УДК 657 ***Procházka D.***

ADOPTION OF IFRS IN THE CZECH REPUBLIC AND ITS INFLUENCE ON THE ARCHITECTURE OF FINANCIAL AND MANAGEMENT ACCOUNTING

The implementation of IFRS into the legislation of the European Union and its member states has brought new quality to financial reporting, esp. in the transitional countries, despite the fact that the necessity to prepare information according to IFRS levies additional costs on the companies. In order to lower the cost burden, IFRS are becoming the leading principles of management accounting for internal users. The paper assumes that IFRS are the driver for convergence of financial and management accounting on the companies' level in the transitional countries, as e.g. in the Czech Republic

1. Introduction

Financial statements and other information reported by companies to the external users are still hugely subordinated to the fiscal and other purposes of the state authorities. This is the main reason for the sharp distinction between financial accounting for external users (or better said tax-financial accounting for state authorities?) and management accounting for internal users after 1989. Some positive steps have occurred in connection with the accession of the Czech Republic to the European Union together with the introduction of the International Financial Reporting Standards into the European legislation. The IFRS implementation provides the external users with a potential source of high quality, comparable and transparent information to assess the company's financial position, performance and other important financial features.

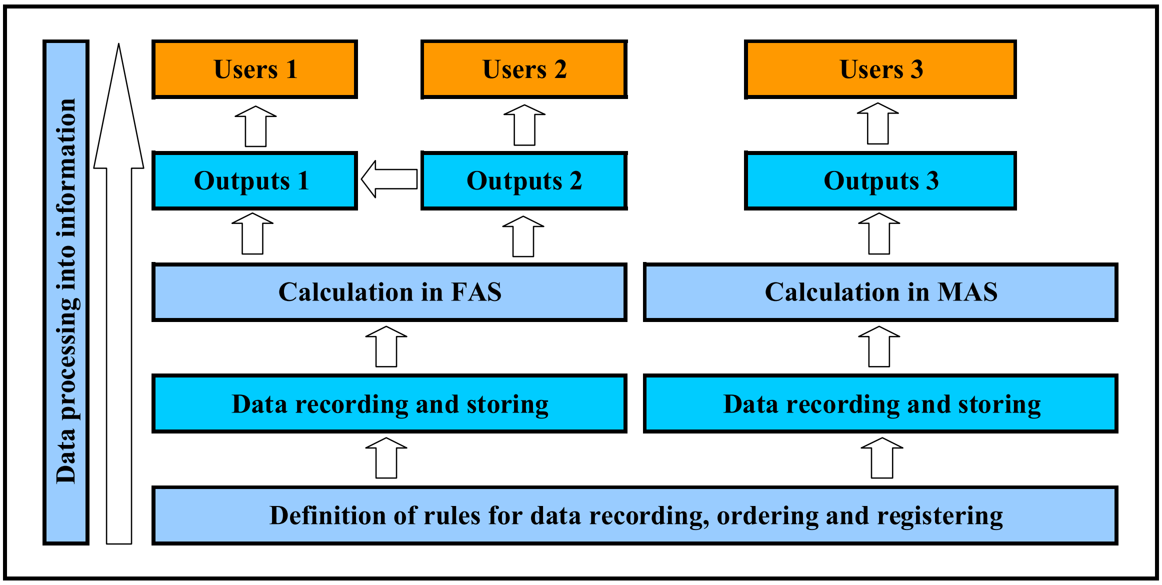
It turns out that the introduction of IFRS has been leading to a greater interconnection between financial and internal reporting in the context of the Czech accounting practice. The necessity to prepare information according to IFRS levies additional costs on the companies. However, IFRS are regarded as useful not only for external users, but also as a relevant basis for internal reporting, control and decision-making. Therefore, IFRS principles are incorporated into corporations' information systems and information based on IFRS has gradually been serving to various users for their different purposes.

2. Background and model development

"The Fall of the Berlin Wall" and subsequent integration of the European Union and the opening of China and other "untraditional" markets had released gates of world business. As a result, the companies have been expanding worldwide and the investors are not restricted to put their money only into the local "projects". The development of ICT supports the linking of national capital markets into one global market. Moreover, it enables also more effective international management of subsidiaries within the concern structures. The management accounting is influenced by the financial reporting requirements (Kaplan, 1984; Nathan, 1996) on the one hand. On the other hand, the stimuli from management accounting (Stewart, 1991) have being incorporated in the financial reporting.

No wonder some authors have started to cope with the terms like "integration of financial and management accounting systems" (Angelkort, 2009) or "the convergence of financial accounting and the management accounting" (Taipaleenmäki, 2009). The question is not to which extent to converge or integrate (Hemmer, 2008), but when the convergence or integration will be finished. For a long time, the accounting systems have been characterised by divided (dual) setup when stand-alone systems are ensuring the information independently for external and internal users.

Fig. 1: *Model I – Dual Accounting System*

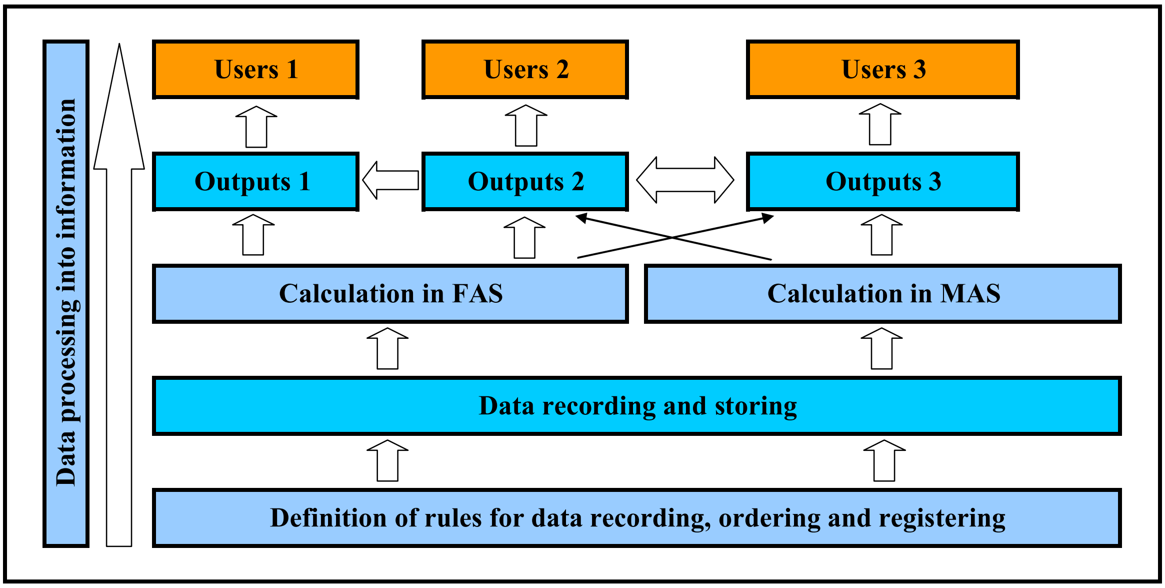


- *FAS* … financial accounting system;
- *MAS* … management accounting system;
- *Outputs 1* ... tax reports;
- *Outputs 2* ... financial statements;
- *Outputs 3* ... budgeting, planning, performance measuring, control, etc.;
- *Users 1* ... tax authorities;
- *Users 2* ... owners, creditors, trade partners, etc.;
- *Users 3* ... managers.

Processing of data into information, which is requested by the users for their informational needs, under separate financial and management accounting system is formalised in *Figure 1*.

Progress of business environment in recent years can be characterised by gradual intergrowth of originally separate systems of financial and management accounting into one integrated structure. There are plenty of possible ways of integration, e.g. on data recording level or on calculation level. Connection on output level or even on users' level appears to be also feasible, but nowadays it seems to be just a theoretical variant. The potential alternative for integration up to "output level" is suggested by *Figure 2.*

Fig. 2: *Model II – Integrated Accounting System*



3. Application for the Czech Republic

Accounting and financial reporting in the Czech Republic is regulated by:

1. Inland legislation, i.e.:

a) Act No. 513/1991 Coll., Commercial code;

b) Act No. 563/1991 Coll., on accounting;

c) Decree of Ministry of Finance No. 500/2002 Coll., amending some enactments of Act No. 563/1991 Coll., on accounting, in the financial statements of business enterprises;

d) Czech Accounting Standards for business enterprises subject to Decree of Ministry of Finance No. 500/2002 Coll.

2. Legislation of the European Union, i.e.:

a) Fourth Council Directive 78/660/EEC of 25 July 1978 based on Article 54 (3) (g) of the Treaty on annual accounts of certain types of companies (incl. subsequent amendments);

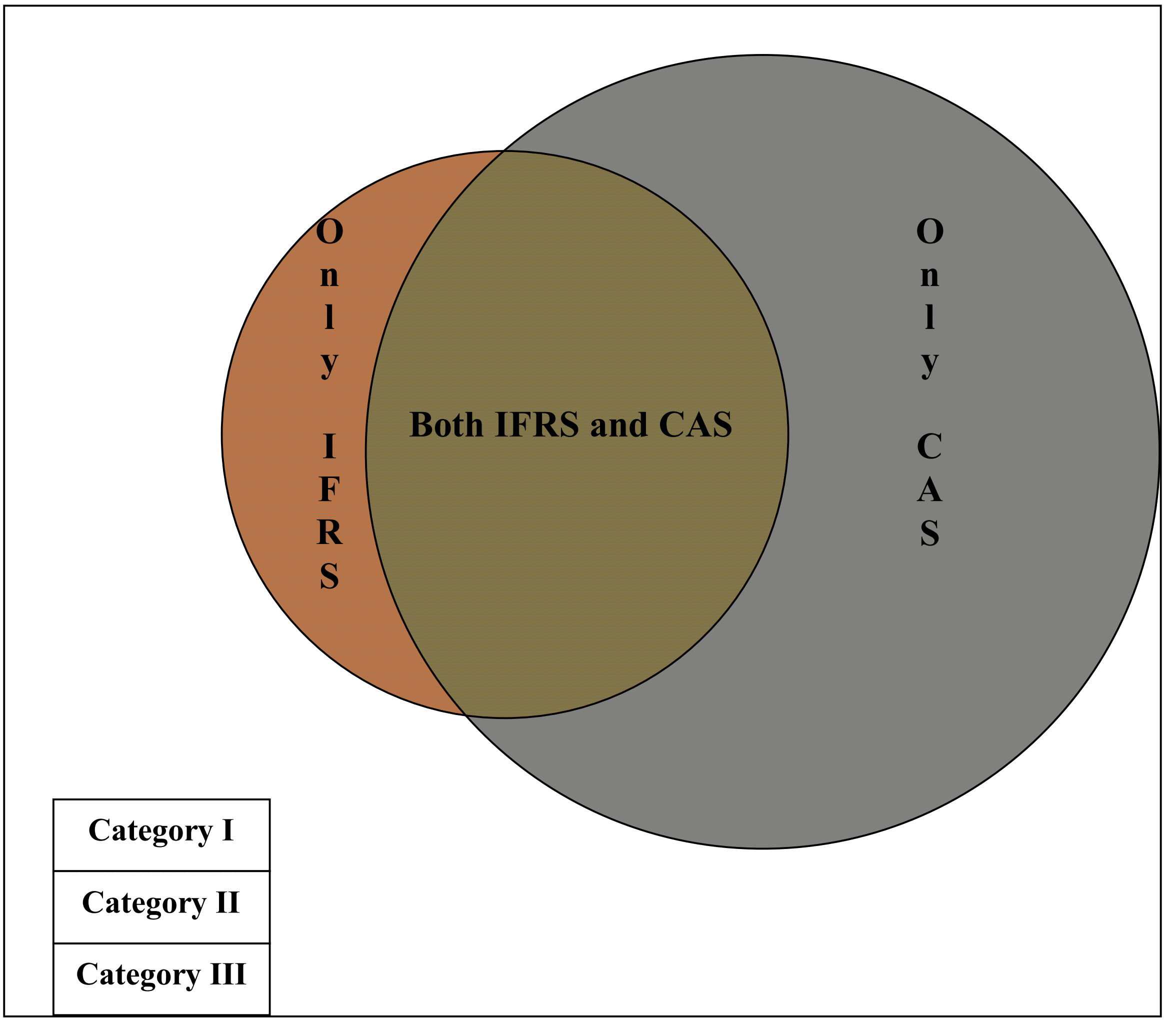
b) Seventh Council Directive 83/349/EEC of 13 June 1983 based on the Article 54 (3) (g) of the Treaty on consolidated accounts;

c) Regulation (EC) 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards.

The Regulation (EC) 1606/2002 states that *"for each financial year starting on or after 1 January 2005, publicly traded companies governed by the law of a Member State shall prepare their consolidated accounts in conformity with the international accounting standards"*. This requirement has been directly incorporated into the Act on accounting.

According to § 19, article 9 of the Act, *"entities, which are business companies and which are the issuers of securities publicly traded on a regulated market in the member states of the European Union, shall apply the International Accounting Standards as adopted by the EU* ***for keeping their accounts*** *and* ***for preparation of financial statements****"*.

Fig. 3: *Financial reporting according to the Czech accounting legislation*



Source: Own presentation based on Act No. 563/1991 Coll., on accounting

Based on the Czech regulatory framework for financial accounting and reporting, the companies can be grouped as follows regarding the requirements on financial reporting:

▪ **Category I** (big Czech companies that are publicly traded on stock exchanges in the EU markets – IFRS reporting only):

These entities have both to account for the transactions and to prepare financial statements using IFRS. These companies are not required to prepare the financial statements according to Czech Accounting Standards (further "CAS")[1] as the financial statements prepared in accordance with IFRS are also accepted for the statutory purposes.[2]

The question stands how to account for in compliance with IFRS. IFRS govern the preparation of the financial statements; they do not ordain how to account for the transactions! For further discussion of the problem, see Žárová (2009).

[1] This is not the full truth. As far as the filling of income tax report concerns all companies have to start with the accounting pre-tax income, which has to be computed based on the rules defined by CAS. This means of course a big and meaningless workload for companies.

[2] All Czech companies have the informational obligation to submit their financial statements and/or annual report to the Business Register.

▪ **Category II** (Small and medium-sized enterprises – both CAS and IFRS reporting):

This category covers a diverse group of companies, from the small to the big ones (sometimes even bigger and more important than companies under Category I). The common feature of Category II is that the companies are not the issuer of publicly traded securities. Nevertheless, their owners are such issuers. Therefore, the companies belonging to this category shall prepare their financial statements in accordance with CAS for statutory purposes. In addition to this requirement, they shall provide their parent companies with the financial statements and other information needed for consolidation in compliance with IFRS. Act on accounting does not permit any voluntary application of IFRS instead of CAS what would be useful and helpful for the entities covered by this category.

▪ **Category III** (Small and medium-sized enterprises – only CAS reporting):

Category III covers family owned companies and other companies that are neither direct, nor indirect issuer of publicly traded securities. They shall account for and report in accordance with CAS (and again without possibility to apply IFRS voluntary).

Low usefulness of accounting information based on CAS strengthens the general tendency to the dual relationship between financial accounting and managerial accounting. On the other hand, the situation is becoming more favourable as a result of IFRS adoption. Recent researches demonstrated the usefulness of information according to IFRS both for external and internal reporting purposes (Christensen, 2007; Armstrong, 2007; Barth, 2008; Angelkort, 2009). Recalling the duty set by the Act on accounting, plenty of Czech companies are covered by Category II and they have to account for transactions according to CAS without possibility to adopt IFRS voluntarily. Therefore, those entities are keeping their accounts with conformity with CAS for tax and other statutory purposes; they are subject of reporting according to IFRS for their parent companies, and, of course, there is present an unquestionable need for informational support of internal management of business.

The solution of “bookkeeping overload” can be twofold:

– to employ additional resource to be able to prepare the requested data for internal users besides two sets of financial accounting information and one set of tax information; or

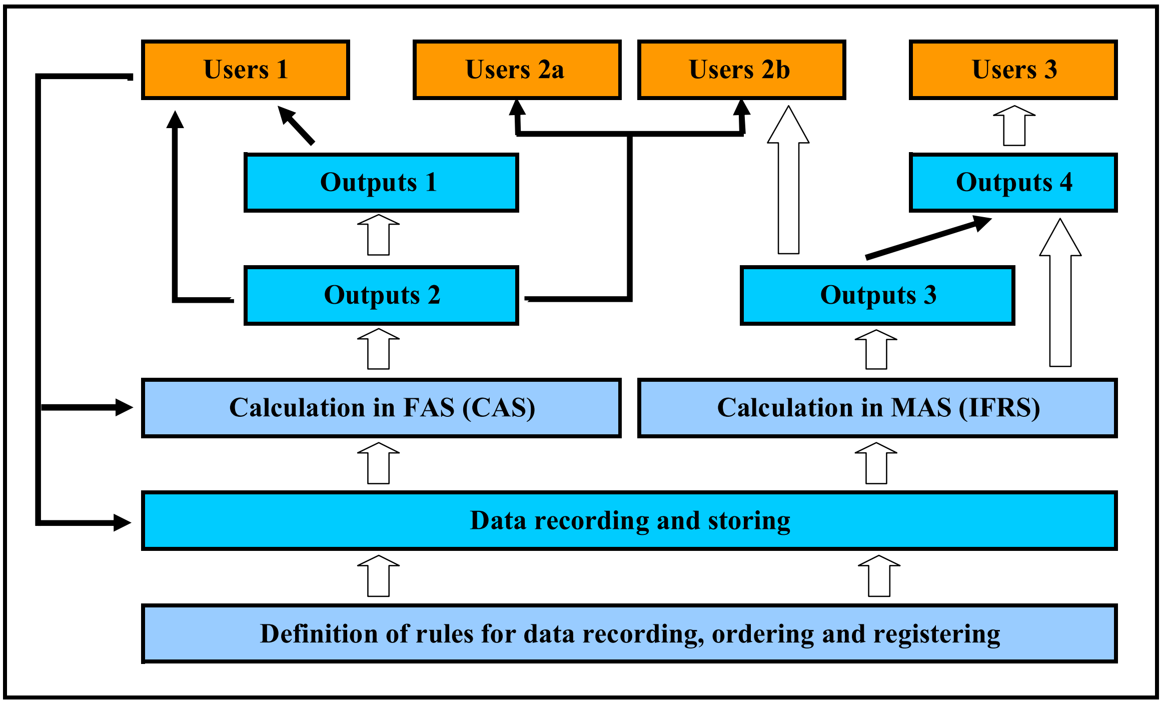
– to rationalise current status and to modify financial reporting principles to be serviceable for internal purposes.

– The growing number of companies has been choosing the second alternative and as the reaction to burden levied by two-way financial reporting, they implement integrated information systems that integrate accounting processes in two ways:

– parallel accounting for all transactions both according to CAS and IFRS (the conversion of financial statements from CAS to IFRS is not performed in data sheets like Excel, but inside the accounting system)

– integration of external and internal processes and using the information for external users as the tool for internal management of company.

Fig. 4: *Model II – Extension for the Czech republic (after IFRS adoption)*



- *FAS* … financial accounting system (based on Czech Accounting Standards);
- *MAS* … management accounting system (based on IFRS);
- *Outputs 1* ... tax reports;
- *Outputs 2* ... financial statements (according to CAS);
- *Outputs 3* ... financial statements (according to IFRS)
- *Outputs 4* ... budgeting, planning, performance measuring, control;
- *Users 1* ... tax authorities;
- *Users 2a* ... external users excluding owners (i.e. creditors, trade partners, etc.);
- *Users 2b* ... external users – owners;
- *Users 3* ... managers.

4. Conclusion

The implementation of IFRS into the Czech legislation has brought new quality to financial reporting. Due to their usefulness, IFRS infiltrate into management accounting systems. In fact, IFRS carry out (satisfy, meet) the function of internal management accounting with some modification allowing better internal performance evaluation in some companies. From the point of companies reporting under CAS and IFRS simultaneously, the financial accounting according to CAS is viewed as “necessary evil” to be able to comply with tax duties. Therefore, they build IFRS in their internal informational systems.

Paradoxically; from the entity’s perspective, the accounting system could be denoted as (almost) fully integrated. However, from the perspective of regulatory framework, the entity’s accounting system should be labelled as (almost) wholly separate. The schizophrenia of Czech accounting could not be more obvious. The high-quality International Financial Reporting Standards are used for internal purposes because of “unlucky” status of the Czech accounting legislation not allowing voluntary utilisation of IFRS. In order to avoid additional burden in the process of preparing information for internal users, IFRS principles have been replacing “standard” management accounting. Question is how to evaluate this trend. I guess, that introducing of IFRS as integral part of internal reporting and management accounting should be apprehend as a noticeably positive issue. Thus, entities are able to reduce costs of preparing needed information and – if properly modified – IFRS can be a surrogate to management accounting in cases when entities are obliged to use simultaneously local standards for the tax purposes and statutory reporting and IFRS for reporting to superordinate consolidating entity.

Current status quo is useful in terms of meeting informational demand of owners and managers. The financial reporting in compliance with IFRS (e.g. for consolidation purposes) is just an internal affair of entities covered by Category II. There is no legal requirement to disclose IFRS financial statements publicly. Therefore, external users other than owners do not posses access to more useful set of information in comparison with local accounting standards. Many interested parties would appreciate if the Act on accounting had been amended by the provision allowing or requiring to present financial statement in conformity with IFRS either on voluntary or on compulsory basis. This would lead to presenting accounting information, which is more useful for public. The second favourable effect would be the reducing cost connected with recording transactions and preparing financial statements under two different set of accounting standards.

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