisions either in Russian financial or tax accounting, IFRS can not act as a basis for profit taxation in Russia and the Russian company is obliged to pay more taxes than it would pay if the tax base was calculated according to the rules of IFRS.

Although non-deductible expenses were not that big of a problem in the scope of the discussed projects as thought before, taxation still has a significant influence on the problem researched. The analogy of the concept long-term contract drawn from taxation to financial accounting describes the position in which tax rules stand in Russian accounting and highlights short-term Project 2 as a specific case among the situations studied. Despite of the fact that the project is understood as long-term under Russian tax rules contrary to IFRS's classification, harmonisation between IFRS, Russian GAAP and Russian tax accounting seems to be possible if stages are specifically added to the contract in question. However, due to the profound difference in the classification of the project as short-term under IFRS but on the other hand, as long-term under Russian GAAP and taxation, it is not taken into account when concluding about the findings and providing practical solutions to the case company's problem.

To conclude, there are three levels on which the solution to the research question can be examined. Firstly, the harmonisation between IFRS and Russian GAAP was found to be possible though some differences remain, mainly due to regulations in other legislation than accounting standards. Project revenues in Russia can be recognised simultaneously and at the same amount than under IFRS but the expense side including formation of provisions is the one to generate the differences. Secondly, Russian financial and tax accounting were discovered congruent with each other concerning revenue recognition but divergent due to the non-deductible character of some expenses. Thirdly, because of non-deductibility of late project costs, all in all, the overall profit tax influence calculated according to Russian tax accounting rules was stated higher than it would be if IFRS acted as such as the basis for profit taxation.

The situation regarding Project 2, as mentioned, leads us to consider the effect of tax accounting on financial accounting in Russia. Clearly minor conflicts in financial accounting can be easily forgotten as long as tax accounting is prepared in compliance with all the rules and regulations. Namely, in principle revenue recognition according to the percentage-of-completion method in long-term projects contradicts with the basic principles of the standard PBU 9/99 as revenue is recognised without the transfer of legal title or acceptance of the work by the client at the point of revenue recognition. It seems that those demands are overruled by the requirement of taxation to recognise revenue so that it is divided between all the years the project touches. Taxation affects also the acknowledgement of expenses. Although a company is now perfectly able to self define which expenses to include among direct project expenses on account 20, the time when the account was intended only for absorption costs that were deductible in taxation certainly has an influence also today. Accountants still consider odd the possibility to use account 20 also for project expenses that in the history of Russian accounting would have not been included in deductible absorption costs. Maybe the most significant implication taxation has is related to the general aim of companies to minimise their tax expense which leads to strong resistance to change towards new practices. According to the research, it is the most major problem in the attempt to introduce IFRS as the system to be used also in Russia.

The aim to minimise tax expense derives from the different objective of Russian accounting compared to IFRS accounting. The research has clearly indicated that the different objective arising from the country-specific cultural, social and economic factors affects the applied accounting principles and in particular, the way accounting principles are perceived and interpreted by Russian accountants, as it was suggested in Walton's (1998) model. In Russia, true and fair view in financial reporting is assumed to be reached by leaning on perfect compliance with laws and regulations, that is, form over substance, while under IFRS, professional judgement is appreciated. Form over substance –principle, mainly followed due to taxation purposes in order to avoid tax conflicts, was discovered to prevent many interpretation possibilities that legislative framework provides. Especially this tendency was detected with regard to percentage-of-completion method and its applicability for Russian accounting, and provisions. Hence, the mindset of Russian accountants show strong resistance to change which can be stated as the most significant barrier on Russia's road towards compliance with IFRS

7.2 Practical Considerations

The practical steps in the process of bringing Russian accounting closer to IFRS begin by updating the accounting policy of the company. Percentage-of-completion method should be named as a method for recognising revenue from long-term contracts, and the list of expenses belonging to account 20 should be expanded to cover all project-related expenses. Some expenses, such as exchange losses, however, can not be added to the list. Moreover, account 46 should be taken into use in order to summarise information on stages of work that have been completed. Since financial accounting through standards PBU 9/99 and PBU 2/2008 allow and concerning construction contracts, even demand the use of percentage-of completion method, and the Tax Code makes the use of the method also possible, by attending to that no stages are included in contracts, most of the barriers in the way of harmonising IFRS, Russian GAAP and Russian tax accounting can be overcome. Hence, contract technique, as well as clear rules to be followed in project accounting by both project managers and accountants, need to be updated.

The problem of the case company, considering both the technical and cultural aspects, could be solved at once if IFRS was accepted as the base for profit taxation as such. This kind of possibility was insinuated already by former Vice Minister of Finance M. Motorin stating that "in the absence of Russian standards the base for tax will be calculated according to the London IFRS Board's rules" (McGee & Preobragenskaya 2006, 33). However, no plans for converging IFRS as the basis of tax reporting have been announced. Moreover, the whole idea would be difficult to enforce since IFRS is not interested in national taxation issues and Russian legislators continue to promulgate their own standards instead of just repealing the current ones and adopting IFRSs automatically as a part of the Russian practice.

Based on the research, Russian GAAP applied in practice seems to have more common with continental than Anglo-Saxon accounting model although some aspects, for example the reluctance to make provisions, argue the view. Pressures for harmonisation of Russian GAAP with IFRS are, though, high. However, it is predominantly harmonisation with the Anglo-Saxon accounting model; it thus conflicts with the economic, social and cultural environment of the Russian system. An existence of de-jure harmonisation without concurrent de-facto harmonisation is not enough; principles of IFRS should be taken also to practical level, which, again, demands a lot from the government promulgating the standards and respectively, from Russian accountants applying them. Within the research, it is impossible to come to one conclusion on how accountants would learn to understand the IFRSs. It is, however, beyond dispute that communication with, inside and between international companies is necessary in order to reach the aim.

Another question to consider here is the doubt about whether it is even necessary to force Russia to adapt to the Western model. Namely, the basic assumption behind also this research is the view that what is done in Finland or Austria is much better and of higher quality than that of Russia. Of course, on the company level, the harmonisation of practices creates some undeniable advantages but it could also be argued for whether it would be more reasonable to let the Russians do what they are best at and leave the consolidation accounts to someone else's concern. Naturally, that would override the whole point of this particular research and be a little bit too a pessimistic angle. To conclude, McGee and Preobragenskaya (2004) remind that markets do their job, in general, well. In the more and more globalised world companies inevitably meet the need to attract capital from international markets. To be able to receive funds, international financial reporting standards are in time applied. All in all, there are many signs in the air that Russian financial and tax accounting are on the threshold of moving closer and closer to the Western practice. This inevitably creates better conditions for understanding and interpreting the legislation from the point of view of IFRS.

7.3 Evaluation of the Research

In establishing trustworthiness of a research, or in other words, in answering the question "how do I know?", validity and reliability are central concepts. Reliability deals with the concern whether the tool or instrument used for measurement produces consistent, non-random, results. It can be assessed mainly by ensuring the possibility to replicate the research. Validity is concerned with whether the tool or instrument used for measurement measures what it is supposed to be measuring and consistently, whether the findings are really about what they appear to be about. These concepts, however, were initially developed in the context of quantitative research and their application to qualitative research is loaded with certain reservations. (Hirsjärvi et al. 2009, 231-232.) Thus, Lincoln and Guba (1985 cited in Robson 2002, 170), for example, prefer the terms credibility, transferability, dependability and confirmability.

Credibility parallels with internal validity and seeks to provide an answer to the question, how believable the findings of the research are. It is concerned with the issue how well the researcher's observations on the phenomenon studied correspond to the conclusions and theoretical ideas the researcher develops. (Bryman & Bell 2007, 410-413.) The main data analysis method, content analysis is criticised as being an incomplete analysis method and producing only organised material for the basis of conclusions. Organised material is often presented as results and in the end, no reasonable conclusions are made at all. (Tuomi & Sarajärvi 2009, 103.) This pitfall is prevented by uniting the analysis based on company data and calculations with the literature on differences between accounting systems and culture as a main reason for differences. In order to be able to show consistent cause-effect relationships, explanation building is used here as a technique during data analysis. In addition, the representatives of the case company have read the report and confirmed that no inconsistencies between the data produced by the company and the findings made based on them are included. Credibility is further increased by data and methodological triangulation.

Transferability is concerned whether the findings apply to other contexts and thus, parallels with external validity (Bryman & Bell 2007, 410-413). Criticism about single-case studies usually reflects fears about the uniqueness or artifactual condition surrounding the case (Yin 2003, 53-54). However, Saunders et al. (2007, 327) state that a well-completed and rigorous case study can more likely be useful in other contexts than one that lacks such rigour. The problem of generalisation is taken into account already in the introduction. Though the subject of the research is only studied within one case, it can be assumed that also other international companies operating in Russia face similar challenges and could gain some benefits from this study.

As a parallel to reliability, dependability is concerned on whether the findings are likely to apply at other times (Bryman & Bell 2007, 410-414). Although reliability is not one of the biggest concerns of the qualitative research, there are often common pitfalls in data collection and transcription including equipment failure, environmental distractions and interruptions. These can be prevented by being thorough, careful and honest in conducting the research and by showing that to others. (Robson 2002, 176.) It is not necessarily even intended that all methods, such as interviews and participant observation, are repeatable since they reflect reality at the time they were collected, in a situation which may be subject to change (Saunders et al. 2007, 319). Within this study, the grounds, objectives and ways to answer the research questions are carefully explained in the beginning. The chosen research strategy and methods have been examined and legitimated, while the actual implementation and critics to the implementation of the research are explicitly reported. The careful reporting continues throughout the work.

Confirmability is concerned with objectivity of the research: has the researcher acted in good faith without allowing personal values to intrude (Bryman & Bell 2007, 414). This question has been discussed in the introduction. It is acknowledged that my background and experience may have created some preconceptions about the research problem. However, by being conscious of the problem I have tried to minimise the effects of researcher bias. This is partly enhanced by being transparent in all my choices and explanations through the research. Objectivity is also related to the major threats to validity of a research introduced by Lincoln and Guba (1985 cited in Robson 2002, 172-175) and partly discussed already beforehand: reactivity, respondent bias and researcher bias.

Having now proved that the essential factors in establishing a trustworthy research have been taken into consideration, it is time to evaluate the research overall. The starting point for the study was the problem of the case company that was hoped to be solved technically within the legislation concerned, e.g. to find out how project accounting in Russia could be brought closer to IFRS. In addition, it was essential to examine the reasons that have lead to the situation, the mental side of the problem. The subject has never been studied to this extent and in this scope before although it can be seen as highly actual for many international companies operating in Russia. The problem was intended to be solved by case study research strategy, both qualitative and quantitative data collection methods and by analysing the data qualitatively. All the research questions were answered during the work. Furthermore, a variety of both theoretical and practical information on differences in project accounting practices between IFRS and Russian GAAP, their effect on taxation (or other way around) and reasons for the differences was discovered, however the subjective and case study character of this research have to be taken into consideration when making generalisations.

The biggest trouble in conducting a feasible research was related to the rather diverse research questions, the two-fold purpose of the research and the combination of both qualitative and quantitative data. The aim to understand a phenomenon inevitably leads to some considerations related to the trustworthiness of the research. Within this study, the data concerning the effect of culture and other factors on differences between IFRS and Russian GAAP were derived only through participant-observation which is a method prone to many external influences. Firstly, researcher's attitude and preconceptions may affect the results gained by means of the method. Similarly, the environment and people being observed may not act as they would without the observer, which may lead to faulty reasoning about the cause-effect relationships. However, in my opinion, the results obtained through participant-observation create a useful basis for considering the problem of the case company further.

The research is carried out systemically, sceptically and ethically, that is, with scientific attitude as proposed by Robson (2002, 18). In this case, systemically refers to giving serious thought to what I am doing, how I am doing it in the circumstances given and in the role I have taken in conducting the research. Sceptically, on the other hand, means subjecting my ideas, observations and conclusions to doubt and scrutiny, while ethically encompasses the requirement to follow a code of conduct ensuring that the interests and concerns of those taking part in the research are taken into consideration.

7.4 Suggestions for Future Research

The joint project of the IASB and FASB to modernise and harmonise the revenue recognition standards has already proceeded to the point in which the exposure draft of the standard "Revenue from Contracts with Customers" has been released. The new standard relies on the principle of performance obligation and its satisfaction that usually takes place when the client receives control over the goods or services under a contract. It is assumed that the new standard will change the revenue recognition practices under IFRS, maybe even significantly. On the other hand, Russian GAAP has plans to update its revenue recognition standards to match with IFRS. Considering the recent, slow development in the convergence process, the update will presumably be made in compliance with the current IFRSs, not with the new one. Hence, maybe already in a year, a research with the same scope as this could be conducted within the brand new legislative framework of IFRS and Russian GAAP.

There are also several other topics that could be further researched. Differences in accounting principles between IFRS and Russian GAAP and reasons for them could be analysed in more detail by testing the cause-effect relationships for example with quantitative measures. Tests could be then directed to the practical level to find out how different accounting principles are applied in practice regarding two different accounting systems. The analysis on the practical level could be conducted, for example, with regards to issues such as revenue recognition, provisions or financial instruments. Also historical perspective could be taken into consideration; the development of IFRS and Russian GAAP differs significantly and could enlighten the way accounting is done today. Furthermore, the effect of language and culture on the application of IFRS's accounting principles in Russia would certainly provide some useful information. Finally, some other problem that international companies face when trying to convert local Russian accounting to consolidated accounting under IFRS might also prove to be interesting to study.

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APPENDIX 1: Provisions on Accounting (PBUs)[1]

Number / effective year	Name
PBU 1/2008	Accounting Policies of an Organisation
PBU 2/2008	Construction Contracts
PBU 3/2006	Accounting for Assets and Liabilities whose Value is Expressed in Foreign Currency
PBU 4/1999	Accounting Reports of an Organisation
PBU 5/2001	Accounting for Inventories
PBU 6/2001	Accounting for Fixed Assets
PBU 7/1998	Events Occurring After the Reporting Date
PBU 8/2001	Economic Contingencies
PBU 9/1999	Income of an Organisation
PBU 10/1999	Expenses of an Organisation
PBU 11/2008	Related Party Disclosures
PBU 12/2010	Segmented Information
PBU 13/2000	Recording of State Assistance
PBU 14/2007	Accounting for Intangible Assets
PBU 15/2008	Loan and Credit Expenses
PBU 16/2002	Information on Discontinuing Operations
PBU 17/2002	Accounting for Research, Development and Technological Work
PBU 18/2002	Accounting for Profit Tax Settlements of Organisations
PBU 19/2002	Accounting for Financial Investments
PBU 20/2003	Information Concerning Participation in Joint Activities
PBU 21/2008	Changes in Accounting Estimates
PBU 22/2010	Correction of Errors in Accounting and Financial Statements

1 Standards are presented as in http://www1.minfin.ru/ru/accounting/accounting/legislation/positions/. Though partly revised, the translations are based on the report of Ernst & Young (Ernst & Young 2009, 40).

APPENDIX 2: Significant differences between IFRS and Russian GAAP[2]

The absence of specific rules on recognition and measurement in the following areas:

Provisions regarding business combinations accounted for as acquisitions	IFRS 3
Consolidation of special purpose entities	SIC 12
The restatement of financial statements of a company reporting in the currency of a hyperinflationary economy in terms of the measuring unit current as of the balance sheet date	IAS 29
The translation of financial statements of hyperinflationary subsidiaries	IAS 21
The treatment of accumulated deferred exchange differences on the disposal of a foreign entity	IAS 21
De-recognition of financial assets	IAS 39
Recognition of operating lease incentives	SIC 15
Accounting for defined benefit pension plans and some other types of employee benefits	IAS 19
Accounting for an issuer's financial instruments	IFRS 2,
Accounting for derivative financial instruments	IAS 39
Hedge accounting	IAS 39
Accounting for long-term assets held for disposal	IFRS 5

No specific rules requiring the disclosure of:

The fair values of financial assets and liabilities	IFRS 7
The fair values of investment properties	IAS 40
Certain segment information (e.g., a reconciliation between the information by reportable segment and the aggregated information in financial statements; significant non-cash expenses other than depreciation and amortisation that were included in the segment expense and, therefore, deducted in measuring the segment result – for each reportable segment)	IAS 14
Summarised financial information on associates	IAS 28
Extensive disclosures on business acquisitions/disposals	IFRS 3
Significant management judgements made in the process of applying the entity's accounting policies and key sources of estimation uncertainty	IAS 1, IAS 26

[2] The information is based on the results of "GAAP 2001 – A Survey of National Accounting Rules", conducted by seven leading accounting firms, including PricewaterhouseCoopers, and updated to include the latest developments in both Russian GAAP and IFRS (PwC 2010b, 42).

Inconsistencies between Russian GAAP and IFRS that can lead to differences in certain areas. Under Russian GAAP:

Goodwill is calculated by reference to the book value of acquired net assets	IFRS 3
Proportionate consolidation may be used for subsidiaries in which the parent holds 50% or less of the voting shares	IAS 27
The useful life of property, plant and equipment is usually determined using periods prescribed by the government for tax purposes	IAS 16
Finance leases are generally defined in legal terms and the right of capitalisation is given to a lessor or a lessee by a contract	IAS 17
Derivative financial assets and liabilities are not recognised	IAS 39
Provisions can be established more widely or less widely than under IFRS	IAS 37
The correction of errors is included in the determination of the net profit or loss for the reporting period, in which errors were identified (no retrospective correction is allowed)	IAS 8
Revenue recognition rules do not differentiate between exchanges of goods of a similar nature and value and exchanges of dissimilar goods, and do not discuss adjustment for the amount of cash or cash equivalents transferred in exchanges for dissimilar goods	IAS 18

The following issues can also lead to differences:

Some parent companies do not prepare consolidated financial statements under IFRS	IAS 27.10
In the definition of control, it is not required that the ability to govern decision-making be accompanied by the objective of obtaining benefits from the entity's activities	IAS 27
Certain subsidiaries may be excluded from consolidation beyond those referred to in IFRS	IFRS 3
A subsidiary that is a bank may be excluded from consolidation if it is dissimilar from the rest of the group	IAS 27
Internally generated brands and similar items can be capitalised if the enterprise has an exclusive legal right	IAS 38
The realisable value of inventories is measured without the deduction of selling costs	IAS 2

APPENDIX 3: Chart of Accounts for Bookkeeping for the Financial and Economic Activities of Organisations[3]

Name of account	Account number	Number and name of subaccount
1	2	3
SECTION I NON-CURRENT ASSETS		
Fixed assets	01	By type of fixed asset
Amortisation of fixed assets	02	
Income-bearing investments in tangible assets	03	By type of tangible asset
Intangible assets	04	By type of intangible asset and by type of expenses for research, development and technological work
Amortisation of intangible assets	05	
…………………………………..	06	
Equipment to be installed	07	
Investments in non-current assets	08	1. Acquisition of plots of land 2. Acquisition of sites for the use of natural resources 3. Construction of fixed assets 4. Acquisition of items of fixed assets 5. Acquisition of intangible assets 6. Transfer of young animals to main herd 7. Acquisition of adult animals 8. Performance of research, development and technological work
Deferred tax assets	09	

[3] План счетов бухгалтерского учета финансово-хозяйственной деятельности организаций и Инструкция по применению плана счетов бухгалтерского учета финансово-хозяйственной деятельности организаций (утверждены приказом Минфина России от 31 октября 2000 г. № 94н, с изменениями от 07 мая 2003 г. № 38н, от 18 сентября 2006 г. № 115н, от 08.11.2010 № 142н). The Chart of Accounts for Bookkeeping for the Financial and Economic Activities of Organisations and the Instruction on the Application thereof (promulgated by Order No. 94n of the Ministry of Finance of the Russian Federation of October 31, 2000 and amended by Order No. 38n of May 7, 2003, Order No. 115n of September 18, 2006 and Order No. 142n of November 8, 2010).

SECTION II PRODUCTION STOCK		
Materials	10	1. Raw materials and other materials 2. Bought-in-semi-finished products and components, structures and parts 3. Fuel 4. Tare and packing materials 5. Spare parts 6. Sundry materials 7. Materials transferred to third parties for processing 8. Building materials 9. Equipment and maintenance accessories 10. Special gear and special clothing in storage 11. Special gear and special clothing in use
Rearers and fatteners	11	
…………………………………….	12	
…………………………………….	13	
Reserves against decreases in the value of tangible assets	14	
Procurement and acquisition of tangible assets	15	
Deviation in value of tangible assets	16	
…………………………………….	17	
…………………………………….	18	
Value added tax on acquired assets	19	1. Value added tax upon acquisition of fixed assets 2. Value added tax on acquired intangible assets 3. Value added tax on acquired inventory
SECTION III PRODUCTION COSTS		
Main production unit	20	
Semi-finished products of own manufacture	21	
…………………………………	22	
Auxiliary production units	23	
…………………………………	24	
General production expenses	25	
General business expenses	26	
…………………………………	27	
Spoilage in production	28	
Service plants and facilities	29	
…………………………………	30	
…………………………………	31	

…………………………………	32	
…………………………………	33	
…………………………………	34	
…………………………………	35	
…………………………………	36	
…………………………………	37	
…………………………………	38	
…………………………………	39	
SECTION IV FINISHED PRODUCTS AND GOODS		
Manufactue of products (work and services)	40	
Goods	41	1. Goods in storage 2. Goods in retail sale 3. Full and empty tare 4. Bought-in products
Trade mark-up	42	
Finished products	43	
Sale expenses	44	
Goods despatched	45	
Completed stages of work-in-progress	46	
…………………………………	47	
…………………………………	48	
…………………………………	49	
SECTION V MONETARY RESOURCES		
Cash	50	1. Cash office of organisation 2. Operational cash 3. Monetary documents
Settlement accounts	51	
Currency accounts	52	
…………………………………	53	
…………………………………	54	
Special bank accounts	55	1. Letters of credit 2. Cheque books 3. Deposit accounts
…………………………………	56	
Transfers in transit	57	
Financial investments	58	1. Stocks and shares 2. Debt securities 3. Loans granted 4. Contributions under simple partnership agreement
Reserves against the devaluation of financial investments	59	

SECTION VI SETTLEMENTS		
Settlements with suppliers and contractors	60	
……………………………….	61	
Settlements with purchasers and clients	62	
Doubtful debt reserves	63	
……………………………….	64	
……………………………….	65	
Settlements in respect of short-term credits and loans	66	By type of credit and loan
Settlements in respect of long-term credits and loans	67	By type of credit and loan
Settlements in respect of taxes and levies	68	By type of tax and levy
Settlements in respect of social insurance and social security	69	1. Settlements in respect of social insurance 2. Settlements in respect of pension provision 3. Settlements in respect of compulsory medical insurance
Settlements with staff in respect of payment for labour	70	
Settlements with accountable persons	71	
……………………………….	72	
Settlements with staff in respect of other operations	73	1. Settlements in respect of loans granted 2. Settlements in respect of compensation for material damage
……………………………….	74	
Settlements with founding parties	75	1. Settlements in respect of contributions to charter (pooled) capital 2. Settlements in respect of income payments
Settlements with sundry debtors and creditors	76	1. Settlements in respect of property and personal insurance 2. Settlements in respect of claims 3. Settlements in respect of dividends and other income due 4. Settlements in respect of deposited amounts
Deferred tax liabilities	77	
……………………………….	78	

Intra-organisational settlements	79	1. Settlements in respect of allocated assets 2. Settlements in respect of current operations 3. Settlements under agreement on the fiduciary management of assets
SECTION VII CAPITAL		
Charter capital	80	
Own shares (share interest)	81	
Reserve capital	82	
Additional capital	83	
Undistributed profit (uncovered loss)	84	
…………………………………	85	
Special purpose financing	86	By type of financing
…………………………………	87	
…………………………………	88	
…………………………………	89	
SECTION VIII FINANCIAL RESULTS		
Sales	90	1. Receipts 2. Cost of production of sales 3. Value added tax 4. Excise duties 9. Profit/loss from sales
Miscellaneous income and expenses	91	1. Miscellaneous income 2. Miscellaneous expenses 3. Balance of miscellaneous income and expenses
…………………………………	92	
…………………………………	93	
Shortages and losses due to impairment of assets	94	
…………………………………	95	
Reserves for future expenses	96	By type of reserve
Expenses of future periods	97	By type pf expenses
Income of future periods	98	1. Income received in respect of future periods 2. Receipts without consideration 3. Future receipts of indebtedness in respect of shortages revealed for previous years 4. Difference between amount recoverable from guilty parties and balance sheet value with respect to shortages of assets
Profits and losses	99	

OFF-BALANCE-SHEET ACCOUNTS		
Leased fixed assets	001	
Goods and materials accepted for custody	002	
Materials accepted for processing	003	
Goods accpeted on commission	004	
Equipment accepted for assembly	005	
Strict reporting forms	006	
Indebtedness of insolvent debtors written off to losses	007	
Securities received for obligations and payments	008	
Securities given for obligations and payments	009	
Depreciation of fixed assets	010	
Leased-out fixed assets	011	