

# THE ACCOUNTING REFORM OF PUBLIC FINANCE IN THE CZECH REPUBLIC

[Účetní reforma veřejných financí v České republice]

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**Abstract:** The accounting reform of public finance in the Czech Republic was an issue intensively discussed in political and academic spheres at the turn of the century. As a consequence of this discussion the Ministry of Finance initiated works on the implementation process of new principles which the reform includes. The main purpose of the reform is the convergence of accounting principles of public and private sector and the creation of consolidated final accounts of the whole Czech Republic. The consolidation should contribute to the comparability of the accounts of Czech Republic and other countries within the European Union. The research is focusing on the evaluation of the reform by the selected accounting entities, municipalities to be specific. The findings of the research are discussed with the outlines of the solutions.

**Keywords:** accounting reform, Czech accounting standards, the Czech Republic, methods of accounting, municipality, New Public Management.

**JEL classification:** M41

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## Introduction

There are various theoretical concepts related to public sector research (see e.g. Bogason and Toonen, 1998 for their review). The essence of these concepts is based on different approaches to structures, procedures, norms, efficiency, and other aspects of public administration. Nowadays, the concept of New Public Management has become politically influential. What are the specifics of this concept?

New Public Management represents a strategy oriented to increasing efficiency and satisfaction of citizens who are understood as customers (see e.g. Svensson et al., 2008; Mörrh, 2009). In other words, New Public Management tries to move the situation in public administration from utilitarian posture of strictly economical models of people's behaviour and the rigidity of public power to the thought of free citizens, responsibility of the politicians, representatives and the officers and the thought of the public administration as the service to the public (Barberis, 1998). Typical features of New Public Management are as follows (Essig and Batran, 2005; Bogason and Toonen, 1998; Lapsley, 1999):

- 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.

It is noteworthy that the New Public Management concept is in accord with the principle of legality. The essential thought of this principle is the fact that state activities require legitimization from citizens (see e.g. Schedler and Felix, 2000).

Within the New Public Management concept we can discuss also the role of accounting. This assertion is related especially to the implementation of new methods how to monitor performance of public sector institutions. Thus, we face the situation when accounting is one of the key measurement tools for public sector rationalization and modernization (see e.g. Lapsley, 1999). Furthermore, Lee (2012) or Lapsley (2008) point at the need to reconcile measurement practices between private and public sectors. Only then, the efficiency and effectiveness principles may be monitored. Finally, Lapsley and Wright (2004) speak about the importance of accounting reforms. They propose reviewing of diffusion processes among accountants in both, public and private institutions, as a relevant research topic. Altogether, demand on a high-quality accounting system arises. If such a system is not developed accounting reforms are desirable. It is noteworthy that there are several prerequisites for a successful implementation of accounting reforms. These include especially political support on one hand and sufficient financial, human and technological resources on the other. If these are missing, the goals of accounting reforms do not have to be fulfilled (see e.g. Chan, 2005).

And just the abovementioned aspects of accounting reforms are our subject of interest. We chose the Accounting Reform of Public Finance in the Czech Republic, set up by the Resolution of the Government of the Czech Republic no. 561 in the year 2007, as our case study. Our main goal is to identify attitudes of accounting entities related to this accounting reform on the basis of a questionnaire survey. A sample of municipalities in three Czech regions was selected for further research. The article is structured as follows. The second chapter introduces the rationale of the Accounting Reform of Public Finance in the Czech Republic in 2007. The third chapter summarizes main findings from the questionnaire survey. The fourth chapter discusses the findings. The last chapter concludes.

## **1 Accounting reform of public finance in the Czech Republic - 2007**

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. Then, the possible advantages of accounting as a monitoring tool of performance are not fully drawn. This long-lasting and painful problem was expected to be solved through the accounting reform of public finance.

The very first document which started to deal with an accounting reform of public finance was *The Action Plan of the Government of the Czech Republic for increasing credibility of accounting and audit* (the Action Plan hereafter) from 2004. The Action Plan was followed by *The Conceptual Framework 2006-2007* and finally by *The Resolution of the Government of the Czech Republic no. 561/2007 from 23<sup>rd</sup> of May 2007* which contained the basic principles of establishment of the state accounting in 2010. Otrusínová and Kubíčková (2011) give, among others, the following goals of the reform:

- to unify a wide variety of accounting systems used in public sector,
- to enable comparison of public and private sector accounting, based on the accrual principle,
- to provide information on the whole state economy in a real time and in the EU context (relevance for operative management),
- to implement e-tools into accounting systems in public sector.

The accord between the abovementioned goals and the New Public Management principles – such as implementation of new methods how to measure quality of public sector activities and wide application of ICT technologies - is noteworthy. It was already mentioned that there could be several barriers to 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 (see e.g. Hampl, 2005). This situation brings certain positives but on the other hand also significant negatives. As for the positives, there is undoubted proximity of the citizens and public administration (Průcha, 2004). It means that the citizens have an immediate opportunity to influence the municipal policy and the public life at all. As for the negatives, the high number of small municipalities is connected with economic inefficiency. Especially small municipalities may have severe problems related to the lack of money and professionalism of their employees and representatives (Perlin, 2006).

Accounting reforms are logically connected with new requirements posed on human resources. Then, the question arises whether Czech municipalities have been able to cope with new procedures defined by the accounting reform of public finance in 2007, if considering the specifics of Czech administrative division. The ability of the Czech Ministry of Finance (the Ministry hereafter) to inform about the implementation phase of the reform is also important. And just the two issues are the main themes of our research. Because the reform, according to its schedule and 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 using a sample of Czech municipalities was realized. The next chapter summarizes the main findings.

## **2 Methodology**

The questionnaire survey was used as the main methodological tool to meet the goal of this article. In this regard, we decided to apply random sampling in choosing municipalities for contacting. To consider eventual interregional differences, municipalities from three regions - the Olomoucký, South-Moravia and Zlínský region - were selected as a target population.

In choosing our final sample of municipalities, explicit stratification of the target population was applied. Location in regions and municipality size were used as the variables for strata creation. Two size categories of municipalities were defined according to their number of inhabitants – less than 1,000 inhabitants, and 1,000 and more inhabitants. Just this cut-off was motivated by our interest in small municipalities. Overall, six explicit strata were distinguished.

The target population of municipalities was categorized in particular strata. Subsequently, a sample of 250 municipalities was randomly selected. Two rules were applied for setting the numbers of municipalities in particular strata:

- First, the number of municipalities in particular regions should be the same.
- Second, the number of municipalities with less than 1,000 inhabitants should be twice larger than the number of municipalities with 1,000 inhabitants and more.

Tab. 1 shows the final distribution of 250 municipalities in particular strata. Subsequently, the corresponding number of municipalities was randomly selected. These municipalities were contacted via email and telephone and asked to participate in the survey. The accounting employees were the target group of our survey because just these employees deal with new

accounting principles in their everyday life. Finally, 102 questionnaires were completely filled in (see Tab. 1 for the response rates in particular strata) and subsequently evaluated using fundamental statistical methods. Note that the questionnaire was structured into three main areas focused on methodical support, workload and changes in accounting. For each of the areas several yes-no questions were formulated.

**Table 1:** Number of municipalities in the sample – distribution in strata; the response rate in the parentheses

Number of inhabitants	Region		
	Olomoucký	South-Moravia	Zlínský
Less than 1,000	56 (34 %)	56 (45 %)	56 (45 %)
1,000 and more	28 (43 %)	28 (46 %)	28 (36 % )

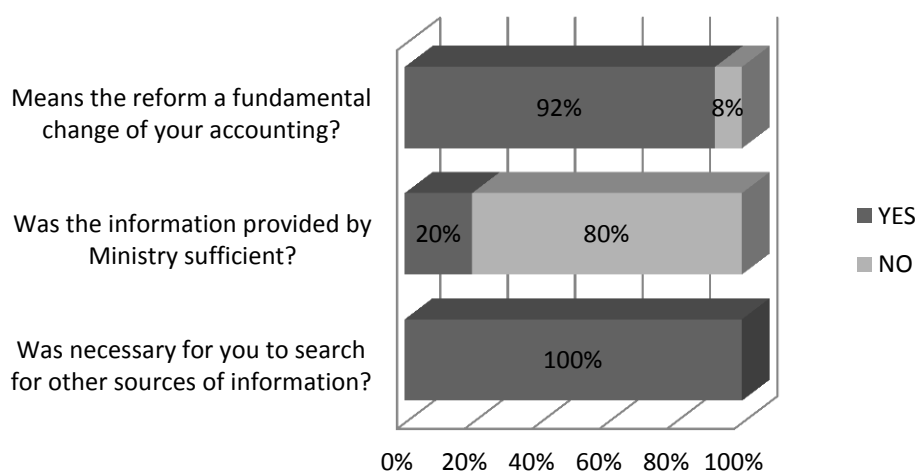
Source: Author's research

Note that the sample design does not fully respect the assumptions of representativeness. These include among others the assumption on sample size and coverage. Thus, it is necessary to interpret the results with cautious.

### 3 Results of the research and their discussion

The first area of our interest is focused on the methodical support which was provided by the Ministry. This area of interest seems to be relevant because more than 90 % of respondents declared a fundamental change of their accounting procedures (see Fig. 1). The methodological support was, according to 80 % of respondents, insufficient, on the low level and, what is most serious, belated (see Fig. 1). All of the respondents mentioned that it was necessary to search for the information from many other sources and it was no exception that the information was not available at all (see Fig. 1). The most frequently mentioned sources of information were methodologies of regions, especially of the South-Bohemia region, the help of auditors and suppliers of accounting software and also experience of other municipalities. The main problem of this approach is that the information from various sources is often diametrically different. It is obvious that the Ministry, as a coordinator of the reform, did not provide sufficient informational assistance to municipalities.

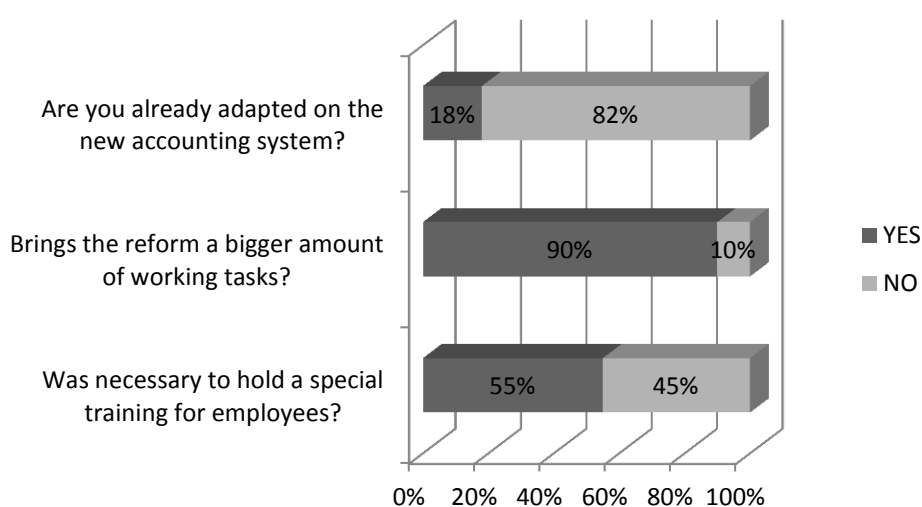
**Figure 1:** Attitudes on methodological support



Source: Author's research

The second area of our interest was dedicated to workload generated by the accounting reform. In this regard, nine respondents from ten answered that the reform meant more work tasks for them (see Fig. 2). It is noteworthy that the tasks related to the preparation work for the central system of accounting information of the state and to the accepting of the new accounting philosophy were more demanding than the accounting procedures. The problem of seizing the main idea of the reform was more obvious for accountants in small municipalities. In addition, more than a half of municipalities mentioned that a special training for their employees was necessary (see Fig. 2). A number of respondents also emphasized that due to increasing agenda it would have been desirable hiring new employees. Finally, more than 80 % of respondents answered the question on general understanding and acceptance of the new accounting system negatively (see Fig. 2). The main reason for this statement was the fact that the rules, announcements and recommendations were continuously changed.

**Figure 2:** Attitudes on working tasks and the reform



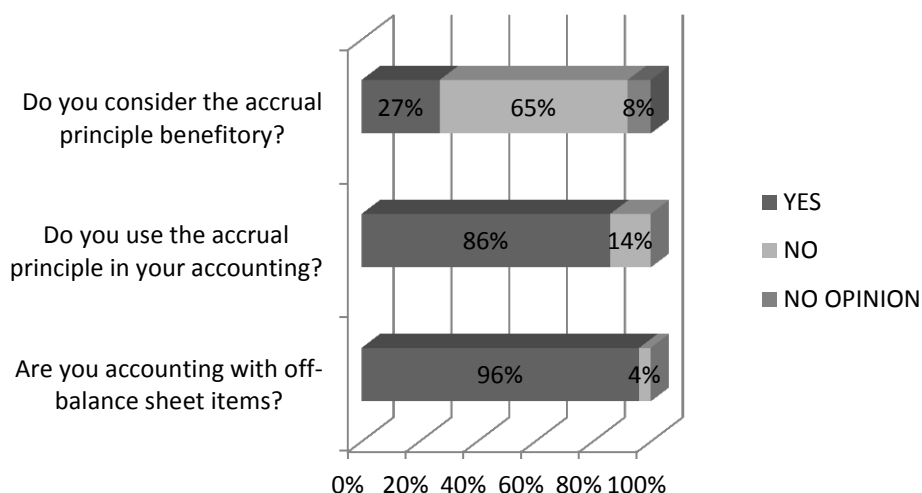
Source: Author's research

The third area of our interest dealt with particular accounting rules which the reform had changed. The first point was the switchover from the cash basis to the accrual principle. While evaluating the benefits of this principle, some municipalities were not able to express it yet. However, 70 % of respondents evaluated this change in a rather negative way (see Fig. 3). As a fundamental problem they mentioned some collision between new accrual-based accounting on one hand and cash-based budget management on the other. Although the accrual principle was compulsory for municipal accounting, there were still 14 % of respondents not using this principle (see Fig. 3). Their explanation was based on the idea that they would wait whether the rules would change again.

The very important change in municipal accounting is indisputably the depreciation of assets. Inseparably there is the condition of precise knowledge of the situation of municipal property and its inventorying. The majority of municipalities mentioned that the inventorying was carried out each year, or before starting depreciation alternatively. Just 14 % of respondents answered that there was no inventorying. Thus, no significant difference in real and accounting state of property was revealed. The depreciation of assets itself is for municipalities very questionable. Respondents do not see a proper sense in it at all. The depreciation is here closely connected with the problem of indebtedness of the municipalities. A high percentage of municipalities face the indebtedness and the depreciation, in other words

a decreasing value of their assets. Such a situation may lead to decreasing municipal liquidity, the ratio of liabilities on assets. 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 municipalities. Just 4 % of respondents answered that they were not accounting according to this principle (see Fig. 3).

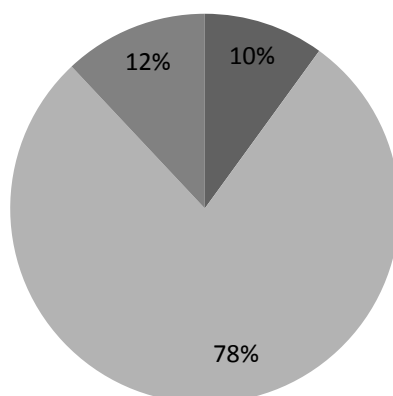
**Figure 3:** Attitudes on particular changes of accounting



Source: Author's research

**Figure 4:** Attitudes on contribution of the reform

■ Beneficial ■ Non-beneficial ■ No opinion



Source: Author's research

Finally, our last question asked on attitudes towards the accounting reform as a whole. In this regard, almost 80 % of respondents evaluated the reform in a negative way (see Fig. 4). These respondents did not agree on the efforts to integrate accounting of public and private sectors, pointing at their different rationale. A number of municipalities also did not understand the goals of the reform. A majority of respondents claimed that more specialists should have participated in the preparation process of the reform, including experts from practice. Finally,

12 % of respondents did not have a clear opinion about the reform. They mentioned that only the future would reveal the real benefits of the reform.

If we should evaluate the general results of the research, we can say that the reform itself was required for a long time and the increase in transparency and unification of the rules was highly desirable. On the other hand, the way of implementation was obviously inconvenient. The new legislative had often huge gaps and its interpretation was not clear. The informational sources were fragmented and disunited. It seems to be that no one had a clear and complete overview about what to do and how to do it. The realization of the reform was, according to our respondents, too quick what was in breach of the long preparations. The searching for the required information was usually more stressful and demanding than the accounting itself.

The municipalities faced not only the lack of information but also of the employees who were required for managing all the agenda. This is actually the problem of whole public administration, not only in the relationship with the accounting reform. State delegates on municipalities further and further tasks without necessary increase in financial and personal resources. This could lead to the future overloading of municipalities which will not be able to carry out their basic tasks. It would also be desirable to enhance the communication between governmental degree and self-governing bodies in general. The gap between these two degrees leads to the negative attitudes to implemented tools and misunderstanding of the purposes. Thus, our research identified two areas of problems related to legislation on one hand and professionalism on the other. Let us look a bit closer at some opportunities how to improve the current state.

## **Conclusion**

To sum up the findings of our research we can claim that the accounting reform of public finance in the Czech Republic was required for a long time because the arrangement of accounting was insufficient and public sector organizations accounted on different principles. However, the way how the reform definitely enacted in 2007 was implemented is questionable. Our research revealed that municipalities, which participated in our questionnaire survey, did not recognize the positive impacts of the reform and were doubtful about the new accounting principles. The lack of methodical support for the accounting entities provided by the central bodies, a porosity of legislation, and an insufficient level of professionalism belong to the main reasons why the accounting reform of public finance in the Czech Republic was evaluated negatively. Thus, it is desirable to search for tools which will reduce the negative influence of these reasons.

Several recommendations may be suggested how to contribute to a more fluent introduction of the accounting reform. The lack of legislation which can be seen as one of the most serious problems should be solved at the central level as soon as possible. The number of accounting standards was dramatically reduced from 28 to 10 and the municipalities deal with situation when there is no valid legislation for the particular accounting case. The solution of this situation could be grounded in the inspiration from abroad. A lot of countries in the European Union use the International Public Sector Accounting Standards - IPSAS (see Chan, 2005). In this regard, it is noteworthy that the new principles of Czech accounting established by the reform are very similar to the IPSAS standards.

The problem of professionalism identified during the questionnaire surveys may be based on the long-lasting change of education and further training (see e.g. Bezes et al., 2012).

Accounting starts to play more and more important role in the public sector management (Gruening, 1998). According to this fact there should be established a special structure of education and training. The successful example of such praxis can be observed in a number of countries, e.g. Germany or France.

The negative assessment of the reform by municipalities is partially caused by the poor level of communication between central bodies and the selected entities during the preparation and implementation of the new principles and rules. Nevertheless, the intensive communication would have contributed to more fluent implementation of the reform. The collective actions and communication between the central, regional and municipal entities is one of the most important and also challenging tasks for the next heading of whole public sector in the Czech Republic.

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