CHANGES IN PARADIGMS FOR REPORTING OF SECURITIES: SOME EVIDENCE FROM CZECH AND MACEDONIA

Jiří Strouhal
strouhal@vse.cz

Fitim Deari
f.deari@seeu.edu.mk
Abstract: This paper presents the analysis of reporting for financial instruments based on national accounting regulation of Czech Republic and Macedonia. There were identified several issues which shall be discussed when thoroughly analyzing accounting regulations for financial instruments. For determination of the level of similarity and dissimilarity of these regulation in correspondence with the international referential (IFRS) were used Jaccard’s coefficients. All findings are being discussed by making the correlation with the economic realities of Czech Republic and Macedonia, their historical evolution and obviously the national capital market.

Keywords: Financial Reporting; Financial Instruments; IFRS; Fair Value; EU.

1. Introduction

Trade literature often speaks of a shift in paradigms when it comes to the move toward fair value measurement. Since a financial reporting paradigm supposes a set of shared beliefs on the objectives of financial reporting and on the accounting principles by which these can be achieved, being grounded in elaborated assumptions, characteristically requiring a theoretical foundation or vindication, and once regulatory bodies adopt a financial reporting paradigm, it becomes the guiding principle for accounting regulation, we perform an analysis on the national GAAPs of Czech Republic and Macedonia in correlation with the international referential, from the perspective of reporting for financial instruments, and conclude on the finding and their implications.

* University of Economics Prague, Czech Republic.
** South East European University Tetovo, Macedonia.
Without dwelling on the development of the accounting reform within these countries, we need to position them in correspondence to the international referential, so that we can proceed to analyzing the specific issue of current reporting for financial instruments under the IFRS, in order to determine the extent to which national accounting systems have absorbed the foresights of the international standard setting body.

Thus we have structured our paper by framing the shifts in financial reporting paradigms for financial instruments within the trade literature, starting with previous researches on international accounting harmonization and continuing with specific issues concerning financial instruments. The research methodology presents the particular approach of the analyzed area, namely identifying the particularities of reporting for financial instruments as foreseen by the sets of national GAAPs in correspondence to IFRS, through both theoretical description and empirical analysis, and continuously linking the findings to the actual knowledge stage and theories developed in the field. The final part of the paper relates the conclusions of the study to national regulatory bodies and also to the international background without forgetting to include limitations of the study.

2. Literature Review

Capital market-based researches in financial accounting go back to the early 70s and still represent a widely approached topic with good reason. The most common studies investigate the association between accounting information and key capital market variables, such as the subject company’s share price, or the rate of return on its shares over some time period, or their systematic risk (Brown and Howreson, 1998) and even go to concluding that multinational firms appear to employ internal capital markets opportunistically to overcome imperfections in external capital markets (Desai et al., 2004).

In the review made while examining the European evidence for the relationship between accounting information and capital markets, Dumontier and Raffournier (2002) classify the European literature into three groups: studies of the market reaction to newly released accounting information; studies of the long term association between stock returns and accounting numbers and studies devoted to the use of accounting data by investors and to the impact of market pressure on accounting choices.

Strouhal et al. (2008a) also analyze the Czech and Romanian derivatives’ market. The authors performed an empirical study of data obtained from 51 companies listed on the Prague Stock Exchange. They focused on a comparison of the reporting of financial derivatives using IFRS versus Czech accounting...
regulations. The findings reveal the existence of information asymmetry which may be advantageous to some parties involved in derivatives trading. The low level of information reported on derivatives operations may produce difficulties for accounting information.

There must be mentioned that narrowing the alleged gap between accounting research and accounting practice was also previously approached within the trade literature (SCHIPPER, 2005; BERESFORD and JOHNSON, 1995; LEISENRING and JOHNSON, 1994).

Research in the field of accounting harmonization has focused primarily on two basic aspects – the reliability and the correctness of the evaluation (e.g. AISBITI, 2001; EMEONYNU and GREY, 1996; HERMAN and THOMAS, 1995). Beyond these aspects we should mention a set of conceptual approaches (CHOI and MEEK, 2005; RADEBAUGH ET AL., 2006; NOBES and PARKER, 2008) which emphasize a system of factors which are considered to be favourable or even determinant for the national accounting diversity. If we intend to identify the common elements of these approaches, it can be concluded that the most often met aspects, which on one hand influence or play an important role in matters concerning the development of national accounting standards, and on the other hand determine the positioning of the accounting profession within the context of international accounting harmonization, can be considered to be reflected through: the degree of global economic integration, the financing resources, the legal and political system, the fiscal system, the accounting professions’ status, the culture, the accounting language and other external influences.

Before the IFRS standards were adopted in the EU, it was stock exchanges in particular which required that listed entities submit financial statements in compliance with the IFRS or US GAAP. Previous researches dealing with the degree of disclosure (COOKE, 1992; MEEK ET AL., 1995), or the probability of using multinational standards (EL-GAZZAR ET AL., 1999; MURPHY, 1999; LEUZ, 2003) indicate a positive correlation between the listing of accounting units on foreign markets and the degree of disclosure and use of multinational standards as the basis for financial reporting. Trade literature which approaches the topic of interaction between regulations issued by FASB1 and IASB2 (CHOI ET AL., 2002; CHAWLA, 2003; ZEFF, 2007) sustain the idea that those standards, which are issued by the international standard setting body (IASB), have a strong practical (material) character when considering matters of presenting financial accounting information.

---
1 Financial Accounting Standards Board (US GAAP Setting Body).
2 International Accounting Standards Board (IFRS Setting Body).
3 Research Design

Paper develops a diagnosis of the national accounting systems of CR and Macedonia in the particular area of reporting for financial instruments. This is done through a descriptive analysis of the considered variables. The quintessence of the research methodology is based on the mutual relationship between information provided through financial reporting and the capital market. On one hand there are accounting regulations strongly influencing the outcome of financial reporting, and then, it is this outcome that determines the reaction of players on the capital markets. The reactions of players on the capital market often leads to financial engineering that must activate the reaction of standard setting bodies which will respond through the tool of accounting regulations and the circle is therefore reengaged. The reactions of players on the capital market and their financial engineering determine the investors' behaviour, while the reaction of standard setting bodies and accounting regulations are part of the accounting regulatory process. The outcome of financial reporting is also influences by the accounting profession and accounting practices. The investors' behaviour, the accounting regulatory process, the accounting profession and accounting practices are all influenced by one country's history, culture, political and economic environment.

An empirical analysis is performed on accounting regulations in the field of financial instruments. It involves closely analyzing the foresights of the national accounting regulation and of the IFRSs. The similarities and dissimilarities between the considered accounting regulations are therefore determined.

In order to achieve a quantification of the similarity degree between the considered accounting referential there was developed an empirical analysis with character of comparison. Based on the methodology of previous studies dealing with formal harmonization (Fontes et al., 2005; Strouhal et al., 2008b) there was identified a series of elements regarding financial instruments which we then organized within five big topics as follows: 1. Financial assets, 2. Financial liabilities, 3. Equity instruments, 4. Derivatives and 5. Hedge accounting. For each one of the 20 elements which were identified we proceeded to achieve a comparison between the accounting treatment as it appears within the four accounting referential considered for analysis. Thus, for each possible and/or existent accounting treatment within at least one of the considered accounting referential we have allocated the 1 or 0 value, where the 1 value shows that the considered accounting treatment exists within the considered accounting referential, and the 0 value is given for the situation when the considered accounting treatment isn't found within the considered accounting referential.

The most frequently used methods in trade literature when an analysis at the level of national accounting regulations is aimed are Jaccards' association...
coefficients. The two considered coefficients offer the possibility of quantifying both the association degree and the dissimilarity degree between different sets of accounting standards taken into consideration for analysis. So as to dimension the association or compatibility degree between two or more accounting systems, the calculation formula for the Jaccards’ coefficients shows as follows:

\[ S_{ij} = \frac{a}{a + b + c} \]  

or

\[ D_{ij} = \frac{b + c}{a + b + c} = 1 - S_{ij} \]  

where:

- \( S_{ij} \) represents the similarity degree between the two sets of analyzed accounting regulations;
- \( D_{ij} \) represents the degree of dissimilitude or diversity between the two sets of analyzed accounting regulations;
- \( a \) – the number of elements which take the 1 value for both sets of regulations;
- \( b \) – the number of elements which take the 1 value within the \( j \)-set of regulations and the 0 value for the \( i \)-set of regulations;
- \( c \) – the number of elements which take the 1 value within the \( i \)-set of regulations and the 0 value for the \( j \)-set of regulations.

The obtained results are then interpreted and discussed in the light of the achieved descriptive diagnosis for national capital markets.

4. Analysis of Accounting Treatment for Financial Instruments in the Czech Republic and Macedonia

4.1. Accounting Systems

The case of the Czech Republic is interesting through the choice made in 1991 referring to building the national accounting system based on the French model, even though the cultural semblance and linguistic closeness criteria did not characterize, during that period, the relationship between France and the Czech Republic. The arguments for this choice can be seen in the intention of creating a certain frontier for the German great economic interest in the Czech economy; even though the German model caught the Czechs’ attention. In fact English model was it was the “gaining field” in the accounting development area, training courses being mostly financed from the European PHARE program; the English model didn’t have enough credibility because of its’ dispersion and because of some scandals which were publicly presented. Moreover American model seemed to be complicated and difficult to implement.
vote for French model was also given by the aim of the Czech Republic to be integrated within the EU.

Czech Accounting Act was adopted since 1992. Following the accession of the Czech Republic to the European Union on May 1, 2004, firms that are corporations and that have issued securities in a regulated market of a Member State of the European Union have to compile their Financial Statements according to the IFRS standards.

Macedonia gained its independence from Yugoslavia in 1991. Since the Stabilization and Association Agreement in April 2001, the economic orientation of Macedonia has moved increasingly towards Western Europe. Consequently of economic integration, accounting harmonization has become even more important after the European Union (EU) granted Macedonia candidate status in 2005.

Although Macedonia is still not a part of EU, all listed companies shall prepare their consolidated financial statements in accordance with the adopted IFRS, published in the “Official Gazette of the Republic of Macedonia”. Thus, implementation of IFRS is not a closed process, but it is the standard-setting process which takes into account the needs of all accounting information users.

4.2. Comparative Analysis based on Association Coefficients

Based on the description of the empirical analysis which was done within the research methodology, there has been empirically tested the comparability degree between the selected accounting referential from two major points of view: 1. the one referring to the similarities between them, and 2. the one of the dissimilarities between the three accounting systems. In order to achieve the proposed comparison, we have considered that the best analysis, for this type of approach, is represented by the nonparametric correlation and the association degree between two or more than two considered variables. The major differences are given especially by the level of disclosures required for financial instruments. The comparative illustration of the obtained results is shown within the following table.

<table>
<thead>
<tr>
<th>Framework</th>
<th>CZE</th>
<th>MAC</th>
<th>IFRS</th>
</tr>
</thead>
<tbody>
<tr>
<td>CZE</td>
<td>1.000</td>
<td>0.645</td>
<td>0.718</td>
</tr>
<tr>
<td>MAC</td>
<td>0.645</td>
<td>1.000</td>
<td>0.548</td>
</tr>
<tr>
<td>IFRS</td>
<td>0.718</td>
<td>0.548</td>
<td>1.000</td>
</tr>
</tbody>
</table>

Source: our analysis
The financial reporting of nonlisted companies in the field of financial instruments is to a certain extent affected by requirements compliant with the IFRS international accounting reporting standards. In the field of equity securities, there are identical requirements for the initial recording of purchasing prices; nevertheless, the subsequent re-valuations are carried out in a different manner, depending on the comparability of the assignment of the individual tools to the respective portfolios. The adoption of portfolios applicable in international standards and the subsequent application of identical requirements to them would be beneficial in the field of investments in equity securities in analysed countries.

In the field of reporting bonds, however, the level of compatibility between the IFRS requirements and Czech and Macedonian regulations is not significant. The issue of amortization of the reminders between the nominal values of bonds and their subscription prices is treated particularly inappropriately (though the solution is relatively elegant in terms of taxation). That is why the introduction of the Held to Maturity portfolio would be beneficial in the Czech Republic and Macedonia on condition that the tax consequences are resolved at the same time, i.e. that the premium amortization is fully allowable for tax purposes from the viewpoint of the investor purchasing a bond. A relatively significant problem regarding accounting for derivative contracts lies in the fact that companies negotiating derivative contracts lack the appropriate information and knowledge, as well as in the fact that the amount of disclosed information on such contracts is insufficient.

5. Conclusion

The performed empirical analysis on aspects concerning reporting for financial instruments documented the existence of a high similarity degree among all considered accounting referential. This study continues previous researches by considering the foresights of the European Directives with a particular reason. Nowadays, lots of fingers seem to be pointing to the international referential as to be a major factor in the current crisis. However, this is too much simple approach in determining the roots of the real problems. Doubtful eyes are already laying on IFRSs asking how they could have allowed this to happen. We should not forget though the role of each national accounting system in generating information used on capital markets. A principle based accounting regulation has as centre piece professionals capable of ethically making decisions that are in their hands, based on sound economic judgements.

It is clear that accounting for financial instruments is likely to remain an extremely difficult area, both in the short term and for a number of years. Still
there seems to be a general consensus among the major standard setters and their representatives that fair valuing all financial instruments can be the only ultimate solution. IASB and FASB have also reiterated their long term objective of requiring all financial instruments to be measured at fair value with realised and unrealised gains and losses recognised in the period in which they occur. This controversial view has to deal with considerable resistance even though the standards setters are trying to move ahead of current practices in offering suitable solutions.

Acknowledgements
This paper is a research output of the project GA402/08/P024 registered at Czech Science Foundation.

References


