The current state of the application of international accounting standards in the Czech Republic

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Abstract: This article deals with the current state of the application of international accounting standards in the Czech accounting legislation. This article aims to highlight the potential problems associated with the implementing of state accounting and drawing up the consolidated financial statements for the Czech Republic. The process of consolidating the financial statements of the Czech Republic is still not completed, are currently being made for its phased implementation. The fundamental problem of consolidation is currently in a stage of legislative arrangements. Based on the research are analyzed in the article areas, which must deal with an entity in connection with the ongoing financial reform.

Key-Words: state accounting, consolidation, financial statements, the Czech Republic, International Financial Reporting Standards (IFRS), International Public Sector Accounting Standards (IPSAS)

1 Introduction

In the area of public finance in the world is necessary to constantly seek ways to improve the information on the development of public sector finances. The extensive accounting reform in public finance field was initiated in the Czech Republic in 2010, aimed at creating conditions for effective provision of accurate, complete, timely and consolidated information on the economic situation of the state. The purpose of the accounting reform lies in the implementation of accounting systems for all accounting entities in the CR according to recognized and proven international experience. A specific aim consists in approaching the accounting methods and principles in the public sector to accounting rules for business entities and implementing such accounting policies that the accounting information contained in the financial statements would predicate more realistically about property and performance situation of accounting entities.

The consolidated financial statements will be prepared for the CR. The implementation of state accounting is accompanied by a number of legislative procedures, ranging from amendments to the Accounting Act, through the issuance of new decrees and continuous issuing of new Czech accounting standards which are binding for the selected accounting entities, which includes government departments (ministries and other state authorities), self-governing territorial units (municipalities and regions), and organizations established by them. State accounting does not mean specific accounting for a state; the Czech Republic has not been and will not be an independent accounting entity that would keep individual accounts. State accounting includes the accounting of selected accounting entities, through whose outputs (financial statements) are prepared final consolidated statements for the entire state by means of consolidation methods and procedures. The overall consolidation of the CR will include approximately 60 thousand accounting entities and approximately 5 000 sub-consolidated groups for which the sub-consolidated financial statements will be prepared [5].

2 The issue to be solved and the methods used

During the current legislative process, the Czech Republic pursues maximum compliance with the Fourth and Seventh EU directive, so that the new national standards would accept the international rules of the IFRS

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(International Financial Reporting Standards), the IPSAS (International Public Sector Accounting Standards) and the European System of Accounts (ESA 95 – European statistical system). The IFAC (International Federation of Accountants) has published numerous studies dealing with the public sector and government sector accounting in various countries around the world; e.g. France, Argentina, the United Kingdom and New Zealand. Various studies have been also published on financial reporting of central governments, reporting the performance of public administration, transition to accrual accounting [7]. A similar situation is currently addressed in the Czech Republic.

The IFRS published by the IASB (International Accounting Standards Board) are becoming the most important financial reporting standards in the world. But institutions in the public sector have not been required to be in compliance with the IFRS. To respond to this need, a strong international reference with standards that encompass public sector has been developed. This occurred in a similar manner to that of the private sector in relation to the IFRS. The IPSAS are based on the same accrual approach as the IFRS, with the necessary adaptations to public sector specificities being made. There remain some problems regarding the accrual basis of accounting and the cash basis of budgeting in the public sector in the Czech Republic.

The application of international principles is determined in each EU country through a wide range of political, historical and cultural barriers. In terms of introduction of the state accounting in the CR, the IPSAS recommendations should be applied with regard to the historical and legal environment, technologies, methodical and control components, and the cost of the entire system with particular emphasis on user's environment. The creation of consolidated groups will not take place on the basis of shares and the typical control as in the business sector, but mainly on the basis of other links. In the case of consolidation of public sector accounting entities, the creation of consolidated groups will not take place on the basis of shares and the typical control as in the business sector, but mainly on the basis of other links.

The methods usually complement each other and, in consequence, overlap. We use methods of qualitative research predominantly based on the exploration of relationships between individual facts which affect the range of accounting, especially the methods of induction and deduction, analysis and subsequent synthesis.

3 Significant differences between the Czech accounting legislation and IFRS

"Czech national standards," can be considered "an accounting system" and, to a limited extent, follow the IFRS. Currently, Czech national standards are comprised only of minimally required basic account classification and financial statements organization. These standards may expand into accounting procedures which can be adapted to meet Czech accounting legislation (below CAL). Unlike the IFRS, the CAL is a national, rule-based accounting system, which is not subject to the requirements of the regulations of the EU. As a result, entities in the Czech Republic were and are faced with obstacles in implementing these regulations into Czech legislation and therefore Czech accounting). The Act on Accounting, which is the cornerstone of the CAL, provides the legal rules for all country-wide entities and therefore determines the accounting methods and financial reporting for all the accounting entities located in the country. Such entities, including small, large and multinational companies, regardless of different activities and purposes must use the CAL [1, 3].

Due to the different principles and priorities on which both of the systems, the CAL and the IFRS, are based, there is a range of conceptual and specific differences. The CAL is rules based while IFRS is principle based. Czech taxes base remain based on the CAL. Consequently, many decisions and assumptions made by management during the preparation of financial statements are made after considering the potential tax consequences of potential accounting treatments. This thinking is not always consistent with what would be considered an accurate view under IFRS. Czech accounting legislation is based upon the premise that individual financial statements are primary statements of accounting. The goal of IFRS as a general accounting mechanism directed at listed companies is based on the assumption that consolidated financial statements are the primary source of information about the economic entity/group. The CAL, due to its nature, does not have a thorough conceptual framework to describe the individual elements of the financial statement and their definitions. A hierarchy referring to other legislations or accounting literature in cases where relevant the CAL rules do not exist [2, 3, 9].

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The financial statements according to IPSAS or the IFRS differ from the Czech financial statement in its purpose. The statements also differ in the way of them are prepared. In order to comply with the IFRS, statement preparation cannot do without professional estimates and references in an effort to respect fundamental accounting principles. It also requires consistent recording of transactions according to their economics and the compliance with the rule of law, if different. The difference in accounting procedures and the reporting of some items according to the Czech accounting standards, IPSAS, and the IFRS results is different in accounting reporting. According to one reporting framework, a company can reach a profit, while according to the other, it can show a loss. Another difference can be found in total balance sums, asset values, and the value of other items of property or liability. The IFRS and IPSAS applications influence the way assets and liabilities are reported and priced and also how the trading income is reported [3, 4, 9].

3.1 Using IFRS in the Czech Republic

In the Czech Republic only listed entities are required to prepare consolidated financial statements according to IFRS (Act on Accounting, 1991). For statutory fillings the preparation of financial statements according to IFRS is not permitted and companies who prepare financial statements according to IFRS prepare them voluntarily and in addition to the financial statements under CZ GAAP. Two research projects that focus on voluntary adoption of IFRS in Czech companies were performed at the Faculty of Management and Economics, Tomas Bata University in Zlín. First research with the sample of 177 Czech companies was held in 2007. The second research with the sample of 89 Czech companies was held in 2009 as part of an ongoing GA CR project. Usage of IFRS was stated by 2 % of companies in 2007 and 6 % of companies in 2009 [8].

The usage of IFRS has slightly increased in the Czech Republic, mainly due to the fact, that Czech companies are becoming important parts of foreign groups and their owners require them to report its financial statements according to group accounting rules based on IFRS. IFRS financial statements are also more frequently required during mergers and acquisitions. On the other hand most of the Czech Companies do not see the opportunities that IFRS could bring them and if the opportunities are seen, the fact that financial statements prepared according to IFRS have to be prepared in addition to Czech financial statements discourages the companies to use IFRS [10].

4 Consolidation under the Czech regulations and IFRS

The obligation to prepare consolidated financial statements in the CR has an entity which is a partnership and has subsidiaries. Exemption from consolidation is possible in cases where, at the end of the balancing day of the reporting period for which the consolidated financial statements are prepared, at least two of the following three criteria are not exceeded: a) gross asset value is greater than CZK 350 million (without accumulated depreciation, adjusting items and other adjustments); b) annual turnover exceeds CZK 700 million; and c) average number of employees during the period is greater than 250 [1].

This exemption does not apply to companies that are issuers of securities traded in the public market, and for banks and insurance companies which act upon special regulations. In addition, the duty to prepare consolidated financial statements does not involve the parent, which is at the same time a subsidiary included in the consolidated group of another parent within the EU and does not have publicly issued traded securities.

The IFRS are engaged primarily in the consolidation under IFRS 3 (Business Combinations), which defines the rules for initial capturing the business combination and calculation of goodwill. Other standards that deal with consolidated financial statements include IAS 27 (Consolidated and Separate Financial Statements), IAS 28 (Investments in Associates) and IAS 31 (Interests in Joint Ventures). Under the IFRS, the consolidated financial statements shall be presented by the parent and shall include all subsidiaries. A parent is not obliged to present consolidated financial statements if the parent is itself a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners have been informed about, and do not object to, and the parent's securities are not traded in a public market, nor the parent is in the process of entering the public market. Another necessary requirement is that the parent is consolidated within another entity under the IFRS [4, 6]. The main differences between Czech accounting legislation and the IFRS show the following table.

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Subject	IFRS	Czech accounting legislation
Business combinations	Business combination shall be accounted for under the Purchase Method. Business combinations of companies under joint control or joint ventures are not addressed in IFRS.	Business combinations are not dealt with as a whole. There are different arrangements for consolidation, purchase and investment; the term “transformation of company” in the case of division and merger of businesses is used. The various types of transactions are accounted for by legal status.
Date of acquisition	A date when the buyer took control over the purchased enterprise.	Often on the basis of legal form, i.e., at the time of transfer of ownership.
Fair value	The purchase price, assets, liabilities of the purchased enterprise is valued at fair value.	Assets and liabilities of the purchased enterprise are revalued according to the requirements of specific laws and with the legal form of transactions.
Minority shares	Reported in the net fair value of acquired assets and liabilities or as a minority interest in the fair value of acquired business.	Valuation of these shares is not precisely regulated. They are often valued at fair value of acquired assets and liabilities. Shall be divided between the items of equity.
Goodwill	Is not depreciated, but should be tested for impairment annually.	According to Czech legislation, the so-called consolidation difference should be depreciated evenly over the period of 20 years.
Negative goodwill	Shall be recorded in the income statement when arises.	It is showed as a negative asset and depreciated to revenues evenly over the period of 20 years.
Publication	Publication involves the names and descriptions of combined enterprises, the acquisition date, an overview of the fair values of assets and liabilities, the impact on the results and financial position of acquirer.	Specific publication is not required, only the names of combined enterprises, the acquisition date and size of the so-called consolidation difference.

Table 1 – The main differences in business combinations [3, 6, 9].

5 Discussion

According to the above we can ask the following question: Are accounting entities in the Czech Republic prepared for the implementation of the government’s accounting? In 2009, before the adoption of the Act, which started a comprehensive reform of public sector accounting in the Czech Republic, research at FaME, TBU in Zlín (Faculty of Management and Economics, Tomas Bata University in Zlín) was carried out on the preparedness of the entities for the fulfilment of reform objectives, thus the full acceptance of the fundamental principles of conceptual framework, which are summarized below:

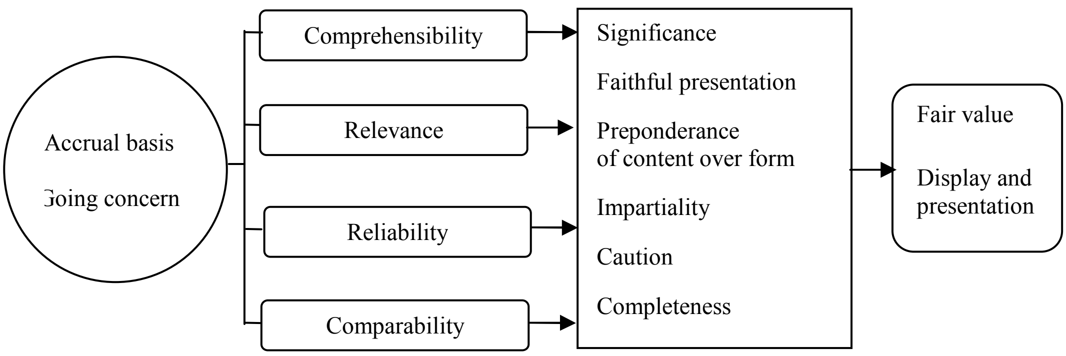

Fig. 2 – Chart illustrating fundamental principles of conceptual framework [own processing].

The reform mostly regards government organizational departments (which are, in particular the ministries), self-governing territorial units (i.e. municipalities – municipalities and regions) and allowance organizations. Allowance organizations operate mostly in education, health, culture and wealth management. The basis was given by the following facts of the fundamental principles of accrual accounting in 2010 for selected entities.

Accounting methods and principles	Income statement	Depreciation	Accruals	Provisions	Impairment of assets	Fair value
Gov. organizational departments	No	No	No	No	No	No
Self-governing territorial units	No	No	No	No	No	No
Allowance organizations	Yes	Yes	Yes	No	No	No

Table 2 – Accounting methods and principles in the selected entities [own processing].

As shown in above table, accounting methods based on the accrual principle were legislatively modified for allowance organizations only; therefore, the following questionnaire was focused only on the area of allowance organizations. Within the research was evaluated a total of 182 interviewees of economic workers.

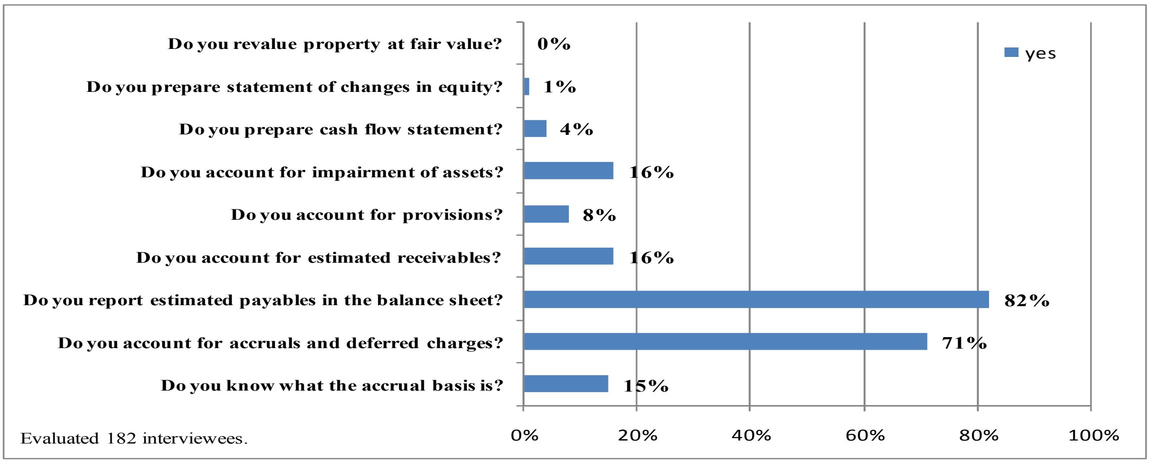

Fig. 3 – Questions asked to the respondents [own processing].

Another issue in the research was focused on the method of depreciation of assets. Respondents indicated that fully 77 % using a linear method. The second most (17 %) common method was the tax depreciation. The remaining 6 % of respondents use performance methods. Other methods (such as component depreciation, sum-of-the years' digits method or double-declining balance method) were not represented in the answers.

In response to the need for the introduction of depreciation to all accounting entities in the CR is required to legislatively resolve the area of depreciation in relation to the reporting of investment subsidies. Specifically, how to account for depreciation of assets purchased with grant? There are three possible procedures. A) The subsidy reduces a purchase price of the acquired assets by the subsidy received; the property is recorded in assets at cost less subsidy and depreciations are recognized from the reduced price only. B) The property is recorded in assets at full amount; the subsidy does not reduce the value of the property. The subsidy is recognized in liabilities, the full amount is depreciated and the received subsidy is reported aliquot to revenues, or depreciations are decreased. The same economic result is reported from this operation as in option, but in a more realistic view of property values and resources. C) The value of assets is recognized in full. The subsidy is recognized in liabilities and is not dissolved into revenues, but remains in liabilities, when it is transferred in the amount of depreciation to the account of investment fund. Only the expense (depreciation) will be reflected in the profit/loss. In terms of meeting the basic principles of management in the public sector, the best option is second, when there is no distortion of assets and profit/loss, the depreciation is covered by own sources.

6 Conclusion

At present, significant differences in the preparation of consolidated financial statements under the Czech legislation and in accordance with IFRS still remain. One of the objectives of ongoing reform is to provide conditions for increasing the credibility of financial statements for the Czech Republic, both towards the European Union and international entities, including foreign investors. This reform of state accounting in the Czech Republic thus includes a large number of organizations within the public budgets. The result of the accounting reform should comprise aggregated data for the public sector. Accounting information of public as well as local allowance organizations will enter the consolidated groups, which will be the founders and all the organizations established by them. The subject of consolidation will include property participation of the state, public sector, municipalities or local governments in business entities, including banks.

The preparation of consolidation decree is accompanied by many problems associated with the gradual introduction of the reform, when the accounting entities concerned gradually adopt new methods of accounting and prepare financial statements in the new structure. The Czech Republic is considered a certain pioneer in preparing the consolidated financial statements for the entire state, having almost zero experience from abroad. The new consolidation decree shall include process including accounting entities in the consolidated group and methods of consolidation of financial statements and definition of the consolidated group and sub-consolidated groups of the state. The whole transfer to the accounts of the state is very difficult and lengthy. Not yet enacted legislation which is necessary to complete the consolidation and implementation of reforms at the state of the Czech Republic. It should be legislatively resolved all changes in registration and management of all public administration institutions. The reform should be completed until 2014.

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