

Institutional Duality and Its Unintended Impact on IFRS Adoption by Czech Private Companies

David Procházka¹

¹ University of Economics, Prague
Faculty of Finance and Accounting, Department of Financial Accounting and Auditing
Nam. W. Churchilla 4, Praha 130 67, Czech Republic
E-mail: prochazd@vse.cz

Abstract: *The paper assesses the influence of IFRS adoption on management accounting of Czech private (unlisted) companies under foreign control belonging to groups, for which consolidated financial statements in compliance with IFRS are prepared. As these Czech subsidiaries prepare their statutory accounts in compliance with Czech GAAP, IFRS are incorporated into management accounting in order to optimise reporting system costs for meeting information demands of all interested parties. The paper investigates the perception of management on the importance of IFRS for internal decision making. Our results, based on a questionnaire survey, show that forced IFRS adopters steadily integrate the IFRS principles into management accounting subsystem. The IFRS influence is derived from the structure of executive compensation schemes constructed by parent companies and has an impact primarily on the definition of key performance indicators and other financial targets. We find also evidence that with increasing number of areas, in which management accounting utilises the IFRS-based measures, the (subjective) perception of their importance increases, too.*

Keywords: *IFRS; transition country; private companies; management accounting*

JEL codes: M41

1 Introduction

The changes in the global economic environment over the last twenty years have also affected financial reporting and management accounting. Companies are expanding worldwide, and investors are not limited to investing into “local” projects only. The development of information and communication technology supports the integration of national capital markets into a single global market. In addition, the technology allows more efficient management of international subsidiaries within the group structures. The global economy brings new challenges for preparers of financial statements as their users require internationally comparable financial information of high quality. This demand is addressed by the growing adoption of International Financial Reporting Standards (IFRS). The worldwide adoption of IFRS has not only microeconomic and macroeconomic effects (Brüggemann, Hitz, and Sellhorn 2013), but it has also an intended impact on the mutual relationship between financial and managerial accounting.

The accounting research addresses mainly the economic consequences of mandatory IFRS adoption by listed companies. The complete overview of relevant studies is impossible. There are also a few papers dealing with the consequences of voluntary IFRS adoption by private companies (Francis et al. 2008), (Nobes 2010), (Bassemir 2011), (Matonti and Iuliano 2012), (André, Walton, and Yang 2012), (Yang 2014). However, all these studies investigate the determinants behind the decision of private companies to switch to IFRS in their statutory filings (if allowed by the regulatory regime in given countries). The conclusions are derived from publicly available data, indicating that the reasons to adopt IFRS voluntarily can be mostly attributed to the reporting incentives of companies analysed. The previous studies assess the impact of IFRS on the management accounting practices (Colwyn Jones and Luther 2005), (Angelkort, Sandt, and Weißenberger 2008), and their integration with financial reporting (Weißenberger and Angelkort 2011) following the changes in key financial indicators (Lantto and Sahlström 2009) and internal

performance measures (Wu and Zhang 2009) induced by the mandatory or voluntary IFRS adoption.

Antecedent dual relationship of financial and management accounting (Colwyn Jones and Luther 2005) started to be partially mitigated by an international convergence of internal management accounting techniques (Granlund and Lukka 1998), (Ittner and Larcker 2001). The managers administrate internal business processes respecting the value creation goal (Abdel-Kader and Luther 2006). Managers strive for creating value not only for the owners but for a wide group of stakeholders (customers, employees, etc.) as well. On this interface, management accounting system for internal users interfaces with the financial accounting systems for external users. In this context, some authors have started to cope with the terms like "integration of financial and management accounting systems" or "the convergence of financial accounting and the management accounting" (Hemmer and Labro 2008), (Taipaleenmäki and Ikäheimo 2013), (Weißenberger and Angelkort 2011).

The goal of the paper is to assess the influence of IFRS adoption by Czech private (unlisted) companies on their management accounting. We focus on specifics of private companies under foreign control belonging to the groups, for which consolidated financial statements in compliance with IFRS are prepared. As these Czech subsidiaries usually prepare their statutory accounts in compliance with Czech GAAP, we expect that IFRS are somehow incorporated into management accounting in order to optimise the structure of their reporting system, meet deadline and minimise costs for meeting increased information demands. The paper investigates the management's perception of the importance of IFRS for internal decision making. More specifically, we presume that with increasing number of areas, in which management accounting utilises the IFRS-based measures, the (subjective) perception of their importance increases, too. Affirmative evidence on the hypothesis could have practical implication. The growing usage of IFRS in management accounting can witness about a deeper integration of financial and management accounting in private companies and provide additional evidence to international research focusing mainly on listed companies. Unlike recent research, this paper focuses on companies not adopting the IFRS as their statutory financial reporting system, but as a complementary reporting system within consolidation group as decided by (foreign) parent company. This clash of global standards with local practices leads to the existence of institutional duality, to which subsidiaries basically face, when dealing with the parent's commands (Kostova and Roth 2002).

2 Methodology and Data

Based on Creditinfo database, which shows the ownership structure, all private Czech companies under foreign control were retrieved. Micro- and small entities were excluded from the sample. Secondly, a Czech company is considered as under foreign control if the foreign owners hold at least 50% of subscribed capital. Thirdly, only Czech subsidiaries having the parent company listed on capital market of any old EU-member state were left in the sample. This restriction is motivated to meet theoretical preconditions for the occurrence of institutional duality and different reaction of subsidiaries to its presence.

From the population defined above, a sample of 300 companies was randomly selected. In the next step, the contacts for representatives responsible for corporate reporting (i.e. chief financial officer, chief accountant, economic director, controllers, etc.) were searched for. There were found contacts for 154 companies from the sample. These respondents were asked to fill-in an online questionnaire containing data from Czech GAAP and IFRS financial statements; financial figures relating to the costs of IFRS reporting and questions about the methods of financial statements conversion; differences between Czech GAAP and IFRS statements; and questions about the usefulness of the IFRS principles for internal decision-making and their role in management accounting. In total, 41 out of 154 completed questionnaires were received from respondents, i.e. the response rate was 27%. However, six fillings were dropped out from the analysis, as respective companies –

despite the assumptions – were not subject to consolidation at all or were consolidated only as “et equity companies”.

Table 1 presents mean values of selected financial indicators.

Table 1 Descriptive statistics

Industry	Cases	Empl.	Total assets	Equity	Revenue	Profit & loss
A	1	1,523	3,866,051	668,739	5,683,758	108,536
B	1	3,464	28,436,782	19,488,797	10,489,481	2,260,595
C	10	638	3,967,314	1,883,126	4,620,450	203,201
D	8	417	7,656,803	2,178,671	13,673,391	276,526
G	4	2,024	5,057,299	2,555,782	10,979,992	353,332
H	3	212	638,569	343,553	2,628,864	234,983
J	4	264	4,742,911	3,383,963	2,245,410	85,010
S	4	1,052	2,211,926	638,265	3,129,968	106,868
Total	35	820	5,234,133	2,393,167	7,002,084	271,404

Source: Own survey

A: Agriculture, forestry and fishing; B: Mining and quarrying; C: Manufacturing; D: electricity, gas, steam and air conditioning supply; G: Wholesale and retail trade, repair of motor vehicles and motorcycles; H: Transportation and storage; J: Information and communication; S: Other service activities

3 Results and Discussion

The survey attempted at answering a question, at what extent the IFRS principles are incorporated into management accounting of Czech subsidiaries under foreign control. Table 2 summarises the respondents' views.

Table 2 The extent of IFRS usage in management accounting

Attitude	Number of cases	Relative share
Very low	4	11.4%
Low	11	31.4%
Middle	8	22.9%
High	9	25.7%
Very high	3	8.6%

Source: Own survey

Almost 35 % of companies integrate the IFRS based measures in their management accounting at a high or even at a very high extent. On the other side, 11.4% of respondents assert that their management accounting is influenced by IFRS principles negligibly and 31.4% of companies employ IFRS figures in internal decision-making relatively infrequently.

Further, perception of IFRS usefulness was investigation with a special interest on the relation to the application of IFRS in management accounting, including other variables collected to control for other effects. In particular, relations across following variables are investigated.

Perception is the subjective perception of the extent of IFRS integration into management accounting.

Area is a weighted index, capturing the number of management accounting areas, in which particular company applies the IFRS.

Frequency controls for the frequency of IFRS reporting during the year (annually, biannually, quarterly, monthly).

Industry controls for the potential variation among companies because of different industry accounting and management practices.

Size controls for the potential variation among companies due to different size of a companies (log of total revenue in thousands CZK is used as a proxy for the size).

Table 3 presents correlation coefficients (Pearson's denoted "P" or Spearman's denoted "S") for the variables specified above. There is a strong positive correlation between "Perception" and "Area". On 1% level, a statistically significant association between subjective assessment of the importance of IFRS in management accounting by responsible managers and the objective extent of their usage is identified. The IFRS are not viewed as a bothering task commanded from the parent company, but they are perceived as a useful tool in internal decision-making. The attitude seems to be a general issue as neither company size, nor industry affiliation were found statistically significant. Frequency of IFRS reporting seems to have a certain effect on the perception of the extent of IFRS usage in management accounting.

The correlation analysis was also run for alternatively defined variables. As a proxy for size, a number of employees and log of total assets respectively were also used. The correlations yielded comparable results to those presented above. In similar way, the calculation was processed for the variable Area calculated as an unweighted sum of management accounting areas, where IFRS are applicable. The signs and statistical (in)significance of correlation coefficients remained the same.

Table 3 Correlation analysis

	Area (S)	Frequency (S)	Industry (S)	Size (P)
Perception	0.81	0.38	0.03	0.25
p-value	0.000*	0.024**	0.844	0.152
Area		0.44	-0.01	0.28
p-value		0.009*	0.942	0.104
Frequency			-0.31	0.27
p-value			0.069	0.113
Industry				0.12
p-value				0.497

Source: Own calculations using R; * 1% significance level, ** 5% significance level

4 Conclusions

The paper provides certain empirical evidence that IFRS are being really incorporated into the architecture of management accounting of the forced IFRS adopters. The main driver for the convergence of financial and management accounting is an effort to lower cost burden of maintaining four different sets of accounting information (Czech GAAP for statutory fillings; special rules for taxation; IFRS for consolidation and performance measurement by the parent company; internal principles of management accounting).

However, there are also some limitations on the paper's findings. Firstly, the research in this field will always struggle with unavailability of data, which are not publicly available. A questionnaire survey (employed by this paper) or interviews might be a solution, although subject to self-selection bias and probable sample restriction, which is also the case of this paper. Secondly, questionnaires are anonymised and the qualification of respondents is questionable. This problem has been overcome by sending the questionnaire to representatives responsible for corporate reporting.

Finally, the research hypothesis might be suspicious as self-explanatory. The assumption that a higher number of management accounting areas utilising IFRS leads to a stronger perception of the IFRS importance is intuitive. It could be stated that analysis just shows, what is evident. However, it has to be stated, that financial reporting in CEE countries lacks reporting incentives for producing high-quality financial statements for external users (Procházka 2012). Any deficiencies and resistance by subsidiaries (Oliver 1991), which can

be one of possible strategic responses to the institutional duality (Kostova and Roth 2002), to adopt the IFRS as commanded by parents can therefore endanger the quality of consolidated financial statements. The awareness of IFRS importance through their integration into management accounting of subsidiaries has thus an unintended positive consequence for the ensuring the quality of the group's accounts.

Acknowledgments

This paper has been prepared within the research project „Economic Impacts of the IFRS Adoption in Selected Transition Countries" (supported by the Czech Science Foundation, No. 15-01280S).

References

- Abdel-Kader, Magdy, and Robert Luther. 2006. "IFAC's Conception of the Evolution of Management Accounting: A Research Note." In *Advances in Management Accounting 15*, 229–47. Bingley: Emerald Group Publishing Limited.
- André, Paul, Peter J. Walton, and Dan Yang. 2012. "Voluntary Adoption of IFRS: A Study of Determinants for UK Unlisted Firms." *Comptabilités et Innovation*, 42.
- Angelkort, Hendrik, Joachim Sandt, and Barbara E. Weißenberger. 2008. "Controllershship under IFRS: Some Critical Observations from a German-Speaking Country." *Working Paper No. 1*, Justus-Liebiguniversität Giessen Arbeitspapiere Industrielles Management und Controlling, , 42.
- Bassemir, Moritz. 2011. "Why Do Private Firms Adopt IFRS?" *SSRN Electronic Journal*. doi:10.2139/ssrn.1896283.
- Brüggemann, Ulf, Jörg-Markus Hitz, and Thorsten Sellhorn. 2013. "Intended and Unintended Consequences of Mandatory IFRS Adoption: A Review of Extant Evidence and Suggestions for Future Research." *European Accounting Review 22* (1): 1–37. doi:10.1080/09638180.2012.718487.
- Colwyn Jones, T., and Robert Luther. 2005. "Anticipating the Impact of IFRS on the Management of German Manufacturing Companies: Some Observations from a British Perspective." *Accounting in Europe 2* (1): 165–93. doi:10.1080/09638180500379160.
- Francis, Jere R., Inder K. Khurana, Xiumin Martin, and Raynolde Pereira. 2008. "The Role of Firm-Specific Incentives and Country Factors in Explaining Voluntary IAS Adoptions: Evidence from Private Firms." *European Accounting Review 17* (2): 331–60. doi:10.1080/09638180701819899.
- Granlund, Markus, and Kari Lukka. 1998. "It's a Small World of Management Accounting Practices." *Journal of Management Accounting Research 10* (1): 153–79.
- Hemmer, Thomas, and Eva Labro. 2008. "On the Optimal Relation between the Properties of Managerial and Financial Reporting Systems." *Journal of Accounting Research 46* (5): 1209–40. doi:10.1111/j.1475-679X.2008.00303.x.
- Ittner, Christopher D., and David F. Larcker. 2001. "Assessing Empirical Research in Managerial Accounting: A Value-Based Management Perspective." *Journal of Accounting and Economics 32* (1–3): 349–410. doi:10.1016/S0165-4101(01)00026-X.
- Kostova, Tatiana, and Kendall Roth. 2002. "Adoption of an Organizational Practice by Subsidiaries of Multinational Corporations: Institutional and Relational Effects." *Academy of Management Journal 45* (1): 215–33. doi:10.2307/3069293.
- Lantto, Anna-Maija, and Petri Sahlström. 2009. "Impact of International Financial Reporting Standard Adoption on Key Financial Ratios." *Accounting & Finance 49* (2): 341–61. doi:10.1111/j.1467-629X.2008.00283.x.
- Matonti, Gaetano, and Giuseppe Iuliano. 2012. "Voluntary Adoption of IFRS by Italian Private Firms: A Study of the Determinants." *Eurasian Business Review 2* (2): 43–70. doi:10.14208/BF03353812.
- Nobes, Christopher. 2010. "On Researching into the Use of IFRS by Private Entities in Europe." *Accounting in Europe 7* (2): 213–26. doi:10.1080/17449480.2010.511889.

- Oliver, Christine. 1991. "Strategic Responses to Institutional Processes." *Academy of Management Review* 16 (1): 145–79. doi:10.5465/AMR.1991.4279002.
- Procházka, David. 2012. "Financial Conditions and Transparency of the Czech Professional Football Clubs." *Prague Economic Papers* 21 (4): 504–521.
- Taipaleenmäki, Jani, and Seppo Ikäheimo. 2013. "On the Convergence of Management Accounting and Financial Accounting – The Role of Information Technology in Accounting Change." *International Journal of Accounting Information Systems* 14 (4): 321–48. doi:10.1016/j.accinf.2013.09.003.
- Weißberger, Barbara E., and Hendrik Angelkort. 2011. "Integration of Financial and Management Accounting Systems: The Mediating Influence of a Consistent Financial Language on Controllership Effectiveness." *Management Accounting Research* 22 (3): 160–80. doi:10.1016/j.mar.2011.03.003.
- Wu, Joanna Shuang, and Ivy Xiyang Zhang. 2009. "The Voluntary Adoption of Internationally Recognized Accounting Standards and Firm Internal Performance Evaluation." *The Accounting Review* 84 (4): 1281–1309. doi:10.2308/accr.2009.84.4.1281.
- Yang, Dan. 2014. "Exploring the Determinants of Voluntary Adoption of IFRS by Unlisted Firms: A Comparative Study between the UK and Germany." *China Journal of Accounting Studies* 2 (2): 118–36. doi:10.1080/21697221.2014.917030.