

# THE CURRENT STATE OF REPORTING ACCORDING TO IFRS IN TRANSITIONAL ECONOMY OF THE CZECH REPUBLIC: RESEARCH SURVEY

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## Abstract

This research empirically investigates the current state of reporting practices in the Czech Republic. Using a questionnaire technique we investigate the International Financial Reporting Standards (IFRS) adoption and special features of its application processes in this transitional economy. We attempt to discover the reasons and obstacles in applying the IFRS. We aim to provide the answers on why the implementation of the international accounting standards is rather slow and why some companies resist it. We also investigate the costs related to the usage of IFRS in comparison to use of the local Czech GAAP. The financial reporting for tax purposes and the role of new informational technology are also touched upon. In this study we have found that the use of IFRS is still relatively low, even though it has increased in comparison to previous studies from 2010 and 2013 from 16 per cent to 28 per cent of firms in the sample. Although the opinion of perceived benefits is slightly different between the group of IFRS adopters and IFRS non-adopters, the most important reasons for not reporting in accordance with IAS / IFRS are the perceived absence of benefits and perceived high costs of its implementation.

**Key words:** Czech GAAP, harmonization, IFRS, taxes

**JEL Code:** M41, I21, A20

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## Introduction

The voluntary adoption of IFRS has been instituted in the Czech Republic in 2004, and more detail was provided by the Czech Finance ministry in 2014. Now this possibility concerns those companies which have to prepare the IAS/IFRS statements due to consolidation with other entities that are obliged to prepare their statements in the international format. The option may also concerns other companies, but those must assure that they gather data on costs and revenues in accordance with Czech accounting standards for tax calculation. The actual development of the use of IFRS shows international reporting is used (1) by Czech listed companies (not many subjects), (2) by international companies (more companies). In

both cases these are big companies (there is a limited number of big companies – according to recent survey of VSE Praha in 2013 only 0.14 per cent of companies can be considered as big companies in the Czech Republic). In general, the Czech financial environment provides no pressure for the IFRS application, neither as a requirement on accounting users, nor as a requirement of recipients in terms of benefits that it can bring. Previously it had been found that Czech enterprises did not rush to use the IAS/IFRS statements because of perceived obstacles and prevailing negative features including: high costs of adoption, different way of thinking and different accounting approaches, high costs related to introduction of international standards (which meant usually purchasing accounting and auditing services from external offices), high costs of change and uncertain positive effects (Müllerová *et al*, 2010; Zárová & Mejzlik, 2011; Strouhal, 2011; Paseková, 2012).

It can be expected, that now five years after the first research, and ten years after the introduction of IFRS into Czech national accounting, there is different perception and the overall penetration of IFRS has changed in the area of Czech companies. We conceive that the IFRS is now used in somewhat larger scale than in the past. This aspect has been investigated in the research project run jointly by VSFS Praha and AAU Praha.

The aim of this research was to find out, whether and how the situation changed for Czech companies, and whether there were any influences in favour of the usage of IFRS, possibly in terms of requirements of international companies to receive comparable data from their Czech partners.

## **2. Previous literature**

Relevant accounting changes in the early years of Czech economic transformation have been characterized by Bailey 1995; Schroll, 1995; Seal, Sucher & Zelenka, 1995. The major change in accounting regulation has taken place in 1993 with the effect of January 1, 1993.

The state of implementation of the new accounting has been investigated by Larson and Street, 2004, who have prepared a comparative study using 17 economies on problems of new accounting after the change to market based economy. The authors Sucher and Jindrichovska (2004) characterised the early state of implementation of the IFRS using a limited number of industrial companies, bankers, big accounting firms and financial industry representatives.

Many further studies concentrated on the impact of IFRS on Czech SMEs, where the issue was considered to be the most controversial e.g.: Kubickova, 2009; Müllerová, Paseková, Kubíčková, 2010; and Kubíčková, 2012. The possible positive impact of partial

adoption of IFRS was assessed by Procházka, 2010; Žárová and Mejzlík, 2011 and Strouhal 2012. The impact of adoption of international standards on key financial indicators was investigated by Kubíčková 2012. The overall transition to new market based accounting and the general problems that if facing the IFRS was analysed in the study of Jindrichovska, Kubickova & Kocmanova, 2014.

Previous detailed empirical studies on IFRS adoption on the Czech market were conducted by M. Paseková at UTB Zlín - research projects 2009-2013 (results are in Paseková, 2010) and later by D. Kubíčková at VSFS Praha (results are in Dlasková, Kubíčková and Turková, 2013). Both of these researches studies discovered that IFRS was used by very small percentage of companies. Major problems of broader usage of IFRS in the area of SMEs were identified as low pressures on the side of international business partners to prepare these statements. The cooperation with foreign partners (suppliers, customers or parent companies) was confirmed in about 60% of respondents. But in most cases these foreign partners didn't require the IFRS financial statements from their Czech partners. The only case when the usage of IFRS was required was the case when there was a relation to parent company (23%), which was itself obliged to report using the IFRS.

In terms of carrying out of the accounting in the Czech SMEs and micro businesses it has been confirmed, that these companies usually use the services of external accounting firms. It has been also found, that only a small proportion of SMEs prepare their financial statements by their own accounting department. Investigated companies confirmed that the cost for these services grow rapidly in relation with IFRS. Thus it can be supposed, that increasing cost was also one of the reasons for a low level of interest in IFRS adoption. Furthermore, it has been confirmed that the level of awareness and preparedness of managers and accounting staff to use IFRS was relatively low and so were their activities.

### **3. Method of investigation**

Based on the results of the previous investigation the questionnaire was adjusted. The questions were divided into several parts: In the first area it was determined, what was the intensity of contacts between Czech companies and foreign partners. Furthermore, there was a question whether the companies used also other than Czech accounting standards for preparation of their financial statements. There was also a forward looking question on future plans of the company to establish contacts with foreign partner, where the use of IFRS could

produce significant positive effects in the form of higher comparability of accounting information and better facilitation in establishment of these contacts.

The second part the questionnaire focused on how much the information on IFRS related to reporting practices and to what extent did it already penetrate into the practices of companies. Here, four degrees were distinguished: (1) use of IFRS for preparation of financial statements; (2) completed staff training in the use of IFRS; (3) interest in training in IFRS; and (4) awareness of IFRS in terms of effects for which they are created and used.

In the third part of the questionnaire the actual conditions of bookkeeping and preparation of financial statements were investigated – i.e. whether the accounts are kept by internal departments or by external company; whether the external accounting firm offers accounting under IFRS; which area is the most comprehensive in terms of accounting; and what were the major costs of transition to IFRS caused in those companies that are now using the IFRS.

The aim was to provide the answers on why is the implementation of the international accounting standards rather slow despite the fact that Czech economy is quite open country with extensive foreign contacts and numerous international business relations. And furthermore, what specific conditions cause that Czech companies are not interested in IFRS and resist its implementation.

Moreover, in those companies, that were using IFRS we tried to investigate, what were their reasons of implementation and what the main benefits from its usage were. The research also investigated the costs related to the implementation and further usage of IFRS in comparison to use of the local Czech GAAP. The requirement of financial reporting for tax purposes and the role of new informational technology that is changing accustomed accounting routines was also touched upon.

#### **4. The results**

The research survey was conducted in March and April of 2015 using an online questionnaire, which was complemented by a small proportion of questionnaires on paper. A database of medium and large firms was used containing 1,613 e-mail contacts to chief financial and accounting departments. In total we processed 258 completed questionnaires. This suggests a response rate of 15.99 per cent. Our sample includes 77 companies, which exceed the thresholds for SMEs definition, i.e. belong to the group of big firms. Predominant share in our sample represent medium business, small firms represent less than 15%, and only a small part are micro firms. The structure of the respondents according to industrial sector is in table 1:

**Tab 1: Sample characteristics**

Company	Number of respondents	Industrial sector				
		Manufacturing	Trade	Services	Construction	Agriculture/Other
Micro	6	0	1	4	1	0
Small	37	8	15	11	3	0
Medium	138	73	20	23	13	9
Big	77	49	6	18	4	0
Total	258	130	42	56	21	9

Source: own research

The first part of the results showed that more than half of the companies (63 %) have business contacts abroad (suppliers, customers, parent). The foreign contacts were established mainly with important suppliers, followed by the links to the parent company, and major customer. The results show that the nature of international contacts represents almost always commercial interests of the company rather than improvement of access to sources on capital market. This corresponds to the nature of Czech economy. Foreign contacts are of various kinds - one company can have multiple links: a contact to its parent company as well as to foreign suppliers and customers.

The second part investigated the state of IFRS adoption. The question was whether companies reports also under other than Czech accounting standards. There were 81 firms i.e. 34 per cent of companies that prepare their financial statements in accordance with CAS plus another system of accounting standards. These companies prepared the statements mostly according to IFRS (28 per cent), and only a small percentage of firms used US GAAP (6 per cent) or other standards. For the preparation of financial statements in accordance with IFRS firms most often used the so-called transformation bridge (48 per cent). Other firms were preparing two sets of accounting books (28 per cent), and 14 per cent of firms reported only selected items in accordance with IFRS. (For more details see table 2)

**Tab. 2: Usage of IFRS in relation to sample characteristics**

Knowledge of IFRS				
	Yes	Basic knowledge	No	
Having enough information about IAS	35%	47%	18%	
		Yes %	No %	
Participation in a training	Questioned persons	45	55	
	Other employees	33	67	
Want to participate in a training in future		39	61	
Practice of accounting				
Accounting kept by:	Own employees	Accounting firm	Individual accountant	
	92% (238)	6% (16)*	2% (4)	
Accounting standards used besides CAS	IAS/IFRS %	US GAAP %	Other %	No %
	28 (70)	4 (10)	3 (9)	66 (169)

Creation of financial statements:				
Translation bridge from CAS	48	40	67	-
Keeping two independent accounting books	28	20	11	-
Translation of selected items only	14	20	11	-
Different way	10	20	11	-
Sample characteristics				
Company location				
Small city in CR	27,1	3,9	3,5	65,5
Regional city in CR	22,5	2,8	3,5	71,1
Prague	24,6	1,6	3,3	70,5
Foreign country	50	50	-	-
Business sector				
Manufacturing	27,7	5,4	5,4	61,5
Trade	28,6	4,8	2,4	64,3
Services	33,9	-	1,8	64,3
Construction	9,5	4,8	-	85,7
Agriculture	14,3	-	-	85,7
Foreign customers				
Yes	28,1	4,	4,3	62,7
No	24,7	1,4	1,4	72,6
Foreign suppliers				
Yes	27,4	4,7	4,2	63,7
No	26,1	-	-	73,9

Source: own research

Note: \* Just five operating accounting firms offer preparation in IAS/IFRS; value in brackets represents number of answers

Awareness of IFRS in the form of completing the IFRS training by firm employees, has been found in 129 companies, i.e. 50 per cent. However, 141 respondents (55 per cent) confirm only basic or no information on IFRS (99 and 42 per cent respectively). The interest to attend such training was identified in 35 companies (27 per cent). Therefore it can be concluded that, the awareness of the company management or company accounting department is relatively high, even if the firm doesn't report under IFRS. But on the other hand there are other firms that have only a small or no information. Surprising is the fact is that 95 of the respondents from IFRS non-adopters (i.e 66 per cent and 38 per cent of the sample) do not see any benefits in reporting according to IFRS. This is despite the fact, that the contact with the foreign customers or suppliers or the intention to establish such contact was confirmed by 108 and 129 respondents in the sample respectively (i.e. 41 and 50 per cent). Thus it can be concluded that firms still do not associate the cooperation with foreign market with the requirement of IFRS reporting. This implies that foreign markets still does not require transparent and comparable information from the Czech partners.

In total, 147 respondents, i.e. 57 per cent answered that they did not use the IFRS. For more details see table 3.

**Tab. 3 Characteristics of IFRS non-adopters**

<b>Non-adopters (147 companies)</b>			
Will you consider IFRS adoption?		Are there any benefits from IFRS adoption for your company?	
Yes	No	Yes	No
5%	95 %	17%	83 %
<b>Main reasons for not adopting IFRS</b>		<b>What are the benefits of IFRS adoption?</b>	
	%		%
No benefits for company	38	Better comparison of accounting data	69
Don't know about benefits from IFRS usage	29	Easier reporting	66
Company is not issuer of securities	14	Higher credibility for business partners	47
Other	11	Better public perception	28
Don't have a foreign business partner	9	Better usage of data for business management	28
		Better quality of inter-company information	22
		Better access to EU funding	13
		Getting loans easier	3

Source: own research

Another view of the usage of IFRS in practice brings the question: what advantages or benefits are perceived by respondents in connection with the use of IFRS (interviewed were those companies that still do not use IFRS). Some benefits of using IFRS perceive 17 per cent of respondents, while 83 per cent see no positive effects in the use of IFRS.

Only 5 per cent of respondents consider the IFRS adoption. From eight enlisted benefits of the use of IFRS the respondents have most frequently chosen the reason: "Better comparison of accounting data" (69 per cent) and "Easier reporting" (66 per cent). Knowledge of the potential benefits reflects the awareness of IFRS at least at a general level. Here 82 per cent of respondents answered, that they know of some benefits. The second most frequently quoted benefit was "Higher credibility for business partners". This was chosen by 47 per cent of respondents. In total 28 per cent of respondents think, that IFRS simplifies the reporting of parent company within a consolidated group. The same number of companies (28 per cent) expects the improvement in the perception of the company by its business environment. Interesting findings follows from the response that 28 and 22 per cent of respondents connects the IFRS reporting with better use of internal data for in-house managerial accounting and internal reporting respectively. This aspect has been already discussed by Prochazka, 2010. Relatively low number of respondents perceived the importance of the use of IFRS for easier access to bank loans (3 per cent). This can be understood as a reflection of the basic designation of the IFRS, but it is also a reflection of the fact that from the standpoint of banks IFRS are not required as reliable statements of financial position. The same reason can be seen in the fact that the perceived benefit of IFRS in terms of better availability of EU funds was mentioned only by 13 per cent of respondents.

Regarding the volume of costs associated with the transition to IFRS, the most frequently reported were the costs in the range of 5 per cent of firm turnover (in case of 31 per cent of respondents). The most frequently reported kinds of costs were the cost of training (67 per cent), consulting services (51 per cent) and IT adjustments (43 per cent). As the main positive effects of IFRS adoption, as perceived by IFRS adopters were: “Getting loans easier“, “Easier increase of equity capital“, “Easier issuance of bonds“, ”Better access to EU funding“ (3,4 and 3,6 per cent) – see table 4.

**Tab. 4 Characteristics of IFRS adopters**

<b>IFRS Adopters (70 companies)</b>					
Time-frame of implementation	< 6 months		6 months – 1 year		1 year – 2 years
	54 %		31%		15%
Costs of implementation [% of business turnover]	< 0,05	0,05 – 0,5	0,5 – 1	> 1	Couldn't estimate
	31%	12%	1%	1%	54%
Types of costs %	Consultancy	IT	Training	Salary	Other
Preparation of IFRS statements	51	43	67	20	6
Implementation of other standards	33	29	20	13	6
<b>Problems</b>	%	<b>Evaluation</b>			*
CAS is subordinate to tax reporting	36	Easier reporting			1,6
Complicated terms under IAS/IFRS	25	Better comparison of accounting data			2,1
Different problem	16	Better quality of inter-company information			2,7
Big difference between CAS and IFRS	10	Better usage of data for business management			2,7
Insufficient instruction for first adoption	6	Higher credibility for business partners			2,9
Difficult translation	4	Better public perception			2,9
Nonexistence of some transactions used in IFRS	3	Getting loans easier			3,4
Insufficiently developed capital market	0	Easier increase of equity capital			3,4
Investors and users are satisfied with CAS	0	Easier issuance of bonds			3,6
		Better access to EU funding			3,4

Source: own research

Note: \* is average mark from 68 companies on a scale from 1 (means yes) to 5 (means no).

## 5. Conclusion, limitation and suggestions for further research

The findings were more or less in line with our expectations. The most important results of this empirical study can be briefly summarized as follows: (1) the use of IFRS is still relatively low, even though it has increased in comparison to previous studies from 2010 and 2013 from 16 per cent to 28 per cent of firms in the sample. (2) the most important reason for not reporting in accordance with IAS / IFRS is the perceived absence of any benefits for companies. More than three quarters of companies do not see or do not know any advantages in the use of IFRS. (3) The offer to prepare the statements according to it IFRS on the part of professional accounting firms is very low, and therefore 80 per cent of all companies prepare



their international students internally - predominantly using the conversion bridge. (4) There are some differences between the IFRS adopters and non-adopters with regards to perceived benefits of the use of IFRS, but the most significant reasons are similar for both groups.

There are some limitations of this study: (1) the used sample can be perceived as one limitation. Although the response rate was relatively high – 15.99 per cent; (2) There is also a possibility to use a different method – semi-structured interviews could be advisable for this type of study; (3) Some questions in the survey questionnaire might have deserved better formulation; (4) There could be also deeper analysis of broader business conditions of both adopters and non-adopters.

In the next stage of investigation it would be desirable to concentrate on positive effects of the use of IFRS adoption and on analysis of further changes in the environment contrasting especially the Czech SMEs and big companies. There is also an unknown area concerning the cultural influences and the real implementation of the principles on which reporting according to IFRS is based. It might be interesting to investigate the influence of national culture and different way of economic thinking in the usage of IFRS.

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