Chapter 6

Economic and Political Implications of IFRS Adoption in the Czech Republic

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ABSTRACT

This chapter analyses the political and economic impact of IFRS adoption in the Czech Republic. It contributes to the current understanding of IFRS adoption from the perspective of a small European transitional market, where local accounting standards were previously well developed and still play a major role in financial reporting mainly, however for local taxation purposes. Although there has been an observable increase in the country’s exports, FDI and international trade since the beginning of the 1990s, the direct impact of IFRS is difficult to discern, because of many political and institutional changes that have taken place concurrently. However, it is clear that adoption of IFRS has contributed to greater cultivation of the economic environment and facilitated international operations. IFRS adoption is not highly prevalent but is gradually increasing. This is apparent mainly in Czech companies with foreign parents that are in any event required to report in IFRS.

INTRODUCTION

The main goal of this chapter is to characterize the political and economic impact of IFRS adoption in the Czech Republic - a small European country in transition. The Czech Republic is considered to be a transitional country as a member of the group of CEE countries (countries of Central and Eastern Europe). The CR is a member of the OECD since December 21, 1995. The socio-economic and political background is characterized by changing from a centrally-planned to a market based economy where market mechanisms, principles and institutions do not work properly as yet. It should be highlighted at the outset that the impact of these new regulations (international accounting standards) will have
disparate impacts depending on the environment where the changes are implemented (Nobes, 2012). As we are dealing with the Czech Republic where the economy was transformed from a state-regulated centralized regime to a market-based economy, one can expect influences of previous arrangements to survive for a substantial period of time. Further, institutional settings do not change instantly, but also take time to modify - due to inertia and resistance of existing institutions and habits - in order to adapt to new conditions. Furthermore, the economics of the “outside world” is becoming more complicated with globalization and the impact of new technologies, and even traditional laws of economics are changing even in developed countries, e.g. Stiglitz 2003 and 2010; Gatti et al., 2012; Komlos, 2015 and others.

IFRS adoption has been influenced to a great extent by change of ownership structure, with 58 per cent of companies in foreign hands (Ernest, 2014). This has been generated by previous mass privatization and the influence of FDIs. This has influenced the scope of implementation or adoption of IFRS in the Czech Republic.

The expected macroeconomic impact of IFRS can be seen in terms of increased foreign direct investment, greater volumes of international trade and higher levels of international mobility of people see e.g. Hail et al., 2010; Beneish, et al., 2010; Liu, et al., 2011; Brüggemann et al., 2013. In the Czech Republic there were recent conceptual publications by, Ištványová et al., 2010; and more analytical publications by Prochazka & Prochazkova Ilînitches, 2012; Prochazka, 2014, Jindřichovska et al., 2014, and Prochazka & Pelak, 2015.

The methodology of this conceptual paper is based on critical analysis of historical development of the local economy, reviewing macro-economic development inside the country, and making a connection with development of accounting practices. The chapter concentrates on the impact of IFRS introduction into the Czech Republic during the transitional period in terms of changing rules and regulations. It also investigates practical interpretation and application of these items. Analysis of real data and particular regulations and contemporary materials is based on holistic methods. It also includes a backward analysis of development process involving accounting harmonization at European and global levels from the perspective of the current level of knowledge and experience. The chapter is complemented by a summary of the present stage of IFRS adoption in Czech companies. The perceived pros and cons from the perspective of Czech companies were analysed by using a questionnaire survey.

The Czech Republic is characterized as an open economy, dependent to a large extent on international trade. The majority of exports are in the machinery and automotive industries. An important feature of the Czech economy is also the ownership structure of Czech companies that were privatized at the beginning of 1990s. The majority of Czech companies are now in foreign hands, which makes the country’s economic planning and strategic development difficult. Foreign interests also dominate the banking sector, where 97 per cent of Czech banking assets is in foreign hands. The overall structure of the economy is now becoming more traditional, with greater emphasis on industrial sectors providing greater value-addition.

An important step in the process of transition toward a market economy was the reconstitution of the Czech capital market. The Prague Stock Exchange was re-established in 1993 after a fifty-year break. After the first couple of years of rather successful trading, the value of trades decreased mainly due to the concentration of ownership and delisting of companies listed during the mass coupon privatisation. An important negative aspect was non-transparent trading and lack of regulations. Introduction of IFRS did not stimulate an increase in trading volumes on the Prague Stock Exchange. Now, there are very few companies listed at the Prague stock exchange, and these companies are not there for financial reasons – to