

# Are Czech and Albanian Accounting Systems Really Different from International Referential: Some Issues for Potential Investors

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## Abstract

The adoption of IFRS is supported in many countries inside and outside the European Union because it may improve the quality and comparability of financial reporting. In addition to the use of IFRS by listed companies and in some countries also by non-listed companies, many countries have developed their own national accounting standards based on the international ones. Although the national standards are based on IFRS, they are not identical. The Czech Republic and Albania are transitional economies based in "Central and Eastern Europe". Czech Republic joined EU in May 2004, whereas Albania is still the candidate country. The purpose of the paper is to compare national accounting standards of the Czech Republic and Albania with IFRS, look at approaches of these countries to aspects of financial reporting, and analyze differences and similarities using Jaccard's association coefficients as a general tool.

## Key words

Financial Reporting; IFRS (International Financial Reporting Standards), Czech Republic, Albania

## 1 Introduction and Literature Review

The globalisation and the expansion of markets as well as the general progress in the technologies available have brought new problems to the compilation of financial reports and to the ascertainment of trading income of supranational corporations and groups in accordance with statutory regulations of countries involved.

Without common accounting standards, there could be 27 different national methods of accounting in addition to the use of IFRS and US GAAP, which are permitted by some EU countries (Whittington, 2005). Brown and Tarca (2005) warn that "the future of the IASB is tied to the successful introduction of IFRS in Europe". The EU motivates the regulation by referring to the enhanced international comparability and transparency of financial statements and improved access to the international capital markets resulting from IFRS usage (Cuijpers and Buijink, 2005).

In the year 2002, the European Parliament and the Council of the European Union issued Regulation 1606/2002 whereby it stipulated certain duties on the part of companies listed on European stock exchanges to compile their consolidated accounting statements in accordance with IFRS. Therefore, beginning from 2005, a large number of listed enterprises, exhibiting significant heterogeneity in size, capital structure, ownership structure and accounting sophistication, started to apply international standards for the first time. The demand for

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detailed application guidance will increase substantially, as will the demand for uniform financial reporting enforcement throughout the European Union.

In addition to the use of IFRS by listed companies, many countries adopt international standards for unlisted companies or model their domestic standards on the basis of international standards. The Australian government had decided to adopt international standards for the statutory accounts of all domestic companies from 2005, and New Zealand has indicated the year 2007. The 2003 survey by Deloitte and Touche (2007) suggested that more than 90 countries would either require or permit IFRS for listed companies by 2005, and according to the latest Deloitte survey now there are over 100 such countries. This provides an interesting example for those who argue that accounting standards should be left to competition in the marketplace (e.g. Watts and Zimmerman, 1986).

The requirements for group listed enterprises to prepare IFRS reports from 2005 were established in most transitional economies, but it is still unclear to what extent other enterprises will prepare IFRS financial statements. Concerns about the lack of suitably trained accountants and auditors and the lack of efficient markets to ensure reliable fair values for the IFRS financial statements, have already been expressed. This may cast doubt on whether the financial statements issued under IFRS will be reliable. Indications are that in most of the transitional economies of Eastern and Central Europe, other non-listed enterprises will not have to prepare financial statements according to IFRS (Sucher et al., 2005).

## **2 Financial Reporting in the Czech Republic and Albania**

### **2.1 Czech Republic**

From the year 2005, IFRS were given as a legal framework for the reporting of listed companies in all E.U. countries. The “target user” of the financial statements in the Czech Republic is still the tax authority, not the investor or owner. Moreover, unlike international standards, the Czech accounting regulations lack a glossary of definitions for basic elements of financial statements, which is why we shall use the definitions applied in IFRS standards, namely in the Framework. Reliable measurement is expected from all entries involved.

In the Czech Republic, items are usually measured at historical costs, while donated or gratuitously procured assets are measured by replacement costs, which are the approximate equivalent of the reproduction cost as defined by IFRS. Under certain circumstances, the realizable value and the fair value also may be used as the measurement bases for financial accounting. On the other hand, the Czech regulations virtually ignore measurement methods based on present value (Strouhal, 2007, Strouhal et al., 2008a), which are required for measurement of long-term receivables, long-term payables and financial assets held to maturity (under IFRS).

Under Czech Accounting Act, the financial statements comprise: balance sheet, profit and loss statement, and notes. At the same time, Accounting Act also contains the following unfortunate sentence “the financial statements may also include a cash-flow statement and the statement of changes in equity”. This means that under Czech laws, the cash-flow statement is not an obligatory component of the financial statements, not even for the accounting entities, which are liable to statutory audit. On the other hand, international standards stipulate that the above statements be an integral part of the financial statements.

### **2.2 Albania**

Albania has prepared a Country strategy and Action Plan in 2008 which is based on the World Bank Report (2006) on the Observance of Standards and Codes on Accounting and Auditing in Albania. This strategy, was developed by the National Steering Committee,

consisted of public and private stakeholders, sets out a clear program of reforms to enhance Albania's legal framework, institutions, accounting and auditing profession as well as its accounting and auditing and business culture, to achieve high quality financial reporting. The enhancement of financial reporting should not be viewed as an objective for its own sake. But, it is much more than this and there is a need of all country's stakeholders to participate in micro level as well in macro level. High quality financial reporting is the basis of a well functioning market economy and the core of a country healthy financial system. The adoption of the IFRS in Albania will increase transparency, comparability and accountability of financial reporting and will improve both the quality and comparability of financial information reported by public and private entities in Albania. Thus, high quality financial reporting is very progressive step and challenge for Albania and its financial system. This will promote, among other things, foreign investment in Albania.

According to Albanian Accounting Standards financial statements are consisted of the: Balance Sheet, Statement of Profit and Loss, Statement of Cash Flow, Statement of Changes in Equity, and Notes. Financial statements have to be prepared based on materiality concept.

### **3 Research Design and Methodology**

As mentioned before, having the belief that once regulatory bodies adopt a financial reporting paradigm, it becomes the guiding principle for accounting regulation (Hitz, 2007), that is, standard setting, we began our research by first analyzing the foresights comprised within the IFRS concerning the matter of financial reporting and then moved forward to the national accounting systems (the Czech and Albanian). Not only have we analyzed the three sets of regulations separately, but also emphasized the particularities found within the three sets of national GAAPs through the perspective of emerging capital markets. An empirical analysis was performed by testing the similarities and dissimilarities between the three sets of standards, taken two at a time in order to draw a well established conclusion regarding the comparability degree existent between them. The source of information for the empirical analysis was also the information gathered by closely analyzing the regulations mentioned above which were accordingly codified and assayed by using some statistical methods which are being detailed in the chapter dealing with the comparative approach of the national GAAPs by reference to international reporting paradigms.

The findings of this study which come from analyzing formal harmonization in the area of financial reporting, are correlated to the current development stage of the national capital markets along with the international trade literature, and make some remarks on the national regulatory bodies.

### **4 Comparative Analysis between National GAAPs of the Czech Republic and Albania with IFRS**

With the aim of identifying the eventual shift on national GAAPs towards international reporting paradigms we have performed an empirical analysis with character of comparison between three accounting systems. For each of the identified elements we proceeded to achieve a comparison between the accounting treatments as it appears within the three accounting referential considered for analysis. Thus, for each possible and/or existent accounting treatment within at least one of the considered accounting referential we have allocated the 1 or 0 value, where the 1 value shows that the considered accounting treatment exists within the considered accounting referential, and the 0 value is given for the situation

when the considered accounting treatment isn't found within the considered accounting referential (Strouhal et al., 2008b).

In order to achieve the proposed comparison, we have considered that the best analysis, in the case of this type of approach, is represented by the nonparametric correlation and the association degree between two or more than two considered variables. Jaccards' association Coefficients have been used since the trade literature (Fontes et al., 2005) frequently uses this measurement instruments when an analysis at the level of national accounting regulations is aimed. On the other hand, the two Jaccard Coefficients offer the possibility of quantifying both the association degree and the dissimilarity degree between different sets of accounting standards taken into consideration for analysis.

Calculation formula for the Jaccards' Coefficients shows as follows:

$$S_{ij} = \frac{a}{a + b + c} \quad (1) \text{ or}$$

$$D_{ij} = \frac{b + c}{a + b + c} = 1 - S_{ij} \quad (2)$$

where:  $S_{ij}$  represents the similarity degree between the two sets of analyzed accounting regulations;  $D_{ij}$  represents the degree of dissimilitude or diversity between the two sets of analyzed accounting regulations;  $a$  – the number of elements which take the 1 value for both sets of regulations;  $b$  – the number of elements which take the 1 value within the  $j$  set of regulations and the 0 value for the  $i$  set of regulations;  $c$  – the number of elements which take the 1 value within the  $i$  set of regulations and the 0 value for the  $j$  set of regulations.

The accounting analyzed elements are therefore given the 1 value for using a certain accounting method and the 0 value for not-using that considered accounting method or treatment.

As a result of the effective measurement of the comparability degree between the Czech, Albanian and International accounting referential (IFRS) based on Jaccards' Coefficients we have reached the conclusion that there is a high degree of similarity between national GAAPs and IFRS on the approached area. Results show quite high level of similarities between analysed systems of financial reporting (see Tables 1 – 3). The major differences are given by the level of required disclosed information.

	CZE/ALB		CZE/IFRS		ALB/IFRS	
	$S_{ij}$	$D_{ij}$	$S_{ij}$	$D_{ij}$	$S_{ij}$	$D_{ij}$
<b>1 Intangibles</b>	0.333	0.667	0.667	0.333	0.250	0.750
<b>2 PPE</b>	1.000	0.000	0.667	0.333	0.667	0.333
<b>3 Investment Property</b>	1.000	0.000	0.667	0.333	0.667	0.333
<b>4 Financial Lease</b>	0.167	0.833	0.000	1.000	0.750	0.250
<b>5 Inventories</b>	1.000	0.000	1.000	0.000	1.000	0.000
<b>6 Financial Assets and Liabilities</b>	0.000	1.000	0.750	0.250	0.200	0.800
<b>7 Financial Derivatives</b>	0.250	0.750	1.000	0.000	0.250	0.750
<b>8 Financial Statements</b>	1.000	0.000	0.833	0.167	0.833	0.167
<b>TOTAL</b>	<b>0.517</b>	<b>0.483</b>	<b>0.645</b>	<b>0.355</b>	<b>0.563</b>	<b>0.438</b>

Tab.No.1: Comparative Analysis of Similarities and Dissimilarities between Local GAAPs and IFRS

<b>Similarities</b>	<b>CZE</b>	<b>ALB</b>	<b>IFRS</b>
<b>CZE</b>	1.000	0.517	0.645
<b>ALB</b>	0.517	1.000	0.563
<b>IFRS</b>	0.645	0.563	1.000

Tab.No.2: Jaccard's Similarity Coefficients

<b>Dissimilarities</b>	<b>CZE</b>	<b>ALB</b>	<b>IFRS</b>
<b>CZE</b>	0.000	0.483	0.355
<b>ALB</b>	0.483	0.000	0.438
<b>IFRS</b>	0.355	0.438	0.000

Tab.No.3: Jaccard's Dissimilarity Coefficients

## 5 Conclusion

The most significant problem of the financial statements and items shown is the complete inconsistency of measurement bases and the application of the historic (acquisition) cost, the fair value and the present value. At present, the principle of measurement based on the historical cost is fading out as it is gradually being replaced by the IFRS trend of reporting fair values, which are, however, difficult to measure in less transparent markets. At the same time, the reporting based on the fair value includes the hidden danger of future volatility of such values and the consequent impact of the changes on financial statements. The results of performed analysis show the high level of compatibility between Czech system and IFRS, candidate country (Albania) progressed its accounting towards international referential too.

### Acknowledgement

This paper is one of the research outputs of the project GA402/08/P024 registered at Czech Science Foundation (GAČR).

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## Summary

Přijetí Mezinárodních standardů účetního výkaznictví (IFRS) je široce podporováno mnoha zeměmi po celém světě, a to zejména s cílem zvýšit kvalitu a srovnatelnost účetního výkaznictví. V mnoha zemích jsou IFRS základní vykazovací bázi pro kótované společnosti; navíc podle nich často vykazují i nekótované společnosti a slouží jako základ pro moderní národní účetní úpravy. Česká republika a Albánie jsou zeměmi ze střední a východní Evropy. Zatímco ČR vstoupila do Evropské unie v roce 2004, a tak v souladu s platnými předpisy musí české kótované společnosti vykazovat podle IFRS; Albánie je stále kandidátskou zemí na vstup do Unie. Cílem tohoto příspěvku je porovnat národní účetní úpravy České republiky a Albánie s Mezinárodními standardy IFRS a pokusit se zanalyzovat rozdíly mezi jednotlivými úpravami za pomoci Jaccardových asociačních koeficientů.