The Czech accounting system and its relationship with IAS (IFRS)

Accounting plays an important role in economic and social system of the Czech republic as well as in the economic system of enterprises. Accounting is often called the "language of business." This language can be viewed as an information system that provides essential information about the financial activities of an entity to various individuals or groups for their use in making informed judgments and decisions. As such, accounting information is composed principally of financial data about business transactions, expressed in terms of money. Accounting provides the techniques for gathering economic data and the language for communicating these data to different individuals and institutions.

Accounting can be divided into two basic systems:

1. Financial accounting,
2. Managerial accounting.

Financial accounting is concerned with the measuring and recording of transactions for a business enterprise or other economic unit and the periodic preparation of various reports from such records. The reports, which may be for general purposes or for a special purpose, provide useful information for managers, owners, creditors, governmental agencies, and the general public[1].

Managerial accounting employs both historical and estimated data, which management uses in conducting daily operations and in planning future operations. For example, in directing day-to-day operations, management relies upon accounting to provide information concerning the amount owed to each creditor, the amount owed by each customer, and the date each amount is due. The treasurer uses these data and other data in the management of cash. Accounting data may be used by top management in determining the selling price of a new product. Production managers, by comparing past performances with planned objectives, can take steps to accelerate favorable trends and reduce those trends that are unfavorable.

The Czech accounting system

The Czech accounting system is regulated by several juridical laws.

The basic law is a law no. 563/1991 – LAW OF ACCOUNTING that constitutes the obligation to keep accounting files for the Czech enterprises. In the first place the law of accounting defines basic conditions and procedures for keeping of accounting evidence. Some paragraphs of this law are relatively brief and for their practical usage it is necessary to specify them more precisely. This is the reason why the law of accounting is next developed by edict of Ministry of finance no. 500/2002 that constitutes the methods and principles of accounting as well as valuation rules. The edict no. 500/2002 is next developed by so-called Czech accounting standards valid since the beginning of the year 2004, that describe in detail concrete accounting principles for concrete economic transactions.

These three basic laws regulate directly accounting procedures. But there are a lot of other laws and regulations in the Czech Republic that are connected with accounting indirectly – for example law of income taxes, law of health and social insurance, etc.

Accounting systems in the Czech Republic

There are two basic "accounting" systems in the Czech Republic:

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[1] WARREN, C.S., FESS, P.E.: *Financial accounting,* p. 15.

1. Tax evidence of incomes and expenditures
2. Double-entry accounting

Tax evidence of incomes and expenditures can be used only by physical persons who are not entered in trade register and whose turnover does not exceed amount 15 mil. CZK per year (turnover means amount of total revenues in according with value-added tax act). The tax evidence is regulated primarily by income taxes act. This is the reason why tax evidence of incomes and expenditures is not considered as a real accounting system. Accounting in the real form is regulated by accounting regulation.

Business units defined by accounting act must obligatory keep accounting files in according with so-called double-entry accounting system. Double-entry accounting system means that all economic transactions are charged on two different accounts. Accounting act is applied on so-called "accounting units" defined by § 1 of accounting act. In according with this regulation, as accounting units in the Czech Republic especially the following units are defined:

1. Corporations (domestic corporations with the residence in the Czech Republic as well as foreign corporations doing business in the Czech Republic),
2. Physical persons doing business entered in the trade register[2],
3. Physical persons doing business with turnover exceeding amount 15 million CZK per year (turnover means amount of total revenues (or incomes) per year (with several exceptions) in according with law no. 235/2004 of value-added tax).
4. Physical persons doing business who keep accounting voluntarily,
5. Physical persons doing business associated in so-called association without legal subjectivity under condition that any person associated in association is an accounting unit[3].
6. Other physical persons doing business whose obligation to keep accounting results from special legal regulation.

Financial statements in the Czech Republic

All accounting units keeping double-entry accounting must obligatory compile three basic financial statements providing basic information about economic and financial situation of the enterprise. These statements are:

1. Balance sheet
2. Profit and loss statement (income statement),
3. Appendix.

The balance sheet is the most important financial statement compiled in the system of double – entry accounting. It provides information about the structure of assets and equities. The structure of the balance sheet valid in the Czech Republic is as follows:

Assets	**Equities**
1. Fixed assets - intangible assets	**1. Owner's equity** - common stocks

[2] Trade register is a list of business units kept by trade courts in the Czech Republic. Obligatory entered units are corporations and from physical persons those who are entered voluntarily or because of some special legal regulation.
[3] This regulation means, that when one member of association becomes an accounting unit, other persons become accounting units too.

- tangible assets - long-term financial assets **2. Current assets** - inventories - long – term receivables - short – term receivables - short – term financial assets	- capital funds - funds created from net profit - economic results **2. Liabilities** - reserves - long – term debts (liabilities) - short - term debts (liabilities) - bank credits (loans)
Σ Assets	**Σ Equities**

The balance sheet does not provide information about other basic accounting categories – costs (expenses) and revenues. These items are icluded in the profit and loss statement (income statement). Revenues and costs are are important, because they directly influence the economic result of the enterprise:

Economic result = Revenues – Costs (Expenses)

The excess of the revenue over the costs incurred in earning the revenue is called **net profit (earnings after taxes).** If the costs of the enterprise exceed the revenue, the excess is a **net loss.**

The revenue is defined as the result (output) of the economic activity of the enterprise achieved by spending of costs. Revenues give the sense to economic existence of the enterprise. The revenue can influence assets (increasing of assets) or equities (decreasing of equities).

The cost is defined as the input into the economic activity of the enterprise with the aim to achieve revenues (outputs). The cost can influence assets (decreasing of assets) or equities (increasing of equities).

Costs and revenues are charged on special accounts in the system of double-entry accounting system. Systematically they are recorded in the profit and loss statement (income statement) (P/L Statement).

The structure of P/L statement is a little bit more complicated than the structure of the balance sheet. The P/L statement is composed gradually with the aim to calculate several partial indicators which represent single parts of economic activity of the enterprise.

The Appendix is the third obligatory compiled statement as a part of an accounting shutter in the Czech Republic. It provides complementing information about financial situation of the enterprise including additional information about items in the balance sheet and profit and loss statement. The appendix also provides additional information about the accounting unit (name, seat, management, etc.).

The European accounting system

The European accounting system is a little bit different than the Czech accounting system. The European accounting system is based on two basic pillars:

1. Directives of the European Union,
2. International Accounting Standards (IAS). The newer term for IAS is International Financial Reporting Standards (IFRS).

The Czech accounting legislation has already accepted a lot of assignments embedded in IAS and Directives with the aim to synchronize Czech and European juridical rules. A need of

European accounting harmonization arose from the formation of the EU in 1957 and it is berthed in foundation treaty (so called Roman treaty). Harmonization itself has been created by accepting and transforming European directives that have been ratified by European Board of Ministers. European directives have not character of international acts but they give a duty to accept them in national legislation of the EU members.

Since the formation of the EU in 1957 13 Directives have been ratified. The most important Directives from the accounting point of view are:

1. Fourth Directive – was ratified in 1978. This Directive focuses on the unification of financial statements in member countries of the EU.
2. Seventh Directive – was ratified in 1983. This Directive concerns compilation of consolidated financial statements that must be compiled by groups of enterprises (holdings, concerns, etc.)
3. Eighth Directive – was ratified in 1984 and determines minimal requirements for auditors' qualification.

The International Accounting Standards (IAS), The International Financial Reporting Standards (IFRS)

The International Accounting Standards (respectively International Financial Reporting Standards) represent the second basic pillar of the European accounting system. The IAS are issued by The International Accounting Standards Committee (IASC). The IASC came into existence on 29 June 1973 as a result of an agreement by accountancy bodies in Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the UK and Ireland and the USA. The objectives of IASC are set out in its Constitution. These objectives are:

1. To formulate and publish in the public interest accounting standards to be observed in the presentation of financial statements and to promote their worldwide acceptance and observance, and
2. To work generally for the improvement and harmonization of regulations, accounting standards and procedures relating to the presentation of financial statements.

Because the most important accounting information are always provided through the financial statements, the IAS give them special attention and define their basic objectives. The main objective of the financial statements in according with IAS (IFRS) is:

- To provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions. Financial statements prepared for this purpose must meet the common needs of most users. Financial statements also show the results of the stewardship of management, or the accountability for the resources entrusted to it.

Till this moment 41 International Accounting Standards and 5 International Financial Reporting Standards have been accepted[4]. Especially International Accounting Standard no. 1 is significant for the purpose of this chapter. **International Accounting Standard no. 1 – Presentation of financial statements** is focused on financial statements obligatory compiled by accounting units that are using IAS. The objective of this Standard is to prescribe the basis for presentation of financial statements, in order to ensure comparability both with the enterprise's own financial statements of previous periods and with the financial statements of other enterprises. To achieve this objective, IAS 1 sets out overall considerations for the

[4] IFRS and IAS summary can be found at www.iasb.org/standards/summaries.asp.

presentation of financial statements, guidelines for their structure and minimum requirements for the content of financial statements. IAS 1 next defines the purpose of financial statements. This purpose is defined as follows: „Financial statements are a structured financial representation of the financial position and of the transactions undertaken by an enterprise". In according with IAS 1 the financial statements should provide information about:

- Assets,
- Liabilities,
- Equity,
- Income and expenses, including gains and losses,
- Cash flows.

A complete set of financial statements includes the following components (according to IAS 1):

- Balance sheet,
- Income statement (P/L statement),
- A statement showing either:
  - All changes in equity, or
  - Changes in equity other than those arising from capital transactions with owners and distributions to owners,
- Cash flow statement,
- Accounting policies and explanatory notes.

As a minimum the balance sheet should include these items:

- Property, plant and equipment,
- Intangible assets,
- Financial assets,
- Investments accounted for using the equity method,
- Inventories,
- Trade and other receivables,
- Cash and cash equivalents,
- Trade and other payables,
- Tax liabilities,
- Provisions,
- Non-current interest-bearing liabilities,
- Minority interest,
- Issued capital and reserves.

As a minimum the income statement should include these items:

- Revenue,
- The results of operating activities,
- Finance costs,
- Shares of profits and losses of associates and joint ventures,
- Tax expense,
- Profit or loss from ordinary activities,
- Extraordinary items,
- Minority interest,
- Net profit or loss for the period.

Next IAS and IFRS regulate other areas of financial accounting (for example inventories, cash-flow statement, revenues, etc.). Some enterprises in the Czech Republic (companies whose securities are traded on public financial markets) must obligatory keep two kinds of accounting (accounting based on the Czech accounting legislation and accounting based on IAS/IFRS).

IAS and their relationship with Czech national accounting standards

Some significant tendencies and trends can be identified in relationship between IAS (IFRS) and the Czech accounting legislation. As the most significant trends can be named:

- The Czech national standards more and more accept IAS (IFRS),
- It is expected that IAS (IFRS) will be completely integrated into the Czech legislation in very near future,
- IAS and US GAAP (US General Accepted Accounting Principles[5]) will probably become the base for united accounting system acceptable for all world countries in the future.

From the worldwide point of view it is expected that in the future only one system of accounting will stay. This system will be probably created as the intersection of IAS (IFRS) and US GAAP.

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[5] US GAAP constitute the basic accounting principles used in the U.S.