

The process of harmonization of accounting in the Czech Republic

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Abstract: *The article was written in response to the amendment to Decree No. 250/2015 Coll., which came into effect from January 1, 2016. This amendment shows the harmonization of the Czech accounting system with the International Financial Reporting Standards (IFRS), e.g. in reporting of extraordinary income and expenses, of formation expenses, or in valuation of inventory produced internally. Consequently, a survey has been conducted, in which 24 persons having experience with the accounting under the IAS/IFRS commented on how they coped with the differences between the Czech Accounting Standards (CAS) and the IAS/IFRS. It has been found that these companies normally keep the accounts simultaneously in both systems (CAS and IAS/IFRS). However, some companies decided to keep the accounts only in one accounting system, supplemented with the differences between the two systems. It is undisputed that the process of harmonization of accounting systems continues. However, the final unification of our national system with the European one has not happened so far. There is a need to harmonize accounting and tax regulations as well.*

Key words: *International Financial Reporting Standards (IFRS); Czech accounting standards (CAS); harmonization of accounting.*

JEL codes: M48

1 Introduction

In Europe, along with economic globalization, there is an ongoing political unification, and in relation to these processes, there is a growing need to harmonize accounting (Dvořáková, 2011).

Also in the Czech Republic, the harmonization of accounting has been taking place. One of the recent steps in adjustment of Czech legislation is the amendment to the implementing Decree to Act on Accounting for Entrepreneurs, effective since January 1, 2016.

There is a clear tendency in the amendment to harmonize Czech legislation with European law, which should help address the accounting differences between the Czech Accounting Standards (CAS) and International Accounting Standards (IAS/IFRS).

The subject of this paper is to describe the current situation of Czech companies which report financial statements under the IAS/IFRS and, at the same time, they have to keep the accounts under the CAS for various reasons, primarily for tax reasons. The objective of the survey is to evaluate how these companies proceed and how they perceive different requirements of national and European accounting standards.

The need for harmonization of accounting

Currently, there are several coexisting systems of financial reporting accepted in global financial markets. The globalization of capital markets also requires a global harmonization of accounting systems. The use of national accounting systems for preparation of financial statements makes gathering information needed for the purposes of comparison very difficult and costly for investors in capital markets (Bohušová, 2008).

The harmonization of accounting means the unification of accounting, valuation and reporting of the same transactions. It is a process that results in a gradual elimination of disparities arising from national processing of accounting transactions that may differ from each other. The main reason is to ensure the comparability of the reported

information for needs of their users, since these statements are often the only source of information about the company, its performance and changes in financial position.

The global harmonization of accounting takes place based on convergence of two main concepts – the European IAS/IFRS and the American – Generally Accepted Accounting Principles in the United States – US GAAP. These issues have been addressed by Peng and Bewley (2010), Liu (2011), Boyle et al (2006).

On the European continent, there is a process of harmonization within the European Union (EU).

The European Union includes countries with different social, economic and political environment, and has 25 different tax regimes. This is the reason why the financial reporting systems in the EU vary (Fox, 2013).

Here, the harmonization has been perceived as part of the single European business environment in order to facilitate comparability of businesses operating in territories where there are unified accounting standards, to alleviate the situation of companies that are expanding their activities outside their home states and to enable an unified understanding and accounting processing of transactions and financial situation of businesses (Šrámková and Janoušková, 2008).

The first efforts to harmonize accounting systems on international level arose from the needs of multinational companies and their increasing pressure. These companies needed to compare their different accounting information (Žárová, 2006).

Today, however, there is an increasing need to harmonize accounting in general, not just in large multinational companies. This is so because the accounting regulations should be the same for all accounting entities, as stated by Jílek:

It is necessary to set up such accounting system that would not be too painful for companies. Accounting must be clear, the same for all accounting entities, transparent, inexpensive and having clear rules of the game. Then, even an average educated person understands it, and costs of accounting and auditing will not be sky-high. At the same time, it supports the competitiveness of companies worldwide (Jílek and Svobodová, 2013).

When creating the Czech accounting standards, it is not necessary to invent anything new, but simply adopt what is common in the world. The best way is to fully apply the International Financial Reporting Standards with all of their interpretations and implementation manuals, without any exception. Then, the development of unified Czech accounting standards would not be difficult at all, as it is claimed sometimes. It is difficult now, for the reason that the financial result represents the starting point for calculating income taxes (lobbying interests) (Jílek and Svobodová, 2013).

Therefore, Jílek does not see a problem in the complexities of transformation of the CAS to the IAS/IFRS, but rather in the tax aspect. It must be noted that in addition to the accounting harmonization on a European scale, there are also differences between the accounting and tax approach in the national level. This difference should be gradually eliminated as well.

In some countries, the accounting and tax reports are identical, in others are not. For example in Germany, financial statements fully comply with tax requirements. On the contrary, in the United States, Great Britain or in our country, the situation is different. Financial statements differ from tax statements that are submitted to tax offices. It means that tax deductible expenses and income are different from accounting expenses and income (Jílek and Svobodová, 2013).

The IAS/IFRS and the US GAAP are similar yet different in some areas. For more see Peng and Bewley (2010), Liu (2011), Boyle et al (2006).

Also, the Czech accounting standards have not fully merged into the IAS/IFRS yet. The process of harmonization of the CAS with the IAS/IFRS still must be done, especially in

the area of reporting of fixed assets, accounting of reserves and contingent assets, in the concept of expenses and income and in the issue of the deferred tax.

The complete harmonization still has not taken place at the national level of accounting and tax regulations, as already stated.

Legislative change

In the 102 Series issue of the Collection of Laws of October 2, 2015, Decree No. 250/2015 Coll. was declared, effective as of January 1, 2016, amending the former Decree No. 500/2002 Coll. This Decree implemented certain provisions of Act No. 563/1991 Coll., On Accounting, as amended, for entrepreneurs as accounting entities who keep double-entry accounting, as amended.

The reason for the amendment of the Decree is primarily to complete the transposition of the Directive 2013/34/EU of the European Parliament and of the Council of June 26, 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC (of July 25, 1978) and 83/349/EEC (of July 25, 1983), in relation to Act No. 221/2015 Coll. (of August 12, 2015) amending Act No. 563/1991 Coll., On Accounting, as amended.

In the amendment, there is a clear tendency to harmonize Czech legislation with European law, specifically in terms of the International Financial Reporting Standards (IFRS) and the International Accounting Standards (IAS).

The amendment includes new financial statements (balance sheet and profit and loss account) both full and summarized including new rearrangement and labeling of entries and new or updated content of entries as well as new attachments in financial statements by categories of accounting entities also introduced by the new Decree.

In the profit and loss account, there is an abolition of separate reporting of extraordinary income and expenses, which are not reported in the income statement by the IAS 1.

The amendment abolishes reporting of formation expenses under the fixed assets. Therefore, formation expenses are no longer considered a real asset of the accounting entity, as with the IAS/IFRS. The reason is the absence of important criterion for recognizing assets, as this asset can be valued by the benefits provided to the accounting entity.

The amendment changes reporting and accounting of a change in inventory produced internally and activation of inventory and fixed assets produced internally. The new legislation in accordance with IAS 2 accounts the change in inventory as well as its activation as the elimination of costs incurred. Interim financial results will no longer be affected by an unrealized production. The amendment also defines to set the own costs in inventory produced internally. The amended provision limits the proportion of the variable and fixed indirect costs, and expressly excludes the sales-related costs, also in accordance with IAS 2.

The above indicates that there is an ongoing process of harmonization of Czech accounting standards, their moving towards the IAS/IFRS.

2 Methodology and Data

Between September and December 2015, 24 respondents, who address the issue of the IAS/IFRS in the Czech Republic, were interviewed by means of semi-structured interview. Their function in the IAS/IFRS, the sector of their activity and information on the placement of their company shares on the stock exchange are included in the Table 1. Interviews' records including contacts are available. However, in order to ensure the anonymity, these persons were coded for the purpose of publication.

Table 1: Information about the persons interviewed

| Code | Function | CZ-NACE sector classification | Stock Exchange |
|-------------|------------------------|---|---------------------------|
| A1 | Auditor | agriculture, forestry, fisheries | in preparation |
| A2 | Auditor | professional, scientific and technical activities | no |
| A3 | Auditor | professional, scientific and technical activities | no |
| A4 | Auditor | professional, scientific and technical activities | no |
| A5 | Auditor | manufacturing industry | no |
| A6 | Auditor | professional, scientific and technical activities | no |
| P1 | project manager | finance and insurance | PSE |
| P2 | project manager | manufacturing industry | PSE |
| P3 | project manager | finance and insurance | no |
| U1 | accountant | manufacturing industry | no |
| U2 | accountant | manufacturing industry | no |
| U3 | accountant | manufacturing industry | no |
| U4 | accountant | manufacturing industry | Frankfurt Stock Exchange |
| U5 | accountant | transport and storage | Luxembourg Stock Exchange |
| U6 | accountant | water supply | no |
| U7 | accountant | finance and insurance | no |
| U8 | accountant | manufacturing industry | no |
| U9 | accountant | production and distribution of electricity, gas, heat | no |
| U10 | accountant | manufacturing industry | no |
| U11 | accountant | finance and insurance | no |
| U12 | accountant | finance and insurance | no |
| U13 | accountant | manufacturing industry | no |
| U14 | accountant | wholesale and retail | Luxembourg Stock Exchange |
| U15 | accountant | production and distribution of electricity, gas, heat | no |

Source: [own elaboration]

The respondents were asked about the way they deal with different CAS and IAS/IFRS requirements in practice.

3 Results and Discussion

The Czech companies which prepare financial statements in accordance with the IAS/IFRS, and also must meet different accounting and tax regulations, can decide for one fundamental method of accounting, while the second system supplements it, or they can keep the accounts simultaneously in both systems.

Persons who have experience with the accounting primary according to the CAS stated as follows:

A1: "The company keeps the accounts according to our national accounting system. When creating documents, so-called reference keys are added, thanks to which the IFRS reports are generated in specific transactions."

A3: "We keep the accounts under the CAS, and we fill out papers for the IAS/IFRS in a certain application of our parent company."

A6: "In my experience, most companies in the Czech Republic still keep the accounts based on Czech accounting system primarily for tax reasons. Components and systems for creation of the IFRS statements have been extra added into this system."

U3: "Although we are obliged to report under the IAS/IFRS, the basis of everything is to keep the accounts according to Czech accounting standards. This basis has been adjusted with entries required by the IAS/IFRS reporting. According to Czech accounting standards, we have to report not only for purposes of reporting income tax, but also for statistical purposes, for reports to banking entities and, last but not least, for internal purposes, since different premium and other indicators are set according to Czech accounting."

U11: "The company continues to keep the accounts under Czech accounting standards considering this method more effective. We would have to recalculate the result from the IFRS to be applicable to the calculation of tax."

U13: "We deal with the accounting issues using conversion bridges to convert the CAS to the IAS/IFRS."

U15: "We keep the accounts under the CAS. Adjustments for technical preparations of documents for IAS/IFRS reporting have been done in Excel."

Persons whose accounting system is based on the IAS/IFRS stated:

U2: "The major standards are the IFRS, or their corporate interpretation. Once a year, for the purpose of preparing the local financial statements / tax returns, the differences from the CAS have been calculated."

U12: "In our company, there is no concurrence of both systems. We keep the accounts under the IAS/IFRS and make adjustments outside the accounts for tax purposes."

P2: "We keep the accounts under the IAS/IFRS. For the purposes of taxation or statistics, we report the required information outside the accounting system."

Most of the respondents, however, decided for the concurrence of both accounting systems. Following persons commented on parallel accounting systems: A2, A4, P1, P3, U1, U4, U5, U6, U7, U8, U10, and U14. Their comments indicate that some concurrence is necessary due to the need to determine the tax base according to Czech accounting standards. They keep parallel accounting books according to Czech accounting standards.

Software begins to emerge on the market that can handle both accounting software at once:

A5: "At the request of the main investor of the holding, a client has introduced new accounting software. This software allows keeping the accounts under the CAS as well as under the IAS/IFRS."

U9: "The official reporting is under the IAS/IFRS. Within the SAP information system, there is a secured option to display statements under the CAS or the IAS/IFRS."

Table 2 represents a complex structure of used accounting systems.

Table 2: Frequencies of used accounting systems

| Accounting system | Number of persons |
|--|--------------------------|
| Primarily CAS, supplemented with IAS/IFRS | 7 |
| Primarily IAS/IFRS, supplemented with CAS | 3 |
| Parallel concurrence of both systems | 14 |

Source: [own elaboration]

The results of the survey have showed that there is no uniformity in how businesses cope with the dual legislation. Most companies preparing financial statements under the IAS/IFRS keep their accounts in two parallel accounting systems. This condition is very counterproductive as it denies the main objective of accounting. The objective is to truthfully and honestly inform about the economic activities of the accounting entity (Act

No. 563/1991Coll., On Accounting). In the current state, however, there are two truthful and honest approaches. Therefore, clarity has been reduced and demands on the accounting entity are increasing.

U12 user said: "Since there is the need to maintain these adjustments and dual methodology as well as to assess each transaction whether it is important for the tax return, the whole process is more complicated."

Businesses often reach for the method of the lesser evil to be able to satisfy both legislative directions. They seek to find liaison bodies which primarily comply with both systems, as U4 user commented: "In all areas possible, we have adopted the IFRS perspective."

Even a company, which preferred to reconsider its long-term payables to short-term ones in order to avoid discounting and to report payables pursuant to the CAS, is probably no exception.

The result is some kind of travesty, a third system, which will last until the CAS and the IAS/IFRS are fully harmonized.

In the context of harmonization, it is also necessary to unify accounting systems with tax systems, see Figure 1, chap. 1.1.

U14 respondent said in this context "We would appreciate if the IFRS were legally recognized as a basis for calculating the tax base."

Therefore, full harmonization of accounting system means not only the harmonization on the territory level (national & European or worldwide convergence), but also the harmonization of accounting and tax regulations.

This harmonization has already taken place in some European countries, e.g. in Germany. In the Czech Republic, however, some differences in accounting and tax base still persist. See more in Jílek and Svobodová (2016).

4 Conclusions

Employees who prepare financial statements under the IAS/IFRS welcome the change in the amendment to Decree, because it is a step towards the CAS and the IAS/IFRS harmonization.

It is undisputed that the process of harmonization of accounting systems continues. However, the final unification of our national system with the European one has not happened so far.

Accounting of Czech businesses preparing financial statements under the IAS/IFRS is currently somewhat counterproductive. Businesses have chosen different methods to cope with the dual legislation. However, it is evident that it involves great demands on time and personnel and technical support and the associated costs.

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