

Public sector accounting in the Czech Republic and Slovakia

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Abstract: *This paper briefly outlines the actual situation of accounting reform of public finance. Nowadays, most countries use the accrual principle in various stages of development to ensure the reliability and accuracy of output data and improve the performance of public sector. The paper should identify some main problems in the implementation of accrual basis in accounting at the municipal level in the Czech Republic and compare with Slovak municipalities. Aim of the research is to present outcomes of analysis focused on currently discussed topics which are related to introducing the accrual principle into accounting of local government, especially small municipalities. First part of the paper summarize current situation, the second part discuss the benefits of accounting reform process and quality accounting information for public finance and performance measurements in this area. Finally the paper includes main findings from the questionnaire survey.*

Keywords: *accrual principle, accrual basis, cash basis, municipalities, public sector accounting, performance.*

JEL: *F53, H75, L32, M41.*

Introduction

The topic of the paper is to describe the public sector accounting and the transformation process to accrual principle accounting in the Czech Republic and in Slovakia. In the first part of this paper the author discuss the main purpose of the reform in an international context. Based on the critical literature review, the research questions were specified. Then the chapter summarizes main findings from the questionnaire survey. Findings presented at the paper derive mainly from a research carried out within the selected accounting entities, especially municipalities and focuses on the differences between opinions Czech and Slovak selected municipalities (some selected accounting entities) on the financial reform. The role of this article as well as further research at Tomas Bata University in Zlin is to provide an empirical study which will discuss the benefits of accounting reform process and quality accounting information for public finance and performance measurements in this area.

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At the turn of the century, the accounting system of public finance in the Czech Republic was connected with several drawbacks. According to the statements of politicians, academics and also practitioners, the essential problem was the absence of a real view of economic activities. It means that relevant accounting entities accounted consistently with law but an accurate and complex picture was missing. This fact forces all entities managing public resources to seek ways to streamline the entire management system. This long-lasting and painful problem was expected to be solved through the accounting reform of public finance. Also, the EU expects member States to provide comparable economic information in order to analyse and evaluate the whole economy.

1. Research aim and specific objectives of the paper

The aim of the questionnaire survey carried out by the Faculty of Management and Economics of TBU in Zlín is to highlight the views of respondents on the issue of the area of accounting reform as one of the effective tools to support performance of public sector institutions. The paper identifies some main issues that occur during the implementation of accrual basis in accounting at the municipal level in the Czech Republic and summarizes key findings from the questionnaire survey. A sample of municipalities from Czech and Slovak regions was selected for the research. The paper should identify some main problems in the implementation of accrual basis in accounting at the municipal level in Czech Republic and compare with Slovak municipalities. Another objective is to find common features of the reform process of adopting the accrual basis and the trend in harmonization of accounting and improving performance and cost effectiveness in the public sector economy. Based on the critical review, the following research question was specified: *Can the accounting reform be viewed as beneficial for the performance of municipalities?*

2. Literature review

The process of harmonization with international public sector accounting standards (IPSAS) takes place as well as attempts to unify financial reporting, including the possibility of statistical evaluation. International public sector accounting standards are based both on the accrual basis and the cash basis. These basic terms are defined by International Public Sector Accounting Standard IPSAS 1. Application of international principles is determined in each country by a number of political, historical, and cultural barriers. The topics are addressed in publications by many authors such as Barton (2009), Bellanca (2013), Jorge de Jesus (2011), Ross (2014) and Walker (2009). IPSAS apply to all public sector entities including national and regional governments and government agencies. They also apply to multinational public organisations, e.g. the United Kingdom has adopted IPSAS for its own financial reporting. It is of course a decision of

individual governments whether to adopt IPSAS for the public sector reporting within each country. Unfortunately, many of the governments of countries actively involved in developing the IPSAS have adopted different standards (often commercial financial reporting standards), e.g. the UK, USA, France, Australia and New Zealand (Parry, 2011, Bellanca, 2015).

Overview and comparison of public accounting and auditing practices in the 27 EU Member States show percentage compliance of the national accounts of the EU at the municipal level with IPSAS (see Fig.1). By this chart the Czech Republic and Slovakia have similar accounting treatment compliance of national public finances with IPSAS, the Czech Republic 65 % and Slovakia 69% both are slightly above the average for all members EU.

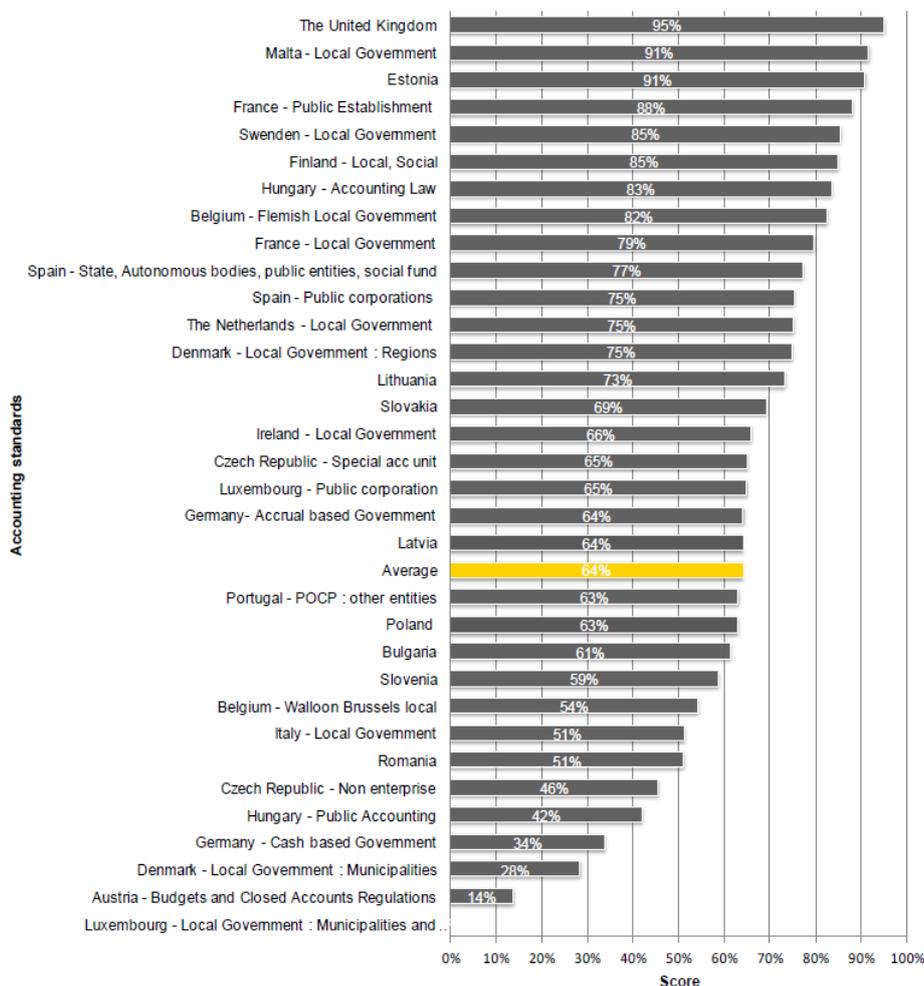


Figure 1. Percentage compliance of the national accounts of the EU at the municipal level with IPSAS (Eurostat, 2012)

Since the late 1980s the New Public Management represents a strategy oriented on increasing efficiency and satisfaction of citizens who are understood as customers (see e.g. Model, 2009; Wynne, 2012). One part of the new Public Management concept should be the bigger role of accounting (Hyndman and Connolly, 2010). Typical features of New Public Management (NPM) are as follows (Jarrar 2007, Wynne 2012, Belas 2014, Benito 2007 and Bolívar 2012) displacement of the old-style public administration with the new management structures, emphasis on key competences and elimination of non-key, inefficient competences, implementation of new methods how to measure quality of public sector activities, increasing role of cooperation between actors, human resource development, wide application of ICT technologies. Berland and Dreveton (2006) states that the NPM should be a way to modernize the public management. The European Federation of Accountants fully recommends that governments and public sector entities use accrual basis accounting, as it increases the accountability and transparency of their financial statements and provides better information for planning and management. OECD (2002) defined improving performance and cost effectiveness in the economy as the primary thrusts of reform initiatives. They believes that the example of the EU and those public organizations and governments that have already implemented similar standards, will be an incentive to others, leading to more transparent, clearer and comparable financial information in the public sector across Europe and beyond.

The Figure 2 introduced four accounting systems currently used by local and central government (Bellanca, 2015).

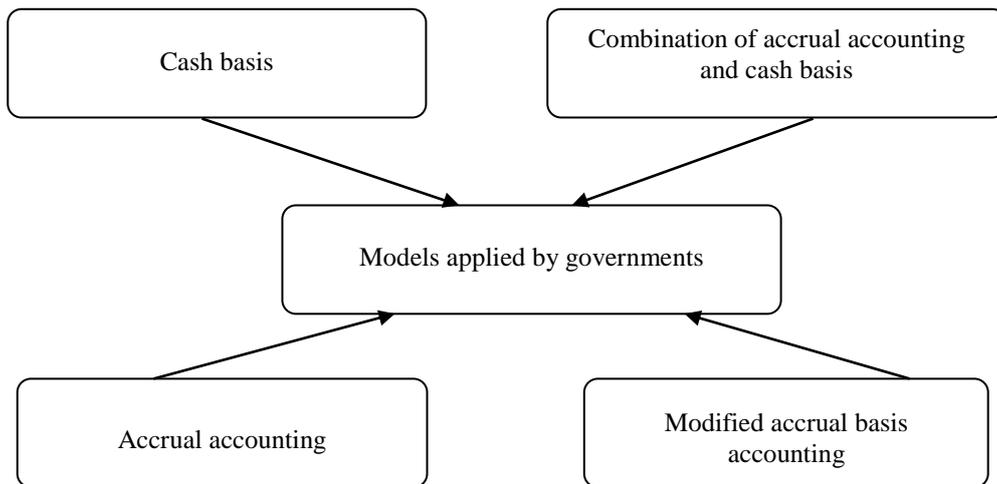


Figure 2. Models applied by governments
(Source: own by Bellanca, 2015)

By the literature review (for ex. Vodakova, 2012, Bellanca, 2015) currently, most countries use accrual accounting in various stages of development. Vodakova (2012) identifies in their research those developed countries which have adopted accrual basis of accounting in the public sector. Some countries have implemented accrual-based accounting with certain elements of the cash basis (Bellanca, 2015). By the Jovanovic (2015) acceptance of accruals has been much wider in financial reporting than in budgeting and the trend in public accounting is a way from cash flow towards the accrual principle.

The Figure 3 introduced the accounting models applied by local and central government in Europe.

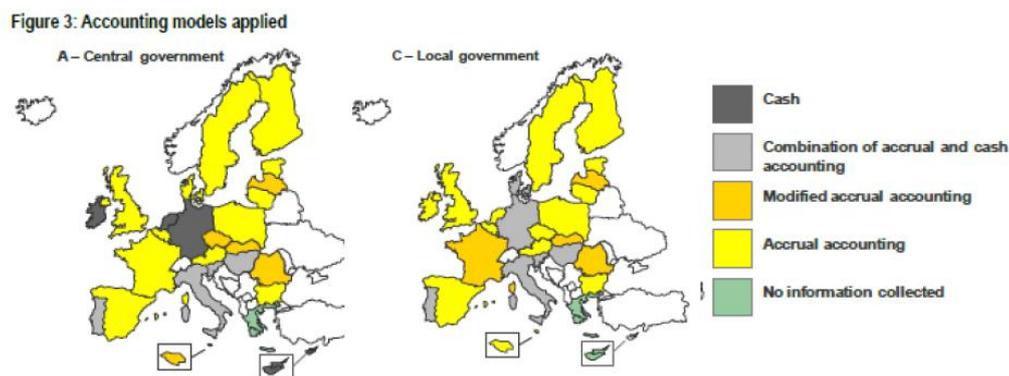


Figure 3. Accounting models applied in EU states

(Source: Eurostat, 2012)

Public finance accounting in most countries as well as the budget is traditionally based on the principle of cash flows - cash basis. Like other developed countries, the Czech Republic and Slovakia used predominantly cash basis in the public sector accounting in past. During the current legislative process, the Czech Republic and Slovakia pursues maximum compliance with the Fourth and Seventh EU directive, so that the new national standards would accept the international rules of IFRS, IPSAS and the European System of Accounts (ESA 95) - European statistical system. Vodakova (2012) give, among others (for.ex. Bellanca, 2015), that Czech Republic used modified accrual basis accounting, they are classified at present as a country with prevailing accrual basis in the public sector accounting including both the local and central government, nevertheless some separated accrual elements that should be implemented in future still exist. Bellanca (2015) has published a list of accounting system used at a local level by Member States of the European Union. By Bellanca (2015) Slovakia and Germany, Belgium, Estonia, France, Greece, Lithuania, Malta, Netherlands, Portugal, United Kingdom, Sweden used accrual accounting in public finance.

3. Accounting reform in the Czech Republic and Slovakia

After 1993 Czech Republic and Slovakia followed its own path in developing its political, legal, economic and social systems. Both countries became EU member states. The Accounting Act No. 563/1991 was the same for both states in Czechoslovakia (Czechoslovakia till 1993). Czech Republic used this Act of Accounting up to now. Slovakia adopted new Accounting Act No. 431/2002 in the year 2002. The basic foundation for the initiation of state accounting reform in the Czech Republic was the amendment to the Accounting Act and other significant legislative changes after 1st January 2010, there are new decrees and changes in Czech Accounting Standards for public sector. In Slovakia there are published new principles in Measures of Ministry of Finance, publishing of important regulations, to which the amended measures referred, was a necessary precondition for the proper functioning of the state accounting system from 1st January 2008.

There could be several barriers for a smooth implementation of accounting reforms. In the case of the Czech Republic, there is an additional specific problem related to its administrative division. The number of municipalities is relatively high in the Czech Republic (about 6230 municipalities). The reform mostly regards government organizational departments (which are, in particular the ministries), self-governing territorial units (i.e. municipalities and regions) and their allowance organizations.

Table 1. The advantages and disadvantages of reform process in the Czech Republic

| Advantages | Disadvantages |
|--|---|
| Better accounting evidence and the efficiency of usage of finance. | More accounting operations to be accounted for, bigger agenda, more time required |
| Harmonisation with accounting for private entities | Not clear, ongoing changes, complicated, different understanding of methodology |
| Better understanding of accounting of the entities | Sophisticated accounting software required |
| Accrual principle | Administrative ambitiousness |
| Substance over from principle | Not linked to other legislation, frequent novelisation |
| Regular information about profit and loss | Difficulties in preparation of financial statements |

(Source: Author's research (Otrusínová, Pastuszková, 2013))

Substantial change which this reform has brought is the usage accrual principle in the accounting in public sector, which needs the application of accounting methods not previously used. These methods are represented by usage of fair value of assets held for sale, proper valuation of cultural objects, collections in museum, items with cultural values, usage of accruals, allowances and provisions. Significant change is also the need to depreciate assets (e.g. state assets

and assets of municipalities previously held in acquisition prices for whole useful life and had not depreciated). Table 1 (see Tab. 1) presents the positive and negative views on the ongoing reform of accounting by the responsible employees of municipalities, which can be summarized in the following points (Otrusínová, Pastuszková, 2013):

4. Research methodology

This section describes research methodology - data collection, the process of designing and implementing and questionnaire survey. Furthermore, it specifies the scientific methods used to answer the research questions. Methods of qualitative and quantitative research were used. The article shows partial results of the research by questionnaire survey conducted at Tomas Bata University in Zlín in the year 2015. The methodology applied in the paper is based on an in-depth review of the secondary sources and structured questionnaire with respondents from Czech Republic and Slovakia. There were used secondary sources which are listed in the references. The research is supposed to contribute to the discussion about the views of municipalities on the issue of the ongoing accounting reform. Due to the broad discussion on accounting issues of public finance and performance of public sector in academic, professional and political circles, there were expected more or less negative assessment of the accounting reform on the part of municipalities. This assumption was tested based on the questionnaire survey results, as the main research instrument used.

The aim of the questionnaire survey was to highlight the views of respondents on the issue of the area of accounting reform. There were collected sources of 200 questionnaires and interviews from Czech respondents and 198 questionnaires and interviews from Slovakia. Every valid questionnaire was statistically analysed and followed by synthesis of obtained information.

In the Czech Republic and Slovakia about 75% municipalities have a population of less than 1000 inhabitants (in the Czech Republic is about 6230 municipalities and in Slovakia is about 2900 municipalities). The accounting employees or mayors of the municipalities with populations of less than 1000 inhabitants were the target group of the survey because just these employees deal with new accounting principles in their everyday life. These municipalities were contacted via email, telephone and personal interview and asked to participate in the survey, using the cooperation of students. The questionnaire survey served as a source for the following three areas selected for the purpose of presenting the results in this paper:

- The problems with the transformation process from the cash basis to the accrual principle
- Benefits of the reform for the financial management
- Advantages and disadvantages of the reform process

Based on the research questions and critical review the following a null hypothesis was determined:

H0: The majority of questioned respondents cannot agree that the introduction of accrual accounting in the public finance will increase the performance of municipalities.

In contrast, an alternative hypothesis that rejects the null hypothesis was determined as follows:

H1: The majority of questioned respondents agree that the introduction of accrual accounting in the public finance will increase the performance of municipalities.

In order to verify the hypothesis were calculated statistical test of appointed the null hypothesis - Chi-squared test with p-value, this test was conducted on the importance level of 5%. The basic methods of scientific research usually complement each other and, in consequence overlap. The methods of induction and deduction, comparison, description, analysis and subsequent synthesis were used in order to fulfil the aim of this paper. Procedures of analysis were used: identification of the processes, analysis of running of processes and analysis of value-added of identified processes. According to the survey results and information gathered, a resulting analysis of the major problems encountered during the reform implementation was performed. Method of synthesis was used in order to draw conclusions.

4.1 Results of the research and discussion

In this part there will be introduced some of the main results of research carried out and analysis followed by the main conclusions.

4.1.1 The problems with the transformation process from the cash basis to the accrual principle

Accounting reforms are logically connected with new requirements posed on human resources. Then, question arises whether Czech and Slovak municipalities have been able to cope with new procedures defined by the accounting reform of public finance. Because the reform, according to legislative framework, is now fully integrated and municipalities should use new accounting principles, the efforts to gain feedback on the issues are substantiated. Therefore, a questionnaire survey on a sample of Czech and Slovak municipalities was realized. Respondents answered a number of questions related to the reform. The research focuses on the differences between opinions Czech and Slovak municipalities on the financial reform.

This part of the research focuses on the differences between opinions Czech and Slovak small municipalities on the transformation process from the cash basis to the accrual principle. Respondents were asked based on their opinion to the problems with the adaptation to the accrual accounting.

- The transformation process from the cash basis principle accounting (incomes and expenses), which was used by municipalities earlier, to the accrual principle (costs and revenues) is for Slovak municipalities without any problems; it was replied positively by 100% of the respondents.
- While evaluating the benefits of this principle in respondents from the Czech Republic, 27 % of respondents evaluated this change in a rather negative way. As a fundamental problem they mentioned some collision between new accrual-based accounting on one hand and cash-based budget management on the other.
- The very important change in municipal accounting is indisputably the depreciation of assets. The depreciation of assets itself is for respondents from Czech municipalities very questionable. It is noteworthy that compared to the frequently discussed questions of accrual principle and depreciation, the new usage of off-balance sheet items did not mean a serious problem for this municipalities.
- In conclusion, the Slovak municipalities are already on the accrual accounting principle adopted better. One of the reasons is that Slovakia adopted the accounting reform of public finances two years earlier.

4.1.2 Benefits of the reform for the financial management

- To summarize the findings of the questionnaire survey and interviews regarding the benefits of the reform for the financial management, 87 % of the respondents from Slovakia evaluated the reform in a positive way and finally, 13 % of respondents did not have a clear opinion about the reform. They mentioned that only future would reveal the real benefits of the reform. The introduction of the reform to accounting practice is viewed by the respondents from Slovakia as beneficial and can bring major benefits to use in practice of financial management.
- Another opinion is in the Czech Republic, where only 33% respondents from respondents evaluated the reform positive and 40% of the surveyed small municipalities perceive the transformation as not beneficial and have a negative opinion. 27 % of the respondents have not carried out an assessment yet. From the research presented by Otrusinova and Pastuszkova (2013) 78 % of the respondents rate the reform as unbeneficial, negative and confusing. Hakalova (2015) state that the introduction of accrual principle is evaluated positively by 48 % respondents and 13 % respondents means that they do not consider

available options as beneficial for the accounting of their municipality. In conclusion, some municipalities perceive the reform as unnecessary, they still prefer cash base in the financial management.

- Another issue, which can be identified based on the conducted survey, is very often lack of financial expertise of accounting employees in the non-profit sector in general, especially in small municipalities. The introduction of a completely new system of accrual principle accounting causes a number of problems to these employees. This problem is bigger because the globalization of economy and the interconnection of international markets demand that accounting qualifications are transferrable across the national borders. This problem is the same in the Czech Republic as in Slovakia.

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4.1.3 Accrual accounting in the public finance and the performance of public sector

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Hypothesis H0 and H1 were established:

H0: The majority of questioned respondents cannot agree that the introduction of accrual accounting in the public finance will increase the performance of municipalities.

In contrast, an alternative hypothesis that rejects the null hypothesis was determined as follows:

H1: The majority of questioned respondents agree that the introduction of accrual accounting in the public finance will increase the performance of municipalities.

The hypothesis was tested based on the questionnaire survey results and interviews. Every valid questionnaire were statistically analyzed and followed by synthesis of obtained information.

The question of "*Can the accounting reform increase the performance of municipalities?*" was answered by the majority of respondents from Slovakia positively (from Czech Republic agree 40% respondents) and some of them still did not have a clear opinion. (see Fig. 4).

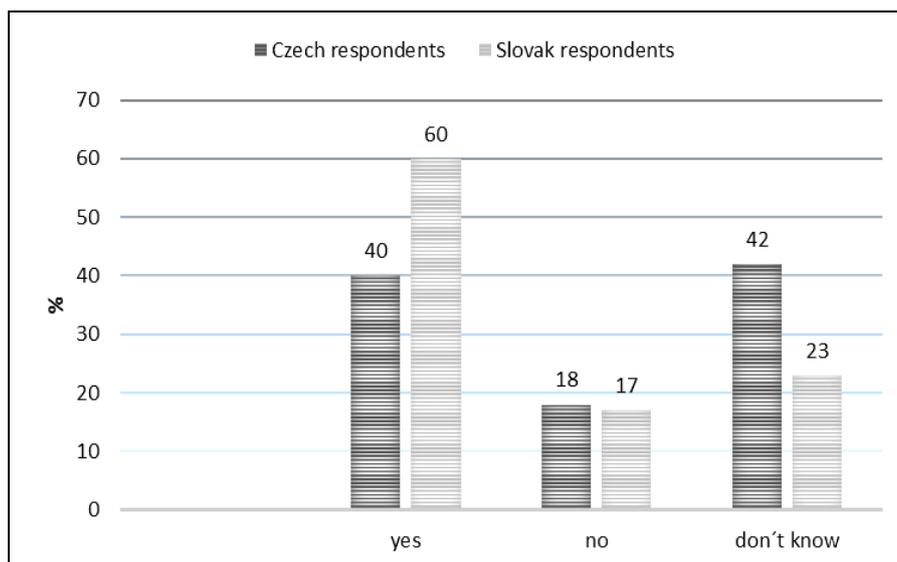


Figure 4 Chart illustrating the respondents answer for the question “Can the accounting reform increase the performance of municipalities?”
(Source: Author’s research)

Table 2. Statistical test of appointed the hypotheses

| | Czech respondents | Slovak respondents |
|--|---|--|
| H0: | $\pi_1 = 0.5$ | $\pi_1 = 0.5$ |
| H1: | $\pi_1 > 0.5$ | $\pi_1 > 0.5$ |
| 1-sample proportions test with continuity correction | ($x=79, n=200, \text{alternative} = "g"$) | ($x=120, n=198, \text{alternative} = "g"$) |
| X-squared | 7.605 | 7.605 |
| df | 1 | 1 |
| p-value | 0.9971 | 0.291 |
| alternative hypothesis: | true p is greater than 0.05 | true p is greater than 0.05 |
| 95 percent confidence interval: | 0.3423134 1.0000000 | 0.5395277 1.0000000 |
| sample estimates: p | 0.4 | 0.6 |

(Source: authors’ calculations)

On the importance level of 5%, we do not refute the null hypothesis, meaning that we cannot claim that the majority of respondents from the ranks of small municipalities in the Czech Republic and in Slovakia cannot agree that the introduction of accrual accounting in the public finance will increase the performance of municipalities. We do not have enough proof to overturn the null hypothesis. The above conclusion basically results in not confirming the hypothesis

H0 and the H1 hypothesis cannot be confirmed. The introduction of the reform to accounting practice is viewed by the respondents as beneficial and can bring major benefits to use in practice of financial management, but only by the respondents from Slovakia. We can say, that currently Slovak respondents from municipalities are better adapted to the application of the accrual principle in accounting.

The research has demonstrated that the situation in the area of the performance in public sector is still questionable. Before the initiation of the state accounting reform 22 Czech Accounting Standards were in force, but at the moment only 10 standards regulate the accounting of municipalities. By the Hakalova (2015) some municipalities do not see it as problem, but more than 50% of respondents of questionnaire survey see it quite not sufficient. By the interview with municipality representatives revealed that the most significant problem from their point of view is depreciation of assets, as states Pernica and Hanusova (2015).

There are many questions and problems in this area. One is “*are municipalities prepared for the consolidation of financial statements?*” The Government of the Czech Republic approved the implementation of the first preparation of consolidated financial statements for the Czech Republic and for sub-consolidated groups for the accounting period of 2015, i.e., in 2016. The consolidated data and their analysis will provide a true and fair view of the real economic situation of the state and will be subsequently used for more efficient, effective and economical management of state property and its control. It will therefore strengthen both financial and budgetary planning (rules and procedures) with an emphasis on ensuring healthy and sustainable financial management of the government and municipal sectors. Last but not least, the data will allow the users (professionals and the general public) of financial statements for the Czech Republic and sub-consolidated groups to gain a real insight into the state economy (Král, Šoljaková, 2016).

The very application of the reform should be supported by, for instance, high-quality educational programs, trainings and publicity, and above all, by the necessity to understand the significant changes not only from the accounting staff point of view but all participants involved. Provided that this does not happen, a situation may arise when the accounting staff will be forced to carry out accounting transactions for the new accounts according to the old rules. It is necessary to submit the existing processes and habits in each selected entity to a rigorous analysis or reorganization and it is not the task of accountants only. This also involves the setting of the entire management and control system, new processes carried out during information and data transmission across the organization so that requirements established by law, regulations and Czech accounting standards could be fulfilled.

The accounting reform in public finance in the Czech Republic was launched in 2010 and state accounting has been gradually formed ever since. In addition to the actual specification of the use of accrual principle and standard

accounting methods, emphasis is placed on the centralization of accounting information at the level of central government and self-governing territorial units.

The main purpose of the state accounting reform is to improve the management and financial control in the public administration and at the same time to enable preparation of consolidated financial statements of the Czech Republic. In conclusion it can be stated that the reform was needed, as it contains a rational core and a number of necessary ideas, procedures and methods. However, as stemming from the analysis presented in the article, it is essential to accept the idea that this reform is a long-term process and there are still many risks associated with the transition to the accrual basis and with the accounting consolidation of the state.

Future research should be concentrated on more detailed analysis of the similarities and differences between state treasury information systems, identification of the most important accounting adjustments and analysis of the resulting impacts on public finance.

Conclusions

The conducted research has demonstrated that in the Czech Republic, the situation in the area of the process of accounting reform is still questionable. The output of paper includes the comparison of the application of the accrual principle in the financial reporting of municipalities in the Czech Republic and in Slovakia.

In conclusion, the Slovak municipalities are already on the accrual accounting principle adopted better, based on a survey. The transformation process from the cash basis to the accrual principles is for Slovak respondents without any problems. The introduction of the reform to accounting practice is viewed by the respondents from Slovakia as beneficial and can bring major benefits to use in practice of financial management.

In conclusion, most small municipalities from Czech Republic still prefer cash base in the financial management. 27% of respondents still evaluated the transformation process in a negative way and only 33% respondents from Czech municipalities evaluated the reform to accounting practice positive.

The question of whether the reform can increase the performance of municipalities was replied positively by 60 % of the respondents from Slovakia and 40% of the respondents from Czech Republic. On the importance level of 5% we do not have enough proof to overturn the null hypothesis and the hypothesis "The majority of questioned respondents agree that the introduction of accrual accounting in the public finance will increase the performance of municipalities." cannot be confirmed. The research revealed that Czech municipalities, which participated in presented questionnaire survey, did not recognize the positive impacts of the reform and were doubtful about the new accounting principles.

The role of further research is to provide an empirical study which will discuss the quality accounting information for public finance and performance measurements in this area.

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