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THE IMPACT OF IFRS ADOPTION ON ACRUAL-BASED EARNINGS MANAGEMENT: EVIDENCE FROM RUSSIA

Master’s Thesis
Department of Accounting
May 2014
This paper examines the impact of the IFRS adoption on earnings management and earnings quality in Russia. Despite the fact that multiple surveys and papers focus on earnings quality, earnings management and IFRS research, these topics are still actively being studied. This research is motivated by the increase of attention to the IFRS implementation process in Russia. The process of harmonization of Russian Accounting Standards with IFRS takes long time as there are significant differences between these two standards. The reasons for that are Russian economic and political issues.

Existing academic research shows controversial results concerning the impact of the IFRS adoption on earnings quality. Some research provides evidence that the IFRS adoption brings significant benefits to a country as it improves disclosure quality and informational environment around the IFRS adoption. However, several studies argue, that, at the same time, IFRS give significant flexibility and discretion to managers. This does not always mean the improvement of disclosure quality. In this paper we provide one more examination of how IFRS influences earnings quality.

This thesis studies the accrual-based type of earnings management. The empirical analysis employs the linear regression model which includes a dependent variable (discretionary accruals) and several control variables. The Jones model is used for the estimation of discretionary accruals as a measure of earnings management. The sample used for the analysis contains 577 observations of Russian companies from various industries during the period 2006-2012.

This research proves that IFRS adoption increases accruals-based earnings management which leads to lower earnings quality in Russian companies. The results of the empirical research support the hypothesis that a positive correlation exists between IFRS adoption and earnings management. The results show that Russian companies use downward earnings management (income minimization) mostly. Finally, this paper demonstrates that IFRS do not always have a positive impact on the quality of accounting information. The adoption of IFRS in Russia is close to the final steps, but it is still not clear if it brings real benefits to the Russian business environment.

The limitations of this study are the usage of the Jones model instead of the Modified Jones model and the relevancy of data set.
ACKNOWLEDGEMENTS

Foremost, I would like to express my sincere gratitude to my supervisor Professor Juha-Pekka Kallunki for his continuous support and advice. Also I would like to thank Dr. Henry Jarva for his help and assistance in data collection.

My sincere thanks also goes to my best friends Rimma Sadykova and Valeriy Zurnachyan for making our studies at Oulu Business School unforgettable.

Last but not the least, I would like to thank my family for supporting and motivating me. My special thanks goes to Oleg for his unofficial guidance, as well as for patience, enthusiasm, support and inspiration.

Oulu, May 2014                              Maria Budrina
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<tr>
<td>BRIC</td>
<td>Brazil, Russia, India, China</td>
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<tr>
<td>CAPEX</td>
<td>Capital Expenditure</td>
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<tr>
<td>CEO</td>
<td>Chief Executive Officer</td>
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<td>CFO</td>
<td>Chief Financial Officer</td>
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<tr>
<td>COGS</td>
<td>Cost Of Goods Sold</td>
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<tr>
<td>EBITDA</td>
<td>Earnings Before Interest, Taxes, Depreciation and Amortization</td>
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<tr>
<td>EU</td>
<td>European Union</td>
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<tr>
<td>FIFO</td>
<td>First In, First Out</td>
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<td>GAAP</td>
<td>Generally Accepted Accounting Principles</td>
</tr>
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<td>IASB</td>
<td>International Accounting Standards Board</td>
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<td>IASC</td>
<td>International Accounting Standards Committee</td>
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<td>IAS</td>
<td>International Accounting Standards</td>
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<td>IPO</td>
<td>Initial Public Offering</td>
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<td>IFRS</td>
<td>International Financial Reporting Standards</td>
</tr>
<tr>
<td>LSE</td>
<td>London Stock Exchange</td>
</tr>
<tr>
<td>LIFO</td>
<td>Last In, First Out</td>
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<tr>
<td>M&amp;A</td>
<td>Mergers and Acquisitions</td>
</tr>
<tr>
<td>NYSE</td>
<td>New York Stock Exchange</td>
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<tr>
<td>PPE</td>
<td>Property, Plant and Equipment</td>
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<tr>
<td>RAS</td>
<td>Russian Accounting Standards</td>
</tr>
<tr>
<td>R&amp;D</td>
<td>Research and Development</td>
</tr>
<tr>
<td>SEC</td>
<td>Securities and Exchange Commission</td>
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<td>SMEs</td>
<td>Small and Medium-sized Enterprises</td>
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1 INTRODUCTION

1.1 Background

International Financial Reporting Standards (IFRS) are international accounting standards created in 1973 by International Accounting Standards Committee (IASC) which was later renamed to International Accounting Standards Board (IASB). IFRS were expected to become key financial reporting standards for all entities all around the world. According to IASB the goal of the IFRS creation is “to develop, in the public interest, a single set of high-quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles” (IASB 2012).

At the moment the largest part of major economies has already adopted IFRS and about 113 countries are in the process of the IFRS adoption through the harmonization of local standards with IFRS (IASB 2012). The Russian Federation is one of the countries where the process of the IFRS adaption is still going on.

The process of harmonization of Russian Accounting Standards (RAS)1 with IFRS takes long time as there are significant differences between these two standards. The reason for that are Russian economic and political issues. The Russian accounting environment was dependent on government and tax authorities for a long time because of historical factors. Financial reporting rules and standards were determined by the tax authorities rather than by the accounting professionals.

After the collapse of the Soviet Union in 1991, Russia entered the international market. However, the Russian state-planned economy could not compete at this market, and Russia started to shift from planned to market economy. It was the process of economic modernization and development, recovery from recession and the emergence of private owners of assets.

Nowadays, the Russian Federation is a country with transitional economy which moves from

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1 Also called Russian Accounting Principles or Russian GAAP
central planning economy toward market economy. The process of transition requires significant changes in all areas of the economy including the finance sector, taxation, accounting, corporate governance and security market. Although this process has started in 1991, the country still faces different problems in setting new institutions and introducing new reforms.

In order to meet the requirements of new market environment, the Ministry of Finance introduced the standardized system of accounting (RAS) in 2000. RAS significantly differ from international accounting standards, but the Russian government implements a program of harmonization of RAS with IFRS. During this process, the Ministry of Finances of the Russian Federation issues new accounting standards to line up Russian accounting practices with IFRS. Nevertheless, there are still crucial differences between RAS and IFRS, and the process of their aligning continues gradually. Thus, during the last fourteen years the Ministry of Finance has been running the process of the IFRS adoption. This process is expected to be completed in 2018 (RIA 2013).

This process of harmonization of international accounting standards has a lot of difficulties as Russia has historically its own accounting rules, and breaking them is not easy. Although most of small and medium-sized enterprises (SMEs) still use only RAS for financial reporting, the majority of the world-known Russian corporations apply IFRS.

Usually, the implementation of international standards in accounting is dictated by economic needs. High-quality financial reporting is an essential condition for the development of financial markets and healthy economy. Therefore, IFRS will be inevitably incorporated into the Russian accounting system, but the speed of this process will depend on how effective is the interaction between the government, business entities, the professional accounting and the auditing community.

The Russian economy is growing at a fast rate since 2000s. The Russian government is interested to attract foreign investments to the Russian economy. However, the process of transition from the command economy to the market economy is still going on in Russia, and IFRS is not totally adopted yet. Moreover, Russia is well known as one of the most corrupted
countries in the world due to the inefficient governance in both companies and the country. Overwhelming bureaucracy and bribery have become the critical characteristics of the Russian economy. Companies have perfect conditions for accounting manipulations in such economic environment. Hence, the quality of reported accounting information is very low. As a result, these factors create high political and economic risks which lead to the high degree of uncertainty that has negative effects on the flow of foreign investments.

Besides, the transition process occurring in Russia and frequent state reforms bring instability to the accounting sector and create possibilities for earnings management. Generally speaking, earnings management is the practice of using different accounting principles in order to produce desired financial results. Due to the prevalence of gray economy and widespread corruption, such accounting manipulations became a typical practice for Russian companies, especially tax management (tax minimization or tax benefits optimization). The managers are not motivated for proper accounting and increasing quality of reporting. Thus, Russia is known as a country of low quality financial reporting and earnings management is one of the reasons.

According to Scott (2003, 369), earnings management is the choice by a manager of accounting policies so as to achieve some specific objectives. Earnings management is one of determinants of earnings quality. For example, Lo (2008) examines how earnings management and earnings quality are related to each other (based on Ball & Shivakumar 2008). Hadani et al. (2011) argues that earnings management increases information asymmetry and negatively impacts the quality of financial reports. Due to this fact, earnings management has a significant impact on earnings quality (i.e. the quality of reported information) and, consequently, earnings quality is negatively correlated to earnings management. If managers manipulate earnings, the reported results become less reliable and the quality declines. Managers can apply legal and permitted accounting methods or practices, but the negative effect on earnings quality is inevitable.

Financial statements helps investors and the public to make predictions about future performance of a company. Thus, outsiders or the public demand the high quality of earnings and the guarantee of this quality. The world practice shows that the high quality of
information might be achieved by the direct use of IFRS or by applying IFRS as a basis for a national system of accounting and reporting. Hence, the implementation of IFRS is essential for improving earnings quality in Russia. The application of IFRS is expected to decrease earnings management and, as a consequence, improve earnings quality.

The Russian Federation has one of the largest economies in the world. But, compared to Europe and USA, it is a country with the transition economy and poor industrial development. Russia came through dramatic changes in the economy over the last 20 years, such as different economic reforms, the growth of the stock market, the procedure of the IFRS adoption. The IFRS implementation is one of the most significant events in the world accounting history and in Russian accounting history as well. The process of the IFRS adoption in Russia comes to the end and it is possible to analyze its results.

1.2 Previous academic research

IFRS is currently a hot topic in the accounting community as the process of the IFRS adoption goes on in many countries. Multiple researchers study IFRS and its influence on different aspects of business in general. The topic of earnings management has been also studied for a long time by academics and practitioners. However, it received great attention last years due to the accounting scandals in 2000s. These scandals raised the question of the quality of financial reporting, and it is commonly known that earnings management is the key determinant of earnings quality.

1.2.1 IFRS and earnings quality

IFRS were created as a common global language for accountants all around the world and it was expected to become the key financial reporting standards for all business entities. IFRS provides understandable, reliable, relevant and comparable accounting rules which can be implemented in every country. IFRS is especially important for growing international companies. At the moment, a lot of countries replaced national accounting standards by IFRS in order to make local accounting more transparent, reliable, relevant and understandable.
The process of the IFRS implementation in different countries has been studied for a long time by multiple researchers. Most of research papers state that the main goal of IFRS is to create better transparency in financial reporting and improve its quality (Bath et al. 2008, Ball et al. 2000, Alon 2013, Amiram 2012, Bagaeva 2009, Borker 2012, Ahmed et al. 2013, Daske et al. 2008, Kao 2013). Ball et al. (2000) and Amiram (2012) point out that IFRS improve market infrastructure, decrease information processing costs, boost international M&A, increase reporting quality and, thus, attract foreign investments.

It is a commonly known fact, that investors and analysts make their estimations based on companies’ reported financial statements. Consequently, they are interested in the reliability of this information and its relevance. The information is considered of high quality if it is relevant and reliable. Otherwise, it is considered as low quality information and investors can not trust the reported data.

Existing research on the topic provides evidence that the IFRS adoption brings significant benefits to the country as it improves disclosure quality and informational environment around the IFRS adoption (Ball et al. 2000, Daske et al. 2008, Barth et al. 2008, Christensen et al. 2008, Alon 2013, Bagaeva et al.2008). However, several studies argue that, at the same time, IFRS give significant flexibility and discretion to managers, that does not always mean the improvement of disclosure quality (Ball et al. 2000, Barth et al. 2008, Christensen 2012, Leuz et al. 2003).

The IFRS adoption is expected to improve the quality of accounting information. For example, Bath et al. (2008) examine whether the application of IAS is correlated to higher earnings quality. Authors use three determinants of accounting quality: earnings management, timely loss recognition and value relevance metrics. The research provides general evidence from 21 countries that adopted IAS between 1994 and 2003 and it proves that the application of IAS results in less earnings management, more timely loss recognition and higher value relevance (Bath et al. 2008). The accounting quality in general improves between pre- and postadoption periods. Although the results of Bath et al. (2008) study support the believe that IFRS improve earning quality, this research also provides reasons both for earnings quality improvement and reduction.
It should be noted that the process of the IFRS implementation varies significantly from country to country due to political, cultural, economic, legal and other aspects. Some countries even state that they converge national accounting rules to IFRS, but they hardly ever will reach full compliance with IFRS (Alali & Cao 2010).

According to Bagaeva et al. (2008), international investors prefer financial reports prepared using IFRS rather than prepared in compliance with RAS. Also it must be mentioned that international investors motivate companies to provide more accurate financial reports and adopt IFRS as an instrument of international accounting. The implementation of IFRS increases earnings quality and makes the financial reports more understandable for the foreign investors (Bagaeva et al. 2008).

Similarly, Ahmed (2009) has proved that Russian companies which use IAS for financial statements have better earnings quality than others companies which still using RAS. Due to the fact that most Russian companies apply RAS, the general quality of earnings is still rather low.

The quality of published accounting information is rather a complex concept and it is hard to improve it just by the IFRS implementation and government reforms. In addition to accounting standards, other factors influence accounting quality too. These factors are state institutions, political difficulties, cultural issues and others. Thus, it is difficult to make one convinced conclusion if IFRS has a positive or negative effect on the quality of accounting information.

1.2.2 Earnings management in Russia

The impact of earnings management on earnings quality has been also examined in several research papers (Bagaeva et al. 2008, Ball & Shivakumar 2008, Dechow et al. 2010, Lo 2008, Spohr 2005, etc.). Some researches look at earnings management as a normal and casual activity in accounting (Ball & Shivakumar 2008, Hadani et al. 2011, Hazarika et al. 2012), while others examine it as a criminal activity (Lo 2008, Healy & Wahlen 1999). Nevertheless, earnings management has negative correlation to earnings quality and
decreases the quality of financial reports.

Multiple researches have examined the incentives for using earnings management by managers (Healy 1985, Dechow et al. 2010, Goncharov & Zimmermann 2006, Klein 2002, Ball & Shivakumar 2008, Burgstahler & Dichev 1997, Lo 2008 etc.). Researchers distinguish different aspects of motivations for managing earnings such as managers’ bonuses, companies’ debt covenant, political reasons, taxation purposes, the change of CEO, IPO, and market’s expectations. Russian companies apply earnings management practices mostly for taxation and bank financing purposes, for earnings stream smoothing and to meet the market’s and investors’ expectations.

Earnings management is difficult to detect. However, there are several different models for detecting earnings management and all of them are widely analyzed in literature on earnings management (Healy 1985, DeAngelo 1986, Jones 1991, Dechow & Sloan 1991, Dechow et al. 1995). However, usually the Jones model (Jones 1991) and the Industry model (Dechow & Sloan 1991) are used for empirical research. All these models focused on detecting accrual-based earning management. Total accruals of the company might be divided into discretionary (abnormal) accruals and non-discretionary (normal) accruals. Non-discretionary accruals are a part of the earning which managers have no flexibility to change (e.g., depreciation and amortization). Discretional accruals, on the contrary, are easily influenced by managers and can be used for manipulations. These models assume that non-discretionary accruals are constant over the period and that helps to detect manipulations in discretionary accruals.

Earnings management is a very popular and a widely used practice in Russian companies. By analyzing the existing research on earnings management and other business resources, we can categorize the most common accounting practices of earnings management used in Russia. We use the patterns of earnings management described by Scott (2003, 383-384) in order to systemize the results:

1. Income minimization (managing earnings downward)

   Russian companies use tax management to decrease tax expenditures. Goncharov &
Zimmerman (2006) examined the role of tax accounting in Russia and its influence on earnings management. For private firms, the main user of their accounting information is still tax authorities and the role of financial accounting is to calculate tax expenses (Preobragenskaya & McGee 2004). Due to such differences, Russian public companies use tax management less aggressively in order to have higher quality earnings (Goncharov & Zimmerman 2006).

2. Income maximization (managing earnings upward)
The research by Goncharov & Zimmerman (2007) also demonstrates that, typically, Russian companies manage earnings upward in order to avoid reporting losses when they apply for bank loans. In other words, companies use earnings management around the lending process to report the positive earnings figures.

3. Income smoothing
The tax accounting in Russia motivates managers not only to reduce profits in order to pay lower taxes, but also to use earnings smoothing in order to create a stream of earnings and decrease risk in order to ensure risk-free relations with tax authorities (Bagaeva 2009). The findings show that Russian companies, which use IFRS for their financial reporting, have better earnings quality in terms of diminished earnings smoothing (Bagaeva 2009). Thus, the usage of IFRS increases the quality of accounting information and decreases earnings smoothing in a company.

Important finding was done by Ahmed (2009). The author found out that earning management has changed the direction from income maximization (positive earnings management) to income minimization (negative earnings management). The change happened after the year 2001, when the corporate governance reforms were implemented by the Russian government. During the pre-reform period Russian, companies increased income (accruals) to show better performance in order to get internal and external financing, while negative earnings management is explained by the IAS adoption (Ahmed 2009).

There are two ways how earnings can be managed: using accruals or changing real activities. Accruals management based on the choice of appropriate accounting methods used to
represent the underlying operating activities of the company. Managing accruals includes changes in accruals in order to increase earnings (reducing the allowance for bad debts, capitalizing expenses) (Gunny 2010). In contrast, real activities manipulations focused on changing these activities to enhance current earnings. Examples of these operations are overproduction to decrease costs of goods sold (COGS) and cutting R&D investments to enhance earnings (Gunny 2010). Managers prefer real activities manipulations, as such actions are harder to identify or detect and there is no benchmark for activities to be done in different situations. On the contrary to the real activities manipulation method, accrual management is easy to detect due to the existence of the benchmarks (accounting standards) (Lo 2008). Thus, most of academic research study accrual-based earnings management as a strategy for accounting manipulations.

1.3 The purpose and the structure of the study

Earnings management is one of the reasons for the low quality of reported information in Russia. The transition process occurring in Russia and frequent state reforms bring instability to the accounting sector and create possibilities for earnings manipulations. Thus, in our paper, we provide analysis of how the IFRS adoption in Russia influences the quality of accounting information. This thesis is focused on earnings management as a determinant of earnings quality.

The purpose of the thesis is to examine the impact of the IFRS adoption on earnings management. In other words, we want to find the evidence that IFRS increase earnings quality of Russian financial reports through the reduction of earnings management manipulations. There are two types of earnings management: real-activity manipulations and accrual-based manipulations. This thesis studies the accrual-based type of earnings management as it is easier to detect. For the empirical part the Jones model is used as it provides the most precise method for the estimation of the discretionional accruals.

Despite the fact that multiple surveys and papers focus on earnings quality, earnings management and IFRS research, these topics are still actively being studied. Existing research shows controversial results concerning the impact of the IFRS adoption on earnings
quality. In our study we provide one more examination of the IFRS influence on earnings quality. At last, this study is also motivated by the increase of attention to the IFRS implementation process in Russia.

The theoretical part of this thesis includes materials from seminar paper “Earnings management and its practices in Russia” submitted in Oulu Business School (Budrina 2012).

The thesis is organized as follows. Chapters 2 and 3 are dedicated to the theoretical issues of IFRS, the IFRS adoption in the Russian Federation, earnings quality and earnings management (its patterns, methods, models for detection). Chapter 4 studies relationships between IFRS and earnings management and develops our hypotheses. Chapter 5 presents the data, the descriptive statistics of the data, methodology, research design and implementation. Chapter 6 overviews the results and the limitations of the study. Finally, Chapter 7 gives general conclusions and assumptions concerning this research.
2 INTERNATIONAL FINANCIAL REPORTING STANDARDS

2.1 Basic concepts of IFRS

International Financial Reporting Standards (IFRS) were created as a common global language for accountants all around the world and it was expected to become the key financial reporting standards for all entities. IFRS provide understandable, reliable, relevant and comparable accounting rules which might be implemented in every country. Especially IFRS is important for growing multinational companies. Nowadays, a lot of countries replaced national accounting standards by IFRS in order to make local accounting more transparent, reliable, relevant and understandable.

2.1.1 Objectives and basic principles of IFRS

In some research articles IFRS are also called International Accounting Standards (IAS) as it was its original title. IAS were issued by the International Accounting Standards Committee (IASC) from 1973 until 2001. In 2001 IASC was transformed to the International Accounting Standards Board (IASB) and IAS were renamed to IFRS. However, the main goal and mission of IASC and IFRS stayed the same.

The main purpose of IASC is to create a single global set of accounting and reporting standards using IFRS as the tool to reach this goal. Thus, according to IASB, the goal of the IFRS creation is “to develop, in the public interest, a single set of high-quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles” (IASB 2012).

At this moment, the largest part of major economies has already adopted IFRS and about 113 countries are trying to adopt IFRS through the process of harmonization of local standards with IFRS (IASB 2012). The European Union (EU) has made IFRS compulsory for all listed companies since 2005. The Russian Federation is one of the countries in where the process of the IFRS adoption is still going on.
IFRS are principles-based accounting standards and their goal is to bring harmony to accounting standards of different countries in order to improve quality and transparency of accounting information in general. IFRS consist of the theoretical framework, standards and interpretations. The framework guides and helps IASB in developing and improving standards. The framework defines objectives, the general principle and underlying assumptions for financial statements, as well as their basic structure (Mirtza et al. 2006). The standards clarify how operational and non-operational activities of a company should be treated and recorded correctly. The standards are the ‘Bible’ for accountant and financial experts who make financial reports in compliance to IFRS. Some of the standards are industry-specific, thus companies use the standards relevant to their area of business. The last part of IFRS, the interpretations, is the methodological instruction for IFRS usage. It resolves the situations when standards might be interpreted incorrectly or inaccurately (Mirtza et al. 2006, Baskerville 2010).

In order to have a general understanding of IFRS and how it influences financial reporting, we should consider the basic principles of IFRS. The following explanation of general principles is based on the last version of the IAS 1 Presentation of Financial Statements document from January 1, 2013 issued by IASB (IAS 1, 2013). This official document gives the guidelines how financial statements should be prepared and describes the general principles of IFRS:

- Fair presentation and compliance with IFRS
  This is required for the faithful representation of the effects of the transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework of IFRS.

- Going concern
  Financial statements are presented on a going concern basis unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.

- Accrual basis of accounting
  An entity shall prepare its financial statements, except for the cash flow information, using
the accrual basis of accounting.

- Materiality and aggregation
An entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial.

- Offsetting
An entity shall not offset assets and liabilities or income and expenses, unless required or permitted by IFRS.

- Frequency of reporting
An entity shall present a complete set of financial statements (including comparative information) at least annually. When an entity changes the end of its reporting period and presents financial statements for a period longer or shorter than one year, an entity shall disclose, in addition to the period covered by the financial statements: (a) the reason for using a longer or shorter period, and (b) the fact that amounts presented in the financial statements are not entirely comparable.

- Comparative information
Except when IFRS permits or requires otherwise, an entity shall present comparative information in respect of the preceding period for all amounts reported in the current period’s financial statements. An entity shall include comparative information for narrative and descriptive information if it is relevant to understanding the current period’s financial statements.

- Consistency of presentation
An entity shall retain the presentation and classification of items in the financial statements from one period to the next, unless: (a) it is apparent, following a significant change in the nature of the entity’s operations or a review of its financial statements, that another presentation or classification would be more appropriate having regard to the criteria for the selection and application of accounting policies in IAS 8; or (b) IFRS requires a change in presentation.
The listed features are applicable to financial statements that are reported in accordance with IFRS. IFRS help to make financial reporting easy and understandable, but at the same time reliable and relevant. Primarily, IFRS serve the interests of investors and other interest groups as governmental agencies, market participants, auditors and corporations. Thus, all these users actively participate in the process of implementation and adoption in order to protect their interests (Alali & Cao 2010).

2.1.2 Determinants of the IFRS implementation process

IFRS adoption is an up-to-date topic in accounting and interest to this topic has been growing from year to year. Over one hundred countries all over the world have already adopted IFRS and the process of the international IFRS adoption still goes on. Although IFRS are unified for all countries that use it, the process of IFRS implementation and harmonization with national accounting standards varies a lot across the countries. Some countries implement the process of shifting from local accounting standards to IFRS easily, while in other countries this process requires more time and efforts.


The IFRS implementation process varies significantly by country due to political, cultural, economic, legal and other aspects. Some countries even state that they converge national accounting rules to IFRS, but they hardly ever will reach full compliance with IFRS (Alali & Cao 2010).

Ding et al. (2005) and Nobes (2001) examined cultural aspects as an explanation for the difference between national accounting standards (GAAP) and IFRS. Both researches demonstrate that culture is a strong factor in the process of harmonization local standards and IFRS.
Rammana & Sletten (2009) studied variations of the decision to adopt or not IFRS using the sample of 102 non-EU countries. They provided evidence that “more powerful countries are less likely to adopt IFRS”, explaining this result by the fact that these countries are less motivated to give away standard-setting responsibilities to an international body. Another important evidence from this study is that a country is more likely to adopt IFRS if: i) the government has higher competency in decision making, ii) costs of switching to IFRS are low, and iii) the country has many trade partners whose are IFRS adopters (Rammana & Sletten 2009).

The results of Rammana & Sletten (2009) are also supported by the research done by Clements et al. (2010), which proves that large countries have higher costs for setting IFRS, and, thus, they are less likely to adopt IFRS, than smaller countries. Clements et al. (2010) also confirm that large countries are usually politically more powerful than small countries, and, thus, large countries are less likely to adopt IFRS. As an example, we can consider two largest countries in the world, USA and the Russian Federation. These two countries are both very powerful politically and have strong financial authorities. Both countries still use national accounting standards: U.S. GAAP and RAS relatively. Although USA is still using GAAP and does not intend to change their national standards significantly, the Russian Federation is has been adopting IFRS since 2000.

Borker (2010) analyzes how culture impacts the IFRS implementation and how culture may help to predict the difficulty of the IFRS adoption process. The author uses cultural dimension of Hofstede (Hofstede 1980) and derived accounting values of Gray (Gray 1988) to analyze BRIC countries. The results of the study demonstrate that Russia and Brazil have a lot of similarities in culture and business. Cultural values in these countries are “associated with the development of accounting system characterized by statutory control, uniformity, conservatism, and secrecy”, and these values are opposite to the values which characterize IFRS “professionalism, flexibility, optimism and transparency” (Borker 2010). According to this research, it can be suggested that the process of IFRS adoption faces a lot of difficulties in these countries.

Another example of using the same methodology as Borker (2010) is presented by Combs et
al. (2013). This study demonstrates the same results for Russia. Combs et al. (2013) also concludes that Russian accountants prefer statutory control, uniformity, conservatism, and secrecy.

By analyzing the related academic papers we can conclude, that cultural and economic aspects of the country are the main determinants of the IFRS implementation process. In this thesis we focus on Russia, a county with transition economy and strong cultural values. The next chapter studies how culture influences the IFRS adoption process in the Russian Federation.

2.2 The IFRS implementation and its role in the Russian accounting system

This section studies the main characteristics of the Russian accounting system and the IFRS implementation in Russia. It overviews the history of RAS, the main steps of the IFRS adoption in Russia and the problems related to this process.

2.2.1 The history of the Russian accounting system

Russia, as a part of the Soviet Union, had a centrally planned economy for more than 70 years. The country was run by Communists regime and it was isolated from the other world by the “Iron Curtain”. All assets, property, plants and investments were state-owned and state-controlled. The country was entirely closed for foreign investments and the only user of financial reporting was the state. The Soviet Union’s accounting environment was strongly dependent on government and tax authorities for a long time. Thus, financial reporting rules and standards were determined by the state tax authorities rather than by accounting professionals.

However, after the collapse of the Soviet Union in 1991, the situation had significantly changed. Russia became an independent state, and dramatic changes in economic and political spheres made the Russian Federation open to foreign investments. It was obvious that the Russian planned economy was not suitable for entering the international market, where production, distribution, pricing and other decisions are made based on autonomous
firms’ interests. Hence, the process of transition from a planned to a market economy had started. It was a long and complicated process of economic modernization and development, recovery from recessions and the emergence of private owners of assets. The state-owned property was privatized and even such terms as “private business” has appeared. The number of private entities has grown from 15 in 1990 to 700,000 in 2002 (Puffer & McCarthy 2003).

However, it should be mentioned, that the process of privatization of state-owned companies was not completely fair. Despite the fact, that it was realized by distributing vouchers among Russian citizens, most of vouchers ended up in hands of top management of enterprises. The privatization resulted in a high level of insider ownership in the leading Russian companies (Filatov et al. 2005).

The development of Russian capital markets had started by the nature of things. Though large economical changes created conditions for foreign investments and capital markets, the development did not create a favorable investment climate. Corruption, bribery, lack of investors’ protection and the ‘gray economy’ made the Russian market very risky and unattractive for investors.

Following the collapse of the Soviet Union in 1991 and economic reforms in the country, the new era of Russian accounting had began. All these economical transformations required the changes in the accounting system and accounting principles. The demand for professional accountants and financial experts was growing rapidly (Vysotskaya & Prokofieva 2013). At the same time, during 1994-1997 years, some large Russian companies intended to be listed on foreign stock markets (e.g. NYSE and LSE) and they needed services of international audit and accounting firms. As a result, the Big 4 (KPMG, E&Y, PwC, Deloitte) audit firms entered the Russian market in 1990s, firstly providing only audit services, but later tax and advisory services as well (KPMG 2012). Thus, audit services appeared in the Russian market with the development of accounting. The history of auditing in Russia is rather new and, due to this fact, there are no significant differences between Russian and international auditing standards. However auditor’s reports and some practical implementations of standards are different (Makarevich 2010). Continuous legislation changes in the Federal law “On Audit” and the law “On the self-regulatory organizations” promote active development of auditing in
Russia and improve its quality.

Together with changes in the economic environment, the accounting system has also been modified a lot. In order to meet new environment requirements, the standardized system of accounting RAS was introduced in 2000. RAS significantly differ from the international accounting standards, but the Russian government implements a program of harmonization of RAS with IFRS. During this process, the Ministry of Finances is continuously issuing new accounting standards to line up the Russian accounting practices with IFRS. Nevertheless, there are still crucial differences between RAS and IFRS and the process of aligning goes on gradually. The government plans to finish a full changeover to IFRS by the end of 2018 (RIA 2013).

Following the changes in the accounting system and the structure of entities, the Russian tax system has also changed significantly since 1991. The first tax reforms were introduced in 1991 and the whole tax system was modernized into an efficient tax collecting mechanism (Preobragneskaya & McGee 2004). The Russian tax system becomes more effective, fair and less complex from year to year as tax reforms still occur.

The reformation of the tax system is a crucial aspect of the current transitional process and the correct reforms lead to future economic growth and stability which attracts foreign investors. However, the Russian accounting is still tax oriented, and the main users of the accounting information are tax inspectors. Even though financial and tax accounting were legally separated in 2004, most Russian companies prepare only one set of financial reports based on RAS and tax laws (Bagaeva 2010, 25).

Nevertheless, the changes in economical and political lives of the country did not change people mindset. At the moment Russia comes through a difficult process of the IFRS adoption in order to meet strict requirements of the fast-growing international market. But are Russian accountants ready for these changes?

The previous chapter discussed that culture has a strong impact on accounting and accounting processes in general. Despite the fact, that Russian economy is West-oriented,
most of Russians still have ‘soviet’ mindsets and mentality. Based on research papers, I have identified the main issues which originate from the state-planned economy of the Soviet Union and still affect the present Russian accounting system. These issues are following:

- Accounting is assumed to be done only for tax purposes (McGee & Preobragenskaya 2005, Bagaeva 2009, Combs et al. 2013);
- The lack of culture of financial reporting (Vysotskaya & Prokofieva 2013);
- Accountants are assumed to have a role of bookkeepers, but not managers’ (Borker 2012, McGee & Preobragenskaya 2005, Bagaeva 2009);
- The lack of understanding of the importance of the reliable accounting information (Combs et al. 2013, McGee & Preobragenskaya 2005);
- The secrecy of accounting information: a general negative attitude to public distribution of financial reports explained as “unnecessary waste of time that would disclose too much information to the competitors” (Combs et al. 2013);
- The preference of strict prescribed rules than flexibility (Vysotskaya & Prokofieva 2013, Combs et al. 2013).

Unfortunately, people attitude and working habits are still based on the old ‘soviet’ values of collectivism and uncertainty avoidance (Borker 2012, Combs et al. 2013) and they change slowly. These issues bring additional complexity to the process of migration to international standards in accounting.

Table 1 briefly overviews and summarizes the most important steps of the development of the current Russian accounting system starting from the dissolution of the Soviet Union until present time (including the future step of the IFRS adoption).

To summarize, the Russian economy undergoes a transition from a state-planned to market economy. This transition involves changes in all areas of the economy including finance, taxation, accounting, corporate governance and security market sectors. Although the transition has started already in 1991, the country still faces different problems in setting new institutions and implementing new reforms.
Table 1. Historical overview of the Russian accounting system

<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>1917-1991</td>
<td>Soviet Accounting (State-planned economy)</td>
</tr>
<tr>
<td></td>
<td>Post-Soviet Accounting (Market economy)</td>
</tr>
<tr>
<td>1991</td>
<td>New chart of Accountants</td>
</tr>
<tr>
<td>1996</td>
<td>First Federal &quot;Law on Accounting&quot;</td>
</tr>
<tr>
<td>1998</td>
<td>Accounting reforms</td>
</tr>
<tr>
<td>2000</td>
<td>Publication of Russian Accounting Standards (RAS)</td>
</tr>
<tr>
<td>2002</td>
<td>Corporate Government Code</td>
</tr>
<tr>
<td>2005</td>
<td>Listed firms are required to present financial reporting according to IFRS</td>
</tr>
<tr>
<td>2007</td>
<td>Draft of a new &quot;Law on Accounting&quot;</td>
</tr>
<tr>
<td>2008</td>
<td>Federal &quot;Law on Auditing&quot;</td>
</tr>
<tr>
<td>2011</td>
<td>Official publication of new &quot;Law on Consolidated Financial Statements&quot;</td>
</tr>
<tr>
<td></td>
<td>Official publication of new &quot;Law on Accounting&quot;</td>
</tr>
<tr>
<td>2012</td>
<td>IFRS mandatory for all public interest entities</td>
</tr>
<tr>
<td>2018</td>
<td>Full transition to IFRS (mandatory for all entities)</td>
</tr>
</tbody>
</table>

2.2.2 The IFRS implementation in Russia

At this moment, the largest part of major economies has already adopted IFRS and about 113 countries are adopting IFRS through the process of harmonization of local standards with IFRS (IASB 2011). The Russian Federation is one of the countries where the process of IFRS adoption is still going on.

The adoption of IFRS started in 1996-1998 when the Federal Law “On Accounting” was approved by the Russian State Duma. The first version of RAS were issued by the Ministry of Finance in 2000 in order to align the Russian accounting practices and IFRS (E&Y 2011). The further process of adoption were separated into two stages according to “Concept of the Development of Accounting and Financial Reporting in the Russian Federation for the Medium term” issued by the Ministry of Finance in 2004 (Minfin 2004). During the 1st stage, all large public companies and commercial banks were obliged to use IFRS for reporting (years 2004-2007). The 2nd stage involved all other entities to the process of transition from
RAS to IFRS (years 2007-2010) (KPMG 2012).

The last important step in the process of the IFRS adoption was the order no. 160 “On implementation of IFRS and interpretation of IFRS in Russia” signed by the Ministry of Finance in November 2011 (Minfin 2011). This order requires obligatory financial reporting under IFRS for all listed companies, credit institutions and insurance companies. This means that IFRS are mandatory for these entities and the first official reporting for year 2013 should be provided in compliance with the international standards. The Ministry of Finance expects to finalize the process by 2018, when all entities will report according to the international standards (RIA 2013, E&Y 2011).

This process of harmonization of international accounting standards has a lot of difficulties as Russia has historically its own accounting rules and replacing them is not easy. Although the most small and medium-sized enterprises (SMEs) in Russia still use only RAS for financial reporting, the majority of the public Russian companies now apply IFRS.

The Russian economy, oriented to Europe and USA, has been growing at a steady rate since 2000s. The Russian government is interested in attraction of foreign investments to the Russian economy. However, Russia is a country with high political and economic risks which lead to a high degree of uncertainty that has negative effect on the flow of foreign investments.

According to Bagaeva et al. (2008) and Goncharov & Zimmermann (2007), international investors prefer financial reports prepared using IFRS, than prepared in compliance with RAS. Also it must be mentioned that international investors motivate companies to provide more accurate financial reports and adopt IFRS as an instrument of international accounting. The implementation of IFRS increases earnings quality and makes the financial reports more understandable for the foreign investors (Bagaeva et al. 2008). Moreover, Ahmed (2009) has proved that Russian companies which use IFRS for financial statements have better earnings quality than the companies which still use RAS. This is one of the reasons why the Russian government is interested in IFRS adoption.
Furthermore, Kim (2013) provides evidence that Russian firms listed on LSE (consequently reporting in accordance to IFRS) produce more value-relevant reports compared to other local companies. Thus, IFRS adoption for all Russian companies will improve the quality of accounting information and attract global investors to the Russian stock market (Kim 2013).

Despite the fact, that the accounting system in Russia had made a great progress toward international standards during the last years, there are still a lot of differences between RAS and IFRS. The Russian accounting has several practices which are difficult to understand for international accounting experts.

According to Massarygina (2010), Borker (2012) and McGee & Preobragenskaya (2004), the main differences of Russian accounting practices in comparison to IFRS are:

- Book value. Russian accountants still use book value instead of fair value and prepare financial statements based on historical costs basis.
- Not considering inflation. Although Russia has a high level of inflation, financial statements are prepared on the historical cost basis ignoring the inflation effect.
- Reporting for Tax Authorities.
- Assets are not tested for impairments.
- The lack of disclosures. RAS do not require a lot of disclosures, and disclosure instructions often do not meet the terms of financial statements.
- Form over substance. This important characteristic of Russian accounting impacts the quality of reported earnings (Accounting in Russia. What Foreigners Should Know 2009). This principle means that the operations are not registered when they occur, but when the required document is signed. Often, there is a gap between the moments when an operation was made and the moment when the document was signed. As financial results are calculated and registered in tax declarations every quarter, such delays leads to inaccurate and imprecise figures in reports.

There are a lot of other practices concerning assets, their measurement, depreciation policies which are influenced by the differences between RAS and IFRS. Detailed list of these differences is provided in the Appendix 1 (Combs et al. 2013). Due to these unique Russian
practices, the current system of accounting does not provide fully sufficient quality and reliability of the reporting information and significantly limits efficient the usage of such information by investors and other stakeholders.

Alon (2013) proposes that RAS are not replaced by IFRS, but they both coexist serving different functions and create dual institutionality. The author explains dual institutionality as the situation which “occurs when distinct but related practices that organizations are using have legitimacy but are rooted in diverse institutional logic and coexist due to different levels of discretion associated with their implementation”. This situation occurs due to the fact that IFRS were adopted steadily, while RAS still were the main standards for a lot of companies, what increased institutional complexity in Russia.

One more barrier which slows down the whole process of adoption is the translation of IFRS into Russian. Until 1998, IAS were not available in Russian and the first official translation was published in 2009 only (Vysotskaya & Prokofieva 2013). Since 1998, there have been made several versions of translation, but they were often out-of-date and not adapted to Russian business context (McGee & Preobragenskaya 2004). As a result, ‘Russian’ IFRS had a lot of mistakes and inaccuracies which created misleading guidance to the users of the document. Most of these mistakes were done due to the fact that some terms used in IFRS do not exist in Russian accounting (Baskerville & Evans 2011) as IFRS use principle-based approach while RAS is rule-based.

The process of harmonization of RAS with IFRS takes long time as there are significant differences between these two sets of standards, and the reasons for that are Russian economic, political and cultural issues. The implementation of international standards in accounting is dictated by economic needs. High-quality financial reporting is an essential condition for the development of financial markets and real economy. Therefore, IFRS will be inevitably fully incorporated into the Russian accounting system, but the speed of this process will depend on how effective is the interaction between the government, business and the professional accounting and the auditing community.
2.3 IFRS and earnings quality

Many research papers study IFRS and its influence on different aspects of business. The process of IFRS implementation in different countries has been studied for a long time by both academics and practitioners, and multiple authors state that the main goal of IFRS is to create better transparency in financial reporting and improve its quality (Bath et al. 2008, Ball et al. 2000, Amiram 2012, Alon 2013, Bagaeva et al. 2008, Borker 2012, Ahmed et al. 2013, Daske et al. 2008, Kao 2013).

Ball et al. (2000) and Amiram (2012) propose that IFRS is supposed to improve market infrastructure, decrease information processing costs, boost international M&A, increase reporting quality and, thus, attract foreign investments.

It is a commonly known fact that investors and analysts make their estimations based on companies’ reported financial statements. Consequently, they are interested in the reliability of this information and its relevance. The information is considered of high quality if it is relevant and reliable. Otherwise, it is considered as low quality information and investors do not trust the reported data.

Previous research on the subject provides evidence that IFRS adoption brings significant benefits to countries as it improves disclosure quality and informational environment around IFRS adoption (Ball 2006, Daske et al. 2008, Barth et al. 2008, Christensen et al. 2008, Alon 2013, Bagaeva et al. 2008). However, there are several studies that argue that, at the same time, IFRS give significant flexibility and discretion to managers, that does not always mean the improvement of disclosure quality (Ball et al. 2000, Barth et al. 2008, Christensen 2012, Leuz et al. 2003).

Earnings quality is a complex term which depends on different factors. For example, according to Dechow et al. (2010), there are six determinants of earnings quality: a firm’s characteristics, financial reporting practices, governance and control, auditors, equity markets’ incentives and external factors. IFRS belongs to the financial reporting practices determinant of earnings quality. As we can see, earnings quality is a complex phenomenon
and a positive change of one element (e.g. the implementation of IFRS) does not guaranty the improvement of earnings quality in general.

It is generally assumed, that IFRS are expected to improve the quality of accounting information. However, several academic papers prove that IFRS does not always have a positive effect on the quality of accounting information (Barth et al. 2008, Daske et al. 2008, Ahmed et al. 2013, Leuz et al. 2003, Kim 2013, Christensen 2012).

Bath et al. (2008) examines whether the application of IFRS is correlated to higher earnings quality. Authors use three determinants of accounting quality: earnings management, timely loss recognition and value relevance metrics. The research provides general evidence from 21 countries that adopted IAS between 1994 and 2003. The authors prove that the application of IAS results in less earnings management, more timely loss recognition and higher value relevance (Bath et al. 2008). The accounting quality, in general, is improved between pre- and postadoption periods. Although the results of Bath et al. (2008) support the belief that IFRS improves earnings quality, the research provides reasons both for earnings quality improvement and reduction. These reasons are presented in Table 2 below.

<table>
<thead>
<tr>
<th>Reasons for improvement</th>
<th>Reasons for reduction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reduction of managerial discretion,</td>
<td>Elimination of other accounting alternatives,</td>
</tr>
<tr>
<td>IFRS are principle-based and difficult</td>
<td>IFRS are principle-based that gives</td>
</tr>
<tr>
<td>to circumvent,</td>
<td>more flexibility to managers.</td>
</tr>
<tr>
<td>Usage of fair values that better reflect</td>
<td></td>
</tr>
<tr>
<td>the underlying situation.</td>
<td></td>
</tr>
</tbody>
</table>

The research by Leuz et al. (2003) also documents that IFRS provides less implementation guidance and more flexibility to managers which might be resulted in more earnings management and thus lower earnings quality.

Ahmed et al. (2013) examine how mandatory adoption of IFRS influences earnings quality. The authors conclude that the result of IFRS adoption significantly depends on whether IFRS
are higher or lower quality than the local accounting standards. IFRS is expected to increase the quality of earnings if IFRS have higher quality than local standards and they are enforced. On the other hand, the quality of accounting information is expected to reduce if IFRS have lower quality than the local standards and they weaken enforcement. The results of Ahmed et al. (2013) study are controversial as they prove that income smoothing and accruals aggressiveness increase, while timeliness and loss recognition significantly decrease. The authors conclude that mandatory IFRS implementation has a negative impact on the accounting quality that contradicts the most of previous research. Thus, it raises the question whether the IFRS adoption has a positive effect and brings any value for accounting.

At the same time, Kim (2013), using a sample of Russian firms, provides evidence of the positive impact of IFRS. The author proves that Russian firms listed on LSE (consequently reporting in accordance to IFRS) produce more value-relevant reports compared to other local Russian companies that use only RAS for reporting. Besides, the result of this study also proves that firms that use IFRS are more value relevant and, therefore, IFRS adoption improves the quality of information. Based on these results, Kim (2013) concludes that IFRS helps to attract foreign investors to the Russian stock market. Similarly, Boker (2010) argues that the IFRS adoption is a priority for BRIC countries as they need to attract foreign capital in order to sustain their rapid economic growth. The IFRS adoption improves the quality of reported information that has a positive effect on the economic and business environment and inflow of foreign capital.

Furthermore, Rammana & Sletten (2009) attempted to find out how the need in investments influences the decision of the IFRS adoption. Interesting, that the authors did not manage to prove that expected changes in investment flows affect the decision of IFRS adoption. Thus, it is still a controversial question whether the countries adopt IFRS only in order to attract investments.

Alali & Cio (2010) made an investigation and found out that the IFRS adoption might be negatively affected by the public authorities through certain politics and laws that oppose some accounting requirements. Alali & Cio (2010) also argue that “IFRS can be regarded as a high-quality standards only when the market place believes so”, otherwise there is no sense
to expect positive results of the IFRS adoption.

The quality of published accounting information is rather a complex concept and it is hard to improve it by the IFRS implementation and government reforms only. Besides accounting standards, there are multiple other factors that influence accounting quality, such as state institutions, political, cultural and others issues. Thus, it is difficult to make one convinced conclusion whether IFRS have a positive or negative effect on the quality of accounting information.

Next, in this thesis we will provide one more evidence on this topic in Chapters 5 and 6, and we will make a conclusion in Chapter 7.
3 THEORETICAL BACKGROUND OF EARNINGS MANAGEMENT

This chapter continues the topic of accounting quality and gives detailed overview of earnings management as a determinant of earnings quality. The chapter presents the incentives for earnings management, patterns and methods of earnings management and its influence on earnings quality.

3.1 The content of earnings management

Analyzing academic literature, the clear definition of earnings management is difficult to distinguish due to diverse approaches to earnings management. Generally speaking, earnings management is the practice of using different accounting principles in order to produce desired financial results. Academics and practitioners have different insight into earnings management, thus the term earnings management has a lot of definitions.

According to Scott (2003, 369), earnings management is the choice of a manager among accounting policies which allow to achieve some specific objectives. Accounting policies include accounting methods and special operation recording: different depreciation methods, inventory valuation methods (LIFO, FIFO, weighted-average), managing working capital (receivable policies), managing expenditures (R&D, advertising) and others. This practice can be also called as a judgment in financial reporting used by managers to achieve some targets.

Healy & Wahlen (1999), in line with Scott (2003), consider that “earnings management occurs when managers use judgment in financial reporting and in structuring transactions to alter financial reporting to either mislead some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reporting accounting numbers”. Misleading stakeholders can be one of the main goals of earnings management, but stakeholders assume that the existence of earnings management is inevitable as managers usually possess the confidential information which is available only for insiders.
Similarly, Klein (2002) supports these assumptions and argues that earnings management is used to obscure the real financial performance of the company from stakeholders. Thus, the reported figures do not show the real financial position of the company.

At the same time, Lo (2008) examines earnings management as the most provocative topic in accounting and finance, as, according to the author, it engages “potential wrongdoing, mischief, conflict, cloak and danger” and it can be viewed as a potential criminal activity.

3.1.1 Patterns of earnings management

Earnings management can be explained by specifying its patterns. According to Scott (2003, 383-384), there are four basic earnings management patterns:

1. Taking a bath
   This pattern is used when a firm produces losses and managers report larger losses to increase future profits.

2. Income minimization
   It is used usually by politically visible companies to decrease profitability for taxation purposes. This pattern is less extreme than the first one.

3. Income maximization
   There are a lot of reasons to maximize income: managers’ bonuses and premiums, increase profitability ratios, debt covenant violations.

4. Income smoothing
   Managers’ incentives for smoothing income are to make their bonus flow less variable and to reduce the probability of covenant violation. Another motivation for this pattern is to show more stable and effective earnings, because investors prefer companies with steady than volatile earnings even if financial results are better.

A company may use various patterns depending on outside and inside conditions. For
example, patterns usually change depending on the political situation, taxation, changes in the board of directors or a new CEO, IPO, the share price.

Regardless the pattern applied, earnings management makes accounting information less reliable that harms the users of this information. According to Lo (2008), among the potential victims of earnings management are investors, bond investors, suppliers, customers, bankers, regulators, unions and competitors.

Healy & Wahlen (1999) made a review of the earnings management literature and summarized the information concerning earnings management in order to help standard setters and regulators to evaluate the occurrence of earnings management. Accounting standard setters and regulators are interested to know the magnitude and frequency of earnings management, specific accruals and accounting methods used by managers, incentives for earnings management and resource allocation effects.

Other researchers point out that academics, practitioners and regulators have different perception of earnings management. Dechow & Skinner (2000) academic research shows that earnings management has insignificant effect on reported earnings, while practitioners and regulators find earnings management both pervasive and problematic.

3.2 Earnings management as a determinant of earnings quality

As we know, investors and analysts make their estimations based on companies’ reported financial statements. Consequently, they are interested in the reliability of this information and its relevance. If information is relevant and reliable, it has high quality, otherwise it is low quality information and investors do not trust the reported figures. Earnings quality is a complex term which depends on different factors. According to Dechow et al. (2010), there are six determinants of earnings quality: a firm’s characteristics, financial reporting practices, governance and control, auditors, equity markets’ incentives and external factors. All these determinants reflect the influence of earnings management on earnings quality.

Earnings quality measures how precise the reported earnings reflect the company’s real
earnings. In other words, one can assume that earnings management is a measure of earnings quality. Due to this fact, earnings management has a significant impact on earnings quality and, consequently, earnings quality is negatively correlated to earnings management. If managers manipulate earnings, the reported results become less reliable and the quality declines. Managers can use absolutely legal and permitted accounting methods or practices, but the negative effect on earnings quality is inevitable.

Nevertheless, the absence of earnings manipulations does not guarantee high earnings quality, as there are other factors influencing the quality of earnings. For example, some information and events which cannot be represented in financial reports, may influence future earnings as well. Financial statements serve to help investors and the public to make predictions about future company’s performance. Thus, outsiders or the public demand the high quality of earnings and the guarantee of this quality.

Lo (2008) examines the close relationships of earnings management and earnings quality based on Ball & Shivakumar (2008) paper. The author, as well as Hadani et al. (2011), argues that earnings management increase information asymmetry and impacts the quality of financial reports.

Information asymmetry is always presents in economics processes and it is unavoidable. The existence of information asymmetry denotes that accounting information cannot be both absolutely relevant and reliable at the same time. Instead, some kind of a tradeoff between relevancy and reliability has to be presented (Scott 2003). Earnings management impacts both these characteristics of financial results and lessens earnings quality. However, the quality of earnings has other indicators such as persistence, timeliness, smoothness, accruals, investor’s responsiveness, loss avoidance and external indicators (SEC enforcement releases, for example) (Dechow et al. 2010). Therefore, different indicators of high earnings quality should be taken into account when estimating the quality of accounting information. Bagaeva (2010) suggests to use conservatism, value relevance and earnings management as measures for the accounting information quality. In this thesis we are focused on earnings management aspect of earnings quality.
Dechow et al. (2010) points out that “higher quality earnings provide more information about the futures of a firm’s financial performance that are relevant to a specific decision made by a specific decision-maker” and a firm’s characteristics such as size, performance, financial leverage can be the determinants of earnings management and earnings quality relationship.

Investors are always interested in high quality of accounting information in order to be able to make objective assessments of a firm’s performance and future perspectives. However, sometimes the reported information might not show real figures due to accounting manipulations by managers. Some researches look at earnings management as a normal and casual activity in accounting (Ball & Shivakumar 2008, Hadani et al. 2011, Hazarika et al. 2012), while others examine it as a criminal activity (Lo 2008, Healy & Wahlen 1999). Nevertheless, earnings management has a negative correlation to earnings quality and decreases the quality of financial reports.

3.3 Incentives for earnings management

This thesis analyses earnings management as a method of accounting manipulations and malpractice used by manager to reach certain goals. However, earnings management is rather a risky practice and it always borders closely to illegal practices. Still, a company’s executives and accountants employ different patterns of earnings management though it can easily grow up to the criminal activity. Why do managers take this risk and use earnings management? The answer to this tricky question is the list of incentives for earnings management. If managers apply earnings management accurately and correctly, it brings certain benefits and introduces only little risk.

There is a variety of reasons and motivations for managers to manipulate earnings. These incentives can be categorized into the following main groups based on the recent research papers:

1. Bonuses
   Earnings management is connected to the CEO’s incentives as the executives’
Bonuses are based usually on revenues or the profitability of financial ratios and their growths. Due to this fact, executives are interested in increasing earnings to make the firm performance look better and, hence, receive high bonuses. Another strong motivation for managers to control earnings is to maximize the share price in order to get good share-based incentives.

This issue is studied by Healy (1985), who analyzes manager’s choices of accounting policies using bonus plan hypothesis. This concerns the managers whose compensation plans depend on reported net earnings. Healy proposes the scheme of compensation called bonus scheme in which the bogey is a threshold level of performance and the cap is an upper limit for the compensation. The researcher assumes that bonus increase proportionally to net income between the bogey and the cap.

Amount of Bonus

Reported Net Income

Figure 1. Typical bonus scheme (Healy 1985)

If earnings are low (below the bogey), managers do not receive any compensation. This is the case when they can ‘take a bath’. The term of ‘take a bath’ means to low earnings even further (to put future earnings to ‘the bank’) in order to enhance future net income and consequently the probability of bonuses in the following years. If net earnings are high (above the cap), managers are interested in decreasing reported earnings and try to keep them for the next period because the bonus for the net income higher than the cap will be lost in the current period. As a result, managers are motivated to manage earnings only if income is greater than the bogey and smaller than the cap.
2. Debt covenant
There are several evidences that debt contracts have an impact on the usage of the earnings management practices. Dechow et al. (2010) explains that if a firm is close to a debt covenant restriction, managers could manipulate income to avoid breaking a covenant. DeFond & Jiambalvo (1994) also report that companies increase earnings one year before the year of covenant violation.

3. Political reasons
Managers prefer to change accounting policies in order to report lower income and postpone it to future periods when the company expects to have political costs. Political incentives are common for big monopolistic firms or for the firms with high profitability as they are more under control of the government. There are several academic papers that study this issue (Jones 1991, Key 1997, Cahan 1992). Jones (1991) provides evidence that companies have higher negative accruals in the period of relief investigation than in the period without investigation. It proves that managers use discretionary accruals in order to report lower earnings when some political investigations occur. Key (1997) demonstrate the same results for the industry of cable television.

4. Taxation
The reduction of tax payments is another incentive for earnings management that was studied in prior research papers by Goncharov & Zimmermann 2006, Guenther 1994, Coppens & Peek 2005. Goncharov & Zimmermann (2006) study an example of tax management in Russia when managers manipulate earnings in order to reduce income tax expenses. At the same time, Coppens & Peek (2005) found that European private companies similarly use tax induced earnings management. They classified European countries into two groups based on similarities in accounting and tax practices. Coppens & Peek (2005) found out that income smoothing is the main pattern used to avoid reporting too high income and paying too high tax.

5. CEO change
When CEO or another top manager of the company has the problem to keep the
position or their leave the company, the managers have an incentive to report higher earnings using accruals or cutting R&D expenses (Klein 2002, Dechow & Sloan 1991).

6. IPO
Prior research shows that managers report higher earnings before the IPO (Ball & Shivakumar 2008, Dye 1988, Prunskaitė 2009, Teoh et al. 1988). Dye (1988) argues that managers have an incentive to manipulate earnings in order to increase the stock price and benefit from that. Teoh et al. (1988) also find out that managers use upward earnings management to raise the IPO’s price.

7. To smooth earnings stream over time
Earnings smoothing makes the income stream more flat in order to provide a view of stable growth to satisfy investors. Burgstahler & Dichev (1997) provide evidence that reported earnings are managed in order to avoid or hide earnings decreases. They exploit the cross-sectional distribution of earnings changes to detect “unusually low frequencies of small decreases in earnings and small losses and unusually high frequencies of small increases in earnings and small positive income”. Thus, managers prefer to report small raises than small declines in earnings.

8. To meet market expectations
Investors examine company’s financial reports to make forecasts and predictions in order to estimate the efficiency of the company’s performance. If the company meets the expectations of the market, the investors become more confident about its future and induce stocks trading. On the contrary, the failure to meet the market expectations leads to uncertainty about the company’s future and provokes the loss of potential investors. Lo (2008) explains that managers report overestimated earnings because these numbers are expected by the market and investors. In this case, the incentive to use earnings management is not to receive bonuses, but to meet expectations. The study by Burgstahler & Dichev (1997) proves that “if earnings are managed to meet forecast goals, we would expect to observe a sharp discontinuity in the vicinity of zero, i.e. significantly lower concentration of (small) negative
deviations of reported earnings from forecast and a significant higher concentration of (small) positive deviations”.

These incentives for earnings management were documented and discussed a lot of by accounting academics and practitioners. However, according to Dechow & Skinner (2000), the main motivation for managing earnings might be just to meet the earnings benchmark, including loses avoidance, reporting the increase in quarterly earnings and meeting analysts’ expectations. These findings by Dechow & Skinner (2000) are also based on an analysis of recent literature. Meeting analysts’ expectations is the same as meeting market expectations, while loses avoidance is correlated to bonuses reasons. All these incentives are closely connected, and usually managers have several incentives for managing earnings.

3.4 Methods and techniques of earnings management

In previous section we discussed four patters of earnings management that managers prefer to use in order to get desirable results. Summarizing all discussions and prior researches on this topic, we can conclude that earnings management can be viewed as a variation of different accounting tools, methods and techniques that are used to record transactions. These methods and techniques can be used to manage earnings upward or downward or to shift earnings from one period to another.

Prior academic studies provide a lot of findings concerning different methods of earnings management used by companies. Every company choses the most appropriate method according to its business, country’s legislation, accounting and tax practices.

In general, there are two ways how earnings can be managed: using accruals or changing real activities. The researches by Healy (1985) and Gunny (2010) consider two approaches to manage income: by controlling accruals and by changing accounting policies per se. These approaches are also called accrual-based management and real activities manipulations.

Accrual-based management is based on the choice of appropriate accounting methods used to represent the underlying operating activities of a company. Managing accruals includes
changing accruals in order to increase earnings (reducing the allowance for bad debts, capitalizing expenses) (Gunny 2010). In contrast, real activities manipulations focus on changing the activities to enhance current earnings. Examples of these operations are overproduction to decrease COGS and cutting R&D investments to enhance earnings (Gunny 2010).

Companies can use both earnings management strategies at the same time. There are several academic papers examining the trade-off between these two practices (Zang 2012, Cohen et al. 2008). Zang (2012) finds that managers choose a method of earnings management based on its relative costs. This means, that managers trade-off two approaches according to their relative costliness. Furthermore, Zang (2012) reports that “managers adjust the level of accrual-based earnings management according to the level of real activities manipulations released”. Thus, managers use these two practices of earnings management as substitutes for each other.

3.4.1 Real activities manipulations

The strategy of real activities manipulations occurs when managers change timing or the structure of expenses, investments, other business operations in order to impact the final output such as net income, EBITDA, CAPEX, R&D, etc. (Gunny 2010). This type of earnings management is widely used by CFOs in order to deliver earnings and avoid reporting losses or miss analysts’ expectations (Roychowdhury 2006).

Gunny (2010) found that the firms, which engaged in real activities manipulation to meet market benchmark, have better operating performance in the next three years than the firms that do not use these practices. Thus, real activities manipulation is not opportunistic, but helps a company to reach current goals and to perform better in future (Gunny 2010). However, Bhojraj et al. (2009) document totally opposite results than Gunny (2010). Their research provides evidences that real activities manipulations used to reach certain targets in a short term can destroy the long-term performance of the company.

Thus, researchers argue that real activities manipulation can significantly improve results in a
reporting year, but devastate the results of the next several years. For example, if the company offers a discount to the customers in order to boost revenues in the current period, further it might be difficult to raise prices again. Therefore, this strategy decreases future sales revenues.

Real activities manipulations are widely studied in academic literature. The most often used practices can be classified as follows:

- Managerial discretion over R&D expenditures (Dechow & Sloan 1991, Cheng 2004);
- Cutting advertising expenditures (Cohen et al. 2010);
- Overproduction of inventory - to decrease COGS (Roychowdhury 2006);
- Sales price reduction (Jackson & Wilcox 2000);
- Sale of assets (Bartov 1993);
- Stock repurchase (Hribar et al. 2006).

Gunny (2010) suggests another classification of real activities manipulations based on existing academic research:

- decreasing discretionary R&D expenses,
- decreasing discretionary selling, general and administration expenses,
- timing of sale of fixed assets,
- overproduction.

Managers prefer real activities manipulations as such actions are harder to identify or detect and there are no benchmarks for activities to be done in different situations. Thus, real activities manipulations are widely used by the companies, but it is difficult to control them.

3.4.2 Accrual-based earnings management

Accrual-based earnings management is a popular technique of accounting manipulations which has been widely studied by researchers (DeAngelo 1986, Jones 1991, Klein 2002, Teoh et al., Healy 1985, Dechow et al. 1995).
Contrary to the real activities manipulation method, accrual management is easy to detect due to existing benchmarks (accounting standards), and accruals are examined by auditors and analysts (Lo 2008). Thus, most of academic researches study accrual-based earnings management as a strategy for accounting manipulations.

Accruals management is based on the choice of appropriate accounting methods used to represent the underlying operating activities of the company. Managing accruals includes changes in accruals to increase earnings, such as reducing the allowance for bad debts, capitalizing expenses, etc. (Gunny 2010).

The empirical results of the research by Zang (2012) and Cohen et al. (2008) show that accrual-based management is constrained by:

- the presence of high-quality auditors,
- the passage of the Sarbanes-Oxley Act (SOX),
- the accounting flexibility (accounting choices in prior periods).

According to Sloan (1996), earnings can be decomposed into operating cash flow and accruals. Further, total accruals of a company can be divided into discretionary (abnormal) accruals and non-discretionary (normal) accruals. Non-discretionary accruals represent real business activity records, while discretionary accruals represent managers’ discretions.

Non-discretionary accruals are a part of the earnings which managers have no flexibility to change (e.g., depreciation and amortization). Discretionary accruals, on the contrary, are easily influenced by managers and can be used for manipulations. Scott (2003) reports that discretionary accruals are more flexible for the usage by managers and cannot be observed by investors. Thus, companies extensively use this type of accruals to manipulate earnings. Schipper (1989) also provides evidence that even the board of directors cannot detect accrual-based earnings management. Consequently, high discretionary accruals lead to high opportunities for earnings management. Discretionary accruals include accounts payable, accounts receivable, provision for bad debts, allowance, etc.
3.5 Detecting earnings management

As mentioned above, earnings management is common among companies and it is a method of accounting manipulation. There are several different models for detecting earnings management and they are all widely analyzed in earnings management literature.

Researchers and analysts employ mostly accrual-based models to detect earnings management. Those models are based on estimating discretionary accruals and can be divided into simple models (discretionary accruals are equal total accruals) and sophisticated models (total accruals are the sum of discretionary accruals and non-discretionary accruals) (Dechow et al. 1995).

We distinguish five practical models which are presented and extensively discussed in the previous researches on earnings management. Next, we present models in chronological order.

1. The Healy model (Healy 1985)

This model, introduced by Healy (1985) was applied to estimate the prediction that systematic earnings occur in every period. The author used the mean total accruals as the measure of non-discretionary accruals and tested earnings management by matching the mean total accruals (scaled by lagged total assets) across the earnings management partitioning variables. The model is presented in Equation 1:

\[
NDA_t = \frac{\sum_{i} TA_i}{T}
\]  

(1)

where:

- \(NDA_t\) – estimated non-discretionary accruals,
- \(TA_t\) – total accruals scaled by previous year total assets,
- \(T\) – number of years in the estimation period.
2. The DeAngelo model (DeAngelo 1986)

The DeAngelo model is similar to the Healy’s as it also explores the mean total accruals (scaled by lagged total assets) as the measure of non-discretionary accrual. However, this model uses the last period’s total accruals. Total accruals were proxies for expected non-discretionary accruals in both models. DeAngelo (1986) tested earnings management by calculating the first difference in total accruals. The next Equation 2 shows this model:

\[ NDA_t = TA_{t-1} \]  

(2)

3. The Jones model (Jones 1991)

The Jones model is a time-series estimation model which presents non-discretionary accruals as constant values. The model controls the effect of a firm economic circumstances’ changes on non-discretionary accruals. Jones (1991) explores receivables and gross PPE measures and firm-specific parameters to generate this model. The Jones model suggests that revenues are non-discretionary and the model removes a part of managed earnings from the discretionary accruals proxy if earnings are managed through discretionary revenues (Jones 1991).

The Jones model (Equation 3) is similar to the Healy and the DeAngelo models, but it estimates non-discretionary accruals more precisely and, thus, it is a better method for accruals estimations.

\[ NDA_t = \alpha_1 \cdot \left( \frac{1}{A_{t-1}} \right) + \alpha_2 \cdot (\Delta REV_t) + \alpha_3 \cdot (PPE_t) \]  

(3)

where:

- \( NDA_t \) – non-discretionary accruals (in period \( t \)),
- \( A_{t-1} \) – total assets in year \( t-1 \)
- \( \Delta REV_t \) – change in revenues in year \( t \) scaled by total assets year \( t-1 \),
$PPE_t$ – property, plant and equipment in year $t$ scaled by total assets year $t-1$,

$\alpha_1, \alpha_2, \alpha_3$ – firm-specific parameters.

The next step in this model is to find discretionary accruals. Total accruals is the sum of discretionary and non-discretionary accruals. Consequently, Equation 4 represents discretionary accruals:

$$DA_t = TA_t - NDA_t$$

(4)

To estimate firm-specific parameters $\alpha_1, \alpha_2$ and $\alpha_3$, Equation 5 is used as the combination of Equation 3 and Equation 4. The residuals from Equation 5 show discretionary accruals.

$$TA_t = \beta_1 \cdot \left( \frac{1}{A_{t-1}} \right) + \beta_2 \cdot (REV_t) + \beta_3 \cdot (PPE_t) + \epsilon_t$$

(5)

Thus, $\epsilon_t$ is residual and discretionary accruals, and $\beta_1, \beta_2$ and $\beta_3$ equal to $\alpha_1, \alpha_2$ and $\alpha_3$.

4. The Modified Jones model (Dechow et al. 1995)

Although the Jones model provides an accurate method for accruals estimation, there are certain limitations. In this model, revenues are treated as an objective measure that is free from manipulations and thus is without any discretion. However, several studies provided evidence that managers can manipulate revenues by boosting sales using a simultaneous increase in accounts receivable and decrease of inventory. Since the original Jones model does not allow us to detect such manipulations of revenues, Dechow et al. (1995) created a modified model in order to overcome this limitation of the Jones model.

The Modified Jones model assumes that all changes in revenues in the event period are produced by earnings management and this is the main difference from the original model. The modified model estimates firm-specific parameters and non-discretionary accruals received from the previous model, but the change in earnings is corrected for the change in receivables during the event period (Dechow et al. 1995). Equation 3 demonstrates the new
modified model using Equation (3) from the Jones model as a basis:

\[ NDA_t = \alpha_1 \cdot \left( \frac{1}{A_{t-1}} \right) + \alpha_2 \cdot (\Delta \ REV_t - \Delta \ REC_t) + \alpha_3 \cdot (PPE_t) \]  

(6)

where:

- \( NDA_t \) – non-discretionary accruals (in period \( t \)),
- \( A_{t-1} \) – total assets in year \( t-1 \),
- \( \Delta \REV_t \) – change in Revenues in year \( t \) scaled by total assets year \( t-1 \),
- \( \Delta \REC_t \) – change in Receivables in year \( t \) scaled by total assets year \( t-1 \),
- \( PPE_t \) – property, plant and equipment in year \( t \) scaled by total assets year \( t-1 \),
- \( \alpha_1, \alpha_2, \alpha_3 \) – firm-specific parameters.

5. The Industry model (Dechow & Sloan 1991)

The industry model by Dechow & Sloan (1991) is similar to the Jones model and assumes that non-discretionary accruals are constant over the whole period. But, this model also assumes that the determinants of non-discretionary accruals are universal across one industry (across firms in the same industry). That means, that companies of the same industry have the same non-discretionary and discretionary accruals structure or distribution.

\[ NDA_t = \gamma_1 + \gamma_2 \text{median}_i(TA_t) \]  

(7)

where:

- \( NDA_t \) – non-discretionary accruals (in period \( t \)),
- \( \text{median}_i(TA_t) \) – the median value of total accruals scaled by lagged total assets for one industry,
- \( \gamma_1, \gamma_2 \) – firm-specific parameters.

The above discussed five models are tested for the ability to detect earnings management in
the research paper by Dechow et al. (1995). The results of their study show that all models generate rational and precise tests for a random sample of event years, but the Modified Jones model creates “the most powerful tests of earning management”. This model assumes that all changes in revenues during the event period are produced by earnings management due to the fact that it is easier to manage earnings by using discretion over the recognition of income on cash sales (Dechow et al. 1995).

Despite the fact, that there are various models for detecting earnings management exist and they have been widely analyzed in previous research on earnings management, the Jones model (Jones 1991) and the Industry model (Dechow & Sloan 1991) are usually used for empirical research. These two models assume that non-discretionary accruals are constant over the period and it helps to detect manipulations in discretionary accruals.
4 HYPOTHESES DEVELOPMENT

The Russian Federation is known as a country of low quality financial reporting and earnings management is one of the reasons for that. The transition process from the state-planned to a market economy occurring in Russia and frequent state reforms bring instability in the accounting sector and create possibilities for earnings manipulations. Due to the presence of shadow economy and corruption, accounting manipulations, especially tax management, became a typical practice for Russian companies.

The inconsistencies of RAS compared to IFRS, the primary importance of taxation in accounting, poor auditing and corporate governance in practice lead to low quality of accounting. Earnings management is very popular and widely used practice in Russian companies. The analysis of prior literature and other business resources assists to detect the three most common accounting practices of earnings management use in Russian companies. These practices are similar to the earnings management patterns described by Scott (2003, 383-384):

1. Income minimization (managing earnings downward)
   Russian companies use tax management to decrease tax expenditures. Goncharov & Zimmerman (2006) examined the role of tax accounting in Russia and its influence on earnings management. For private firms, the main user of their accounting information is still tax authorities and the role of financial accounting is tax expenses’ calculations (Preobragenskaya & McGee 2004). Due to this, Russian public companies use tax management less aggressively to have the higher quality earnings (Goncharov & Zimmerman 2006).

2. Income maximization (managing earnings upward)
   The research by Goncharov & Zimmerman (2007) demonstrates that Russian companies usually manage their earnings to avoid reporting losses when they apply for bank loans. In other words, companies use earnings management around the lending process and they try to report the positive earnings figures (Goncharov & Zimmerman 2007).
3. Income smoothing

Tax accounting in Russia motivates managers not only to reduce profits in order to pay lower taxes, but also to use earnings smoothing to create a stream of earnings and decrease risk in order to ensure risk-free relations with tax authorities (Bagaeva 2009). The findings show that Russian companies using IFRS for their financial reporting have better earnings quality in terms of diminished earnings smoothing (Bagaeva 2009). Thus, the use of IFRS increases the quality of accounting information and decreases earnings smoothing in the company.

As we have discussed already in the previous chapter, earnings management and earnings quality are closely related to each other. Earnings management increases information asymmetry and impacts the quality of financial reports. Thus, the next step in our paper is to make an analysis if the IFRS adoption has an impact on earnings management and consequently on earnings quality in Russia. We expect the improvement of the financial reports quality with the adoption of IFRS due to the following reasons:

- The main users of IFRS financial reports are investors, but not tax authorities (RAS). Taxation is the main reason for preparation of financial reports in Russian accounting (Bagaeva et al. 2008, Goncharov & Zimmermann 2007, McGee & Preobragenskaya 2004). However, IFRS financial reports are used by investors, thus most of companies voluntary adopt IFRS in order to make them more transparent for investors. Additionally, IFRS reports are not used for tax purposes.

- IFRS require the usage of fair value (in contrast to book value according to RAS). Fair value provides more precise and up-to-date information about assets as it reflect their real value. In addition, the impairment of assets do not exist in RAS, while IFRS require the assessing the impairment of assets.

- IFRS take into account the inflation, while RAS do not have such practice. It is difficult to make an objective estimation of financial reporting in a dynamic economy when reported figures do not reflect the inflation. This is true especially in Russia, there the inflation rate is quite high. Thus, IFRS reporting will provide more relevant financial information.
There are also other reasons for the improvement of financial reporting using IFRS, such as the guidance for employers’ benefits, the capitalization of financial lease and hedge accounting (E&Y 2011). As a result, IFRS reflect real economic value better than RAS.

As the majority of previous literature on IFRS reports that IFRS improve earnings quality, we assume that the IFRS adoption increases the quality of accounting information in Russia. Thus, we argue that financial reporting prepared in accordance with IFRS demonstrates better quality than financial reporting prepared in accordance with RAS. The quality is improved due to reduction of earnings management practices used by Russian firms.

As a determinant of earnings management we use accrual-based earnings management practices as they are easy to detect. Using different mathematical models we can estimate discretionary accruals as a proxy for earnings management. Thus, the first hypothesis is:

Hypothesis 1. The adoption of IFRS results in the decrease of accruals-based earnings management in Russian companies.

At the same time, several academic researchers shows that IFRS do not improve earnings quality (Barth et al. 2008, Daske et al. 2008, Ahmed et al. 2013, Leuz et al. 2003, Kim 2013, Christensen 2012). RAS are rule-based standards, while IFRS are principle-based. RAS give accountants clear rules and strict guidance how to record accounting transactions and prepare financial reports. IFSR, on the contrary, give accountants more flexibility in preparation of financial reports by providing guidance and principles, rather than strict rules. Some researches argue that IFRS will not bring expected improvements. For example, Bagaeva (2009) states the IFRS complexity, significant differences between RAS and IFRS, and economic issues in Russia are the main reasons for that. Moreover, there is no clear guidance for the companies how to implement IFRS exist, and since IFRS give more flexibility to managers and accountants, we could expect more earning volatility and higher rate of manipulations. Thus, the second hypothesis is:

Hypothesis 2. The adoption of IFRS results in the increase of accruals-based earnings management in Russia companies.
5 RESEARCH DESIGN AND DATA

5.1 Model and methodology

In our research we use discretionary accruals as a measure of earnings management. As we noted in the Chapter 3, the Modified Jones model is the strongest model for detecting earnings management. This model, as well as the original Jones model, uses the calculation of discretionary accruals as a proxy for earnings management. However, in the Modified Jones model a change in earnings is corrected for the change in receivables during the event period (Dechow et al. 1995). The Modified Jones model assumes that all changes in revenues in the event period are produced by earnings management and this is the main difference from the original model. The Modified Jones model allows us to receive more accurate results by reducing the measurement errors.

Nevertheless, while collecting data for empirical research, we found out, that certain information from financial statements is largely missing for Russian companies in the database. In particular, Accounts Receivable are absent for most of the companies. Therefore, the Modified Jones model cannot be applied for this case. Thus, we use the original Jones model for our research. Discretionary accruals are calculated as total accruals deducted by non-discretionary accruals:

\[ DA_t = TA_t - NDA_t \]  

Total accruals are calculated as a net change in working capital and depreciation, scaled by total assets from a previous period (Kothari et al. 2005, Dechow et al. 1995):

\[ TA_t = \frac{\Delta CA_t - \Delta CASH_t - \Delta CL_t + \Delta STD_t - \Delta DEP_t}{A_{t-1}} \]  

where:

- \( TA_t \) - total accruals,
- \( \Delta CA_t \) - change in current assets,
\( \Delta CASH_t \) - change in cash and cash equivalents,
\( \Delta CL_t \) - change in current liabilities,
\( \Delta STD_t \) - change in debt included in current liabilities,
\( \Delta DEP_t \) - change in depreciation and amortization expenses,
\( A_{t-1} \) - lagged total assets.

High total accruals (scaled by total assets) are usually an evidence of low earnings quality and, thus, an existence of earnings management. However, accruals can reflect both earnings management and standard accounting estimations based on future expectations. Thus, total accruals are rough measures for earnings management, as they might be influenced by normal accounting activities.

Non-discretionary accruals are calculated according to the Jones model (Jones 1991) and presented next:

\[
NDA_t = \alpha_1 \cdot \left( \frac{1}{A_{t-1}} \right) + \alpha_2 \cdot (\Delta REV_t) + \alpha_3 \cdot (PPE_t) \tag{10}
\]

where:
- \( NDA_t \) – non-discretionary accruals (in period \( t \)),
- \( A_{t-1} \) – lagged total assets,
- \( \Delta REV_t \) – change in Revenues in year \( t \) scaled by total assets year \( t-1 \),
- \( PPE_t \) – property, plant and equipment in year \( t \) scaled by total assets year \( t-1 \),
- \( \alpha_1, \alpha_2, \alpha_3 \) – firm-specific parameters.

Using Equations 8, 9 and 10 we can calculate discretionary accruals for our samples. However, discretionary accruals are used to manipulate earnings both upwards and downwards. Thus, we need to use absolute values of discretionary accruals. It helps us to use both positive and negative values of discretionary accruals to detect earnings management in both directions (Hazaricka et al. 2012).

\[
|DA_t| = |TA_t - NDA_t| \tag{11}
\]
5.2 Regression model

In order to identify a relationship between discretionary accruals and the standards used for financial reporting (RAS or IFRS), we create the regression model that employs dependent and control variables, as well as independent variables.

By the dependent variable we denote discretionary accruals, calculated using Equation (11). By the independent variable we denote accounting standards (IFRS or other). IFRS is a dummy variable which equals 1 if a company has financial statements reported under IFRS. If the company uses RAS or other standards, this dummy variable equals to 0.

Based on previous research we choose the following control variables for our regression model: the size of a company (SIZE), debt structure (LEV), annual growth (GROWTH), risk (RISK), auditor (AUD), return on equity (ROE), and operating cash flow (OCF). We use control variables as certain firm’s characteristics may influence the earnings management practices in the company. The result is presented in Equation 12:

\[
|DA_{it}| = \beta_0 + \beta_1 IFRS_{it} + \beta_2 SIZE_{it} + \beta_3 LEV_{it} + \beta_4 RISK_{it} + \beta_5 GROWTH_{it} + \beta_6 AUD_{it} + \beta_7 ROE_{it} + \beta_8 OCF_{it} + \varepsilon_{it} \tag{12}
\]

where:

- \( DA_{it} \) - DA calculated from Equation (11),
- \( IFRS_{it} \) - dummy variable; equals 1 if a company uses IFRS, 0 otherwise,
- \( SIZE_{it} \) – natural logarithm of total assets,
- \( LEV_{it} \) – leverage, the ratio of total liabilities to total assets,
- \( RISK_{it} \) – dummy variable, systematic risk, equals to 1 if net income is negative, 0 otherwise,
- \( GROWTH_{it} \) - annual percentage of changes in sales,
- \( AUD_{it} \) - dummy variable, equals 1 if a company is audited by Big-4 auditors, 0 otherwise.
- \( ROE_{it} \) - return on equity,
\( OCF_{it} \) - current year operating cash flow scaled by total assets.

The size of a company is chosen as a control variable and calculated as a logarithm of total assets. There is no clear relationship between the size and earnings management as previous academic research provides controversial results. However, we assume that large companies use less earnings management. The larger is the company, the less earnings management is used as large companies care about their reputation (Barton & Simko 2002). The second reason is the fact that larger companies have more stable operations (Dechow & Dichev 2002). On the other hand, big companies have more pressure from capital markets and there are a lot of opportunities for manipulations.

Leverage helps to control the debt structure of the company and it equals to total liabilities divided by total assets. Leverage is positively correlated with earnings management (DeFond & Jiambalvo 1994). The risk variable is a systematic risk of a negative income. We assume that companies with losses have more motivations to manipulate. Thus, the dummy variable RISK equals 1 if the net income is negative, and 0 otherwise.

The Growth variable is used to control a firm growth, and it equals to annual changes in sales. Based on previous research papers, we assume that high-growth companies are more likely to use earnings management (McNichols 2000, Kothari et al. 2005). According to McNichols (2000) and Kothari et al. (2005), accruals are correlated with firm performance. McNichols (2000) argues that companies with higher expected growth are likely to have greater accruals. At the same time Kothari et al. (2005) suggest that these growth-related changes in accruals should be treated as non-discretionary accruals. Thus, both researched emphasize the importance of control for growth in detecting earnings management and estimating DA using the Jones model.

Auditor is an indicator variable, and we assume that companies audited by Big-4 firms (KPMG, PWC, E&Y and Deloitte) have lower earnings management. Thus, this dummy variable equals 1 if the firm is audited by Big-4, otherwise it equals 0.

Return on equity ratio equals to net income divided by shareholders’ equity. According to
Freeman et al. (1982) the fluctuation of future earnings and ROE has negative correlation. Also operating cash flow (current year operating cash flow scaled by total assets) is negatively related to discrentional accruals.

### 5.3 Data

The present research is based on the sample of Russian firms collected during years 2006-2012. The sample contains firms of different industries, including financial sector, insurance, telecommunication, automotive, aircraft, manufacturing, energy industry, etc. The financial data was retrieved from Thomson WorldScope Database. The original sample included 478 Russian firms and 3339 firm-year observations. However, most of the firms did not have all the financial figures necessary for our research. Thus, after excluding the firms with missing data, we reduced the sample to 117 Russian firms and 765 firm-year observations for the period from 2006 to 2012. All monetary values are in Russian rubles.

As we have a large number of observations, we need to make a test for outliers. We use the Tietjen-Moore test (Tietjen & Moore 1972) to detect multiple outliers in our data set. We apply the two-sided test with the significance level $\alpha$ equal to 0.05, and the critical value of $t$-distribution 0.975. After the test, the final sample consists of 95 firms and 557 firm-year observations.

### Table 3. The final sample of observations

<table>
<thead>
<tr>
<th>Years</th>
<th>IFRS</th>
<th>RAS</th>
<th>Total number of firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>39</td>
<td>56</td>
<td>95</td>
</tr>
<tr>
<td>2007</td>
<td>44</td>
<td>51</td>
<td>95</td>
</tr>
<tr>
<td>2008</td>
<td>47</td>
<td>48</td>
<td>95</td>
</tr>
<tr>
<td>2009</td>
<td>47</td>
<td>46</td>
<td>93</td>
</tr>
<tr>
<td>2010</td>
<td>46</td>
<td>46</td>
<td>92</td>
</tr>
<tr>
<td>2011</td>
<td>45</td>
<td>46</td>
<td>91</td>
</tr>
<tr>
<td>2012</td>
<td>49</td>
<td>42</td>
<td>91</td>
</tr>
<tr>
<td>Total number of observations</td>
<td>317</td>
<td>335</td>
<td>-</td>
</tr>
</tbody>
</table>

A high-level analysis of the sample shows that most Russian public international
corporations use IFRS since early 2000s (e.g. Gazprom OAO, Severstal OAO, Rosneft Oil OAO, Rostelecom OAO). Other large corporations shifted from RAS to IFRS in 2006, when the Russian government obliged all public companies to provide financial reporting in accordance with IFRS (e.g. AvtoVAS OAO, Kamaz OAO, AK Yakutskenergo OAO, Aeroflot OAO). Table 3 overviews our sample divided by two groups: the firms reporting in accordance with IFRS and the firms reporting in accordance with RAS. These two sets are used for further analysis.

5.4 Descriptive statistics

We use descriptive statistics in order to analyze our data set. Table 4 presents descriptive statistics for the main financial indicators: Total Assets, Sales, PPE, Net Income, Total Accruals, and Discretionary Accruals (DA nominal and DA absolute numbers). All monetary values are in millions Russian rubles.

<table>
<thead>
<tr>
<th></th>
<th>N</th>
<th>Mean</th>
<th>Median</th>
<th>St. Dev</th>
<th>Minimum</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
<td>557</td>
<td>304 540,9</td>
<td>53 348,0</td>
<td>1 048 880,8</td>
<td>533</td>
<td>12 068 139</td>
</tr>
<tr>
<td>Sales</td>
<td>557</td>
<td>177 924,4</td>
<td>36 204,0</td>
<td>507 504,2</td>
<td>130</td>
<td>4 764 411</td>
</tr>
<tr>
<td>PPE</td>
<td>557</td>
<td>261 391,8</td>
<td>32 500,0</td>
<td>946 775,9</td>
<td>60</td>
<td>11 242 010</td>
</tr>
<tr>
<td>Net Income</td>
<td>557</td>
<td>26 283,2</td>
<td>1 582,0</td>
<td>110 500,2</td>
<td>-53 999</td>
<td>1 307 018</td>
</tr>
<tr>
<td>Total Accruals</td>
<td>557</td>
<td>0,022</td>
<td>0,011</td>
<td>0,193</td>
<td>-0,516</td>
<td>2,669</td>
</tr>
<tr>
<td>DA</td>
<td>557</td>
<td>-0,950</td>
<td>-0,973</td>
<td>0,617</td>
<td>-2,768</td>
<td>1,788</td>
</tr>
<tr>
<td>DA_abs</td>
<td>557</td>
<td>0,983</td>
<td>0,980</td>
<td>0,562</td>
<td>0,012</td>
<td>2,768</td>
</tr>
</tbody>
</table>

Standard deviation is high for key financials (assets, PPE, sales, net income) due to the fact that values differ significant. The huge differences between mean and median, minimum and maximum also prove the significant deviation of values in the sample. Mean values for Total Assets and PPE are quite close. Thus, we can conclude, the most companies from the data have high amounts of PPE in assets. Hence, these companies operate in manufacturing and extractive (oil, gas, and mining) industries. Also, based on descriptive statistics, we can conclude, that companies are profitable on average. However, some of the observations have negative net income.
Total accruals and discretionary accruals are stretched and have low volatility. Mean and median values for these variables are close, and standard deviations are small. Discretionary accruals on average have negative values, which show that downward earnings management is present. On the contrary, the positive abnormal accruals indicate that reported earnings are managed upward. For our model we use absolute numbers of discretionary accruals in order to control both upward and downward earnings management.

Table 5 provides more detailed descriptive statistics of total accruals and discretionary accruals and shows the trend over the years.

Table 5. Descriptive statistics for accruals

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>N</td>
<td>95</td>
<td>95</td>
<td>93</td>
<td>92</td>
<td>91</td>
<td>91</td>
</tr>
<tr>
<td><strong>Accruals</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mean</td>
<td>0.092</td>
<td>0.001</td>
<td>0.005</td>
<td>0.032</td>
<td>0.003</td>
<td>-0.002</td>
</tr>
<tr>
<td>Median</td>
<td>0.031</td>
<td>-0.005</td>
<td>0.015</td>
<td>0.021</td>
<td>0.015</td>
<td>0.006</td>
</tr>
<tr>
<td>St. Dev</td>
<td>0.356</td>
<td>0.159</td>
<td>0.132</td>
<td>0.122</td>
<td>0.135</td>
<td>0.117</td>
</tr>
<tr>
<td>Minimum</td>
<td>-0.44</td>
<td>-0.49</td>
<td>-0.52</td>
<td>-0.22</td>
<td>-0.49</td>
<td>-0.37</td>
</tr>
<tr>
<td>Maximum</td>
<td>2.67</td>
<td>0.47</td>
<td>0.37</td>
<td>0.45</td>
<td>0.42</td>
<td>0.39</td>
</tr>
<tr>
<td><strong>Discretionary accruals</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mean</td>
<td>-1.103</td>
<td>-1.089</td>
<td>-0.671</td>
<td>-1.002</td>
<td>-0.999</td>
<td>-0.829</td>
</tr>
<tr>
<td>Median</td>
<td>-1.145</td>
<td>-1.067</td>
<td>-0.702</td>
<td>-1.005</td>
<td>-0.988</td>
<td>-0.821</td>
</tr>
<tr>
<td>St. Dev</td>
<td>0.557</td>
<td>0.717</td>
<td>0.635</td>
<td>0.551</td>
<td>0.592</td>
<td>0.525</td>
</tr>
<tr>
<td>Minimum</td>
<td>-2.77</td>
<td>-2.70</td>
<td>-2.29</td>
<td>-2.23</td>
<td>-2.62</td>
<td>-2.03</td>
</tr>
<tr>
<td>Maximum</td>
<td>0.24</td>
<td>1.79</td>
<td>1.08</td>
<td>0.58</td>
<td>0.48</td>
<td>0.48</td>
</tr>
<tr>
<td><strong>Discretionary accruals (abs)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mean</td>
<td>1.108</td>
<td>1.129</td>
<td>0.766</td>
<td>1.015</td>
<td>1.018</td>
<td>0.856</td>
</tr>
<tr>
<td>Median</td>
<td>1.145</td>
<td>1.088</td>
<td>0.752</td>
<td>1.005</td>
<td>0.988</td>
<td>0.821</td>
</tr>
<tr>
<td>St. Dev</td>
<td>0.546</td>
<td>0.645</td>
<td>0.514</td>
<td>0.525</td>
<td>0.559</td>
<td>0.478</td>
</tr>
<tr>
<td>Minimum</td>
<td>0.05</td>
<td>0.01</td>
<td>0.01</td>
<td>0.04</td>
<td>0.01</td>
<td>0.03</td>
</tr>
<tr>
<td>Maximum</td>
<td>2.77</td>
<td>2.70</td>
<td>2.29</td>
<td>2.23</td>
<td>2.62</td>
<td>2.03</td>
</tr>
</tbody>
</table>

Total accruals have a trend to decrease, as both minimum and maximum, as well as mean values were gradually decreasing on annual basis. During the whole period of observation
discretionary accruals on average have high negative values, which indicate downward earnings management. However, they also demonstrate a tendency to decrease, which might be an indicator of less earnings management. This trend can be a result of more conservative accounting and less earnings management for tax purposes. Absolute values of discretionary accruals demonstrate the same trend, as mean, median, minimum and maximum values steadily decrease. Standard deviation shows that discretionary accruals become less volatile from year to year. Thus, earnings manipulations become less extreme. It can be a result of improvements in corporate governance, competence of auditors and accounting standards.

In order to analyze the relationships between dependent and independent variables of our regression model, we use Pearson correlation coefficients. Table 6 presents the results of Pearson correlation for our linear regression model.

*Table 6. Pearson Correlation (p-values)*

<table>
<thead>
<tr>
<th></th>
<th>DA_abs</th>
<th>IFRS</th>
<th>SIZE</th>
<th>LEV</th>
<th>RISK</th>
<th>GROWTH</th>
<th>AUD</th>
<th>ROE</th>
<th>OCF</th>
</tr>
</thead>
<tbody>
<tr>
<td>DA_abs</td>
<td>1,000</td>
<td>0,166</td>
<td>0,166</td>
<td>-0,211</td>
<td>-0,230</td>
<td>0,411</td>
<td>0,222</td>
<td>0,145</td>
<td>0,273</td>
</tr>
<tr>
<td></td>
<td>(0,000)</td>
<td>(0,000)</td>
<td>(0,000)</td>
<td>(0,000)</td>
<td>(0,000)</td>
<td>(0,000)</td>
<td>(0,000)</td>
<td>(0,000)</td>
<td>(0,000)</td>
</tr>
<tr>
<td>IFRS</td>
<td>1,000</td>
<td>0,345</td>
<td>-0,053</td>
<td>0,044</td>
<td>0,121</td>
<td>0,533</td>
<td>-0,075</td>
<td>0,080</td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0,000)</td>
<td>(0,108)</td>
<td>(0,149)</td>
<td>(0,002)</td>
<td>(0,000)</td>
<td>(0,039)</td>
<td>(0,029)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SIZE</td>
<td>1,000</td>
<td>-0,136</td>
<td>-0,024</td>
<td>0,107</td>
<td>0,595</td>
<td>0,010</td>
<td>0,075</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0,001)</td>
<td>(0,283)</td>
<td>(0,006)</td>
<td>(0,000)</td>
<td>(0,404)</td>
<td>(0,038)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LEV</td>
<td>1,000</td>
<td>0,334</td>
<td>-0,073</td>
<td>-0,085</td>
<td>-0,160</td>
<td>-0,108</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0,000)</td>
<td>(0,042)</td>
<td>(0,023)</td>
<td>(0,000)</td>
<td>(0,005)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>RISK</td>
<td>1,000</td>
<td>-0,224</td>
<td>-0,053</td>
<td>-0,484</td>
<td>-0,052</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0,000)</td>
<td>(0,107)</td>
<td>(0,000)</td>
<td>(0,111)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GROWTH</td>
<td>1,000</td>
<td>0,139</td>
<td>0,211</td>
<td>0,007</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0,001)</td>
<td>(0,000)</td>
<td>(0,437)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>AUD</td>
<td>1,000</td>
<td>0,019</td>
<td>0,146</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0,325)</td>
<td>(0,000)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>ROE</td>
<td>1,000</td>
<td>-0,028</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0,253)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>OCF</td>
<td>1,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Notes:
Number of observations N = 557
(0,000) - p-values
DA_abs – absolute value of discretionary accruals
IFRS- dummy variable; equals 1 if a company uses IFRS, 0 otherwise,
SIZE – natural logarithm of total assets,
LEV – leverage, the ratio of total liabilities to total assets,
RISK – systematic risk, equals to 1 if net income is negative, 0 otherwise,
GROWTH - annual percentage of changes in sales,
AUD - dummy variable, equals 1 if a company is audited Big-4 auditors, 0 otherwise.
ROE - return on equity,
OCF- current year operating cash flow scaled by total assets.

All p-values for correlation between discretionary accruals and independent variables are lower than 0.05. Thus, the results are statistically significant. The results indicate a positive correlation between discretionary accruals and accounting standards (0.166), and a strong positive correlation between the discretionary accruals and firm’s growth (0.411). Thus, the positive growth is associated with positive discretionary accruals and vice versa. Also, operational cash flow and ROE have a positive association with discretionary accruals.

At the same time, discretionary accruals, as a measure of earnings management, are negatively correlated to leverage (-0.211) and risk (-0.230). Based on these results, we can conclude, that big companies with higher growth rate are assumed to have higher discretionary accruals (more earnings management). Simultaneously, companies with loss and financial problems are trying not to use earnings manipulations. Appendix 2 presents scatterplots for the main correlations. The results show, that variable AUD (auditor) has a strong positive correlation with IFRS (0.533) and firm size (0.595). Thus, we can suggest, that the bigger a company, the more likely it applies IFRS as accounting standards and hires Big-4 firms as auditors.

The descriptive statistics presented in Table 7 helps us to analyze how discretionary accruals and control variables differ between the firms reporting with IFRS and RAS. We decomposed our data set into two groups of companies based on the variable of accounting standards (IFRS). There are two groups with almost equal numbers of observations (279 and 278 observations), that makes the results of descriptive statistics comparable.

The results of descriptive statistics point out, that IFRS firms are larger, less leveraged, and have higher growth than RAS firms. Besides, statistics reveals that 97% of IFRS firm use services of Big-4 auditors, while only 47% of RAS firms are audited by Big-4. Furthermore,
firms with IFRS have higher risks and lower ROE than firms with RAS.

Table 7. Descriptive statistics for two sets of variables (reporting with IFRS or RAS)

<table>
<thead>
<tr>
<th></th>
<th>DA</th>
<th>DA_abs</th>
<th>SIZE</th>
<th>LEV</th>
<th>RISK</th>
<th>GROWTH</th>
<th>ROE</th>
<th>AUD</th>
<th>OCF</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>RAS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>N = 279</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mean</td>
<td>-0.82</td>
<td>0.89</td>
<td>4.33</td>
<td>0.52</td>
<td>0.14</td>
<td>0.14</td>
<td>0.14</td>
<td>0.47</td>
<td>0.05</td>
</tr>
<tr>
<td>Median</td>
<td>-0.85</td>
<td>0.89</td>
<td>4.18</td>
<td>0.53</td>
<td>0.00</td>
<td>0.13</td>
<td>0.12</td>
<td>0.00</td>
<td>0.09</td>
</tr>
<tr>
<td>St. Dev</td>
<td>0.64</td>
<td>0.55</td>
<td>0.99</td>
<td>0.28</td>
<td>0.35</td>
<td>0.30</td>
<td>0.22</td>
<td>0.50</td>
<td>0.24</td>
</tr>
<tr>
<td>Minimum</td>
<td>-2.63</td>
<td>0.01</td>
<td>2.73</td>
<td>0.04</td>
<td>0</td>
<td>-0.96</td>
<td>-1.26</td>
<td>0</td>
<td>-2.08</td>
</tr>
<tr>
<td>Maximum</td>
<td>1.79</td>
<td>2.63</td>
<td>6.53</td>
<td>1.64</td>
<td>1</td>
<td>1.32</td>
<td>1.34</td>
<td>1</td>
<td>0.57</td>
</tr>
</tbody>
</table>

<p>| | | | | | | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>IFRS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>N = 278</td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mean</td>
<td>-1.07</td>
<td>1.08</td>
<td>4.97</td>
<td>0.50</td>
<td>0.18</td>
<td>0.21</td>
<td>0.08</td>
<td>0.95</td>
<td>0.09</td>
</tr>
<tr>
<td>Median</td>
<td>-1.05</td>
<td>1.05</td>
<td>4.90</td>
<td>0.46</td>
<td>0.00</td>
<td>0.19</td>
<td>0.13</td>
<td>1.00</td>
<td>0.09</td>
</tr>
<tr>
<td>St. Dev</td>
<td>0.57</td>
<td>0.56</td>
<td>0.65</td>
<td>0.22</td>
<td>0.38</td>
<td>0.34</td>
<td>0.42</td>
<td>0.22</td>
<td>0.18</td>
</tr>
<tr>
<td>Minimum</td>
<td>-2.77</td>
<td>0.01</td>
<td>3.19</td>
<td>0.08</td>
<td>0</td>
<td>-0.52</td>
<td>-3.54</td>
<td>0</td>
<td>-1.17</td>
</tr>
<tr>
<td>Maximum</td>
<td>0.48</td>
<td>2.77</td>
<td>7.08</td>
<td>1.08</td>
<td>1</td>
<td>2.62</td>
<td>2.44</td>
<td>1</td>
<td>0.83</td>
</tr>
</tbody>
</table>

The comparison of statistics for discretionary accruals and its absolute numbers shows, that firms reporting with IFRS have higher discretionary accruals than firms reporting with RAS. Thus, we can make a preliminary assumption, that implementation of IFRS does not improve earnings quality.
6 EMPIRICAL RESULTS

This Chapter introduces our empirical results obtained through the model explained in the Chapter 5, and discusses the limitations of the study.

6.1 Results of the study

In the previous chapter we designed the methodology for our research. We used discretionary accruals as a measure for earnings management. We calculated discretionary accruals applying the Jones model. However, for our research, we decided to use absolute number of discretionary accruals in order to control both earnings increasing and earnings decreasing practices. After that, we created the regression model which included independent and dependent variables, as well as control variables. The descriptive statistics helped us to get a general overview of variables used in the regression model and allowed to make preliminary assumptions.

Although we discovered, that most of the companies manage earnings downward (negative discretionary accruals), there is a tendency of a decline in earnings management. This can be a result of improvements in corporate governance, auditing services or accounting standards. At the same time, we did not find any evidence that IFRS decrease earnings management (e.g. discretionary accruals). On the contrary, we noticed that IFRS have a positive correlation with discretionary accruals, and firms reporting with IFRS have higher average discretionary accruals.

The next step in our research is an analysis of linear regression. We explore our regression model in order to find the relationships between IFRS implementation and the quality of earnings. The results of regression for the whole sample with a constant value are presented in Table 8. We test the significance of results with p-values assuming significance at the 5% level. Parameters coefficients demonstrate the effect of independent (control) variable on the independent variable (DA_abs).

The results, displayed in Table 4, show that F-value of our model equals to 27.75 with p-
value 0.000. Thus, our whole model is statistically significant and, hence, we can continue analysis. Also R-square adjusted is 27.8\%, which is quite good for the model with constant value.

**Table 8. Regression results**

<table>
<thead>
<tr>
<th>Parameter coefficient</th>
<th>Intercept</th>
<th>IFRS</th>
<th>SIZE</th>
<th>LEV</th>
<th>RISK</th>
<th>GROWTH</th>
<th>AUD</th>
<th>ROE</th>
<th>OCF</th>
</tr>
</thead>
<tbody>
<tr>
<td>p-value</td>
<td>0.000*</td>
<td>0.207</td>
<td>0.536</td>
<td>0.004*</td>
<td>0.040*</td>
<td>0.000*</td>
<td>0.128</td>
<td>0.737</td>
<td>0.000*</td>
</tr>
<tr>
<td>F-value</td>
<td>27.75</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>(0,000)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R-sq</td>
<td>28.8%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adj. R-sq</td>
<td>27.8%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>N</td>
<td>557</td>
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<td></td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

N - Number of observations
*statistically significant at the level 5% (two tailed)

According to the results (Table 8), only variables leverage, risk, growth and operating cash flow are statistically significant (p-value<0.05). Consequently, their parameter coefficients are reliable. Thus, growth and cash flow have a strong positive influence on discretionary accruals. It means that fast-growing companies have reasons to use earnings management, most probably to meet market expectation. At the same time, leverage and risk variables have negative coefficients. Thus, the companies with negative net income and low leverage are less involved in earnings management manipulations, than companies with positive income and higher leverage.

Variables IFRS, Size, Audit and ROE are statistically insignificant (p-value>0.05). IFRS variable has a small positive coefficient of 0.061 (p-value 0.207), what might be interpreted as a positive impact of IFRS on earnings management, though this result is statistically insignificant. Thus, the results of regression don’t prove clearly whether IFRS influences earnings quality.

In order to have more detailed analysis, we can divide our sample by dividing into two datasets by a certain criteria. The first criteria is the size of a firm. We use the median value of total assets (53 348 million rubles) for a decomposition of the data. Small firms are below
or equal median, others are big firms. We obtain two samples of almost equal samples, and the results of regression are presented in Table 9.

Table 9. Regression results for big and small firms

<table>
<thead>
<tr>
<th>Parameter coefficient</th>
<th>Intercept</th>
<th>IFRS</th>
<th>SIZE</th>
<th>LEV</th>
<th>RISK</th>
<th>GROWTH</th>
<th>AUD</th>
<th>ROE</th>
<th>OCF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small firms</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Parameter coefficient</td>
<td>0,860</td>
<td>0,179</td>
<td>-0,035</td>
<td>-0,015</td>
<td>-0,099</td>
<td>0,720</td>
<td>0,069</td>
<td>-0,051</td>
<td>0,579</td>
</tr>
<tr>
<td>p-value</td>
<td>0,001*</td>
<td>0,025*</td>
<td>0,614</td>
<td>0,901</td>
<td>0,341</td>
<td>0,000*</td>
<td>0,599</td>
<td>0,533</td>
<td>0,000*</td>
</tr>
<tr>
<td>F-value</td>
<td>11,64</td>
<td>(0,000)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R-sq</td>
<td>25,6%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adj. R-sq</td>
<td>23,4%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>N</td>
<td>279</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Big firms</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Parameter coefficient</td>
<td>1,368</td>
<td>-0,054</td>
<td>-0,100</td>
<td>-0,576</td>
<td>-0,155</td>
<td>0,558</td>
<td>0,433</td>
<td>0,001</td>
<td>0,778</td>
</tr>
<tr>
<td>p-value</td>
<td>0,000*</td>
<td>0,368</td>
<td>0,058</td>
<td>0,000*</td>
<td>0,072</td>
<td>0,000*</td>
<td>0,000*</td>
<td>0,989</td>
<td>0,000*</td>
</tr>
<tr>
<td>F-value</td>
<td>18,55</td>
<td>(0,000)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>R-sq</td>
<td>35,6%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adj. R-sq</td>
<td>33,6%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>N</td>
<td>278</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

N - Number of observations
*statistically significant at the level 5% (two tailed)

F-values in both samples are statistically significant, that means we can use the results for analysis. Adjusted R-square for the sample of big firms is higher than for small firms, and, thus, results for big firms are more reliable. In both samples variable of growth have a high positive coefficient and it is statistically significant. Thus, it is possible to conclude that the whole sample has a positive correlation between discretionary accruals and companies’ growth. However, we should remember, that a growing firm usually has a high level of accruals in order to support its growth. Hence, high discretionary accruals do not always denote manipulations.

The variable IFRS has a positive parameter for small firms (0,179) and negative for big firms (-0,054). However, this result is not statistically significant for big firm. Thus, based on the
sample of small firms, we can conclude, that the variable IFRS has a positive effect on
discretionary accruals. Thus, we make a conclusion that the adoption of IFRS has a negative
impact on earnings quality at least for small firms. The sample of small firms has 279
observations during the period of 2006-2012, and this is enough to obtain consistent results.
Hence, we can support our second hypothesis that the IFRS adoption leads to the increase of
accruals-based earnings management in Russian companies, and, consequently, decreases the
quality of accounting information.

In the previous analysis of the regression model, we used absolute values of discretionary
accruals. We can use nominal values of discretionary accruals in order to test our hypothesis
as well. We divide our data into two sets: observations with positive discretionary accruals
and with negative discretionary accruals (none of observations equals 0). We have already
mentioned during previous investigations, that Russian companies use downward earnings
management more often, than upward. Thus, the number of observations with negative
discretionary accruals is significantly higher than with positive discretionary accruals (499 vs
58), and we can expect biased outcomes. The results for both groups of companies are
presented in Table 10.

The first set of observations with positive discretionary accruals has extremely low R-square
adjusted (0,4%) and F-value (1,13), and statistically insignificant p-value for both F-value
and all parameters coefficients. Hence, we can conclude that these results are not indicative,
and precise assumptions based on these results cannot be taken.

However, the second group of observations has statistically significant F-value (16,52) and
sufficient R-square adjusted (20,0%). Variables IFRS, leverage, risk, growth and OCF are
statistically significant. Growth and cash flow have positive coefficients (statistically
significant) as in the previous results. It confirms one more time that these two factors have a
consistent positive impact on discretionary accruals, and, thus, fast-growing companies have
motivations to use downward earnings management (for tax minimization). These findings
support results of McNichols (2000) and Kothari et al. (2005) who demonstrated that
accruals are correlated with a firm performance and companies with higher expected growth
are likely to have greater earnings management.
Table 10. Regression results for positive and negative discretional accruals

<table>
<thead>
<tr>
<th>DA &gt; 0</th>
<th>Intercept</th>
<th>IFRS</th>
<th>SIZE</th>
<th>LEV</th>
<th>RISK</th>
<th>GROWTH</th>
<th>AUD</th>
<th>ROE</th>
<th>OCF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Parameter</td>
<td>0.032</td>
<td>-0.034</td>
<td>0.015</td>
<td>0.271</td>
<td>-0.095</td>
<td>-0.250</td>
<td>-0.093</td>
<td>0.005</td>
<td>0.147</td>
</tr>
<tr>
<td>coefficient</td>
<td>0.925</td>
<td>0.740</td>
<td>0.860</td>
<td>0.115</td>
<td>0.358</td>
<td>0.104</td>
<td>0.318</td>
<td>0.951</td>
<td>0.496</td>
</tr>
<tr>
<td>p-value</td>
<td>1.13</td>
<td>1.40</td>
<td>0.60</td>
<td>0.30</td>
<td>0.15</td>
<td>0.10</td>
<td>0.30</td>
<td>0.20</td>
<td>0.15</td>
</tr>
<tr>
<td>F-value</td>
<td>16.52</td>
<td>0.000*</td>
<td>0.003*</td>
<td>0.724</td>
<td>0.007*</td>
<td>0.020*</td>
<td>0.000*</td>
<td>0.140</td>
<td>0.430</td>
</tr>
<tr>
<td>R-sq</td>
<td>14.3%</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Adj. R-sq</td>
<td>0.4%</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>N</td>
<td>58</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
<td>50</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>DA &lt; 0</th>
<th>Intercept</th>
<th>IFRS</th>
<th>SIZE</th>
<th>LEV</th>
<th>RISK</th>
<th>GROWTH</th>
<th>AUD</th>
<th>ROE</th>
<th>OCF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Parameter</td>
<td>1.015</td>
<td>0.051</td>
<td>-0.010</td>
<td>-0.243</td>
<td>-0.177</td>
<td>0.554</td>
<td>0.099</td>
<td>-0.072</td>
<td>0.511</td>
</tr>
<tr>
<td>coefficient</td>
<td>0.000</td>
<td>0.003*</td>
<td>0.724</td>
<td>0.007*</td>
<td>0.020*</td>
<td>0.000*</td>
<td>0.140</td>
<td>0.430</td>
<td>0.000*</td>
</tr>
<tr>
<td>p-value</td>
<td>16.52</td>
<td>0.000*</td>
<td>0.000*</td>
<td>0.000*</td>
<td>0.000*</td>
<td>0.000*</td>
<td>0.000*</td>
<td>0.000*</td>
<td>0.000*</td>
</tr>
<tr>
<td>F-value</td>
<td>21.3%</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>R-sq</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>Adj. R-sq</td>
<td>0.0%</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
<td>0.00</td>
</tr>
<tr>
<td>N</td>
<td>499</td>
<td>500</td>
<td>500</td>
<td>500</td>
<td>500</td>
<td>500</td>
<td>500</td>
<td>500</td>
<td>500</td>
</tr>
</tbody>
</table>

N - Number of observations
*statistically significant at the level 5% (two tailed)

The IFRS parameter is positive (0.051) and statistically significant. Thus, we confirm the previous analysis for the sample of small firms and make an assumption that the IFRS adoption results in the increase of accruals-based earnings management. In this case, it is downward earning management.

These results support our second hypothesis that denotes a positive correlation between the IFRS adoption and earnings management. Our results go in line with studies by Goncharov & Zimmerman (2006) and Preobragenskaya & McGee (2004), who examined the role of tax accounting in Russia. We can make an assumption that Russian companies use income minimization in order to avoid high taxes.

Another important step of the empirical analysis is to test residuals for normality. The results are presented in Appendix 3. The histogram and p-plot demonstrate that residuals are normally distributed.
6.2 Limitations of the study

The limitation of this study is the usage of the Jones model instead of the Modified Jones model. The Jones model does not control sales-based manipulations, which has been addressed in the Modified Jones model (Dechow et al. 1995). The Modified Jones model allows to reduce the measurement errors and, thus, to receive more accurate results. However, we did not use this model due to the lack of financial data for Russian companies. Comparing two models, the original Jones model provides reliable results, but in the circumstances of fast growing Russian business, the Modified Jones model could provide more precise results.

Also this study could be more relevant if we had data for the year 2013. IFRS are compulsory for all public companies in Russia since 2012. Thus, the financial reporting for the year 2013 is done in accordance with IFRS. Unfortunately, financial results of the year 2013 are not available in the database yet, and we had limited opportunity to get enough observations with all necessary financial information for the last year.
7 CONCLUSION

The world practice shows that the high quality of accounting information can be achieved by the direct use of IFRS or by applying IFRS as a basis for a national system of accounting and reporting. The application of IFRS is expected to decrease earnings management and, as a consequence, improve earnings quality.

IFRS is currently a hot topic in the accounting community as the process of the IFRS adoption goes on in many countries. Multiple researchers study IFRS and their influences on different aspects of business in general. Existing research on the topic provides evidence that the IFRS adoption brings significant benefits to the country as it improves disclosure quality and informational environment around the IFRS adoption (Ball et al. 2000, Daske et al. 2008, Barth et al. 2008, Christensen et al. 2008, Alon 2013, Bagaeva et al. 2008). However, several studies argue that, at the same time IFRS, give significant flexibility and discretion to managers, that does not always mean the improvement of disclosure quality (Ball et al. 2000, Barth et al. 2008, Christensen 2012, Leuz et al. 2003).

This thesis provides one more examination of how IFRS influences earnings quality using the sample of Russian companies. Russia is known as a country with low quality accounting information and, thus, the implementation of IFRS is essential for improving earnings quality in Russia. The Russian economy undergoes a transition from a state-planned to market economy, and this transition involves changes in all areas of the economy including finance, taxation, accounting, corporate governance and security market sectors. The IFRS adoption is one of the most significant events in Russian accounting history. Despite the fact that the accounting system in Russia had made a great progress toward international standards during the last years, there are still a lot of differences between RAS and IFRS. This study is motivated by the increase of attention to the IFRS implementation process in Russia during the last years.

This research examines the impact of the IFRS adoption on earnings management as a determinant of earnings quality. There are two types of earnings management: real-activity manipulations and accrual-based manipulations. The empirical part of this thesis applies the
accrual-based type of earnings management. We use discretionary accruals as a measure for earnings management, and the Jones model is applied for the estimation of the discretionary accruals. As the results of existing academic research are controversial, we propose two hypotheses. The first one is that the adoption of IFRS results in the decrease of accruals-based earnings management in Russian companies, and the second one is reverse (increase of accruals-based earnings management).

The empiric research of this paper is based on the sample of Russian firms during the years 2006-2012. The financial data was retrieved from Thomson WorldScope Database. The original sample included 478 Russian firms and 3339 firm-year observation. After excluding the firms with missing data and the outliers, the final sample consists of 95 firms and 557 firm-year observations.

The empirical analysis of this thesis employs the linear regression model, which includes a dependent variable (discretionary accruals), an independent variable (accounting standards) and control variables (the size of a company, debt structure, annual growth, risk, auditor, return on equity, and operating cash flow). We use absolute values of discretionary accruals as dependent variable in order to control both upward and downward earnings management. The regression is run separately for the whole sample of observations, for two samples of big and small firms, and for the samples of firms with positive and negative discretionary accruals. This division gives us more detailed analysis and helps to make correct conclusions.

Based on the empirical results for the samples of small firm and firms with negative discretionary accruals, we found out that the IFRS adoption increases accruals-based earnings management in Russian companies, and, consequently, decreases earnings quality. The results of empirical research support our second hypothesis of a positive correlation between IFRS adoption and earnings management. In addition, our results show that Russian companies use income minimization (downward earning management) mostly.

Nevertheless, the results of the regression model and descriptive statistics analysis for the different samples of observations are controversial, and it is difficult to make a clear assumption about the IFRS impact on discretionary accruals.
Nevertheless, this research shows that the quality of published accounting information is rather a complex concept, and it is hard to improve it just by the IFRS implementation and the government reforms. The whole business environment needs to be changes to achieve that. To sum up, it is difficult to make one convinced conclusion if IFRS have a positive or negative effect on the quality of accounting information.

There are several limitations of this study. The first one is the usage of the Jones model instead of the Modified Jones model. The Jones model does not control sales-based manipulations, which are addressed in the Modified Jones model. However, we did not use the later one due to the lack of financial data for Russian companies. Also this study could be more relevant if we had data for the year 2013 as IFRS are compulsory for all public interest companies in Russia since 2012. Unfortunately, financial results for this year are not available in the database yet, and we had no opportunity to get enough observations with all necessary financial information for the last year.

This paper demonstrates that IFRS do not always have a positive impact on the quality of accounting information. The adoption of IFRS in Russia is close to the final steps, but it is still not clear if it brings real benefits to the Russian business environment. More precise conclusions can be made in 2-3 years, when IFRS reporting will become a regular procedure for all public interest Russian companies. Further research can study how it is economically effective to shift from RAS to IFRS for the companies (i.e. costs of the IFRS adoption versus benefits). It could be interesting to study how practices of earnings management are changing during the process of IFRS adoption.
REFERENCES


Baskerville, R. (2010). 100 Questions (and Answers) about IFRS.


Prunskaitė, S. (2009). Earnings management and earnings quality before the initial public
offerings. Oulu: [S. Prunskaitė].


Appendix 1. Differences between IAS and RAS (Combs et al. 2012)

<table>
<thead>
<tr>
<th>Difference in Russian accounting</th>
<th>IAS/IFRS Reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Russian accounting may differ from that required by IFRS/IAS because of the absence of specific rules on recognition and measurement in the following areas</td>
<td>IFRS 3</td>
</tr>
<tr>
<td>Provisions regarding business combinations accounted for as acquisitions</td>
<td>IFRS 3</td>
</tr>
<tr>
<td>Consolidation of special purpose entities</td>
<td>IAS 12</td>
</tr>
<tr>
<td>The restatement of financial statements of a company reporting in the currency of hyperinflationary economy in terms of the measuring unit current as of the balance sheet date</td>
<td>IAS 20</td>
</tr>
<tr>
<td>The translation of financial statements of hyperinflationary subsidiaries</td>
<td>IAS 21</td>
</tr>
<tr>
<td>The treatment of accumulated deferred exchange differences on disposal of a foreign entity</td>
<td>IAS 21</td>
</tr>
<tr>
<td>De-recognition of financial assets</td>
<td>IAS 39</td>
</tr>
<tr>
<td>Recognition of operating lease incentives</td>
<td>IAS 17, IAS 15</td>
</tr>
<tr>
<td>Accounting for defined benefit pension plans and some other types of employee benefits</td>
<td>IAS 19</td>
</tr>
<tr>
<td>Accounting for an issuer’s financial instruments</td>
<td>IAS 32, IFRS 2, IFRS 7</td>
</tr>
<tr>
<td>Accounting for derivative financial instruments</td>
<td>IAS 39</td>
</tr>
<tr>
<td>Hedge accounting</td>
<td>IAS 39</td>
</tr>
<tr>
<td>Accounting for long term assets held for disposal</td>
<td>IFRS 5</td>
</tr>
<tr>
<td>There are no specific rules requiring disclosures of the fair values of financial assets and liabilities</td>
<td>IAS 32, IFRS 7</td>
</tr>
<tr>
<td>The fair values of investment properties</td>
<td>IAS 40</td>
</tr>
<tr>
<td>Certain segment information</td>
<td>IAS 14</td>
</tr>
<tr>
<td>Summarised financial information on associates</td>
<td>IAS 28</td>
</tr>
<tr>
<td>Extensive disclosures on business acquisitions/disposals</td>
<td>IFRS 3</td>
</tr>
<tr>
<td>Significant management judgements made in the process of applying the entity’s accounting policies and key sources of estimation uncertainty</td>
<td>IAS 1, IAS 36</td>
</tr>
</tbody>
</table>

There are inconsistencies between Russian Accounting Rules and IFRS that could lead to differences for many enterprises in certain areas. Under RAS, goodwill is calculated by reference to the book value of acquired assets. IFRS requires goodwill to be calculated by reference to the fair value of the acquiree.

Proportionate consolidation may be used for subsidiaries in which the parent holds 50 percent or less of the voting shares. Under IFRS, parent companies are required to consolidate all subsidiaries.

The useful life of property, plant and equipment is usually determined using periods prescribed by the government for tax purposes. Under IFRS, companies are required to estimate the useful life of assets based on their expected usage.

Finance leases are generally defined in legal terms and the right of capitalisation is given to a lessor or a lessee by a contract. Under IFRS, a lease is classified as an operating lease if it does not transfer substantially all the risks and rewards of ownership to the lessee.

Derivative financial assets and liabilities are not recognised under RAS. Under IFRS, derivative financial instruments must be recognised in the financial statements.

Provisions can be established more widely or less widely under IFRS. Under RAS, provisions are only required to be established for obligations that are probable and measurable.

The correction of errors is included in the determination of the net profit or loss for the reporting period, but disclosed separately. Under IFRS, errors are corrected prospectively and disclosed in the financial statements.

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. Under IFRS, revenue recognition is based on the transfer of control of goods or services.

In certain enterprises, the following issues could also lead to differences from IFRS:

- Some parent companies do not prepare consolidated financial statements under IFRS.
- 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.
- Certain subsidiaries may be excluded from consolidation beyond those referred to in IFRS.
- A subsidiary that is a bank may be excluded from consolidation if it is dissimilar from the rest of the group.
- Internally generated brands and similar items can be capitalised if the enterprise has an exclusive legal right.
- The realisable value of inventories is measured without deduction of selling costs.
Appendix 2. Scatterplots

Partial Regression Plot
Dependent Variable: DA.Abs

Partial Regression Plot
Dependent Variable: DA.Abs

Partial Regression Plot
Dependent Variable: DA.Abs
Appendix 3. Plots of residuals

Histogram

Dependent Variable: DA_Abs

Normal P-P Plot of Regression Standardized Residual

Dependent Variable: DA_Abs