IAS (IFRS) and their relationship with Czech accounting standards

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Accounting of the enterprises in the Czech Republic

- All enterprises in the Czech Republic have the obligation to keep accounting files
- This obligation is determined by the law of accounting nr. 563/1991
- The last amendment of this law has been valid since the beginning of the year 2009
- During last 3 years the law has been changed for several times with the aim to approximate Czech juridical regulation to European juridical regulation

The European accounting system

- is based on two pillars
  - Directives of the European Union
  - International Accounting Standards (IAS). The newer term for IAS is International Financial Reporting Standards (IFRS)
- The Czech law of accounting has accepted a lot of assignments embedded in IAS and Directives with the aim to synchronize Czech and European juridical rules before entering the Czech Rep. to the EU.

Czech accounting

- Czech accounting knows two systems:
  - Single-entry accounting
  - Double-entry accounting

But: Single-entry accounting can be used only in case of some non-profit institutions.

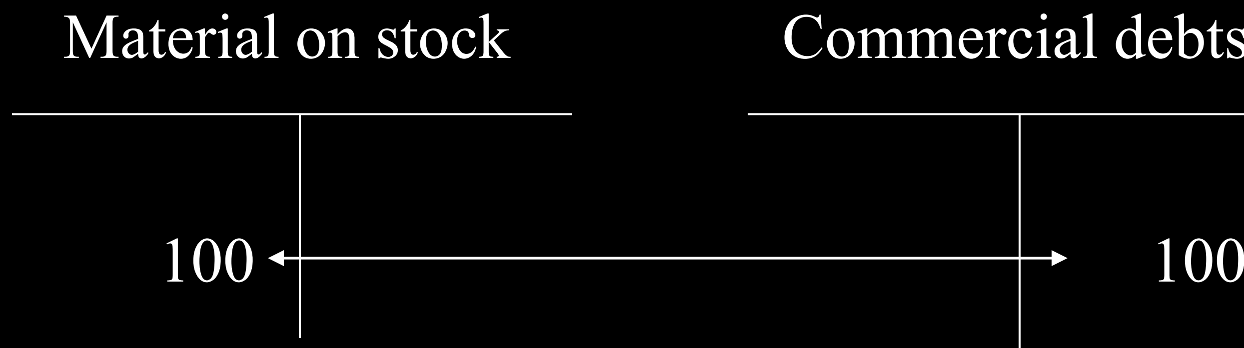
Situation of the Czech accounting after entering to the EU

- Only one system of accounting has stayed since year 2005 – double-entry accounting
- Physical persons whose turnover is lower than 25 mil. CZK per year are allowed to keep so called tax evidence of incomes and expenditures
- Physical persons whose turnover is higher than 25 mil. CZK will have to keep obligatory double-entry accounting.

There can be no exceptions!

Double-entry accounting in the CR

- Since 2005 will be the only possibility how to keep accounting files
- Means that all economic transactions in firm are accounted on two correlated accounts
  - Example: Firm buys material (value is 100 CZK– accounting document is an invoice bill)



Main rules valid for accounting

- Accounting must be complete, correct and conclusive.
  - Accounting is complete when all economic transactions are charged on accounts
  - Accounting is correct when no law and instruction is broken
  - Accounting is conclusive when all economic transactions can be attested by some accounting document.

All these rules must be kept together!!

Purpose of accounting

- Accounting gives information to owners, managers, employees, creditors, banks, financial institutions and other external subjects about economic and financial situation of the enterprise.
- Financial statements are obligatory rendered to the revenue authority, because they pose the base for compilation of tax declaration.
- Financial statements are also obligatory rendered to the commercial register.
- In case of larger firms their financial statements are the part of their annual report.

Financial statements

- At the end of the accounting period all firms in the CR must compile 3 basic financial statements:
  1. Balance sheet – provides information about assets and liabilities of the enterprise.
  2. Profit and loss statement – provides information about costs, revenues and economic result of the enterprise.
  3. Appendix – provides other information not included into balance sheet and P/L statement – accounting methods, valuation rules, allowances for depreciation, etc.

Cash-flow statement in the CR

- Its compilation is not obligatory, but it is suitable to compile it (optionally compiled statement).
- Provides information about financial flows in the company, it means about incomes and expenditures.
- Adds obligatory compiled statements, especially P/L statement.
- Is a part of appendix.
- Is often asked when enterprise applies for credit, because it provides better information about real financial situation than P/L statement.

Differences between cash-flow statement and P/L statement

- Result from so called accrual principle of accounting.
- Accrual principle means that enterprises charge revenues and costs on accounts regardless to the fact whether real movement of cash (income or expenditure) happened.
- Costs and revenues must be charged in the period they objectively and timely relate to. In other case costs and revenues must be timely differentiated to keep the previous condition.

General accounting principles

- Caution principle – assets and revenues must not be overvalued and liabilities and costs must not be undervalued
- Independence of the accounting periods – economic transactions must be charged in the period they are connected with
- Definition of the realization moment – it must be strictly defined the moment when enterprise can charge on accounts

- Definition of the accounting unit – it means the unit that keeps accounting files and compiles financial statements
- Restriction of compensation – mutual compensation of accounting items is strictly limited and it is possible only in very special cases (for example in case of receivables and debts to the same subject with the term of payment shorter than one year that are charged in the same currency)
- Going concern – presumes unlimited continuance of the firm
- Accounting methods stability – firm must not change its accounting methods during the accounting period. Each exception must be justified by the aim of better expression of reality

- Historical costs – this principle means that property valuation is made in the moment of its acquirement
- Balance continuity – balance-sheet compiled at the beginning of an accounting period must correspond with the balance sheet compiled at the end of the previous accounting period
- Materiality principle – financial statements must contain informations that are important for all users from the point of their future decisions
- Objectivity principle – accounting must be complete, correct and conclusive

Again: all these principles must be kept together!!!

European accounting harmonization

- 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 has been created by accepting and transforming European directives that have been ratified by European Board of Ministers
- European directives have not character of an international law but they give a duty to accept them in national law of the EU members

Directives of the EU

- 13 Directives have been ratified since 1957
- The most important Directives 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.

IAS (IFRS)

- International Accounting Standards (respectively International Financial Reporting Standards) represent the second basic pillar of the European accounting system
- IAS are issued by The International Accounting Standards Committee (IASC). 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

The objectives of IASC are set out in its Constitution. These objectives are:

- 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
- To work generally for the improvement and harmonization of regulations, accounting standards and procedures relating to the presentation of financial statements

The objective of financial statements

In according with IASC objectives the objective of financial statements 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.

IAS 1 – Presentation of financial statements

- 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 presentation of financial statements, guidelines for their structure and minimum requirements for the content of financial statements (next it will be used abbreviation FS).

Purpose of FS in according with IAS 1

- Financial statements are a structured financial representation of the financial position of and the transactions undertaken by an enterprise.
- FS provide information about an enterprise´s:
  - Assets
  - Liablities
  - Equity
  - Income and expenses, including gains and losses
  - Cash flows

Components of FS (in according with IAS 1)

- A complete set of FS includes the following components:
  a. Balance sheet
  b. Income statement (P/L statement)
  c. A statement showing either:
     i. All changes in equity, or
     ii. Changes in equity other than those arising from capital transactions with owners and distributions to owners
  d. Cash flow statement
  e. Accounting policies and explanatory notes

Balance-sheet (IAS1)

- 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

Income statement (IAS 1)

- 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

IAS 2 - Inventories

- The objective of this Standard is to prescribe the accounting treatment for inventories under the historical cost system.

- Inventories are assets
  - Held for sale in the ordinary course of business
  - In the process of production for such sale
  - In the form of materials or supplies to be consumed in the production process or in the rendering of services

IAS 7 – Cash-flow statement

- The objective of this Standard is to require the provision of information about the historical changes in cash and cash equivalents (for example checks – property simply convertible to a known amount of cash with insignificant risk of changes in value) of an enterprise by means of a cash-flow statement which classifies cash flows during the period from operating, investing and financing activities.

IAS 8 – Net profit or loss for the period, fundamental errors and changes in accounting policies

- The objective of this Standard is to prescribe the classification, disclosure and accounting treatment of certain items in the income statement so that all enterprises prepare and present an income statement on a consistent basis. Accordingly, this Standard requires the classification and disclosure of extraordinary items and the disclosure of certain items within profit or loss from ordinary activities. It also specifies the accounting treatment for changes in accounting estimates, changes in accounting policies and the correction of fundamental errors.

IAS 10 – Events after the balance sheet date

- The objective of this Standard is to prescribe:
  - When an enterprise should adjust its financial statements for events after the balance sheet date
  - The disclosures that an enterprise should give about the date when the financial statements were authorised for issue and about events after the balance sheet date
- This Standard also requires that an enterprise should not prepare its financial statements on a going concern basis if events after the balance sheet date indicate that the going concern assumption is not appropriate.

IAS 12 – Income taxes

- The objective of this Standard is to prescribe the accounting treatment for income taxes. The principal issue in accounting for income taxes is how to account for the current and future tax consequences of:
    - The future recovery (settlement) of the carrying amount amount of assets (liabilities) that are recognised in an enterprise´s balance sheet
    - Transactions and other events of the current period that are recognised in an enterprise´s financial statements.

IAS 16 – Property, plant, equipment

- The objective of this Standard is to prescribe the accounting treatment for property, plant and equipment. The principal issues in accounting for property, plant and equipment are the timing of recognition of the assets, the determination of their carrying amounts and the depreciation charges to be recognised in relation to them.

IAS 18 - Revenue

- The primary issue in accounting for revenue is determining when to recognise revenue.
- Revenue is recognised when it is probable that future economic benefits will flow to the enterprise and these benefits can be measured reliably.
- This Standard identifies the circumstances in which these criteria will be met and, therefore, revenue will be recognised. It also provide practical guidance on the application of these criteria.

IAS 21 – The effects of changes in foreign exchange rates

- The principal issues in accounting for foreign currency transactions and foreign operations are to decide which exchange rate to use and how to recognise in the financial statements the financial effect of changes in exchange rates.
- The questions above are answered by this Standard

IAS 22 – Business combinations

- The objective of this Standard is to prescribe the accounting treatment for business combinations.
- This Standard covers both an acquisition of one enterprise by another and also the rare situation of a uniting of interests when an acquirer cannot be identified.
- Accounting for an acquisition involves determination of the costs of the acquisition and also allocation of the costs over the identifiable assets and liabilities.

IAS 27 – Consolidated financial statements and accounting for investments in subsidiaries

- This Standard prescribes conditions for compilation of consolidated financial statements.
- A parent which issues consolidated financial statements should consolidated all subsidiaries (domestic and foreign) except of subsidiaries when:
  - Their control is intended to be temporary
  - They operate under severe long-term restrictions which significantly impair its ability to transfer funds to the parent.

IAS 32 – Financial instruments: Disclosure and presentation

- The Standard prescribes certain requirements for presentation of financial instruments and identifies the information that should be disclosed about financial instruments.
- This Standard is narrowly connected with IAS 39 – Financial instruments: Recognition and measurement, which established principles for recognising, measuring and disclosing information about financial assets and financial liabilities.

IAS and their relationship with Czech national accounting standards

- Czech national standards more and more accept IAS.
- It is expected that IAS will be completely integrated into the Czech legislation in very near future
- This process has already started
- IAS and US GAAP (US General Accepted Accounting Principles) will probably become the base for united accounting system acceptable for all world countries in the future.