Regulation of disclosed information in British and Czech accounting regulatory systems

Marcela Žárová[1]

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

Abstract: *This paper compares regulation of disclosed information in British and Czech accounting regulatory system. In spite of the fact that legal framework for information disclosure in annual reports, Directive 2013/34/EU, is identical for companies in both systems, in the UK and in the Czech Republic, this paper concerns ways of information disclosure regulation and brings evidence about fundamental differences in information disclosure between systems. Moreover, this paper highlights that even in the UK, where disclosed information in annual reports is in high quality; investors require more detailed information than is currently provided by companies.*

Keywords: *British accounting regulatory system, Czech accounting regulatory system, information disclosure, nonfinancial information*

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1 Introduction

It is evident, that there is not unified European approach in disclosing information in annual reports as European countries operate within two different legal systems. Disclosure of information in annual reports is based not only on different legal backgrounds but also on different tradition and policies introduced in above mentioned environments. Despite the fact that Alexander and Archer (2000) suggested that it is a myth that there is a coherent group of countries that was using Anglo-Saxon accounting, this paper uses comparison of simplified British approach against Continental European one. Facts that come from the comparison of these approaches not necessarily bring a clear view which approach is better (Žárová, 2016). Despite the fact that there is no clear answer which approach is better, there is evidence that UK companies have a longer tradition to disclose and publish business information.

The Czech accounting regulatory system has been chosen as a representative of Continental European approach. Characteristic features of this accounting regulatory system is that financial reporting is regulated by law, which is too detailed on one hand and on the other hand most legislators are not well informed about accounting concepts and technicalities of financial reporting. Accounting profession, through to their professional chambers, has very low level of influence. At the second, the stock exchange is less important, companies obtain majority of their funds from banks and other financial institutions. As companies in Britain are more dependent on financial sources from stock exchanges, British companies developed strategies concerning information disclosure in annual reports a long time ago. Approach used in British model could be used for decision on what kind of information should be disclosed. This paper brings observation of good practice of British companies.

Research literature mostly concerns accounting regulation in general, not particular examples from different European countries. There are described at least two approaches for accounting regulation in research works on accounting as it is stated in Dennis (2014) and Di Pietra, McLeay and Ronen (2014). Despite the fact that above mentioned research doesn´t represent examples in particular countries, this research is used as a research framework on information disclosure regulation.

Little research has been done in the Czech Republic directly toward regulation. Research that has been carried out has mainly focused on influence of IFRS on financial reporting. Procházka (2015) prepared an overview of research studies in transitive economies and confirm that majority of research studies concentrate on IFRS implementation. Reasons for this situation see as consequences of lower level of GDP in absolute value or GDP per capita, with the exception in Poland. Moreover there is no systematic research on information disclosure in annual reports of non-listed companies in the Czech Republic. Therefore an example from research of companies listed on Prague Stock Exchange, with disclosure requirements in compliance with IFRS, is used. Dvořák (2017) in his research of fair value disclosure in companies listed on Prague Stock Exchange argues that over 60% of the companies fail to present description of the valuation technique(s) and the inputs used in the fair value measurement when Level 2 or 3 of the fair value hierarchy is recognized. It is evident that users of financial statements are not able to recognize how the fair value of an asset or liability was determined. From this research is also evident that minority of companies report valuation techniques.

As requirements on business model disclosure in UK is rather new, this paper uses research and field study papers provided by Financial Reporting Council (FRC Lab, 2016). This paper compares British and Czech accounting systems, highlights experience from both systems and tries to give answer whether British system could bring new aspects into information disclosure attitude in Continental European tradition.

2 Regulatory frameworks and methodology

The development of the Czech Accounting system has been finalized before the Czech Republic joined the European Union (EU) in May, 2004. Since January 2004, legislation framework was enhanced into three separate regulatory levels: Accounting Act, Decrees to Accounting Act and Czech Accounting Standards (CAS). Accounting Act is prepared by the Ministry of Finance and approved by the Parliament; Decrees to Accounting Act and CAS are issued by the Ministry of Finance. On the other hand, Ministry of Finance admits the possibility of existence a rule-making body since 2004 (Žárová, 2011) but not a once was any professional body asked to do it. Last amendment of the Act on Accounting is a consequence of the Directive 2013/34/EU. This Directive which aims at designing and delivering regulation of the highest quality whilst respecting that the administrative burdens are proportionate to the benefits they bring. Amended Act on Accounting came into force since January 1st, 2016. As a part of amended Act, requirements concerning published information in annual report have been completed.

In the UK, Corporate reporting is regulated by the Government and Financial Reporting Council (FRC). FRC originally established in 1990 to be responsible for setting and monitoring UK accounting standards. Number of activities has been increasing since 1990. At present FRC set standards for corporate reporting, audit and actuarial practice and monitor and enforce accounting and auditing standards. FRC also oversees the regulatory activities of the actuarial profession and the professional accountancy bodies and operate independent enforcement arrangements for public interest cases involving accountants and actuaries. The aim of the FRC is to promote high quality corporate governance and reporting to foster investment.

The aim of this paper is to compare regulation of information disclosure in annual reports in the UK with information disclosure requirements for annual reports in the Czech Republic. As the paper analyses legal requirements on accounting information disclosure in annual reports which is regulated by the Act on Accounting, content analysis was used. Then method of comparison was used to compare disclosure information required by the Act in the Czech Republic with information disclosure in annual reports primarily prepared for shareholders.

3 Results and Discussion

Due to regulation of accounting in Europe by Directives there is a space for different transposition of Accounting Directives into national legislative system. Even in unified Union accounting legislation there are differences in financial reporting. Using a wide spread opinion that there exists British approach against Continental one (Nobes, 2008; Nobes, 2012; Flower, 2002) this paper brings experience of accounting disclosure in annual report from the UK and the Czech Republic as an example of an accounting system with Continental European approach. This paper compares best practise of UK companies with information disclosure requirements for annual reports by representatives of Continental European approach based on disclosure requirements set by Directive 2013/34/EU.

Nobes (2012) and Flower (2002) see clear distinction between answer on the question "What is primary objective of financial statements in Europe? " Primary objective in simplified British approach is to provide information for capital market. Primary objective in simplified Continental European approach is to regulate distributions to stakeholders" while in the preface of the Directive 2013/34/EU is stated that "annual financial statements pursue various objectives and do not merely provide information for investors in capital markets but also give an account of past transactions and enhance corporate governance". Moreover there is a stress on fact that Union accounting legislation needs to strike an appropriate balance between the interests of the addressees of financial statements and "the interest of undertakings in not being unduly burdened with reporting requirements".

3.1 Czech experience

In the Czech Republic, accounting information disclosure in annual reports is regulated by the Act on Accounting. Act determines obligation to prepare annual reports according to categories of undertakings. Besides requirements in Act on Accounting, there is no interpretation, standard or manual available for practice to guideline in which way or detail to recognize disclosed information. No special guidance on this topic has been developed.

Obligation to prepare annual report has audited accounting entities. These entities have obligation to disclose financial and non-financial information. Medium sized, small sized entities and micro entities are obliged to disclose only financial information in annual report. As medium sized, small sized entities and micro entities have exception from obligation to disclose non-financial information, this paper will not concern these entities. The Act on Accounting regulates disclosure of audited accounting entities. All audited accounting entities has obligation to prepare annual report in order to provide overall, well-balanced and comprehensive information on their performance, activity and current economic position. Annual report shall include financial statements. The Act determines that besides that information in annual report which provides overall, well-balanced and comprehensive information on entity´s performance, activity and current economic position including financial statements, there is an obligation to publish other financial and non-financial information. Financial and non-financial information to be presented at least on:

- after balance sheet dates events and all material information with regards to compliance with the purpose of an annual report;
- the expected development of the accounting entity´s activity;
- the activities in research and development;
- acquisition of own shares;
- the activity in the field of environmental protection and in labour relations;
- the fact whether company has an organizational branch abroad;
- including other information required by other statutory provisions.

Accounting entity holding financial instruments or other similar financial instruments, has obligation to disclose material information in order to assess a certain accounting entity´s property and other assets, equity and liabilities, to recognize financial position of entity and profit or loss. Additional information is to be disclosed on:

- objectives and methods of the company´s risk management, including its policies for hedging all types of planned transactions for which hedging derivatives are used ; and
- the pricing, credit and liquidity risks and also cash-flow risks faced by the accounting entity.

The Act on Accounting determines conditions, methods and places, where information shall be published.

3.2 British experience

In August 2013, the UK Government published new Regulations for the strategic report and directors' report. The UK Strategic Report Regulations, applicable for periods ending on or after 30 September 2013, introduced a requirement for quoted companies to disclose their business model. This brought a requirement to disclose the business model into law for the first time, having been required under the UK Corporate Governance Code since 2010 (on a 'comply or explain' basis), and is seen as having codified common market practice.
As an assistance to public, in June 2014, FRC published non-mandatory Guidance on the Strategic Report which recommends the following information be described in the business model disclosure:

- how the entity generates or preserves value over the longer term;
- how the entity captures that value;
- what the entity does and why it does it;
- what makes the entity different from, or the basis on which it competes with, its peers;
- high level understanding of how the entity is structured;
- high level understanding of the markets in which it operates and how it engages with those markets; and
- broad understanding of the nature of the relationships, resources and other inputs that are necessary for the success of the business.

The FRC encourages entities to prepare a high quality Strategic report which provides shareholders with a holistic and meaningful picture of an entity's business model, strategy, development, performance, position, and future prospects. Within FRC structure, several committees provide research and assist public to develop guidance on Business model reporting including disclosure. The most important conclusion from the project concerned Business model reporting including disclosure is that investors want more detailed information than most companies are currently providing, although they note that this should not lengthen the disclosure significantly. Instead, investors want companies to better use the space currently taken by the disclosure, to provide relevant factual information. The second conclusion is that investors would like companies to develop one high quality disclosure and use it consistently across the different reporting channels, which will give the investment community confidence that the disclosed business model is the real business model. The third conclusion is that there is a need for linkage between strategic report and business model in annual report.

Conclusions

This paper compares regulation of information disclosure in annual reports in British accounting regulatory system with information disclosure requirements for annual reports in the Czech Republic. In the Czech Republic, information disclosure requirements for companies are regulated by the Act on Accounting where Directive 2013/34/EU was transposed. Accountants on the Continent must follow the rules. This is also an aspect of difference in the relative importance of the accountancy profession and the state under the both approaches (Žárová, 2016). This paper confirms hypothesis that in countries with widespread ownership of companies by shareholders who do not have access to internal information, there will be a pressure for disclosure, audit and "fair" information (Nobes,

2012) while in most Continental European countries, the comparative lack of "outside" shareholders has meant that external financial reporting has been largely invented for the purpose of protecting creditors and for government, as tax collectors or controllers of economy. It may lead to uniformity in that way that information is provided in compliance with requirement at the minimum level of details that is sometime not sufficient for investors to make informed decision. This is the situation where accounting profession and their professional departments could bring knowledge in order to improve information disclosure in annual reports.

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