THE VALUE STATEMENTS ACCORDING TO IFRS IN COMPARISON WITH THE FINANCIAL STATEMENTS IN ACCORDANCE WITH CZECH ACCOUNTING STANDARDS

Marie Padrtová, Marek Vochozka

1 Institute of Technics and Business in Ceske Budejovice, Czech Republic, padrtova@mail.vstecb.cz
2 Institute of Technics and Business in Ceske Budejovice, Czech Republic, vochozka@mail.vstecb.cz

Abstract

This paper compares the informative value of financial statements drawn up under IFRS and according to Czech accounting standards by using financial analysis.

A particular company statements processed by both procedures: IFRS and Czech accounting standards was selected. A large group of financial ratios based on the methods of Schmallenbach’s society was selected, including indicators of profitability, activity, liquidity and solvency and then applied on selected company financial statements. It was expected that the value of the ratios calculated from the statements drawn under different standards would significantly vary. The financial analysis results proved the impact of IFRS implementation on financial performance of the company. Financial statements prepared under Czech accounting standards showed the company more healthy than financial statements drown under IFRS.

Keywords: IFRS, financial analysis, profitability, liquidity, activity, debt, accounting standards.

JEL Classification: G30, M40.

Introduction

Since 2001, almost 120 countries have required or permitted the use of IFRSs. All remaining major economies have established time lines to converge with or adopt IFRSs in the near future.

Czech Republic has adopted the IFRS for publicly listed companies since 2005 and for companies with publicly negotiable bonds since 2007.

Considering the fact that IASB has prepared the IFRS for small and medium-sized entities (SMEs), which are estimated to account for over 95 per cent of all companies around the world including Czech republic, it may be useful to analyse the impact of the implementation of IFRS on financial performance of the company.

The objective of this paper is to examine the financial statement effects of the implementation of IFRSs in Czech Republic through the use of financial ratios based on the methods of Schmallenbach’s society.

Background and Research Questions

The transition to IFRS was already undertaken by many companies worldwide. The benefits of implementing IFRSs include higher comparability and facilitate international investments. IFRSs assist investors in making financial decisions and predictions of firm future financial performance (Larson, Street 2004) and give a signal of higher quality accounting and transparency (Tarca, 2004). Although the transition to IFRS corresponds with economics globalisation, a lot of Czech experts think, that the adoption of IFRS represents escalation of bureaucratic burden for companies by preparing declaration of taxes. Anyway it mustn’t be forgotten that the main task of accounting isn’t to serve the needs of tax system, but to furnish confidential information about economic efficiency of the company (Ficbauer, 2007).

This paper aims to examine the impact of the implementation of IFRSs on company performance measured by basic financial ratios. It’s expected that the results of financial analysis will differ after IFRS adoption.

Similar investigation, hold in UK proved that IFRS implementation has favourably affected the overall financial performance and position of firms. Under IFRSs, key financial figures, such as profitability and growth, appear to be higher. Also firms exhibit higher leverage measures following the high IFRS financial reporting quality, which can reduce the potential uncertainty and risk that is attributed to a firm and subsequently enhance the credibility and the borrowing bargain power of firms (Iatridis, 2010). This investigation was focused on the differences between UK GAAP and IFRS. Evidently Czech accounting standards are different than UK GAAP so the results of this paper may bring different conclusion.
Data and Methods

To accomplish the target of this paper it’s necessary to choose suitable financial ratios, to consider the way of their calculation and especially to determine which data will be used for calculation of chosen ratios.

Before this it’s indispensable to select company whose statements will be used for analysis. This procedure may appear unusual, but it mustn’t be forgotten that IFRSs besides mandatory parts allow a lot of modifications, which can significantly affect the methodology.

Considering the fact that the predicated value of financial ratios is solved from point of view of external evaluator, it was necessary to select such company, which is publicly providing financial statements compiled under both IFRS and Czech accounting standards. The statements of company ČEZ inc. were found the most suitable for this purpose.

Its annual report says (Final Account of ČEZ year 2004, 2005), that: “Joint stock company ČEZ was founded by State property fund of Czech Republic as the only founder on grounds of deed of foundation (containing Resolution of the founder by course of § 172 clause 2, 3 and § 171 clause 1 of law 513/1991 Collection of law, Commercial code) dated 30. April 1992 by the record into Company register. The major object of activity of ČEZ, inc. is sale of electric energy obtained mainly by own production and related supporting services to electricity supply system, farther than production, distribution and sale of heat.” ČEZ inc. is of the biggest companies in the Czech Republic.

The basic underlay for application of this methodology will be the data got from annual report 2004 and 2005 of ČEZ inc. published on its web page. In those years the company transited from Czech accounting standards to IFRS. So the same data processed by both standards are available and through their analyzing the target of this paper may be accomplished.

Applied financial analysis includes following ratios (Kilingerová, 2007, Marek, 2006):

1. Profitability:
   a. ROA – Return on Assets: EBIT (earnings before interest and taxes + costs interests)/Assets;
   b. ROS – Return on Sales I: EBIT(earnings before interest and taxes + costs interests)/Sales;
   c. ROS – Return on Sales II: EAT (earning after taxes)/Sales;
   d. ROCE – Return on Capital Employed: EBIT (earnings before interest and taxes + costs interests)/(Equity + Long term debt);
   e. ROE – Return on Equity: EAT (earning after taxes)/Equity;
   f. Leverage ratio: Assets/Equity;
   g. Cash Flow to Equity: Cash Flow/Equity.

2. Activity (Efficiency Ratios):
   a. Total Assets Turnover: Sales/Assets;
   b. Inventory Turnover: Sales/Inventory;
   c. Total Assets Turnover Period: Assets/(Sales/360);
   d. Inventory Turnover Period: Inventory/(Sales/360);
   e. Debts Collection Period: Debts/(Sales/360);
   f. Liabilities Payment Period: Short-term Debts/(Sales/360).

3. Liquidity:
   c. Indicator of Capitalization: Fixed Assets/(Long-term Debts + Equity);
   d. Overall Liquidity: Current Assets/Current Liabilities;
   e. Current Liquidity: (receivables+ Cash and Securities)/Payables;
   f. Cash Position: Cash and Securities/Current Liabilities;

4. Solvency:
   a. Equity Ratio: Equity/Assets;
   b. Debt Ratio I: Debt/Assets;
   c. Debt Ratio II: (Long-term Debts + Current Liabilities)/Assets;
   d. Debt Equity Ratio: Debt/Equity;
   e. Interest Coverage I: EBIT (earnings before interest and taxes + costs interests)/Interests;
   f. Interest Coverage II: EBIT (earnings before interest and taxes + costs interests) + Depreciation/Interests.
The results will be farther compared as in their absolute value as in the form of ratio. As basic variable for comparison for both - quotient and division - method will serve the results got from IFRS statements.

Results

It’s obvious, that chosen ratios aren’t able to describe global financial situation of company. However we can describe and evaluate basic characteristics of financial situation of company ČEZ Inc. in the same order as in previous chapter.

Profitability ratios calculated up to the previously described method are summarized in table 1.

<table>
<thead>
<tr>
<th>Ratio</th>
<th>IFRS</th>
<th>CAS</th>
<th>IFRS-CAS (absolute change)</th>
<th>IFRS/CAS (relative change)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return on Assets</td>
<td>0,056</td>
<td>0,082</td>
<td>-0,025</td>
<td>0,689</td>
</tr>
<tr>
<td>Return on sales I</td>
<td>0,232</td>
<td>0,3</td>
<td>-0,068</td>
<td>0,773</td>
</tr>
<tr>
<td>Return on sales II</td>
<td>0,167</td>
<td>0,199</td>
<td>-0,032</td>
<td>0,841</td>
</tr>
<tr>
<td>Return on capital employed</td>
<td>0,063</td>
<td>0,087</td>
<td>-0,024</td>
<td>0,726</td>
</tr>
<tr>
<td>Return on equity</td>
<td>0,064</td>
<td>0,084</td>
<td>-0,02</td>
<td>0,764</td>
</tr>
<tr>
<td>Leverage ratio</td>
<td>1,573</td>
<td>1,542</td>
<td>0,031</td>
<td>1,02</td>
</tr>
<tr>
<td>Cash Flow to Equity</td>
<td>0,149</td>
<td>0,162</td>
<td>-0,012</td>
<td>0,924</td>
</tr>
</tbody>
</table>

Up to the profitability ratios company ČEZ inc. seems to be healthy firm. The results of both statements are adequate to ČEZ high financial standing. The shareholders and investors receive in comparison with bank sector higher remuneration for capital allocation. The effect of leverage ratio is also obvious, debts help to increase return on equity.

Activity ratios are summarized in table 2.

<table>
<thead>
<tr>
<th>Ratio</th>
<th>IFRS</th>
<th>CAS</th>
<th>IFRS-CAS (absolute change)</th>
<th>IFRS/CAS (relative change)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Assets Turnover</td>
<td>0,244</td>
<td>0,273</td>
<td>-0,03</td>
<td>0,892</td>
</tr>
<tr>
<td>Inventory Turnover</td>
<td>19,184</td>
<td>4,834</td>
<td>14,35</td>
<td>3,969</td>
</tr>
<tr>
<td>Total Assets Turnover Period</td>
<td>1478,422</td>
<td>1318,023</td>
<td>160,399</td>
<td>1,122</td>
</tr>
<tr>
<td>Inventory Turnover Period</td>
<td>18,766</td>
<td>74,474</td>
<td>-55,709</td>
<td>0,252</td>
</tr>
<tr>
<td>Debts Collection Period</td>
<td>31,062</td>
<td>33,238</td>
<td>-2,176</td>
<td>0,935</td>
</tr>
<tr>
<td>Liabilities Payment Period</td>
<td>79,755</td>
<td>54,57</td>
<td>25,185</td>
<td>1,462</td>
</tr>
</tbody>
</table>

The informative value of activity ratios consist from interpretation of group of ratios. Total Assets Turnover Period shows high quota of fixed assets in company, which corresponds to specific character of assessed company. From group of activity ratios the two most interesting seems to be Debts collection Period and Liabilities Payment Period. Debts Collection period is significantly shorter than Liabilities Payment Period, which indicates very effective use of financial resources. Also the group of activity ratios allows affirming that ČEZ achieves above-average financial results.

Solvency ratios are summarized in table 3.

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Table 3. Solvency ratios

<table>
<thead>
<tr>
<th>Ratio</th>
<th>IFRS</th>
<th>CAS</th>
<th>IFRS-CAS (absolute change)</th>
<th>IFRS/CAS (relative change)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity Ratio</td>
<td>0,636</td>
<td>0,649</td>
<td>-0,013</td>
<td>0,98</td>
</tr>
<tr>
<td>Debt Ratio I</td>
<td>0,353</td>
<td>0,348</td>
<td>0,005</td>
<td>1,016</td>
</tr>
<tr>
<td>Debt Ratio II</td>
<td>0,364</td>
<td>0,351</td>
<td>0,013</td>
<td>1,036</td>
</tr>
<tr>
<td>Debt Equity Ratio</td>
<td>0,556</td>
<td>0,536</td>
<td>0,019</td>
<td>1,036</td>
</tr>
<tr>
<td>Interest Coverage I</td>
<td>8,398</td>
<td>8,349</td>
<td>0,05</td>
<td>1,006</td>
</tr>
<tr>
<td>Interest Coverage II</td>
<td>15,451</td>
<td>13,921</td>
<td>1,53</td>
<td>1,11</td>
</tr>
</tbody>
</table>

Above mentioned effect of leverage ratio divines that debts have positive effect on the firm economy. They help to increase shareholders’ benefits. This proves also the solvency ratios. Ascertained values of solvency ratios don’t exceed recommended values with note that in the company dominates equity capital. Liquidity ratios are summarized in table 4.

Table 4. Liquidity ratios

<table>
<thead>
<tr>
<th>Ratio</th>
<th>IFRS</th>
<th>CAS</th>
<th>IFRS-CAS (absolute change)</th>
<th>IFRS/CAS (relative change)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Working Capital</td>
<td>1,066</td>
<td>0,915</td>
<td>0,151</td>
<td>1,165</td>
</tr>
<tr>
<td>Net Working Capital on Assets</td>
<td>0,754</td>
<td>2,667</td>
<td>-1,913</td>
<td>0,283</td>
</tr>
<tr>
<td>Indicator of Capitalization</td>
<td>0,472</td>
<td>0,019</td>
<td>0,453</td>
<td>24,571</td>
</tr>
<tr>
<td>Cash Position</td>
<td>0,083</td>
<td>0,019</td>
<td>0,064</td>
<td>4,307</td>
</tr>
</tbody>
</table>

Except Overall Liquidity all ratios indicate very effective use of financial resources. This conduct would be considered as risky if it was a case of smaller or less healthy company, grace to the good standing of company this can be reduced to a positive trend.

The results of financial analysis listed above confirm former expectation. They are significantly different after adoption of IFRS. The profitability ratios differ in degree of per cent. The relative differences of ratios in this category are about 60 %. All results gained from financial statements compiled under Czech accounting standards are higher than values from statements under IFRS, except Leverage ratio. In this case it is opposite, but with very small deviation.

By activity ratios the situation is more complicated. Significant difference can be observed by Inventory Turnover and Inventory Turnover Period and by Debt Collection Period. Under IFRS methodology is the inventory volume lower than under Czech accounting standards. That represents the growth of number of turns of the inventory - less liquid current assets and in the same time abbreviation of the Inventory turnover Period. Measured inventory turnover period under Czech accounting standards is 75 days, but with application of IFRSs decreases on 19 days. The same relation appears in case of the Liabilities payment period, it seems much longer - more than 25 days under IFRS. After adding observed decrease of debt collection period, it is evident that results of activity ratios under IFRS present the company economy in better light than under Czech standard. The volume of financial capital seems to be higher and offers possibilities of its investment.

The results of solvency ratios are almost the same. They show little favorable differences towards IFRS statements. But the differences are insignificant. Liquidity ratios seem also balanced. Higher differences can be observed only by Current Liquidity. The value of Current liquidity recommended in professional literature is for production companies about 2.2. Ratio calculated from Czech accounting standards statements exceeds this value of 0.4. This results shows at very conservative management of liquidity and globally financial capital. It’s necessary to remain that in this terms conservative means less effective. On the contrary the Overall Liquidity of IFRS statement isn’t reaching even to 0.8. The difference is probably caused by change in inventory volume. In such case the recommended value oscillates between 1.2 – 1.6. None of calculated values of ratio reaches recommended
range and both methods predicate aggressive management of liquidity. Under Czech accounting standards
the policy appears even more aggressive than under IFRS.

It is evident that the results are very different. It mustn’t be forgotten that by IFRS adoption it was
indispensable to overrate assets and make many other changes in methodology of accounting and standards
application. In ČEZ annual report 2005 is submitted: “Attached nonconsolidated final accounts have been
prepared in conformity with International Financial Accounting Standards. The data from year 2004
(31.12.2004) are in final accounts presented according to the new structure of data applied in year 2005. The
methods of evaluation and accounting, applied in the past, have been adjusted. Final accounts were prepared
up to the rule of historical prices with only exception for cases, where IFRS necessitate other evaluation
method.” But these were not the only changes. The forecasts played also very important role. “For
preparation of final account under IFRS it is necessary to estimate the assessments and define expectations,
which can affect stated value of assets and liabilities to balance date. Also the information about conditional
assets, conditional liabilities, level of cost and revenue must be published. The real result can be different
than those assessments”(Final Account of ČEZ year 2005).

In spite of the change of method of assets evaluation and probably uncertain forecasts the changes in
final accounts are especially caused by the change of method of accounting under IFRS. After all remains the
question which standards should be recommended. If the consequence of IFRS adoption would be
disfiguration of the reality, it would be duly justified to conclude that the company shouldn’t adopt the IFRS.
From point of view of company management and from point of view of investors, shareholders or creditors
are the results under Czech accounting standard more favourable, better. The shareholders and creditors
better valorise their investments (higher ROE and ROA). The leverage effect works on adequate level. Both
ratios of Return on Sales result in better evaluation of company – company has higher added value. This
decision can’t be influenced by little bit less favorable results of activity ratios. Their importance in relation
to main target of company – increase of shareholder value, isn’t very high.

On the other hand accounting is only instrument of recording. So the change of accounting method
doesn’t represent the change of real economic situation of the company. The volume of fixed or current
assets as well as the volume of equity or debt remains physically the same as before the change of method.
The only difference is in the method of their evaluation and definition. This is not an attempt to depreciate
the importance of accounting standards. There is definitely high informative value of financial statement
prepared under both standards. Czech accounting standards present the economic situation in better light than
IFRS, which is preferable image for company management and present shareholders or creditors. On the
contrary the potential investor or external evaluator would logically prefer the IFRS point of view as they are
more prudent in company evaluation especially in its profitability. Czech accounting standard could lead to
groundless optimistic perspective of the economic situation of the company. The trough is that ČEZ is a
stable company of European consequences and the company managers didn’t have the choice, whether they
want to adopt IFRS or not. Every external evaluator must appraise the possibility to compare the company
economic situation with foreigner companies and evaluate potential investment in relation with similar
companies.

Conclusion

It was demonstrated on the case of company ČEZ inc. that there is a direct impact of IFRS adoption on
company evaluation. From the result of financial analyses of annual statements of the company arises the
effect of IFRS adoption. The financial situation of the company after IFRS adoption appears inferior to its
situation under Czech accounting standards. The external evaluators or potential investors must appreciate
this effect of IFRS adoption. The main ratios go down and the image of every company is rather worse after
application of IFRS. So the shareholder and creditors can be disappointed by the lost of value especially on
measuring the profitability of the company. It looks like he loses money. However we must declare that
accounting is especially an instrument of evidence. So it itself has no influence of economical results of a
company. It only describes the financial and economic situation of an entity. And we can confirm that the
IFRS help to create more real description of reality. Profitability is lower. However it is compensated by
higher creditability and transparency.

The objective of this paper was to examine the financial statement effects of the implementation of
IFRSs in Czech Republic through the use of financial ratios based on the methods of Schmallenbach’s
society. The objective of the contribution was fulfilled.
References