The CBA Analysis of IFRS Implementation in the Czech Republic

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***Abstract**: As part of the ongoing harmonization of accounting system there is an increasing tendency to keep the accounts under IAS/IFRS. Consequently, a research in companies following the IAS/IFRS has been conducted. The aim of the research was to identify information, financial and time demands and also the benefits of the IAS/IFRS implementation. It was found that more companies use the services of an external consultant than an internal employee. Businesses normally do not share their knowledge. The costs of the implementation process are most often up to 100 thousand Euros, but most businesses acknowledged additional unquantified costs. The duration of the implementation process was to one year. There are different views of the respondents on the level of individual standards. Most respondents admitted making mistakes in the first years of the implementation, but these were rather minor flaws. Regarding the perceived benefits, the majority of respondents agreed that the IAS/IFRS enable good comparability. However, when it comes to their brand and financial statements, they stated that for the company's reputation the brand was more important than financial statements. It was found, however, that the majority of businesses have not experienced a reduction in the cost of capital.*
Keywords: International Financial Reporting Standards (IFRS), International Accounting Standards (IAS).

JEL codes:M41, M42

1 Introduction

A majority of countries have permitted public listed companies to be included in the process of implementing IFRS and to prepare consolidated financial statements. (Uzma, 216). Since 2003, the International Accounting Standards (hereinafter referred to as IAS) have been gradually replaced by the International Financial Reporting Standards (hereinafter referred to as IFRS) (Šrámková & Janoušková, 2008). Those IAS, that have not been replaced by the IFRS yet, still apply, and therefore, these accounting standards are referred to as IAS/IFRS.

Primary sources of information in the IAS/IFRS implementation are the standards themselves issued annually by the International Accounting Standards Board (IASB) in the form of books (Jílek, 2013). The International Accounting Standards as adopted by the European Union (2016) are freely accessible on the toll-free websites in 23 languages, and amendments are available only in English for some time. There are some remarkable resources available on the Internet, most of which are free of cost. The first place anyone should start researching IFRS is the Web site of the International Accounting Standards Board (www.iasb.org). Meanwhile, the major accounting firms have all spent a great deal of money preparing outstanding Web-based resources for both clients and educators. PricewaterhouseCoopers has excellent tools available for faculty and students at www.pwc.com/faculty. KPMG has a Web site dedicated to IFRS, www.kpmgifrsinstitute.com, which provides links to news articles and KPMG insights and technical publications on current issues related to IFRS. Ernst & Young has an IFRS-related Web site as well, www.ey.com/ifrs. Rounding out the Big Four, Deloitte also has a Web site dedicated to IFRS, www.iasplus.com. (Krom, 2009)

The costs associated with the IAS/IFRS implementation have been determined by the The Institute of Chartered Accountants in England and Wales (ICAEW, 2016) as follows:

the establishment of a project team, training of other employees, such as IT staff, internal audit and management, training of staff, external technical advise, tax advise, software and information systems changes, communications with third parties, external audit costs, renegotiating debt covenants and other external data requirements. Jermakowicz and Gornik-Tomaszewski (2006) consider these costs to be too high.The above costs are evident. There are other costs, however, that are not immediately obvious (Meek et al, 1995), e.g. a lack of well-trained people (PWC, 2016).Using a comprehensive dataset of all publicly traded Australian companies, we quantify an economy-wide increase in the mean level of audit costs of 23 percent in the year of IFRS transition. We estimate an abnormal IFRS-related increase in audit costs in excess of 8 percent, beyond the normal yearly fee increases in the pre-IFRS period. Further analysis provides evidence that small firms incur disproportionately higher IFRS-related audit fees (De George, Ferguson and Spear, 2013). IFRS adoption has led to an increase in audit fees. We also find that the IFRS-related audit fee premium increases with the increase in audit complexity brought about by IFRS adoption, and decreases with the improvement in financial reporting quality arising from IFRS adoption. Finally, we find some evidence that the IFRS-related audit fee premium is lower in countries with stronger legal regimes. (Jeong-Bon, Xiaohong, L., Zheng, L., 2012). Kovanicová (2008) stresses that IAS/IFRS fundamentally avoid any binding adjustments of financial statements, let alone a determination of the accounting model, chart of accounts or a specific correlation. Strouhal et al (2012) points out that the aim of the CAS is to determine the accounting procedures (not IAS/IFRS). Dvořáková (2009) admits the incompatibility of standards. The biggest obstacle for compatibility (Haverals, 2007) is the fact that the EU has 25 different tax regimes.

Not only turbulent development, but also the imperfection of the original IAS has resulted in their gradual replacement by the IFRS. In order to make information contained in the published standards more accurate, their interpretations (acronyms SIC/IFRIC) have been produced, which are, however, time-delayed. The process of creating standards is very time-consuming. Dvořáková (2009) indicates 11 steps, Jílek (2013) states that adoption of a standard, an amendment or an interpretation usually lasts more than one year, therefore, there is a risk that a business would be missing information for the period of approving. Oremusová (2007) defines the general benefits of the international accounting standards as follows: easier access to foreign capital markets, higher credibility of foreign companies on domestic capital markets, global comparability of financial data, increased transparency, greater clarity due to „common accounting language", simpler regulation on capital markets, lower influence of accounting standards by political pressures. Landsman et al. (2012) declares that the adoption of IFRS benefits in three aspects: improves the information content, reduces the lag in reporting and augments the flow of foreign investment. Our results suggest that mandatory IFRS adoption improves cross-country information comparability by making similar things look more alike without making different things look less different. Our results also suggest that both accounting convergence and higher quality information under IFRS are the likely drivers of the comparability improvement. In addition, we find some evidence that cross-country comparability improvement is affected by firms' institutional environment. (Yip and Danqing, 2012). We broadly summarize the development of the IFRS literature as follows: The majority of early studies paint IFRS as bringing significant benefits to adopting firms and countries in terms of improved transparency, lower costs of capital, improved cross-country investments, better comparability of financial reports, and increased following by foreign analysts. However, these documented benefits tended to vary significantly across firms and countries. More recent studies now attribute at least some of the earlier documented benefits to factors other than adoption of new accounting standards per se, such as enforcement changes (De George, 2016).We find evidence that, unlike previous studies, Spanish listed companies show a significant reduction in their cost of equity capital after the mandatory adoption of IFRS in 2005, after controlling by a set of firm-risk and market variables. According to our results, increased financial disclosure and enhanced information comparability, along with changes in legal and institutional enforcement, seem to have a joint effect on the cost of capital, leading to a large decrease in expected equity returns (Castilo-Merino, 2014).The IFRS mandate significantly reduces the cost of equity for mandatory adopters by 47 basis points. I also find that this reduction is present only in countries with strong legal enforcement, and that increased disclosure and enhanced information comparability are two mechanisms behind the cost of equity reduction. Taken together, these findings suggest that while mandatory IFRS adoption significantly lowers firms' cost of equity, the effects depend on the strength of the countries' legal enforcement (Li, 2010). Further literature research showed the following possible benefits of the IAS/IFRS implementation: O'Connell and Sullivan (2008) state the impact on the business income, Verrecchia (1999) says lower costs of capital, higher value of the shares, Chalmers and Godfrey (2004) indicate reputation and credibility for investors, greater explanatory power of foreign models designed to assess the level of financial stability of a company, Kuběnka, (2014), Hrdý and Strouhal (2010) state the reporting of relevant information, particularly in reporting risks, Jermakowicz and Gornik-Tomaszewski (2006) emphasize better investment opportunities, increased transparency, Cairns et al (2011) points out the comparability of the reporting information, Cornell and Sirri (1992) state the reduction in information asymmetry to improve market liquidity of company shares, De Jong et al (2006) stresses the increase in debt. De Jong et al (2006) describes the increase in debt as a result of the IAS/IFRS implementation, and Verrecchia (1999) even refers to reducing the cost of capital. Jílek (2013) lists the measures, so-called prudential filters, which should neutralize the impact of the IAS/IFRS on capital. The cost of capital is one of the key indicators, not only with regard to the implementation of the principle of optimizing the capital structure, but also for setting corporate discount rate, in evaluation of economic performance of the company, and in investment planning and selection (Kuběnka, 2015). Therefore, one of the questions concerning the benefits included the impact of the IAS/IFRS implementation on reducing the cost of capital.

2 Methodology and Data

Between October 2017 and January 2018, all twenty-three public listed companies on Praque Stock Exchange (on the Prime, Second and Free Market) were interviewed by means of semi-structured interview. They were auditors, project managers preparing the implementation process and accountants themselves (users). The main areas of these interviews were information sources, legislation, and costs and benefits of the IAS/IFRS introduction. The particular function of individual respondents within the IAS/IFRS and the sector of their activity are included in the Table 1.

Table 1: Information about the persons interviewed

Code	Function	Sector
A1-A2	Auditor	Energy Supply
A3-A4	Auditor	Consumer Services
A5	Auditor	Consumer Goods
A6	Auditor	Finance
P1	Project manager	Chemical Industry
P2	Project manager	Consumer Goods
U1	Accountant	Energy Supply
U2	Accountant	Consumer Goods
U3-U8	Accountant	Finance
U9	Accountant	Technology and telecommunication
U10	Accountant	Consumer Services
U11	Accountant	Consumer Goods
U12-U14	Accountant	Energy Supply
U15	Accountant	Basic Industry

Source: own

The interview included thirteen questions divided by areas: information sources, costs and duration of the implementation process, legislation and benefits, see Table 2.

Table 2: Information about the persons interviewed

Question number	**Area**	**Question**
1	Information sources	Have you ever used the external services?
2	Information sources	With whom have you consulted?
3	Information sources	Have you observed the implementation process of others? Have you collaborated with other businesses? Have you learned from it?
4	Costs and duration of the process	How costly the process of the IAS/IFRS implementation has been?
5	Costs and duration of the process	Have you seen any costs in the implementation process that could not be quantified?
6	Costs and duration of the process	What was the duration of the implementation process?
7	Legislation	Did you make mistakes resulting from the misunderstandings in the early years?
8	Legislation	Have you found any of the IAS/IFRS to be better processed than others?
9	Legislation	Have you received enough information from the IAS/IFRS or have you improvised during the implementation?
10	Benefits	Do you think that the existence of several options in the IAS/IFRS does not preclude the comparison of financial statements among companies?
11	Benefits	Comment on the brand & financial statements links and their importance for the reputation.
12	Benefits	Specify the perceived benefits of implementation.
13	Benefits	Do you believe that the implementation reduces the cost of capital?

Source: own

Respondents were encouraged to express on the topic as fully as possible so that the most of their views could be captured. Therefore, direct speech is included in the paper making it even more interesting. The next chapter presents the results of the research. By virtue of their positions, not all respondents were able to answer all the questions so the sum of responses in the following results subsections will not be equal to the total number of twenty-three respondents.

3 Results and Discussion

As already mentioned, as for information sources, the aim of the interviews conducted was to determine whether businesses used the published standards without assistance of an external consultant, with whom they consulted, and whether there was any direct or indirect collaboration with other businesses that implement, see questions 1 – 3, Table 2. Thirteen respondents stated they had worked with an external consultant while 8 respondents had used only internal staff. Cooperation with the supplier of information systems and training in IAS/IFRS were commonplace. These responses, however, were not included for the assessment of the number of external consultants.

Respondents were asked about other sources of information, but further communication regarding the IAS/IFRS implementation took place mostly within the holding (mentioned by ten respondents). The question about benchmarking in the IAS/IFRS was very interesting. Eight respondents, i.e. half of the interviewees said they had been truly interested in how other businesses implemented. However, there was no direct cooperation. Rather, it was only on the level of studying companies' publicly available financial statements and attachments thereof. Only respondents from the banking field admitted they had actively shared information among themselves. P2 project manager stated: "The others also did not know whether they were doing it well or not, and there was minimal willingness to share anything‟. A partial aim of this paper was to quantify the evident costs, to uncover the hidden costs and to determine the duration of the implementation process. They are generally up to 100 thousand Euros, only 3 respondents had costs over 100 thousand Euros.

In addition to these quantified costs, eleven respondents out of seventeen said there had been some extra costs that could not be quantified or had not been quantified yet. These were mostly salary bonuses for overtime resulting from the inexperience of staff, and wage compensations for the time spent on training. Several respondents simply named time to be one of those "invisible costs". U8 respondent even said these costs had exceeded the calculated costs. Regarding the duration of the implementation, A6 auditor characterized it the best. He stated the implementation process in the smaller units had taken about three months, and in the larger units it had been from fifteen to eighteen months. There was even an answer that the implementation process took only a few weeks. U1 user, on the other hand, said the implementation process had been ongoing since 2013 and was steadily improving.As for this area of the research, the aim was to obtain an opinion from the implementing businesses on the IAS/IFRS and to determine whether and to what extent they improvised and whether they faced misunderstandings of the IAS/IFRS resulting in making mistakes when reporting under the IAS/IFRS, see questions 7, 8, 9 in Table 2.Half of respondents (ten respondents) stated that individual standards had the same level of processing. On the contrary, eleven respondents believed that certain standards were better understood than others. A2 auditor also agreed with this statement, but added he was positive about the creation of interpretations. U15 user felt good about the present level of standards. Initially, however, he lacked a sufficient number of examples and accurate interpretations of allowances, for example. U4 user lacked information regarding the property.Thirteen respondents said the standards had provided them with sufficient information, ten respondents improvised. According to U14 user, improvisation and own judgment is necessary when working with the IAS/IFRS. U7 and U8 users admitted a certain detachment, but in accordance with fundamental ideas. A6 auditor concluded: „It is necessary to get accustomed to their language and the method of processing which differs from the CAS. It is so because the IAS/IFRS rather deal with the number in the final account than the means how to get to it. The IAS/IFRS definitely do not contain any accounting correlations Czech accountants have been used to." When asked whether they made mistakes in the early years, fifteen respondents admitted it. six of them added that these were minor things, such as inaccurate estimates and immaterial errors. Six respondents were not aware of any misconduct. A3 auditor said the most frequent mistakes were the faulty methods of evaluating and reporting data to the wrong parts of statements. A6 auditor noticed that profits from the sale of treasury shares were misreported in the income statement, as well as mistakes in the use of hedge accounting when conditions were not satisfied, and ignoring the principle of priority of substance over form. Above, I have summarized those findings from the IAS/IFRS implementation which represent a certain burden for a company – information, time and financial demands and legislation. The following text will show whether these negatives may be outweighed by some benefits for implementing businesses. Questions 10 – 13 see Table 2 were focused on the benefits. Generally declared positives of the IAS/IFRS implementation include the comparability of financial statements. This statement was confirmed by eleven respondents. U6 user said that otherwise the IAS/IFRS implementation would be pointless. Three respondents stated that the numbers were not the only one thing to compare. Five respondents disagreed with higher comparability of financial statements in the IAS/IFRS implementation compared to CAS. Here are some respondents‵ opinions on the comparability, from the positive ones to the negative ones: A6 auditor: "I think that most of the alternatives that prevented the comparison among businesses have been abolished, and where they were kept, it was because of an adequate distinction.‟ U4 user "The standards can not be custom written.‟ U10 user:

"Full comparability can be achieved only in theory." P1 project manager: "There may be some misrepresentation. When comparing the numbers the user must necessarily go through the valuation methods, depreciation methods, materials for estimates, set risk weights, materiality thresholds and more in order to be able to tell what the number means and not compare apples and oranges, as the saying goes." U2 user: "It is impossible to compare without detailed knowledge of the structure, processes and interpretation of the IFRS." U11: "Only businesses with exactly the same structure can be compared." U5: "The reason for the poor comparability is, for example, a disparity in reporting of investment grants." U4: "Due to poor comparability there is still an internal harmonization within the group". In addition to the comparability, the perceived impact of financial statements on the company's reputation was also the subject of research. Eight respondents said that the brand was more important than reputation based on the financial statements. Only two respondents stated that financial statements had a greater impact on the overall reputation. A3 auditor said that it was in case that: "this is not Coca-Cola". Twelve respondents were not able to judge that, but they agreed that the statements are important to corporate reputation. A2 auditor stated: „I see a tendency within reputable companies that they want everyone around to implement the IAS/IFRS." U15 and U16 users believed that the statements are more important when applying for a loan and in negotiations with creditors. U3 user said that the impact of statements on the overall reputation could be seen especially in large companies. In addition to views on the comparability of financial statements and their impact on the reputation the respondents were supposed to name additional benefits associated with the IAS/IFRS implementation. The most commonly perceived benefit is an easier access to capital, which was also confirmed by U16 user: "better capital raising, more realistic budgets, more reliable investment plans, high-quality acquisition analysis". A5 auditor believed that accounting system separated from taxes might have a better explanatory power, as seen in case of the costs, for example. It would not be necessary to take into account whether it was a tax or a non-tax cost but its real nature. A6 auditor added that the IAS/IFRS implementation had improved the results and financial position with modern accounting theory, and that there was a better link with the regulatory requirements for financial Institutions. The last question concerned the benefit which was mostly perceived, i.e. the easier access to capital. It was explored whether the IAS/IFRS implementation has reduced the cost of capital. This phenomenon is not usually seen by businesses, because eleven respondents disagreed and only five respondents confirmed the reducing of the cost of capital. U8 user believed that due to the reducing of the risk for investors, the required return on capital was reduced as well. U5 user said that reporting under the IFRS had enabled to obtain an international rating and favorable financing in international bond markets.

4 Conclusions

This paper dealt with the IAS/IFRS implementation. It was found that more companies use the services of an external consultant than an internal employee. The likely reason is to transfer the risks associated with the implementation to an external entity. Businesses normally do not share their knowledge of the implementation and communicate only within the holding. However, half of the respondents confirmed that they used publicly available financial statements of other enterprises during their own implementation process. The costs of the implementation process are most often up to 100 thousand Euros, but most businesses acknowledged additional unquantified costs. The duration of the implementation process, in most cases, was to one year. There are different views of the respondents on the level of individual standards. Half of the respondents believed that the individual IAS/IFRS do not differ. The other half, on the other hand, saw differences in processing and clarity of individual standards. A considerable number of respondents improvised during the implementation process. However, a certain level of detachment is necessary when working with the IAS/IFRS. Most respondents admitted making mistakes in the first years of the implementation, but these were rather minor flaws. Regarding the perceived benefits, the majority of respondents agreed that the IAS/IFRS enable good comparability. However, when it comes to their brand and financial statements, they stated that for the company's reputation the brand was more important than financial statements. In addition to the comparability the most common benefit was a better access to capital. It was found, however, that the majority of businesses have not experienced a reduction in the cost of capital. This article dealt with the cost and benefits of implementing IAS / IFRS. The biggest problem is the difference between IAS / IFRS and CAS. Its possible solution is the harmonization of accounting regulations.However, for the purpose of taxation, the countries may follow their national accounting system; therefore, it may be costly for companies that run two parallel accounting systems. (Chen et al., 2010). The countries consider IFRS adoption or convergence with IFRS (Brown, 2011). Chen et al. (2010) have advocated the replacement of domestic standards with the IFRS that would increase the quality of financial reporting. A clear sign of convergence of the Czech legislation with international accounting standards is the ongoing harmonization of accounting system. Recently, an essential step in contributing to the harmonization has been the amendment to Decree No. 250/2015 Coll. Amending the existing Decree No. 500/2002 Coll. for entrepreneurs as accounting units who keep double-entry accounting. Pursuant to this Decree, certain provisions of Law No. 563/1991 Coll., on accounting have been implemented. The amendment came into force on January 1st, 2016.Harmonization leads to gradual convergence of both systems and thus to lower costs of IAS / IFRS implementation.

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