

REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC) Czech Republic

ACCOUNTING AND AUDITING

July 17, 2003

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Executive Summary

Financial reporting and auditing requirements in the Czech Republic are currently in transition from compliance with national standards to compliance with International Accounting Standards (IAS), International Standards on Auditing (ISA), and the European Union (EU) Directives.

In law, the Czech Republic seeks to attain maximum compliance with the EU Fourth and Seventh Directives and the EU Regulation on the use of IAS, and to create an environment for implementation of IAS for the financial statements of public interest entities by 2005. Small- and medium-size enterprises prepare their financial statements in accordance with Czech Accounting Standards, which are largely based on the EU Directives and IAS. In practice, compliance with certain complex EU Directives and IAS requirements, including those dealing with consolidation and deferred tax, has been delayed. Compliance with IAS is not effectively enforced at present.

The transition to full IAS compliance for public interest entities will be demanding. It requires extensive education in a different style and philosophy of accounting requirements. The transition to full IAS will require a culture shift to reduce the influence of tax accounting on general-purpose financial statements.

In law, the Czech Republic seeks to attain compliance with the EU Eighth Directive and ISA. There are, however, serious issues because Czech Standards on Auditing remain less robust than ISA, the Chamber of Auditors in the Czech Republic (CACR) has not adopted the International Federation of Accountants Code of Ethics, and certain EU Recommendations on auditor's independence and quality assurance have not yet been endorsed. While the CACR is aware of the challenges it faces, the transition to full ISA audits requires extensive education and strict enforcement of standards.

This report draws upon recent international experience in developed economies and accession countries, as well as expected amendments to EU Directives, and recommends that the current self-regulation of the audit profession should be reviewed and an adequate oversight mechanism be established.

This report was prepared by a team from the World Bank on the basis of the findings from a diagnostic review carried out in the Czech Republic in May 2003. The staff team comprised M. Zubaidur Rahman (OPCFM) and Frédéric Gielen (ECSPS). The review was conducted through a participatory process involving various stakeholders and led by the country authorities.

I. INTRODUCTION

1. This assessment of accounting and auditing practices in the Czech Republic is part of a joint initiative of the World Bank and the International Monetary Fund (IMF) to prepare Reports on the Observance of Standards and Codes (ROSCs). The assessment focused on the strengths and weaknesses of the accounting and auditing environment that influence the quality of corporate financial reporting. International Accounting Standards (IAS)¹ and International Standards on Auditing (ISA) have served as benchmarks for the assessment, which involved a review of both mandatory requirements and actual practice.

2. The Czech Republic has a population of 10.2 million and Gross Domestic Product (GDP) per capita of US\$7,409.² There are 79 companies listed on the Prague Stock Exchange with a market capitalization of US\$15.8 billion as of end-2002, which represents approximately 21 percent of 2002 GDP. As of end-2002, 237 companies were listed on the RM-System, an over-the-counter exchange, with a market capitalization of US\$12.3 billion. However investors are trading in only seven blue-chips stocks. There are 37 banks operating in the Czech banking system, with banking assets totaling US\$83.4 billion. There are 39 insurance companies, which wrote around US\$2.5 billion in premiums in 2002. There are 91 open-ended investment funds with total net assets amounting to US\$13.7 billion.

3. Since the Association Agreement in 1991, the Czech Republic's economic orientation has increasingly moved toward western Europe, with European Union (EU) membership a unanimous goal among country leadership. The EU membership is currently planned for May 2004 and has been a driving force in adopting such reforms as the Accounting Act (amended 2001) and the Act on Auditors (amended 2002).

II. INSTITUTIONAL FRAMEWORK

A. Statutory Framework

4. **In law, the Czech Republic seeks to attain maximum compliance with the EU Directives and the EU Regulation on the use of IAS, and to create an environment for implementation of IAS for consolidated financial statements.** The accounting legislation is based on the Accounting Act No. 563/1991 (recently amended in 2001). Seven Decrees (No. 500/2002 to 506/2002, effective January 1, 2003) are the instruments that effect the detailed regulations.³ The wording of primary and secondary legislation suggests that the Czech Republic's real priority is compliance with EU Directives rather than adoption of IAS.

5. **All companies in the enterprise sector are required to present legal entity financial statements in conformity with accounting regulations set out in Decree No. 500/2002 and consolidated financial statements prepared in conformity with either Decree No. 500/2002, IAS, or other internationally recognized accounting standards.** The allowed use of "other

¹ Within this report, IAS refer to International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board, the Standards issued by the Board of the International Accounting Standards Committee, and each applicable Interpretation of the International Financial Reporting Interpretations Committee.

² Value based on the rate applicable at December 31, 2002 (CZK30.141=US\$1).

³ Decrees No. 500/2002 to 506/2002 were specifically enacted in an effort to comply with the EU Fourth and Seventh Directives.

internationally recognized accounting standards” may give rise to certain enforcement issues, because auditors and regulators may not have adequate capacity to audit and enforce standards, such as accounting principles generally accepted in the United States. The issue is further exacerbated by the lack of a mechanism whereby the Ministry of Finance would approve the use of other internationally recognized accounting standards by a company. Companies subject to audit requirements must file their audited legal entity and consolidated financial statements with the Trade Registry within 30 days of approval by the shareholders (in practice, within seven months of the year-end).

6. **All banks are required to present legal entity financial statements in conformity with accounting regulations set out in Decree No. 501/2002 and consolidated financial statements prepared in conformity with either Decree No. 501/2002, IAS, or other internationally recognized accounting standards.** In practice, most banks elect to prepare their consolidated financial statements in conformity with IAS, which is required by foreign shareholders, correspondent banks, and credit-rating agencies. Decree No. 501/2002, which deals with specific accounting regulations for banks, was published in 2002 in an effort to comply with the EU Banking Directive. The Banking Act does not set out specific filing or publication requirements for banks financial statements. Therefore, banks merely have to comply with the requirements set out in the Code of Commerce and the Accounting Act, which generally require filing within seven months of the year-end.⁴ The same date applies for submission of audited financial statements to the Czech National Bank, which in the case of a landmark bank failure received audited financial statements as late as August of the following year. Such late filing significantly reduces the relevance of information to dependent users.

7. **The Accounting Act (most recently amended in 2002) mandates that listed companies prepare annual legal entity financial statements in accordance with Czech Accounting Standards and consolidated financial statements in accordance with either the Czech Accounting Standards, IAS, or other internationally recognized accounting standards.**⁵ Within four months of the year-end, all listed companies must file their legal entity and consolidated financial statements with the Czech Securities Commission. The Commission is responsible for filing these financial statements on behalf of the issuer with the Trade Registry. When the audit is not completed by April 30, listed companies must issue preliminary financial statements. This practice may have a negative impact on the audit process. Indeed, international experience with earnings release prior to the audit completion (and hence the publication) has shown that auditors may undergo increased pressure from the companies not to adjust the financial statements after the earnings release.

8. **The listing rules of the Prague Stock Exchange require that companies listed on the main and secondary markets submit to the Stock Exchange their audited legal entity and consolidated financial statements prepared in conformity with Czech and International Accounting Standards within six months of the fiscal year-end (seven months for consolidated financial statements).** These companies must prepare up to four sets of audited financial statements, which is an excessive reporting burden. Also, requiring an enterprise to publish IAS-based legal entity financial statements within six months and IAS-based consolidated financial statements within seven months of the year-end is in conflict with IAS 27, *Consolidated*

⁴ Listed banks and banks that conduct brokerage activities are subject to more timely filing requirements set out in the Securities Act.

⁵ Within this report and for convenience purposes, Czech Accounting Standards refers to accounting standards and rules set out in primary and secondary Czech legislation, such as the Accounting Act, Decree No. 500/2002, Decree No. 501/2002, etc.

Financial Statements and Accounting for Investments in Subsidiaries. IAS 27 effectively requires that the consolidated financial statements should be issued contemporaneously with the legal entity financial statements.

9. **From January 1, 2003, all insurance companies are required to present legal entity financial statements in conformity with accounting regulations set out in Decree No. 502/2002 and consolidated financial statements prepared in conformity with either Decree No. 502/2002, IAS, or other internationally recognized accounting standards.** Decree No. 502/2002 on specific accounting regulations for insurance companies was published in 2002 in an effort to comply with EU Directive 91/674/EEC. Decree 502/2002 supersedes Regulation No. 430/1992 (as subsequently amended), which was valid for the financial year ended December 31, 2002. The accounting requirements are supplemented by the requirements of the Insurance Act, which prescribes the methods for the calculation of technical provisions.

10. **Exemptions from consolidation that are provided in secondary legislation have an adverse impact on the transparency of financial reporting by Czech groups.** The Accounting Act requires that all banks, insurance companies, and companies exceeding two of three thresholds—expressed in euro for the balance sheet total (Euro 11.6 million), net turnover (Euro 23.2 million), and number of employees for the average workforce (500)—prepare consolidated financial statements. These thresholds are in line with those in the EU Seventh Directive, except for the average workforce.⁶ Further, the Decrees provide an exemption from consolidation when a company is itself a subsidiary of a company that prepares consolidated financial statement in accordance with Czech Accounting Standards or IAS. The EU Seventh Directive and IAS provide a similar exemption so that companies in a group that are required by law to publish financial statements under IAS, in addition to the group's consolidated financial statements, would not be unduly burdened. However, the EU and IAS exemptions are conditional upon, among other things, the availability of the group's consolidated financial statements and the approval of minority shareholders. The Czech exemption does not include these fundamental conditions, which may have adverse impact on the transparency of financial reporting.⁷ In addition, while Czech law provides that the aforementioned exemptions from consolidation do not apply to listed

⁶ The EU Seventh Directive threshold is 250 employees. The Ministry of Finance has drafted an amendment to align Czech law with EU requirements.

⁷ The current IAS 27 wording permits that a parent, which is a wholly owned or virtually wholly owned subsidiary, need not present consolidated financial statements provided (in the case of one that is virtually wholly owned) the parent obtains the approval of the owners of the minority interest. Such a parent should disclose the reasons why consolidated financial statements have not been presented. The name and registered office of its parent that publishes consolidated financial statements should also be disclosed.

The EU Seventh Directive requires that the consolidated financial statements, the related annual report, and auditors' report of the parent must be published by the Member State subsidiary according to the publication requirements of the Czech Republic. The Czech Republic may impose that the parent's consolidated financial statements be translated into Czech language.

The International Accounting Standards Board issued an exposure draft in October 2002 amending IAS 27. The proposed amendment states that a parent need not present consolidated financial statements to comply with IAS if and only if:

- (a) It is a wholly-owned subsidiary or the owners of the minority interests unanimously agree that the parent need not present consolidated financial statements.
- (b) Its securities are not publicly traded.
- (c) It is not in the process of issuing securities in public securities markets.
- (d) The immediate or ultimate parent publishes consolidated financial statements that comply with IAS.

companies—an excellent rule that is included in the proposed amendment to IAS—the Czech Securities Commission granted a special exemption to a listed insurance company not to present consolidated financial statements in its 2001 annual report (latest available annual report).

11. **The Code of Commerce includes several provisions whereby dividends available for distribution, legal reserve requirements, and other company law issues may be significantly impacted depending on which accounting standards are used in preparing the legal entity financial statements.** The coexistence of legal entity financial statements prepared in conformity with Czech Accounting Standards, IAS, or other internationally recognized accounting standards might raise concerns about whether large companies and small- and medium-sized enterprises are on a level playing field.

12. **Many Czech medium-sized enterprises are subject to annual statutory audit requirements.** The Code of Commerce requires that all joint stock companies (approximately 15,200) be audited. In addition, under the Accounting Act, all companies exceeding two of three thresholds—expressed in euro for the balance sheet total (Euro 1.3 million), net turnover (Euro 2.6 million), and number of employees for the average workforce (50)—will be required to be audited..

13. **Neither the Code of Commerce nor other legislation sets out appointment and termination procedures for auditors.** Auditors may hence be appointed and terminated by management or the board of directors. Such appointment and termination mechanisms do not appear to provide adequate safeguards to preserve the independence of external auditors.

14. **The Czech National Bank has the authority to reject the appointment of the audit firm appointed by a bank within 30 days of receiving notification of the appointment.** However, such right of veto is the only sanction mechanism available to the Czech National Bank, which is given little flexibility in cases that may not warrant such a strict sanction. Neither the Czech Securities Commission nor the Insurance Supervision Department within the Ministry of Finance has such right of veto.

15. **While the Accounting Act requires that annual audited financial statements be filed at the Trade Registry, in practice audited financial statements are not yet always readily and timely available.** The World Bank ROSC consultant selected a sample of 22 companies. The consultant approached the Trade Registry, which is obliged to make these reports public. In seven instances, audited financial statements were not available. When available, audited financial statements were generally eighteen-months old. However, the ROSC team expects a significant improvement in the availability (not the timeliness) of financial statements at the Trade Registry following the enactment and actual levy of severe administrative fines for non-filing.

B. The Profession

16. **The Chamber of Auditors in the Czech Republic (CACR) has 1,353 individual members who are all actively engaged in audit work.** In addition, 307 audit firms are CACR members. Audit firms include local member firms of international audit firm networks, as well as strictly local firms. The CACR was established in 1993 and the right to audit financial statements was reserved to its members only. The Union of Accountants is a professional organization of Czech accountants, which was established in 1969 and has approximately 4,900 members. Membership to the Union of Accountants is voluntary and does not grant members any privileges. The Union of Accountants is sponsoring draft legislation, which would reserve the

functions of chartered accountants in public practice (i.e., not auditors) to members of a newly created professional organization.

17. **The Act on Auditors (amended 2002) recognizes the profession as self-regulated and independent and requires CACR to regulate professional performance as a matter of public interest.** Among procedures that the Act requires of CACR are the following: organize and conduct professional examinations; organize and monitor continuing professional education; maintain registers of auditors, including auditing firms and individuals; develop a professional code of ethics for members; develop, if necessary, professional audit rules and techniques; and control the quality of audit activity and members' professional conduct.

18. **The CACR lacks professional ethics requirements and strict guidelines for auditor independence.** The CACR has a code of professional conduct for both its members, which falls short of the International Federation of Accountants (IFAC) Code of Ethics for Professional Accountants (revised in November 2001). The CACR members did not endorse the IFAC Code of Ethics at the last annual meeting. However, the Board will resubmit it to the members and the Code is expected to be adopted by early 2004. Also, the Act on Auditors and the Chamber's guidelines do not prevent auditors from accepting nonaudit work from audit clients, including financial information systems design and implementation and appraisal or valuation services. Furthermore, there is no restriction on the hiring of the audit engagement team members by the audited company. The absence of an adequate code of ethics and adequate independence requirements in fact and appearance may hinder enforcement actions by the authorities against a violator of specific independence rules provided in the IFAC Code.

19. **The Czech legislation relating to auditor's liability has never been tested.** The main issues concerning the current Czech legislation of auditors' activities include the following:

- ***Lack of definition of the parties who could pursue a claim for damages against the auditors for a breach of their duties.*** Under the Act on Auditors, an auditor or an audit firm is obliged to provide auditing services duly and carefully and observe the rules of the profession. An auditor has so-called "objective liability" for any damages incurred in connection with the services the auditor provides and may be released from such liability only if he proves that he has exercised all efforts, which can be reasonably required. However, the Act fails to say expressly whether parties other than the audited company (e.g., creditors, investors, or any person relying in good faith on the auditor's opinion) may have a direct recourse against the auditor. In the absence of such provision, Czech lawyers contend that third parties would be in a difficult position to prove before a Czech court that they have title and legal standing to pursue the claim for damages against the auditor. It is also uncertain whether the auditor is liable for damages vis-à-vis the regulatory authorities.
- ***Vague description within the Act on Auditors of reporting duties of the auditors to the Czech regulators and no specific identification of audited entities, in relation to which the reporting duties apply.*** Any auditor should honor the confidentiality concerning all information supplied by the client in connection with the audit services. However, this obligation is automatically suspended if the client is subject to banking or "state supervision" and certain adverse events are discovered. In such a case, the auditor must notify the relevant regulator (for example, the Ministry of Finance) of these events. However, the Act on Auditors fails to define the concept of "state supervision" (for example, does that extend to telecommunication operators, who are subject to supervision by the Czech Telecommunication Office?).

- ***Lack of sanctions for failure to meet the reporting duties.*** The Act on Auditors does not contain any sanction for a breach of the reporting duty and it would be difficult for a regulator to successfully impose effective sanctions against the auditor.
- ***Unclear linkage between the Criminal Code and the Act on Auditors.*** Czech lawyers generally contend that the Criminal Code's terminology is vague and there is a need to establish clearer linkage between the Criminal Code and the Act on Auditors.

The significance of these issues is heightened by the lack of landmark higher court decisions on these subjects. The reason for this may be that the creditors and the equity holders do not pursue their claims against the directors and auditors due to a lack of trust in the Czech courts. There is an uncertainty whether the individuals responsible for the misconduct have sufficient property for eventual satisfaction of the claims. The ROSC team is not aware of any civil or criminal decision of Czech courts on a claim against auditors to date.

20. **Audit firms are generally incorporated as a limited liability company with very low share capital, which offers little protection to claimants.** The Act on Auditors requires that auditors take out professional indemnity insurance to cover "reasonably anticipated damages." In the event that the auditor's insurer does not satisfy the plaintiff's claim for damages, the legislation provides that plaintiff may initiate judicial proceedings against the audit firm and against any or all of the auditors (individuals) who have participated in providing the audit services (joint and several unlimited liability).

C. Professional Education and Training

21. **A registered auditor must have acquired appropriate higher education, obtained relevant practical experience, and passed the CACR examination.** The Act on Auditors complies with the EU Eighth Directive by requiring the following:

- ***To qualify as a trainee*** one must have graduated from college in a master's program.
- ***To qualify as an auditor*** one must have obtained three years of additional practical experience in auditing and passed the CACR examination that covers the seven subjects mandated by the EU Eighth Directive, including economy and financial management, accounting, and auditing standards.

While these requirements are in line with the EU Directive, observers note that audit trainees in local member firms of international audit firm networks prefer to attend the program of the United Kingdom's Association of Chartered Certified Accountants (ACCA). Although expensive, the program is taught locally and its international recognition appeals to young professionals. The local affiliates of international audit firm networks generally sponsor their staff attending the ACCA program. There is no bridge between the ACCA program and the CACR examination.

22. **No mechanism exists for screening practical training providers on their suitability for providing appropriate experience for the prospective auditor.** The audit trainee receives professional coaching by a registered auditor of his or her own choice. The practical training is not supervised by CACR for quality.

23. **The CACR requires, but does not enforce effectively, that members participate in an annual minimum of 35 hours of continuing professional education (CPE).** The CACR operates its own established CPE programs. Programs offered by other institutions also qualify under the continuing professional education requirement. The CACR monitors compliance with

CPE requirements based on an annual statement of CPE fulfillment filed by members. The only applied sanction in cases of noncompliance involves publication in the monthly CACR bulletin. As of end-2002, more than 300 members (representing over 22 percent) of the CACR had not complied with the CPE requirement or had failed to inform the CACR by not submitting the annual statement.

D. Setting Accounting and Auditing Standards

24. **Accounting regulation is driven by the Ministry of Finance, which also regulates and collects taxes.** Going forward, adequate checks and balances must be established to ensure that the accounting standard-setting process takes into account the needs of all users of general-purpose financial statements.

25. **Accounting standards for banks are supplemented by certain regulations issued by the Czech National Bank.** The Czech National Bank issues prudential regulations that have an impact on the preparation of financial statements. For example, Provision No. 9 of the Czech National Bank, dated November 6, 2002, forms the basis for the determination of loan loss allowances. The Czech Securities Commission and the Insurance Supervision Department within the Ministry of Finance do not set accounting standards.

26. **The Czech translation of IAS is readily available but outdated.** The 2000 version of IAS was translated into the Czech language in cooperation with the Prague University of Economics and published by a commercial company. The 2001 and 2002 versions were not published and hence not readily available in Czech. The 2000 Czech version remains expensive by local standards. This unaffordability concern could be alleviated when the Czech Republic joins the EU, at which time IAS in Czech would be published in the Official Journal. The Czech Republic will still need a process to translate the standards into Czech.⁸

27. **The CACR sets the Czech Standards on Auditing.** The Act on Auditors requires that auditors conduct their audits in accordance with Czech Standards on Auditing. While Czech standards are largely based on ISA, the CACR lags behind the IFAC in adopting auditing standards so that a number of important recent new international standards and amendments to ISA have yet to be reflected in the Czech Standards on Auditing. Auditors opining on IAS-based consolidated financial statements generally conduct their audit in accordance with ISA.

E. Enforcing Accounting and Auditing Standards

28. **The Czech Securities Commission reviews the financial statements of listed companies for completeness and obvious errors.** The Securities Issues Department at the Czech Securities Commission employs five young economists and lawyers who receive all issuers' legal entity and consolidated annual financial statements. Because of resource constraints and lack of accounting expertise, the Securities Issues Department reviews the financial statements for coherence and completeness, but does not enforce accounting standards. The Commission has never ordered restatement of financial statements, which gives evidence that the Commission does not have a process in place to enforce accounting standards effectively. The Prague Stock Exchange and the RM-System do not enforce accounting standards.

⁸ In preparation for the implementation of IAS in the EU, the European Commission is cooperating with the International Accounting Standards Committee Foundation (IASCF). The standards are translated in the member states and subjected to a comprehensive review process, which was established by the IASCF.

29. **The existing legal system does not provide the Czech Securities Commission with necessary power to conduct monitoring and enforcement of the highest level of professional implementation of IAS by listed companies and the highest standards of ethical behavior and implementation of ISA by auditors.** While the Securities Act and the Act on the Czech Securities Commission allow the Commission to levy fines, it is debatable whether the Commission could impose any fine on individuals (for example, directors or officers) or auditors, natural or legal persons, who assist or facilitate noncompliance with IAS and ISA. Also, the law does not provide the Commission with power—under specific circumstances and defined procedures—to ask for information from the auditors, which might include requesting audit work papers and conducting a special self-initiated inspection.

30. **The Czech National Bank and the Insurance Supervision Department do not enforce accounting standards within general-purpose financial statements of banks and insurance companies, respectively.** The Czech National Bank reviews banks' financial statements, but the primary responsibility rests with the auditors.⁹ The Insurance Act authorizes the Insurance Supervision Department within the Ministry of Finance to appoint an auditor to examine the audit work performed by an insurance company's auditor when there is just cause to question the audit quality. However, the Ministry has never exercised this authority. The Insurance Supervision Department has not had to enforce IAS because no insurance company has used IAS when preparing consolidated financial statements.

31. **The CACR has established procedures for quality control of auditors and audit firms, though its effectiveness remains questionable.** The CACR supervisory committee of seven elected members supervises two CACR full-time technical employees. The CACR conducts a continuing program of inspection of its members to assess the degree of compliance with professional standards. The inspections are conducted not less than once every six years. Inspections generally focus on formal rather than substantive issues. The CACR does not disclose publicly a written report of the findings for each inspection or for the inspection program.

III. ACCOUNTING STANDARDS AS DESIGNED AND AS PRACTICED

32. **There are wide ranging differences between Czech and International Accounting Standards, which have an impact on the financial statements of companies in the enterprise sector, banks, and insurance companies.** Selected differences include the following:

- ***Changes in accounting policies.*** The effect of certain changes in accounting policies is included in extraordinary items in the current period, whereas IAS 8, *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies*, requires that adjustment resulting from a change in the accounting policy be reported by adjusting the opening balance of retained earnings (benchmark treatment and only treatment accepted under the Exposure Draft of Proposed Improvements to IAS). As a consequence, information presented in accordance with the Czech Accounting Standards does not provide the most useful information for trend analysis of income and expenses.¹⁰

⁹ General-purpose financial statements are prepared based on the same accounting standards as those for regulatory reporting.

¹⁰ For example, a bank reported net profit of US\$3.3 million for the year ended December 31, 2002, of which US\$2.9 million resulted from the effect of changes in accounting policies recorded as

- **Intangible assets.** Establishment costs, such as legal and secretarial costs, incurred in establishing a legal entity are recognized as an asset and amortized over a maximum of five years, whereas IAS 38, *Intangible Assets*, requires that they be expensed. As a consequence, information provided in accordance with Czech Accounting Standards may present a flattering picture of the financial position of an entity.
- **Business combination.** The assets and liabilities of the acquired entity are revalued based on the Commercial Code requirements, which may differ from IAS 22, *Business Combinations*, fair valuation requirements. There is no specific guidance on subsequent adjustments to fair value and contingent consideration. As a consequence, companies may hide from stakeholders the actual premiums they pay for acquisitions, especially in cases where one company issues stock to the shareholders of the acquired company.
- **Special purpose entities.** Czech Accounting Standards do not require consolidation of special-purpose entities or disclosure of their existence in footnotes. The accounting treatment is generally based on the special-purpose entities' legal status. Such entities may allow a company to take in capital from outside investors or lenders to finance the company's ventures. As a consequence stakeholders may not be informed of certain off-balance sheet shenanigans.
- **Financial leasing.** Czech Accounting Standards do not require presentation of finance leasing transactions in accordance with IAS 17, *Leases*. Consequently, finance leases are accounted for as operating leases.

While these shortcomings may not be critical for certain enterprises, accounting standards for public interest entities should produce more transparent numbers and consistency, which together help steer capital to the companies that deserve it the most.

33. **There are specific differences between Czech Accounting Standards pertaining to enterprise sector companies and IAS.** Czech Accounting Standards pertaining to enterprise sector companies are primarily set out in the Accounting Act, supplemented by Decree 500/2002. Selected differences include the following:

- **Substance over form.** Czech Accounting Standards do not endorse the substance-over-form qualitative characteristic set out by the International Accounting Standards Board Framework. Transactions and other events may be accounted for and presented in their legal form, but not in accordance with economic reality. Since 2002, the Accounting Act provides a true and fair view override, which could be used as an argument to comply with the substance-over-form principle. This override remains rarely used by practitioners.
- **Subsidiaries excluded from consolidation.** Dissimilar activities between a parent and a subsidiary may be grounds for excluding the subsidiary from consolidation. This may significantly distort the presentation of a group's financial position and performance.
- **Segment reporting.** While companies may elect to report segment information, they are only required to provide a split of revenue by main activities and disclose the split of domestic and foreign revenues. The lack of segment information hinders analysis

extraordinary income. This could mislead investors and other stakeholders who may not always plow through the income statement and the footnotes.

of a group's financial performance and is severely criticized by institutional investors.

34. **There are specific differences between Czech Accounting Standards pertaining to banks and IAS.** Czech Accounting Standards pertaining to banks are primarily set out in the Accounting Act, supplemented by Decree 501/2002 and Czech National Bank regulations. For example, Provision No. 9 of the Czech National Bank requires banks to calculate impairment in the unsecured portion of loans and receivables on the basis of a provisioning matrix that specifies a range of fixed provisioning rates for the number of days a loan has been classified as nonperforming (0 percent if less than 30 days, 1 percent if 30-90 days, 20 percent if 90-180 days, 50 percent if 180-360 days, and 100 percent of more than 360 days). The National Bank regulation may not always be appropriate to calculate the recoverable amount of originated loans and receivables under IAS 39, *Financial Instruments: Recognition and Measurement*. IAS 39.111 requires impairment or bad debt losses to be calculated as the difference between the asset's carrying amount and the present value of expected future cash flows discounted at the financial instrument's original effective interest rate, which may differ significantly from the Czech National Bank regulation. However, the Czech National Bank represented that Provision No. 9 does not conflict with IAS 39.

35. **There are specific differences between Czech Accounting Standards pertaining to insurance companies and IAS.** Czech Accounting Standards pertaining to insurance companies are primarily set out in the Accountancy Act supplemented by Decree 502/2002. For example, Czech Accounting Standards require that treasury shares be recorded as an asset. IAS 32, *Financial Instruments: Disclosure and Presentation*, requires that treasury shares be presented in the balance sheet as a deduction from equity. Such accounting treatment raises additional concerns, as treasury shares do not appear to be deducted for purposes of determining the solvency ratio.¹¹

36. **The ROSC team made assessments of the compliance gap with IAS and the Czech Accounting Standards.** For the review, the ROSC team selected IAS-based financial statements prepared by five enterprise sector companies listed on the Prague Stock Exchange, as well as seven banks; and Czech Accounting Standard-based financial statements prepared by 10 companies in the enterprise sector, five insurance companies, four investment funds, and four banks. The ROSC team could not obtain any IAS-based financial statements prepared by insurance companies or investment funds, as these entities do not prepare financial statements using IAS.

37. **A significant minority of IAS-based consolidated financial statements prepared by companies in the enterprise sector did not comply with IAS.** The related audit reports were not qualified, which may be because the auditors considered these issues were not a material departure from IAS:

- **Uniform accounting policies.** The accounting policies used by a major associate (as defined by IAS 28, *Investments in Associates*) are not fully comparable with group accounting policies and no adjustments have been made to achieve uniformity. This associate is very significant in terms of its contribution to the group's profit. This associate's profit eliminates the loss from other group activities. This does not

¹¹ Elimination of any double gearing of capital is the accepted practice throughout the EU. Therefore, treasury shares are to be deducted from capital. Should this treatment be applied in the Czech Republic, certain insurance companies in the sample would lose a significant portion of their capital and may in fact be undercapitalized.

comply with paragraph 20 of IAS 28, and raises the significant issue of the reliability of those financial statements.

- **Reporting interests in joint ventures.** The company decided to change its method of accounting for a 50 percent share in a joint venture from proportionate consolidation to equity method as a result of its decision no longer to support financially the activity and development of that joint venture. The company has therefore provided fully for the carrying amount of the investment. It has not recognized the liability for any additional financial support and losses for that joint venture. The disclosures make it difficult for the readers to understand the nature of the continued relationship and the possible financial effects. The other joint venture party has continued to report its interest using proportionate consolidation.
- **Revenue capitalization.** The revenue from the sales of products or services generated during the construction of assets are deducted from the cost of that asset, which does not comply with IAS 16, *Property, Plant, and Equipment*. The amounts are disclosed and are material. This may be an example of existing tax-driven national practices influencing the application of IAS.
- **Retirement benefit costs.** The company is obliged to make lump-sum payments to employees on their retirement, the amount of which depends on their length of service. This obligation is in substance a defined benefit plan. The company does not account for the obligation because employee contracts are renegotiated annually and it claims that there is no legal or constructive obligation to make payments beyond the period of the current contracts. While the amounts involved may not be material, this accounting treatment conflicts with IAS 19, *Employment Benefits*, which requires defined benefit plan accounting for those constructive obligations for which the entity has no realistic alternative but to continue payments.
- **Disclosure about nature and terms of long-term debt.** While interest rates and maturity dates for each item of long-term debt are disclosed, the currency of each item is not disclosed. Currency disclosures are given only in aggregate. This may not comply with IAS 32, *Financial Instruments: Disclosure and Presentation*, and makes it difficult for a reader to understand the exposure of a company to interest rate risk and currency rate risk.

38. **The IAS-based consolidated financial statements prepared by banks were generally adequate with a minority of significant exceptions.** However, areas of possible conflict with IAS were noted. The related audit reports were not qualified, which may be because the auditors considered these issues were not a material departure from IAS:

- **Restructuring provisions.** Selected sample banks created a provision for restructuring in 2000 based on a detailed formal plan. This restructuring continued throughout 2001 and 2002 and completion is expected in 2003. The time period for this restructuring brings into question whether there was a detailed formal plan in 2000 that met the requirements of IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*. Furthermore, there are significant transfers related to the restructuring provision between the provision, income statement and, for asset impairments, property plant and equipment. It is possible that these banks may not be complying with the requirements of IAS 36, *Impairment of Assets*, and IAS 37.
- **Undisclosed contingent liability.** Under Czech law, savings accounts that have been idle for 20 years are statute barred. In 2002, one of the sample banks had written off US\$12.8 million of such accounts as income (equivalent to approximately 4 percent

of profit before tax). While the bank does not have a legal obligation to repay such accounts, the financial statements state that it is “normal practice” to do so, a statement that acknowledges the existence of a constructive obligation. It paid US\$560,000 in 2002 and has made a provision for further payments of US\$2 million. While the provision may represent the best estimate of the liability arising from the constructive obligation, there may be a substantial undisclosed contingent liability. The financial statements of other banks in the sample were silent on this issue.

- ***Allowance for loan losses.*** Some sampled banks appear to provide for loan losses in accordance with Czech National Bank regulations rather than in accordance with IAS 39.
- ***Amortized cost and revenue recognition.*** It appears that transaction costs are included in the amortized cost calculation, whereas the related fees charged to customers are recognized in income immediately. If this were the case, this may not comply with IAS 39 and would result in the overstatement of net income.

39. **The Czech Accounting Standards-based financial statements prepared by insurance companies conform, in all material respects, to Czech Accounting Standards but do not provide adequate information about the financial position and performance necessary to investors, regulators, and other stakeholders in making economic decisions.** This gives evidence that companies do not comply with a higher standard of reporting voluntarily. In addition, some areas were noted where Czech Accounting Standards allow differing accounting policies. As a result the comparability of results between insurance companies may be limited:

- ***Deferred acquisition costs.*** Czech accounting standards neither prohibit nor require the deferral of acquisition costs in life insurance. While most companies adopt a Zillmerization method¹² (as is common in continental Europe), one company in the sample expenses all acquisition costs as incurred. It should be noted that within the European Union some member states have used the option to prohibit deferral while others have not. As such, the issue of inconsistency is applicable to the European insurance market as a whole. The issue of deferral of acquisition costs is currently being reviewed by the International Accounting Standards Board as part of its project on a standard for insurance contracts.
- ***Unrealized foreign exchange gains.*** While most insurance companies record unrealized foreign exchange gains in the income statement (as required by Czech Accounting Standards), one insurance company does not recognize them until realized. This may jeopardize the comparability of financial statements and undermine regulatory supervision especially when taking into account sea changes in exchange rates.

40. **The financial statements prepared under Czech Accounting Standards by companies in the enterprise sector and investment funds were generally in compliance with local requirements.** However, areas of possible conflict with Czech standards were noted. The related audit reports were not qualified, which may be because the auditors considered these issues were not a material departure from Czech Accounting Standards:

- ***Disclosures.*** The notes to the financial statements of several sample companies did not include important disclosures required by Czech Accounting Standards, such as a

¹² Zillmerization is a method of calculating reserves in life insurance.

presentation of financial investments, accounts receivable, provisions, bank loans, and deferred tax.

- ***Special report on related parties.*** The Commercial Code requires a special report on related parties, which must be reviewed by the auditor. In one instance, the special report available at the Trade Registry differed from the report published in the annual report.

IV. AUDITING STANDARDS AS DESIGNED AND AS PRACTICED

41. **In law, the Czech Republic seeks to attain maximum compliance with the EU Directives and Recommendations on auditing and to create an environment for implementation of ISA.** The Act on Auditors and current practice do not yet comply with all provisions within European Commission recommendations on auditor's independence (May 16, 2002) and on quality assurance for the statutory audit (November 15, 2000). Selected areas of difference include the following:

- ***Public oversight.*** The European Commission recommends that quality assurance systems should have adequate public oversight with a majority of nonpractitioners on the overview board of the quality assurance system. This public oversight requirement is meant to ensure that the quality assurance is in fact and appearance an exercise with sufficient public integrity. The existing quality assurance system in the Czech Republic does not have such public oversight.
- ***Link between quality reviews and disciplinary sanctions.*** The European Commission recommends that there be a systematic link between negative outcomes of quality reviews and initiating sanctions under the disciplinary system. The link between quality reviews and disciplinary sanctions adds public credibility and is also logical because quality assurance can be seen as an enforcement tool. The CACR has established a process whereby its external quality control function can refer issues to the disciplinary function. However, few substantial issues appear to have been referred and few sanctions taken. Also, the existing system lacks transparency.
- ***Fee disclosure.*** When a public interest entity (as defined in the European Commission Recommendation) has a governance body (e.g., the Supervisory Board), the Commission recommends that the auditor—at a minimum annually in writing to the governance body—should disclose the total fees that the auditor, the audit firm, and its network members have charged to the client and its affiliates for the provision of services during the reporting period. This total amount should be broken down into four broad categories of services: statutory audit, further assurance, tax advisory, and other nonaudit. Furthermore, the European Commission recommends that such fees be disclosed publicly. At present, this is neither required by the Czech legislation nor generally accepted by the audit profession.

The CACR is well aware of the aforementioned shortcomings and is currently undertaking to propose amendments to the legislation to comply with the *acquis communautaire*.

42. **Although Czech Standards on Auditing are largely based on ISA, important differences remain with adverse impact on the robustness of the Czech standards.** Czech Standards on Auditing need updating in keeping with revisions to ISAs; for example, immediate consideration should be given to Czech standards in relation to major changes in ISAs relating to “Going Concern” and “The Auditor’s Responsibility to Consider Fraud and Error.” Moreover,

certain ISAs have no comparable Czech standards: ISA 260, *Communications of Audit Matters with Those Charged with Governance*; ISA 505, *External Confirmation*; and ISA 550, *Related Parties*. Adoption of ISA in their entirety would be consistent with the EU's objective to use ISAs from 2005 onwards for all EU statutory audits.¹³

43. **While many audit firms make strenuous efforts to carry out audits in accordance with Czech Standards on Auditing or ISA, it appears that few shareholders, directors, and members of management understand the purpose of an audit, which makes audit evidence difficult to obtain.** While this problem undoubtedly occurs in other countries, including those with developed audit requirements and practice, the extent of some problems is more widespread in the Czech Republic than in other countries. There is an obvious need for more education of investors, directors, and members of management that could be addressed under the follow up on the ROSC Corporate Governance module.

44. **In practice, some audit reports are very confusing.** During the review of financial statements, the ROSC team noted that auditors might address their reports to the Board of Directors and sometimes to the shareholders. This is likely a consequence of the deficiencies noted in Paragraph 13 above. Also, the team noted that some auditors tend to opine on the fair presentation, in all material respects, of the financial statements (the U.S. approach), whereas the EU requires the auditor to opine on the presentation of a true and fair view and compliance with accounting standards, which is why there is a true and fair override.

45. **In one of the sampled listed companies, the auditors state that they have not audited the financial statements of a significant associate and that their audit opinion is based solely upon the report of other auditors.** This does not comply with ISA and raises significant concerns, as the accounting policies used by this associate are not fully comparable with group accounting policies and no adjustments have been made to achieve uniformity. This inappropriate caveat may be the result of the general lack of cooperation among auditors.

46. **Clients lack financial reporting expertise and therefore expect the auditors to prepare their IAS-based financial statements.** There is reasonable evidence that audit firms are involved extensively in the preparation of IAS-based financial statements on behalf of their clients. Clients emphasize that audit firms gradually transfer knowledge to company staff who then can take over drafting financial statements. This practice has implications for ownership by preparers of their IAS-based financial statements and raises issues of audit independence.

V. PERCEPTIONS ON THE QUALITY OF FINANCIAL REPORTING

47. **There is little evidence that a large demand for transparent financial statements has developed among potential investors.** The low demand for financial statements is compounded by the perceived lack of reliability in financial information and the fact that funding is provided by local banks or through late payment of creditors. Interviews with representatives of institutional investors, foreign and local bankers, analysts, and various other users of corporate financial information revealed a shared view that the quality of financial reporting would improve when there is a strong regulatory regime combined with effective enforcement mechanisms to ensure compliance with accounting and auditing standards, and accountant's and auditor's professional ethics.

¹³ Refer to the Communication of the European Commission to the Council and the Parliament, "Reinforcing the Statutory Audit in the EU," May 21, 2003.

VI. POLICY RECOMMENDATIONS

48. The following policy recommendations were agreed between the World Bank staff, the Ministry of Finance, and country stakeholders. It was also agreed that a detailed Country Action Plan would be developed and implemented on the basis of these policy recommendations. The Country Action Plan will be developed by in-country stakeholders and implemented under the coordination of the Ministry of Finance with assistance from international development partners. The policy recommendations are based on the existing legislative framework.

49. **Amend accounting and auditing laws and standards.** The Accounting Act, the Act on Auditors, the Banking Act, the Insurance Act, the Securities Act, the Code of Commerce, as well as secondary legislation should be amended and other measures taken to incorporate the following legislative recommendations:

- ***Financial reporting by public interest entities.*** The IAS and related interpretations issued by the International Accounting Standards Board should be mandatory for the financial statements of all public interest entities.¹⁴ The audit of financial statements prepared by public interest entities should be carried out in accordance with the ISA and other related pronouncements issued by the IFAC.

The use of “other internationally recognized accounting standards” in lieu of IAS should only be authorized in specific cases, subject to approval by the Ministry of Finance. For example, generally accepted accounting principles in the United States (U.S. GAAP) may be used by companies in the oil and gas industry, since U.S. GAAP currently is the internationally recognized benchmark for that industry; and the International Accounting Standards Board has only recently issued a discussion document on “accounting by mining and oil and gas companies.”

The Prague Stock Exchange listing rules should not mandate the presentation of Czech Accounting Standards-based financial statements in addition to IAS-based financial statements.¹⁵

- ***Financial reporting by small- and medium-sized enterprises and micro-enterprises.*** The legislation should provide small- and medium-sized enterprises with a reporting framework more adapted to their size.
- ***Community law.*** A working group should undertake a comprehensive review of primary and secondary legislation compared to the EU Fourth, Seventh, and Eight Directives; and the Insurance and the Banking Directives (and forthcoming amendments) to identify existing discrepancies (e.g., consolidation exemptions) and propose amendments where necessary.
- ***Code of commerce.*** A working group should review the Code of Commerce in line with the forthcoming European Commission Recommendation, which will define minimum standards applicable to the role of audit committees in supervising the audit function, both in its external aspects (e.g., selecting the external auditor for

¹⁴ Public interest entities may be defined by the nature of their business, their size, and their number of employees; or by their corporate status by virtue of their range of stakeholders. Examples of public interest entities might include banks, insurance companies, investment funds, pension funds, listed companies, and large enterprises.

¹⁵ Such legislative amendments are consistent with Regulation No.1606/2002 of the European Parliament and of the Council of July 19, 2002, on the application of IAS and extend the scope of the Regulation to privately held entities where there is a public interest.

appointment by shareholders, monitoring the relationship with the external auditor including non-audit fees if any) and its internal aspects (e.g., reviewing the accounting policies). The working group should proposed amendments where necessary.

- **Auditing law and standards.** The Chamber of Auditors in the Czech Republic should adopt ISA and the IFAC Code of Ethics. The IFAC Code of Ethics should also apply to the members of the to-be-established Chamber of Chartered Accountants. In addition, the legislator and the CACR should amend the existing regulatory framework to incorporate the provisions within European Commission Recommendations on auditor's independence and on quality assurance for the statutory audit. In particular, the legislator and the CACR should assess whether more stringent restrictions than in the current European Commission Recommendation, regarding the provision of additional services, should be imposed on auditors with a view to avoiding potential conflicts of interests and be an early adopter of changes to the *acquis communautaire*.¹⁶

50. **Ensure accounting and auditing standard setting and interpretations.** Accounting and auditing standard-setting and interpretation mechanisms should be reviewed to ensure adoption of IAS and ISA and transparency of due process and to better represent the public interest regarding Czech Accounting Standards.

- **Accounting standards.** The adoption of IAS for public interest entities requires the establishment of a sustainable system within the appropriate body to enable (a) immediate translation and adoption of new International Financial Reporting Standards and exposure drafts issued by the International Accounting Standards Board, and new interpretations developed by the International Financial Reporting Interpretations Committee (IFRIC); and (b) to issue implementation guidelines on individual IAS that should link into IFRIC.

The transition to full IAS compliance for public interest entities will be demanding. It requires extensive education in a different style and philosophy of accounting requirements. The transition to full IAS will require a culture shift to reduce the influence of tax accounting on general-purpose financial statements.

As Czech Accounting Standards remain applicable to small- and medium-sized enterprises, the accounting standard-setting body should be composed of professional accountants, business representatives, regulators, and other stakeholders, such as the Ministry of Finance and the tax authorities. All of the standard-setter's work and discussions should be made public, as should the procedures set out in its by-laws.

Regulatory accounting requirements (e.g., loan loss provisioning in the banking sector) should not affect IAS-based general-purpose financial statements. Where the regulators need additional (unpublished) information for prudential supervision purposes, this should come by topping-up IAS. However, since the regulators would have a keen interest in ensuring that the fundamental IAS-based general-purpose financial statements are correct—since their reports would be built on that foundation—this would mobilize them to assist in the enforcement of shareholder- or stakeholder-oriented financial statements as well.

¹⁶ Such legislative amendments are consistent with the trend set out in the Communication for the European Commission to the Council and the Parliament reinforcing the statutory audit in the EU dated May 21, 2003.

- **Auditing standards.** The adoption of ISA for public interest entities requires the establishment of a sustainable system within the CACR to enable (a) immediate translation and adoption of new ISA and exposure drafts issued by the International Federation of Accountants; and (b) to develop audit guidance related to individual ISA.

51. **Strengthen publication and filing of legal entity and consolidated financial statements.** The Securities Act and other relevant laws should be amended and enforcement mechanisms reviewed as follows:

- For public interest entities, publication requirements should be strengthened in terms of timeliness and electronic availability. Audited legal entity and consolidated financial statements should be published within three months of the year-end. The current practice whereby the listed companies publish a set of unaudited preliminary financial statements should be discontinued.
- Publication of abridged financial statements (in newspapers, in annual reports, and on websites) should be avoided or authorized only if the following actions are taken:
 - Abridged financial statements are appropriately titled to identify the audited financial statements from which they have been derived, for example, “Summarized Financial Information Prepared from the Audited Financial Statements for the Year Ended December 31, 2002.”
 - Auditor’s report accompanying the abridged financial statements is in accordance with ISA 800, *The Auditor’s Report on Special Purpose Audit Engagements*, and which, among other things, includes the statement, “For a better understanding of the Company’s financial position and the results of its operations for the period and of the scope of our audit, the summarized financial statements should be read in conjunction with the financial statements from which the summarized financial statements were derived and our audit report thereon.”
 - Audited financial statements are readily available to all interested parties and the publication states where the full set of audited financial statements can be obtained.

Article 49 of the EU Fourth Directive provides for similar caveats relating to the publication of abridged financial statements—though the wording is slightly different.

52. **Strengthen oversight of accounting and auditing practices.** The ROSC review has found significant compliance gap relating to accounting and auditing standards. This gap and recent scandals have prompted calls for strengthening oversight arrangements, including the following:

- **Powers to conduct monitoring and enforcement of IAS and ISA.** Amend the existing regulatory framework to provide the necessary legislative changes required in a civil law legal system that will provide the Czech National Bank, the Czech Securities Commission, and other regulators with the necessary powers to conduct monitoring and enforcement of (a) the highest level of professional implementation of IAS by public interest entities and (b) the highest standards of ethical behavior and implementation of ISA by auditors.

- **Monitoring and enforcing IAS at the national level.** Establish monitoring and enforcement arrangements within the Czech National Bank, the Czech Securities Commission, and other regulators, which comply with the requirements expressed in recital 16 within the EU Regulation on the application of IAS. While enforcement of accounting standards is arranged at the national level rather than at the European level, enforcement arrangements should provide for international coordination mechanism in order to create a level playing field across the EU and to ensure consistent decisions. The enforcement processes should ensure that the regulators make unbiased decisions, have transparent and clear procedures, investigate rapidly and confidentially, have a risk-based approach reflective of available resources, have appropriate means of rectifying defective financial information inconsistent with Czech law, and have the authority to impose sanctions or provide information that assists existing authorities in imposing sanctions. It should be stressed that consistent and robust decisionmaking should not result in standard setting.
- **Effective sanction mechanism.** Impose realistic administrative, civil, and/or criminal penalties that are based on a civil law system on both auditors, natural or legal persons; and officers, directors, or employees of the auditors or enterprise that assist or facilitate noncompliance with IAS and ISA.
- **Monitoring and enforcing ISA and the Code of Ethics.** The CACR should develop its quality assurance system to ensure that auditors comply with applicable auditing and ethical standards, and independence requirements. The system should include in-depth quality reviews of audit firms and specific audit engagements based on an established schedule, so that (a) every audit firm or sole practitioner and (b) the audit working papers for every public interest entity would be subject to regular oversight (for example, every three years). Remedies should provide for sanctions, including injunctions, fines, temporary and permanent disbarment, and criminal liability.
- **Public oversight of the audit profession.** As deficiencies of self-regulatory arrangements become clearer on the international scene, the current audit profession self-regulatory arrangement and power to impose sanctions should be balanced with an adequate oversight system, which is currently lacking. Appropriate public oversight of the audit profession should be established to extend further than the oversight of the quality assurance required by the European Commission Recommendation of May 2002. Therefore, the scope of the oversight might extend to education, licensing, standard-setting, quality assurance, and disciplinary systems in line with forthcoming changes in the *acquis communautaire*. While the Czech National Bank and the Czech Securities Commission may be proxies for the public interest, the public oversight body should include other stakeholders.

53. **Enhance professional education and training.** In adopting IAS and ISA for public interest entities the Czech Republic will set challenging and demanding objectives for itself. This translates into a need for related education and training for preparers, auditors, and regulators. Training plans should encompass some of the following areas:

- **University curriculum.** Develop an accounting curriculum at colleges and universities that meets the needs of corporate Czech Republic. While the accounting major curriculum would include IAS training, it should also include more business administration and case studies to ensure that the graduates are better prepared to operate as accountants (rather than bookkeepers or tax compliance officers) in corporate Czech Republic.

Review and update the accounting curriculum in order to incorporate IAS and ISA and practically oriented teaching at the undergraduate level in higher educational institutions. The ethical dimensions of business management, corporate finance, and accounting and auditing should be taught with case studies in the undergraduate programs of business schools and commercial training faculties. Particular attention needs to be given to increasing the critical thinking skills of the students. To enhance the capacity of higher educational institutions to teach accounting and auditing courses with international components, there is a need to organize a training-the-trainers program.

- **Regulators.** Provide meaningful IAS theoretical and practical training to the staff of the Czech Securities Commission, the Czech National Bank, and other regulators so they can enforce accounting standards as recommended.
- **Continued professional education.** Monitor and enforce the CACR continuing professional education.
- **Quality of training.** Arrangements need to be made so that the CACR regularly monitors the quality of practical training provided by authorized training providers to the trainee auditors.
- **IAS Training.** Corporate accountants in public interest entities ought to be trained in IAS. Failure to provide rigorous training to corporate accountants will exacerbate the existing practice whereby audit firms are involved extensively in the preparation of IAS-based financial statements on behalf of their clients.