Measurement of Accounting Harmonization in the Czech Republic, Macedonia and Albania

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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. Although the national standards are based on IFRS, they are not identical. The purpose of the paper is to compare national accounting standards of the Czech Republic, Macedonia 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, International Harmonization, Transitional Economies, Measurement, Harmonization Measurement, CEE countries.

1 Introduction

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. 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 [2].

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 [11]. 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 [12].

Many stock exchanges around the world allow foreign registrants to prepare their financial statements according to IFRS or US GAAP. Prior studies show that the probability of using non-local GAAP [1, 3, 4, 7] is positively associated with the number of foreign stock exchange listings of a firm. The impact on financial reporting of cultural differences has been well documented [9]. There may be more disclosure by UK and US companies that have a culture of disclosure of information than by companies that have not traditionally aimed to produce especially transparent financial statements (e.g. companies from transitional economies such as the Czech Republic, Macedonia or Albania) [10].

2 Financial Reporting in Selected Countries

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 [10], which are required for measurement of long-term receivables, long-term payables and financial assets held to maturity (under IFRS).

According to Czech Accounting Act, the financial statements comprise: balance sheet, profit and loss statement, and notes. At the same time, 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 Macedonia (FYROM)

Macedonia gained its independence from Yugoslavia in 1991. Since the Stabilization and Association Agreement in April 2001, the economic orientation of Macedonia has moved increasingly toward Western Europe. Consequently of economic integration, accounting harmonization has become even more important after the European Union (EU) granted Macedonia candidate status on December 17, 2005.

According to Company Law (2004, Article 469), each commercial entity shall be obliged to keep accounting records and submit annual accounts in a manner determined by this law, and the accounting regulations. Each large and medium size commercial entity, commercial entities specified by a law, as well as commercial entities performing banking activities, insurance activities, commercial entities listed on the Stock Exchange and commercial entities, the financial statements of which are included in the consolidated financial statements of the above mentioned commercial entities, shall be obliged to prepare and submit financial statements in accordance with the adopted International Accounting Standards, published in the “Official Gazette of the Republic of Macedonia”.

2.3 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 International Accounting Standards (IAS) 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.

Financial statements must be submitted annually. National Accounting Standards (NAS) and International Financial Reporting Standards (IFRS) apply for certain companies, effective January 1st, 2008. According to Albanian National Accounting Standard 2 (NAS 2: Financial Statements Presentation, p.5), financial statements are consisted of the: Balance Sheet, Statement of Profit and Loss, Statement of Cash Flow , Statement of Changes in Equity, and Notes.

3 Methodology

Having the belief that once regulatory bodies adopt a financial reporting paradigm, it becomes the guiding principle for accounting regulation [6], 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 three national accounting systems (the Czech, Macedonian and Albanian ones). 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 our 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 Formal Harmonization Measurement

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 the four 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. 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 association degree between two or more than two considered variables. Jaccards' association coefficients have been used since the trade literature [5, 8] frequently uses this measurement instruments when an analysis at the level of national accounting regulations is aimed.

The Jaccard coefficient is defined as the size of the intersection divided by the size of the union of the sample sets:

$$J(A,B) = \frac{|A \cap B|}{|A \cup B|} \quad (1)$$

The Jaccard distance is complementary to the Jaccard coefficient and measures the dissimilarities. It is obtained by dividing the difference of the sizes of the union and the intersection of two sets by the size of the union:

$$J_\delta(A,B) = \frac{|A \cup B| - |A \cap B|}{|A \cup B|} \quad (2)$$

As a result of the effective measurement of the comparability degree between the Czech, Macedonian, Albanian and International (IFRS) accounting referential based on Jaccards' Coefficients we have reached the conclusion that there is a high degree of similarity between the three national GAAPs and IFRS on the approached area. Results show quite high level of similarities between analysed systems of financial reporting (see Tables 1 – 6). The major differences are given by the level of required disclosed information.

Table 1. Measurement of Similarities and Dissimilarities (Czech Republic versus FYROM)

	CZE/FYROM	
	S_{ij}	D_{ij}
1 Intangibles	1.000	0.000
2 PPE	1.000	0.000
3 Investment Property	1.000	0.000
4 Financial Lease	0.500	0.500
5 Inventories	0.750	0.250
6 Financial Assets and Liabilities	0.333	0.667
7 Financial Derivatives	0.250	0.750
8 Financial Statements	1.000	0.000
TOTAL	**0.692**	**0.308**

Source: our analysis

Table 2. Measurement of Similarities and Dissimilarities (Czech Republic versus Albania)

	CZE/ALB	
	S_{ij}	D_{ij}
1 Intangibles	0.333	0.667
2 PPE	1.000	0.000
3 Investment Property	1.000	0.000
4 Financial Lease	0.167	0.833
5 Inventories	1.000	0.000
6 Financial Assets and Liabilities	0.000	1.000
7 Financial Derivatives	0.250	0.750
8 Financial Statements	1.000	0.000
TOTAL	**0.517**	**0.483**

Source: our analysis

Table 3. Measurement of Similarities and Dissimilarities (Czech Republic versus IFRS)

	CZE/IFRS	
	S_{ij}	D_{ij}
1 Intangibles	0.667	0.333
2 PPE	0.667	0.333
3 Investment Property	0.667	0.333
4 Financial Lease	0.000	1.000
5 Inventories	1.000	0.000
6 Financial Assets and Liabilities	0.750	0.250
7 Financial Derivatives	1.000	0.000
8 Financial Statements	0.833	0.167
TOTAL	**0.645**	**0.355**

Source: our analysis

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Table 4. Measurement of Similarities and Dissimilarities (FYROM versus Albania)

	FYROM/ALB	
	S_{ij}	D_{ij}
1 Intangibles	0.333	0.667
2 PPE	1.000	0.000
3 Investment Property	1.000	0.000
4 Financial Lease	0.167	0.833
5 Inventories	0.750	0.250
6 Financial Assets and Liabilities	0.000	1.000
7 Financial Derivatives	0.000	1.000
8 Financial Statements	1.000	0.000
TOTAL	**0.467**	**0.533**

Source: our analysis

Table 5. Measurement of Similarities and Dissimilarities (FYROM versus IFRS)

	FYROM/IFRS	
	S_{ij}	D_{ij}
1 Intangibles	0.667	0.333
2 PPE	0.667	0.333
3 Investment Property	0.667	0.333
4 Financial Lease	0.000	1.000
5 Inventories	0.750	0.250
6 Financial Assets and Liabilities	0.200	0.800
7 Financial Derivatives	0.250	0.750
8 Financial Statements	0.833	0.167
TOTAL	**0.471**	**0.529**

Source: our analysis

Table 6. Measurement of Similarities and Dissimilarities (Albania versus IFRS)

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

Source: our analysis

As a most problematic areas can be considered reporting of financial leases and reporting of financial instruments. Reporting of financial leases in the Czech Republic does not follow the substance over form principle and legal form is the only binding concept (i.e. leasing company is the legal owner of the object of financial lease). Therefore lessees are not allowed to report object of financial lease within their balance sheets (nor depreciate them).

The reporting of financial instruments is one of the most discussed areas of accounting round the world, not only by researchers, but also in common practice. Several measurement approaches are used within this area, e.g. Macedonia and Albania prefers historical costs approach; Czech Republic follows the IFRS guidelines and uses fair value approach. Year 2010 is very important for this area because of the proposed changes in international reporting according to brand-new international standard IFRS 9 Financial instruments which will replace current IAS 39. New standard will bring the simplification in reporting of financial assets and liabilities and it will be in full force from 1st January 2013.

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 (64.5 %), candidate countries (especially Albania) progressed its accounting towards international referential too (Macedonia – 47.1 %; Albania – 56.3 %). On the other hand shall be stated, that these coefficients are measures of formal harmonisation. Presented information from certain SMEs in practice, however, show lower compatibility.

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