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HEDGING PRACTICE IN RUSSIA: PROBLEMS AND PROSPECTS

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Abstract

The economic crises of recent years in the world economy and in Russia have led to the awareness of business participants vulnerability to financial risks and the need to manage them with modern methods. This has led to a significant growth of the financial market segments that offer protection against risks, as well as the development of strategies and tactics for risk management. The most important method of risk management is risk hedging based on trading derivatives. According to the Moscow Exchange, the authors found that during the period 2013-2019 the value of exchange trading in derivatives in the Russian Federation was unstable. It reached its peak volume in 2016 with a structural ratio of 95% futures and 5 % options. The study found that the inefficient use of hedging advantages by Russian companies is due on the one hand, the novelty and complexity of these instruments for domestic business, and on the other - the insufficiently developed legal framework in the field of legal regulation, taxation, as well as the reflection in accounting and financial reporting of hedging operations using derivative financial instruments. The authors analyzed the progressive practice of using hedging instruments in foreign companies. A comparative analysis of the Russian practice and legal regulation of hedging operations has led to the conclusion that there are considerable differences in approaches to accounting for and reporting of derivative financial instruments and hedging activities in banking sector and in non-credit organizations.

Keywords: Hedging transactions, derivative financial instruments, tax hedging, and risk management.

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1. Introduction

Since 2017 to date, there has been a decrease in the volume of trade in derivatives, which may be due to serious shortcomings in the methodological support for the reflection of transactions with derivatives, and operations of hedging risks for companies in the non-banking sector of the economy.

Hedging is a portfolio risk management tactic aimed at reducing the risk of the underlying asset by opening an opposite position on the same asset. The purpose of hedging is to insure price risk. Hedging operations can be viewed in a broad and narrow sense. In a broad sense, risk hedging is a mechanism in financial management by which you can minimize or eliminate a particular financial risk. In a narrower sense, hedging is understood as a set of transactions of purchase and sale of special financial instruments that can partially or fully compensate for possible financial losses.

Hedging is a kind of form of insurance for which the hedger pays a price that is expected to be significantly less than the possible future losses in the event that a position is not hedged. Therefore, when making a decision to hedge a particular risk, an objective assessment of the magnitude of potential losses that the company may incur in case of refusal to hedge is necessary. The optimal risk structure establishes a compromise between the benefits of hedging and the costs of hedging. If the potential losses are insignificant, i.e. with little impact on the organization's revenues, the benefits of hedging operations may be less than the costs of conducting them. Thus, the purpose of hedging is to insure price risk. The main hedger instruments are derivatives-futures, options, forwards.

The growing interest of Russian companies in hedging operations is due to the development of the Russian financial market in General, and derivatives, in particular, the instability and high volatility of both the Russian and foreign financial markets, the requirements of foreign shareholders, investors and creditors. Existing restrictions on the use of hedging risks in Russia due to relatively high cost of hedging, is insufficient, compared with foreign, the level of development of financial derivatives market and appropriate legislation and absence of stimulating tax rules that increase the attractiveness of hedging risks by businesses.

2. Problem Statement

According to researchers about 47% of companies actively manage risks, in particular, hedgers prevail in Northern Europe, while non - hedgers in southern Europe, South America and Asia. In Kim, Si Xia, and Zhang (2018) study found that hedging can reduce a company's information imbalance and reduce the risk of financial collapse through curbing pessimistic expectations as well as reducing excessive investment. As a result of the global financial crisis, the IFRS Board has faced serious criticism of accounting standards for financial instruments (Kusano & Sanada, 2019). However, studies by many authors, notably Li, Sougiannis, and Wang (2017), Chang, Donohoe, and Sougiannis (2016), Gumb, Dupuy, Baker, and Blum (2018), Schwarzbichler, Steiner, and Turnheim (2018), testify to information advantages of formation of financial statements under IFRS for the purposes of management of financial instruments on the basis of increase of prognostic value of reporting information. For example, research by Tahat, Dunne, Fifield, and Power (2016) on companies operating in Jordan showed that as a result of

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the application of IFRS in the preparation of financial statements, they have achieved a higher level of disclosure of financial activities, especially from the application of IFRS 7.

In terms of the relationship between accounting standards and risk management tools, a team of researchers Bonini, Dallocchio, Raimbourg, and Salvi (2016) found an interesting relationship that derivatives are more often used by businesses applying GAAP, while loans and mixed solutions are preferred by multinational corporations applying IFRS or national accounting standards. Martinez, Reinoso, Antonio, and Santos (2019) investigated an equally important relationship between the use of financial derivatives by non-financial corporations and the quality of tax policies. There was evidence that the tax policy of non-financial entities using derivatives can be called more aggressive and risky.

In Russia, the derivatives market lags behind the foreign one. The very concept of "derivative financial instrument" was introduced into the legislation relatively recently - in 2010 in the Federal law of 22.04.96 No. 39-FL "On the securities market" (1996).

Currently, the Russian national accounting standards do not establish a special procedure for accounting for derivative financial instruments, except for credit institutions, which since 2012 in accounting are guided by the norms of the industry standard, and non-credit organizations that are professional participants in the securities market and apply the "Industry standard for accounting of derivatives by non-credit financial organizations" (the basic requirements of these regulations generally comply with IFRS).

The rules of accounting and financial reporting for other entities in the securities market do not contain the concept of "derivative financial instrument", valuation approaches and methods used for determining fair value, accounting rules and the accounting of hedging transactions. The Russian national standard for accounting of financial investments for organizations of investors in the non-banking sector of the economy regulates only the procedure for recognition, evaluation and accounting of certain transactions with major securities, which causes serious difficulties when they reflect transactions with derivative financial instruments.

In the development of urgent financial market complexity of transactions with derivative financial instruments in Russia and to expand the range of used tools of hedging risks increasing demands on the quality of their accounting, taxation, and present them information in the financial statements. At the same time, the study shows the urgent need to improve regulatory regulation, both the circulation of these instruments and accounting, taxation of transactions with derivative financial instruments in the Russian Federation and reporting on them in accordance with IFRS.

3. Research Questions

In accordance with the identified problems in the field of hedging operations in Russia in the framework of this study the following questions were formulated:

- What is the scope of application of derivative financial instruments in the Russian market and what is the structure by type of instruments?

- What measures in terms of the development of hedging operations will help to overcome the existing differences in the banking and non-banking sectors of the economy in Russia, to bring the principles of their reflection to IFRS?

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4. Purpose of the Study

The objectives of this study are as follows:

-to analyze the volume of application of derivative financial instruments in the Russian market and their structure by type;

- to develop proposals for regulating the accounting of hedging operations aimed at convergence with IFRS requirements and reducing the risks of Russian companies as a result of the expansion of the scope of application of derivative financial instruments.

5. Research Methods

5.1. Formation of research hypothesis

H1The capacity of the exchange markets of derivative financial instruments in Russia increases with a slight change in their specific structure.

H2 The development of standards governing hedging operations based on IFRS principles for companies in the non-banking sector of the economy will improve the quality of accounting and analytical support for these operations and more effectively manage their risks.

5.2. Research methodology

The methodological basis of the research was formed by general scientific methods such as analysis and synthesis, comparison, abstraction, detailing and generalization, system approach. The methods of analysis of normative legal acts and financial statements of Russian and foreign economic entities, IFRS, as well as synthesis of existing approaches to disclosure of information on the results of hedging operations for the purpose of risk insurance were used.

5.3. Data collection procedure for the study

The information base of the study was scientific publications on the subject, materials of reports of the Bank of Russia, IFRS. In order to identify shortcomings in the domestic practice of risk hedging operations, as well as to determine the benefits of the introduction of IFRS principles in respect of accounting for derivative financial instruments and hedging on their basis, the study analyzed the rules for the reflection of hedging operations in accounting and financial reporting in accordance with IFRS and Russian national accounting standards. The authors estimate the capacity and structure of the exchange markets of derivative financial instruments of Russia on the basis of the analysis of published indicators of the Moscow Exchange (2019).

6. Findings

The value of open positions on the exchange futures market of the Russian Federation sustainable grew all the years of the existence of this market, except for the crisis of 2008, when it was extremely sharp fall (Danilov, 2018). The derivatives market in terms of the ruble-denominated value of open positions recovered after the crisis in 2010, after which it continued to grow dynamically.

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During the period 2013-2019 considered by the authors, the value volume of exchange-traded derivatives in the Russian Federation was unstable (Table 01). It reached its peak volume in 2016 with a structural ratio of 95% futures and 5 % options. From 2017 to the present, there has been a decrease in the volume of trading in derivative financial instruments. It seems that the reason for this was the general deterioration in the dynamics of socio-economic development of the Russian Federation since this year, which led to a significant outflow of foreign investors from domestic financial markets. That is the hypothesis H1 is not fully confirmed.

Table 01. Value volume of exchange trade in derivative financial instruments in Russia in 2013-2018, billion rubles

Year	**Futures, billion rubles.**	**Share of futures, %**	**Options, billion rubles.**	**Share of options, %**	**Market total, billion rubles.**
2013	44588	91,74	4017	8,26	48605
2014	55566	90,62	5749	9,38	61316
2015	90231	96,28	3482	3,72	93713
2016	109489	94,98	5782	5,02	115271
2017	77624	91,87	6872	8,13	84496
2018	82211	92,26	6896	7,74	89107
2019 (8 monthes)	49745	93,98	3186	6,02	52931

Source: authors based on the analysis of published indicators of the Moscow Exchange's monthly statistics on the derivatives market (Moscow Exchange, 2019).

As we can see, based on the analysis of data on exchange trading in derivative financial instruments in Russia, futures are mainly used, allowing hedging of currency risk. One can name the following reasons for the predominance of this type of derivative financial instruments:

- comparative low transaction costs;

- when buying and selling futures on the secondary market, transparency of the pricing process is ensured, which, for example, is not typical for forward contracts, the prices of which are set by financial institutions;

- no need to establish the exact date of receipt or payment of currency, as futures do not necessarily close before the actual receipt of money or payment.

At the same time it is necessary to note some shortcomings of futures application in relation to the risk management process:

- concluded contracts cannot be changed, adapting to the specific requirements of the user;

- due to the presence of basic risk and the use of a number of contracts, there is a certain inefficiency of hedging;

- with the help of futures, a limited number of currencies are hedged, which can create problems in the conditions of dynamically waving economic relations;

- lack of opportunity to use favourable currency changes.

In this regard, options, whose share on average is about 7% of the value of exchange traded derivatives in Russia, give investors a certain mobility due to the possibility of using favourable changes

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in exchange rates. Due to the flexibility that currency options give, their holder can exercise them at any time, but when buying an option, its seller is immediately paid a premium, which is essentially the maximum amount of costs in the process of hedging currency risk. Among the disadvantages of options is a significant dependence of their value on the projected volatility of exchange rates, the rate of execution and the duration of the option. In addition, options, like futures, exist in certain types of currencies and, if there are specific requirements of a particular client, they are not assignable.

The current Russian accounting rules do not establish a special procedure for accounting for hedging operations, except for credit institutions and non-credit organizations that are professional participants in the securities market.

Accounting rules in force in the sphere of activity of other subjects of the securities market, regulated by the national standard of accounting for financial instruments, characterize only the procedure for recognition, evaluation and accounting of transactions with major securities. This procedure for accounting for transactions with derivatives does not take into account the peculiarities of hedging operations, namely, exchange or off-exchange types of derivatives, supply or settlement nature, the purpose, hedging or speculative purpose of operations, and others.

Before updating the national standards for accounting for financial instruments as part of the transition of Russian companies to IFRS, the need for which is indicated by many scientists and economists in practice, when reflecting transactions with derivative financial instruments in accounting and reporting, Russian business entities should be guided by general principles and rules, as well as methodological experience of credit institutions.

From the point of view of accounting methodology, there is no significant difference between hedging and non-hedging (speculative) futures transactions, since the economic essence of these transactions is the same, namely, the purchase and sale of various financial assets for which the settlement date does not coincide with the date of the transaction. Therefore, it seems that there is no need to develop any special order of accounting for hedging transactions in comparison with accounting for derivatives.

The lack of regulatory requirements for accounting for these transactions limits the use of derivatives for hedging risks by Russian companies. Therefore, the development of a methodology for the reflection of derivative financial instruments in accounting and financial reporting is one of the most pressing problems in the field of accounting and analytical support of non-banking financial market entities.

The current rules of profit taxation in Russia with respect to derivative financial instruments are based on the principle of dependence of the order of taxation of transactions on the purpose of their conclusion (speculative or hedging), on the nature of the derivative (supply or non-delivery), and on the type of instrument (traded or not in an organized market). Moreover, the terminology of tax legislation differs significantly from the definitions adopted in the sphere of legal regulation of the circulation of derivative financial instruments. In particular, the Federal law "On the securities market" (1996) provides for the definition of a derivative financial instrument in accordance with international practice. For the purposes of tax legislation, in turn, derivative financial instruments as financial instruments of time transactions which do not quite correspond to the economic nature of the derivatives.

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For tax purposes in the Russian Federation, a financial instrument of futures transactions is a contract that is a derivative financial instrument in accordance with the legislation, except for certain types of transactions. Thus, weather and statistical derivatives, as well as transactions that are not subject to judicial protection (for example, as a result of gaming and betting) are not recognized for tax purposes.

In order for a transaction to be recognized as concluded for the purpose of hedging for accounting in the taxation process of Russian companies, it is necessary that it be registered on the exchange in accordance with the requirements of the Federal Executive authority regulating operations with futures and options contracts. So, for income tax purposes under the hedging transactions refers to the transaction (set of transactions) with financial instruments of term transactions in order to reduce (compensate) adverse taxpayer consequences (fully or partially), due to the occurrence of loss, loss of profit, decrease revenue, decrease market value of the property, including property rights (rights of claim), the increase in a taxpayer's obligations due to changes in prices, interest rates, exchange rate, including the exchange rate of foreign currency to the currency of the Russian Federation, or other indicator of the hedging object.

In the tax legislation of the Russian Federation defined the objects of the hedge, which are recognized as property, property rights of the taxpayer, his obligations, including rights of claim and obligations, bearing monetary in nature, the deadline of which is on the date of hedging transactions not occurred, including rights of claim and obligations, the fulfilment of which is due to the claims of the parties to the contract and in respect of which the taxpayer took a decision on hedging. The underlying assets of financial instruments of futures transactions, which are used for hedging operations, may differ from the object of hedging. For hedging purposes, it is allowed to enter into more than one financial instrument of different types of futures transactions, including the conclusion of several financial instruments of futures transactions within one hedging operation during the entire hedging period.

In accordance with the requirements of the tax legislation, the taxpayer allocates for separate tax accounting transactions with a financial instrument of futures transactions concluded to compensate for possible losses arising as a result of an adverse change in the price or other indicator of the underlying asset (hedging object).

To confirm the reasonableness of attributing transactions with financial instruments of futures transactions to hedging operations, the taxpayer shall submit a calculation confirming that the performance of these operations leads to a decrease in the amount of possible losses on transactions with the object of hedging. Reference-calculation is made on the date of the conclusion of these transactions or the first of the transactions - at the conclusion of several transactions within the same hedging operation. On the date of conclusion of the hedging agreement, the taxpayer shall draw up a certificate-calculation for each hedging operation separately. The calculation should illustrate the profitability of this transaction for the organization and contain a forecast for the result of hedging. The calculation is presented in an free form, but must contain the following data:

1) description of the hedging operation, including the name of the hedging object, types of insured risks (price, currency, credit, interest and similar risks), planned actions regarding the hedging object (purchase, sale, other actions), financial instruments of futures transactions that are planned to be used, terms of execution of the transaction;

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2) the start date of the hedging operation, its end date and (or) its duration, intermediate conditions of calculation;

3) the volume, date and price of the transaction (s) with the object of hedging;

4) volume, date and price of the transaction (s) with financial instruments of futures transactions;

5) information on the costs of this operation;

6) other data confirming the transaction for hedging purposes.

A serious problem for Russian organizations in the practice of taxation is the preparation of such a calculation, as to justify the profitability of hedging, the organization uses analytical data provided, as a rule, by the interested party. The calculations may be subjective and, if a loss is received as a result of the hedging operation, may become the subject of disagreements with the tax authorities.

7. Conclusion

In the framework of financial reporting, it is advisable for Russian organizations to disclose users the assessment of the effectiveness of the derivatives used in order to increase transparency. It is necessary to develop a methodology for such an assessment, made in the form of reconciliation of profits and losses by types of instruments used and the corresponding objects of hedging. Ultimately, the goal of an optimal hedge accounting methodology should be to eliminate volatility in the income statement and, therefore, to provide more reliable and reliable information to internal and external users of the statements.

A measure of operational action in the current conditions for Russian companies in order to minimize disagreements with regulatory authorities is the justification and consolidation of the policy of hedging individual transactions in internal corporate acts, such as, for example, "Risk management policy". At the same time, it is necessary to determine the criteria and essential parameters to prove the feasibility of a hedge.

In view of the high formality of Russian legislation, the development of a unified concept of legal regulation, taxation, accounting and presentation in the financial statements of transactions with derivative financial instruments and within them with operations of hedging financial risks will not only expand the scope of their application, but also adequately assess the economic effect of the use.

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