



Audit Conclusion

17/36

Accounting Reform in Public Finance

The audit was included in the audit plan of the Supreme Audit Office (hereinafter the “SAO”) for 2017 under number 17/36. The audit was headed and the Audit Conclusion drawn up by SAO member Ing. Jan Málek.

The objective of the audit was to verify whether the accounting reform in public finance had been prepared and implemented as to ensure that reliable and usable information is reported about the economic position of the state and of entities such as organisational units of the state and government subsidised organisations¹.

Audited entities:

Ministry of Finance (“MoF”),
Czech Statistical Office (“CZSO”)

The period under review was 2007-2016; both the previous and subsequent periods were also considered for contextual reasons.

The audit was performed by the audited entities between September 2017 and March 2018.

The Board of the SAO, at its 12th session held on 17 September 2018,
approved, by Resolution No. 7/XII/2018,
the ***Audit Conclusion*** as follows:

¹ With regard to the competence of the SAO and the approved objective of Audit KA 17/36, the audit focused on the process of the accounting reform only for organisational units of the state and government subsidised organisations. Instead of referring to organisational units of the state and government subsidised organisations, the text of the Audit Conclusion also makes references to the so-called “selected accounting entities”, which, according to Section 1(3) of Act No. 563/1991 Coll. on accounting, covers organisational units of the state, state funds according to budgetary rules, territorial self-governmental units, voluntary associations of municipalities, regional councils of the cohesion regions, government subsidised organisations, and health insurance companies.

Key facts

| 18,177 | CZK 5,133 bn | ??? CZK |
|--|--|--|
| Number of ² selected accounting entities as at 6 September 2018 | Value of net assets according to the statement of the state's assets and liabilities as at 31 December 2016. | The MoF does not have a report of the total cost of the implementation of the accounting reform. |

Definition of the objectives and benefits of the accounting reform

The objectives of the accounting reform were not specific enough and its benefits were not defined.

More comprehensive information on financial management

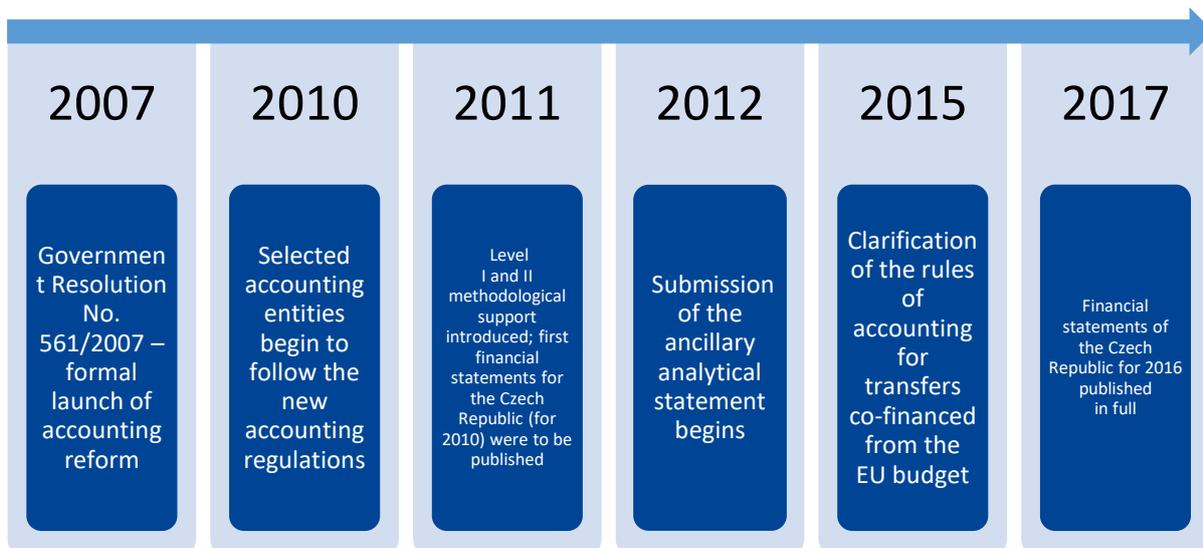
The state's accounting is set up so as to generate more comprehensive information for the assessment of the financial position and performance of the selected accounting entities in comparison with the situation before the accounting reform was launched.

Problems in the early years of the accounting reform

Especially in the early years, the accounting reform was accompanied by problems concerning accounting laws and regulations and methodological support, which may have adversely affected the reliability of the reported information.

Use of financial information

The MoF makes hardly any use of accrual financial information in compiling the state budget, the closing accounts of the state budget chapter and the state closing account.



² Source: Calculation by SAO according to: http://www.info.mfcr.cz/ares/ares_es.html.cz.

I. Summary and Evaluation

By its Resolution No. 561 of 23 May 2007 (“Resolution 561/2007”), the Government approved the creation of the state’s accounting as of 1 January 2010 to implement elements of accrual³ accounting in the public sector in the Czech Republic. The accounting in the public sector of the Czech Republic had previously failed to sufficiently accomplish the purpose of financial reporting, i.e. to provide information about the entity with a view to accountability and decision-making. According to Resolution 561/2007, the purpose of the reform was to create conditions to ensure the efficient provision of accurate, complete and timely information about the economic position of the state and of the relevant entities.

The objective of the audit was to verify whether the accounting reform in public finance⁴ had been prepared and implemented as to ensure that reliable and usable information is reported about the economic position of the state and of entities such as organisational units of the state and government subsidised organisations. For this purpose, the SAO performed the verification of the audited entities (MoF and CZSO) in terms of the setting of the objectives of the accounting reform, creation of conditions for the implementation of the accounting reform, and ensuring the reliability and usability of the financial information about the economic position of the state, the organisational units of the state and government subsidised organisations. The SAO based its audit on Resolution 561/2007. The amount expended on the activities related to the accounting reform could not be quantified.

Having performed the audit, the SAO states the following:

- **Before the reform was launched in January 2010, state accounting was not prepared to such an extent to ensure the ability of organisational units of the state, government subsidised organisations and the state to report reliable and comparable financial information.**
- **Because of the manner in which the accounting reform was implemented the conditions created, in particular in the early years of the accounting reform, failed to contribute sufficiently to ensuring the reliability of financial information. Only subsequently in the course of the accounting reform were the accounting regulations and methodological support improved, establishing the prerequisites for ensuring higher reliability of the reported information.**
- **The financial information reported by organisational units of the state and government subsidised organisations is used to prepare financial statements for the Czech Republic and national accounts. However, this comprehensive information is not used for compiling the state budget, which fails to link accounting and budgeting as foreseen within the meaning of Resolution 561/2007. Accrual financial information is thus used for the drawing up of the closing accounts of state budget chapters and for the drawing up of the state closing account only to a minimum extent.**

³ The accrual accounting principle is based on recognising revenues and expenses in the period when the event occurs in terms of content and timing regardless of when the revenues and expenses are actually received or paid.

⁴ The terms *accounting reform in public finance*, or its abbreviated form *accounting reform* (the subject of SAO Audit No. 17/36), and *state accounting* (annex to Government Resolution 561/2007 of 23 May 2007) are treated as interchangeable and having the same meaning in this Audit Conclusion.

- **There are significant reserves in the way the MoF and CZSO use information about the facts posted in off-balance sheet accounts provided in the annexed statement and information specified in the cash flow statement and the statement of changes in equity. Similarly, subareas were found in the ancillary analytical statement report for which no specific use was identified.**
- **With regard to the low utilisation of financial information by the MoF, the benefits of the accounting reform are reduced significantly and fail to meet the efficiency principle specified in Resolution 561/2007.**

The audit revealed the following:

1) Objectives set by the accounting reform and evaluation of their fulfilment (Part IV, Sections 1.1 to 1.2 of the Audit Conclusion)

Even though the **objective of the accounting reform** set by the MoF was to create conditions to ensure accuracy, completeness and timeliness of information about the economic position of the state and of the relevant entities, it is obvious from Resolution 561/2007 that the sought-after output of the accounting reform was accurate, complete and timely financial information itself in order to ensure efficient economic management of the state. The principles to be used to fulfil the objective of the accounting reform were defined by the MoF only in general terms and without determination of any criteria for their evaluation. The MoF did not evaluate the objective of the accounting reform or the individual principles established by Resolution 561/2007. **The benefits of the accounting reform** were not defined specifically enough.

The reports on setting up the state's accounting, submitted to the government in the period 2008–2010, thus failed to include the evaluation of the fulfilment of the objective of the accounting reform because of the general nature of the objectives and the absence of evaluation criteria.

2) Creating conditions for the implementation of the accounting reform (Part IV, Sections 2.1 to 2.3 of the Audit Conclusion)

The accounting regulations were not published well in advance of their effective date, in particular, for the accounting periods 2010 and 2011. Because of this, the organisational units of the state and government subsidised organisations did not have enough time to be able to correctly account for new facts and apply the new accounting methods. The lack of time for the correct application of the new obligations in this period thus may have had a negative impact on the reliability of the financial information of the organisational units of the state and government subsidised organisations, even though reliability is fundamental for any meaningful use of such information.

The failure to ensure the reliability of the financial information reported in this period was also aggravated by the fact that, in 2009 and 2010, the MoF failed to ensure sufficient **methodological support** for the organisational units of the state and government subsidised organisations. In the period from 2011 to 2017, the MoF, along with other ministries and regions, was already providing methodological support in accordance with Resolution No. 921 of the Government of the Czech Republic of 22 December 2010 ("Resolution 921/2010).

A questionnaire survey⁵ showed that, while the methodological support was viewed rather positively by the approached organisational units of the state and government subsidised organisations, there were still areas for which these organisational units of the state and government subsidised organisations would appreciate stronger methodological support from the MoF (in particular, as regards the area of assets and transfers).

The SAO has concluded that the **accounting regulations were ambiguous between 2010 and 2014**. Out of 17 financial audits that verified the financial statements for the above-mentioned accounting period, the SAO give an opinion on the reliability of the financial statements because of the ambiguity and unclarity of the accounting regulations in 11 audit conclusions, i.e. in 65% of the cases.⁶

In particular, there were no accounting regulations available in 2010 to **comprehensively** cover all the required areas. This resulted in increased uncertainty on the part of the organisational units of the state and government subsidised organisations regarding whether or not they were keeping their accounts correctly (this fact was also indicated by the questionnaire survey conducted). While the accounting regulations have improved gradually, there are still areas where the accounting regulations are still inadequate (e.g. long-term financial assets or clearing relations).

A fundamental deficiency resulting from the incomprehensive accounting regulations was the fact that **the first preparation of the financial statements for the Czech Republic was delayed by 5 years**. The financial statements for the Czech Republic were originally supposed to be prepared for the accounting period 2010. However, they were only for the first time prepared for 2015, and even then, only to a limited extent. The financial statements for 2016 were already prepared in full.

There **conceptual framework continues to be missing**, i.e. coherently formulated starting points for financial reporting in the public sector (what is its purpose and objective, how to attain the objective, and who are the users of the financial statements) and definitions of certain fundamental elements (assets, liabilities, costs, revenues), which poses a risk of an inconsistent application of the accounting regulations and, ultimately, reporting incomparable financial information.

⁵ As an additional source of information, the SAO used a questionnaire survey to approach a total of 75 respondents in the course of the audit (50 organisational units of the state including all the administrators of the budget chapters and other major organisational units and 25 major government subsidised organisations) to determine how certain aspects of the accounting reform in public finance were viewed by the entities directly concerned with the reform. The request for completing the questionnaire was addressed to the heads of the departments comprising the accounting office and the instructions stated, among others, that the questionnaire should be completed in cooperation with the person responsible for keeping the accounts (e.g. Chief Accountant) or for its methodology. The response rate was slightly over 77 %.

⁶ A fundamental example of the ambiguity of the accounting regulations, consisting in various options of recognising transfers co-financed from the EU budget and provided in the form of pre-financing from the state budget, was removed by an amendment to the Czech accounting standard for certain selected accounting entities No. 703 – *Transfers* and by an amendment to Decree No. 410/2009 Coll. implementing certain provisions of Act No. 563/1991 Coll. on accounting, as amended, for certain selected accounting entities; the two amendments became effective on 1 January 2015.

3) Reliability of the financial information on the economic position of the state, organisational units of the state and government subsidised organisations (Part IV, Sections 3.1 to 3.3 of the Audit Conclusion)

The reliability of financial information is a fundamental prerequisite so that this information may meet its purpose, i.e. for accountability for the management of the entrusted assets and for decision-making by users.

Out of the eleven cases in which the SAO issued its opinion on the financial statements under verification in the financial audit of organisational units of the state, the financial statements provided a faithful and fair representation of the subject of accounting and of the financial position of the entity in two cases. In four cases, the SAO issued its opinion on the reliability of the financial statements with reservations. In another four audits, the SAO stated that the financial statements did not provide a faithful and fair representation of the subject of accounting and of the financial position of the entity. In one case, the SAO did not issue its opinion on the reliability of the financial statements due to inconclusive accounting.

In the financial audits of organisational units of the state performed by the SAO with a focus on the periods under review of 2012 to 2016, the SAO found that some of the financial statements approved by the approving authorities under Decree No. 220/2013 Coll. on requirements for the approval of the financial statements of certain selected accounting entities (hereinafter “Decree 220/2013”) did not, according to the findings of the SAO, provide a faithful and fair representation of the subject of accounting and of the financial position of the entity, or they only provided it with the reservation of certain important facts. **The validation processes pursued according to Decree 220/2013 thus do not ensure that the financial statements comply with the quality required by the accounting regulations.**

An overview of the inaccuracies found by the financial audits of the SAO for which the opinion issued by the SAO on the financial statements under verification was other than unmodified (positive) is provided in Annex 2 to the Audit Conclusion.

SAO’s financial audits also suggest that the audited entities which are subject to repeated financial audits often show a decrease in the error rate of the reported data. It can therefore be stated that **systematically repeated audits contribute to improvements in the reliability of the reported data.**

4) Use of the financial information about the economic position of the state, state organisational units and government subsidised organisation for the purposes of accountability and decision-making (Part IV, Sections 4.1 to 4.3 of the Audit Conclusion)

The financial information about the economic position of the state, state organisational units and government subsidised organisations is publicly available. Other than the citizens of the Czech Republic, its main users include the MoF and the CZSO. **However, neither the MoF nor the CZSO use the financial information provided in the cash flow statement or the statement of changes in equity for decision-making purposes. The information posted in the off-balance sheet accounts in the annexed statement is not used by the CZSO and is used by the MoF only for preparing the financial statements for the Czech Republic.**

The MoF uses accrual financial information about the economic position of organisational units of the state and government subsidised organisations mainly to draw up the financial statements for the Czech Republic. The financial statements for the Czech Republic have

been drawn up by the MoF and published on the MoF website since 2015. The financial statements for the individual sub-consolidated groups of the state and for the higher sub-consolidated groups of the state are not published. Nevertheless, these data can provide financial position and performance information, for example, for the individual chapters of the state budget or for the higher sub-consolidated group of the government or the higher sub-consolidated group of municipalities. In addition, the MoF uses the financial information to draw up the governmental financial statistics and to prepare regular financial management reports for six selected ministries for use in operational management. **However, no link has been established between the accounting and the budget**, as foreseen within the meaning of Resolution 561/2007⁷ even though the contingent liabilities account should provide information about the demand for future budgets⁸. **In addition, the accounting reform also failed to lead to the use of accrual financial information at the level of the closing accounts of the state budget chapters or at the level of the state closing account** because, save for minor exceptions, the current regulations do not contain any provisions that would require the use of this information in the closing accounts of the state budget chapters and thus in the state closing account. **The potential of accrual financial information is thus not fully utilised by the MoF.** On the contrary, Austria, which has also reformed its accounting in the public sector, has made accrual financial information an integral part of its state closing account.⁹

The CZSO prepares the national accounts using financial information from the *Central System of State Financial Information*, in particular, in the form of the financial statements (balance sheet and profit and loss account) and ancillary analytical statement. In the course of the audit the CZSO proposed potential reductions in the ancillary analytical statement consisting mainly in merging certain analytical accounts.

In the course of the response and appeal procedure, **the MoF contested the financial audits performed by the SAO** in the following areas:

- **Objectivity of the SAO's audit conclusions**, absence of independent third-party assurance of the correct practices of the SAO – According to Article 97 of the Constitution of the Czech Republic and Section 2(1) of Act No. 166/1993 Coll. on the Supreme Audit Office, the Supreme Audit Office is the independent audit authority of the Czech Republic. The position of the SAO set up by the law does not foresee any additional verification of the objectivity of the SAO's audit conclusions by any other parties. Independent third-party assurance of the objectivity of the SAO's audit conclusions is thus contrary to the Constitution of the Czech Republic and Act No. 166/1993 Coll. on the Supreme Audit Office.
- **Evaluation of the inaccuracies found during SAO's audits** (isolated evaluation of the inaccuracies found, without economic context and impacts) – In the course of SAO's financial audits, the reliability of financial information is assessed within the context

⁷ The explanatory report for Resolution 561/2007 states: *“The state budget, specifically, the link between the information captured in the accounting and the information from the state budget systems, will also become an important subject of accounting.”*

⁸ See the provisions of Section 7 of Act No. 23/2017 Coll. on budgetary responsibility rules.

⁹ In addition to consolidated financial statements (fiscal data), Austria's state closing account also includes consolidated accounting statements (accrual data) with strong emphasis on the presentation of the reported data (graphics are used to clearly indicate to the users what data are based on the balance sheet and profit and loss account (i.e. accrual) and what data are fiscal).

of the applicable accounting regulations, which are created and guaranteed by the MoF. All the inaccuracies which were established by these financial audits by the SAO as having an impact on the reliability of the financial statements represent conclusive violations of accounting regulations. When conducting financial audits, the SAO assumes that the accounting regulations require that the selected accounting entities recognise and report only useful information, i.e. that used for accountability and decision-making purposes. In the opinion of the SAO, the MoF, being the creator and guarantor of the accounting regulations, should ensure that it is required to report only information that is actually used.

On the basis of the facts established by the audit, the SAO recommends the following:

- **Use accrual financial information in compiling the state budget, the closing accounts of the state budget chapter and the state closing account. Increase the awareness of the usefulness of accrual financial information among the users of these documents (in particular, legislators, managers of selected accounting entities, as well as the professional and general public).**
- **Formulate the general starting points of state accounting** (what is the purpose and objective of financial reporting, how to attain the objective and who are the users of the financial statements) **and define certain fundamental elements** (assets, liabilities, costs, revenues).
- **Improve areas of accounting regulations which are ambiguous or insufficient** (reporting of financial corrections, state ownership interest in corporations, and emission allowances).
- **Work with the CZSO to revise the ancillary analytical statement to rationalize the statement and reduce the number of reported facts.**
- **Publish the financial statements for the Czech Republic at the same place where the financial information for organisational units of the state and government subsidised organisations are published, i.e. on the MONITOR information portal (e.g. as a hyperlink).**
- **Publish also the financial statements for the individual sub-consolidated groups of the state and for the higher sub-consolidated groups of the state.**

II. Information on the audited area

1. Objectives and users of financial reporting

In accordance with the conceptual framework of the International Public Sector Accounting Standards¹⁰ (“IPSAS Conceptual Framework”), the **objective of financial reporting by public sector entities is to provide information** about an accounting entity that is generally useful to users of the financial statements for **accountability** and **decision-making** purposes.

¹⁰ The Czech version of the *Handbook of International Public Sector Accounting Pronouncements for 2016* (including the IPSAS Conceptual Framework) is available at <https://www.nku.cz/cz/publikace-a-dokumenty/ostatni-publikace/prirucka-mezinarodnich-ucetnich-standardu-pro-verejny-sektor-vydani-2016-id9494/>. The current original version of the *Handbook of International Public Sector Accounting Pronouncements (for 2017)* is available at <http://www.ifac.org/publications-resources/2017-handbook-international-public-sector-accounting-pronouncements>.

According to Czech accounting regulations, the purpose of financial reporting is to provide users reliable information on the basis of which they can make economic decisions.

The IPSAS Conceptual Framework states that governments and other public sector accounting entities are accountable to those who provide them with resources, and to those who receive such resources. Meeting the accountability obligation requires the provision of information to the citizens regarding how the public sector accounting entity manages the resources entrusted to it for the delivery of services to constituents and others.

According to the IPSAS Conceptual Framework, the **primary users** of information from general purpose financial reporting in the public sector includes **resource providers** (e.g. tax payers or creditors), **public service recipients** and **legislators** (as representatives of the above-mentioned providers and recipients), who do not possess the authority to require a public sector accounting entity to disclose specific information. **Other users** of information provided by general purpose financial reporting include accounting entity management, other governing bodies, supreme controllers, rating agencies, analysts, and media.

2. Public sector accounting in the Czech Republic before 2010

Before 2010, public sector accounting in the Czech Republic was failing to meet the above-mentioned basic objectives of financial reporting adequately. The main reasons included the following:

- There were diverse accounting policies for different public sector accounting entities (after the launch of the accounting reform, these are referred to as “selected accounting entities”), rendering the reported information incomparable;
- The accounting policies applicable to the organisational units of the state and territorial self-government units did not include certain common elements of advanced accrual accounting (e.g. cost and revenue reporting within a temporal and material context, depreciation of fixed assets, creation of allowances, creation of provisions);
- There was no financial information available about the total value of assets and liabilities of the state as a whole (including all the accounting entities controlled by the state) and for other suitably defined sub-consolidated groups.

3. Launch of the accounting reform in public finance

The creation of state accounting based on the accrual principle was recommended to the Czech Republic by the World Bank as early as 2003 on the basis of the accounting assessment and audit in the Czech Republic. This need was also identified in the preparation of the state treasury project.

The accounting reform in public finance was formally launched in the Czech Republic **by Resolution no. 561 of the Government of the Czech Republic of 23 May 2007** and has not been formally completed as at the approval date of this Audit Conclusion. Public sector accounting entities were supposed to start their accounting and reporting based on the accrual principle from 1 January 2010. The objective of the accounting reform in public finance according to Resolution 561/2007 was to *“create conditions to ensure the efficient provision of accurate, complete and timely information about the economic position of the state and of the relevant accounting entities”*. According to Resolution 561/2007, the objective was to be achieved through the following principles:

- Creating appropriate conditions – these conditions were to be represented by a set of legislative, technical and other means;
- Efficiency of the selected means – the efficiency principle was to be applied to obtaining the means for the creation of the accounting of the state so that the scope of, and demand involved in, the newly imposed obligations, would correspond to the benefits enjoyed by the users of the newly reported information;
- Faithfulness of the posted information – the changes were to ensure that the reported information is accurate and complete;
- Timeliness – the state was to obtain data not only at the level of individual financial statements but, if needed, it should also have at its disposal selected aggregated data usable during the year. The subject of state accounting was therefore to also include contingent assets and contingent liabilities and the state was to acquire interim information about the available resources.

4. Process of the accounting reform in public finance

The principle of creating appropriate conditions for state accounting was to be fulfilled by creating a set of **legislative means**. In this context, the need arose to amend the legislation both in the area of accounting and in the related areas (e.g. the state budget, state assets management), given that the existing basic structure of accounting regulations (i.e. Act No. 563/1991 Coll. on accounting [“Accounting Act”], decrees concerning the individual groups of accounting entities, and Czech Accounting Standards for certain selected accounting entities) was found suitable for the creation of state accounting by the MoF. Table 1 contains an overview of the accounting regulations issued or amended in connection with the creation of state accounting.

Table 1: Overview of the accounting regulations issued or amended in connection with the creation of state accounting

| Accounting regulation |
|--|
| Act No. 563/1991 Coll. on accounting |
| Decree No. 383/2009 Coll. on the accounting records in a technical form of selected accounting entities and on their transmission to the Central System of State Financial Information and on requirements applicable to technical and mixed forms of accounting records (“Technical Decree on Accounting Records”) |
| Decree No. 410/2009 Coll. implementing certain provisions of Act No. 563/1991 Coll. on accounting, as amended, for certain selected accounting entities. |
| Decree No. 270/2010 Coll. on the inventory of assets and liabilities |
| Decree No. 220/2013 Coll. on requirements for the approval of the financial statements of certain selected accounting entities |
| Decree No. 312/2014 Coll. on the conditions for compiling financial statements for the Czech Republic (the State Consolidation Decree) |
| Czech Accounting Standards for certain selected accounting entities Nos. 701 to 710 |

The modification of the set of legislative means was followed up by two-tier **methodological support**, which has been provided to all the selected accounting entities in the area of the accounting reform since 2011. Level I methodological support is provided to the staff of the selected accounting entities by the individual ministries and regions and consists in giving specific or general answers to the questions raised by the selected accounting entities. The MoF provides Level II methodological support, which involves communication with Level I

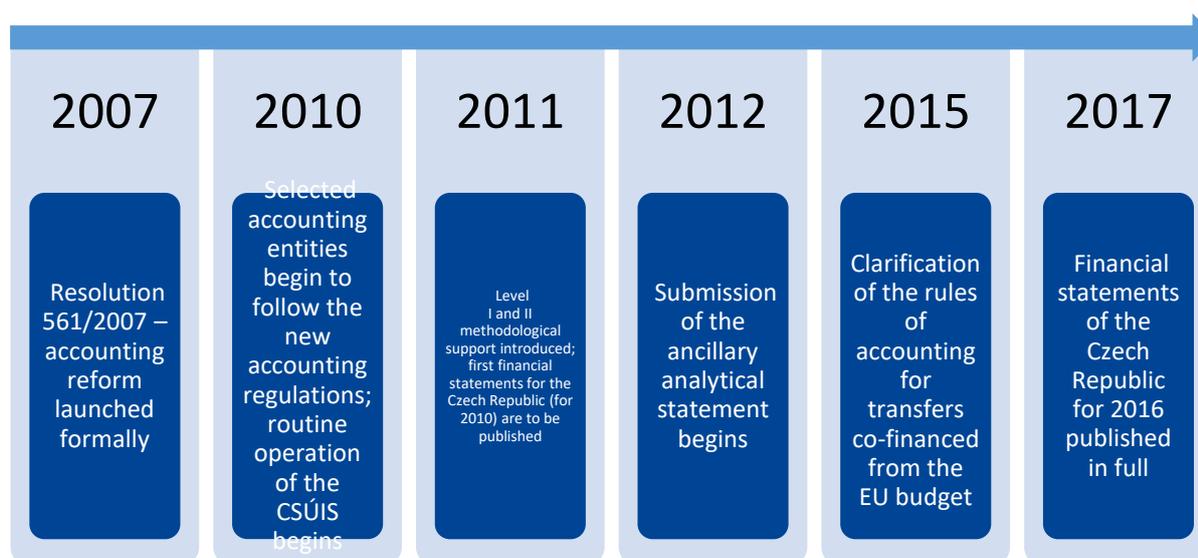
support (in the form of the so-called “Methodology Days”) and providing answers to general questions. In addition, the MoF also provide methodological support through lectures, training courses, workshop, and individual consultations. The MoF website also publishes methodological aids and FAQs.

The **Central System of State Financial Information** (with the Czech acronym “CSÚIS”) was created as a part of the *Integrated Information System of the State Treasury* to be used for collecting accounting records from selected accounting entities. The Central System of State Financial Information is managed by the MoF. In addition, the MoF also created the MONITOR information portal¹¹, which provides free access to the budgetary and financial statements for all levels of government and self-government.

Major selected accounting entities have been preparing the ancillary analytical statement since 2012 for the purposes of compiling national accounts based on the ESA 2010 standard by the CZSO.

The accounting reform in public finance continued in the form of the preparation of the **financial statements for the Czech Republic**, which were first prepared for 2015 to a limited extent (but they still contained information regarding 7,298 accounting entities¹²). The 2016 financial statements were already prepared in full (for 18,103 accounting entities¹³).

Key events under the accounting reform in public finance



¹¹ <http://monitor.statnipokladna.cz/2018/>.

¹² Report on the Financial Statements for the Czech Republic for 2015 – available at <https://www.mfcr.cz/cs/verejny-sektor/ucetnictvi-a-ucetnictvi-statu/ucetni-reforma-verejnych-financi-ucetnic/ucetni-vykaznictvi-statu/ucetni-vykazy-za-ceskou-republiku>.

¹³ Report on the Financial Statements for the Czech Republic for 2016 – available at <https://www.mfcr.cz/cs/verejny-sektor/ucetnictvi-a-ucetnictvi-statu/ucetni-reforma-verejnych-financi-ucetnic/ucetni-vykaznictvi-statu/ucetni-vykazy-za-ceskou-republiku>.

III. Scope of audit

The subject of the audit was the accounting reform in public finance. The objective of the audit was to evaluate whether the accounting reform in public finance had been prepared and implemented as to ensure that reliable and usable information is reported about the economic position of the state and of accounting entities such as organisational units of the state and government subsidised organisations.

The areas under audit were assessed in terms of efficiency and included the following areas of the accounting reform:

- The setting of the objectives of the accounting reform in public finance and their ongoing evaluation;
- Creation of conditions (legislative, financial, methodological support) for the implementation of the accounting reform in public finance;
- Implementation of measures to ensure the provision of reliable financial information from organisational units of the state and from government subsidised organisations;
- Utilisation of the financial information about the economic position of the state, the organisational units of the state and government subsidised organisations.

The audited entities were the MoF and the CZSO. With regard to the subject of the audit, the MoF is responsible for preparing and implementing the accounting reform in public finance and, at the same time, it is a specific user of the information obtained from the accounting of the state (using it to prepare financial statements for the Czech Republic, prepare the state budget, prepare the governmental financial statistics, analyse economic performance, etc.).

The CZSO is also a specific user of the information from the accounting of the state, using it to compile the national accounts.

The period under review includes activities from 2007, when the accounting reform was launched formally, to 2016; where relevant, the preceding and subsequent periods were also scrutinised for contextual reasons.

While resources were expended by the MoF, the CZSO and the selected accounting entities in connection with the implementation of the accounting reform, these resources were not monitored separately and were not quantified in the course of the audit, either. For example, these resources include the cost of the acquisition of the Central System of State Financial Information, the cost of the modification of accounting information systems, increased personnel costs concerning the staff involved, and the cost of methodological support and training. In addition, the accounting reform has not been formally completed.

In the course of the audit, the SAO analysed documents and instruments and interviewed MoF and CZSO representatives.

The audit conclusions of the SAO from financial audits conducted since 2010 were an important source for the evaluation of the reliability of the information newly acquired from the accounting of the organisational units of the state (a list of all these audits is provided in Annex 1. An overview of the inaccuracies found by the financial audits of the SAO for which the opinion issued by the SAO on the financial statements under verification was other than unmodified (positive) is provided in Annex 2 to the Audit Conclusion.

As an additional source of information, the SAO used a questionnaire survey to approach a total of 75 respondents in the course of the audit (50 organisational units of the state including all the administrators of the budget chapters and other major organisational units and 25 major government subsidised organisations) to determine how certain aspects of the accounting reform in public finance were viewed by the entities directly concerned with the reform. The request for completing the questionnaire was addressed to the heads of the departments comprising the accounting office and the instructions stated, among others, that the questionnaire should be completed in cooperation with the person responsible for the accounting (e.g. Chief Accountant) or for its methodology. The response rate was approximately 77 %.

IV. Detailed facts ascertained by the audit

1. Objectives set by the accounting reform and evaluation of their fulfilment

1.1. While the need for the accounting reform was duly justified, the MoF failed to specify its benefits sufficiently.

The identification and justification of need should precede each decision to implement state intervention. Before the decision is made about state intervention, its benefits should be defined because that very decision to implement it should be based on the comparison of the benefits of the intervention and the cost of its implementation.

The SAO states that the creation of state accounting on the accrual principle was recommended by the World Bank as early as 2003 (*Report on the Observance of Standards and Codes, Czech Republic, Accounting and Audit and 40 Recommendations for the Treasury*). In parallel, this need was identified in the preparation of the state treasury project. According to output from those activities, the timeliness and quality of the financial information regarding the public sector entities in the period prior to the launch of the accounting reform were not useful for management and international comparison purposes. The MoF then reflected the World Bank's recommendations in its policy documents (e.g. the *Action Plan of the Czech Republic in the Area of Accounting and Audit*).

The policy documents of the MoF and then Resolution 561/2007 provided only a general description of the benefits of the accounting reform. The policy documents of the MoF state, for example, that the newly reported financial information should contribute to improving the "health" of the economy or that state accounting should provide complete and timely information necessary for decision-making at all levels of management to improve the efficiency of handling public resources. Similarly, the explanatory report concerning Resolution 561/2007 states that the creation of a state accounting system will improve the efficiency of the management of the state economy and of managing public resources and that financial information will be linked to the state budget. It is unclear from the formulations mentioned above how specifically the information should be used by the individual users to manage and handle public resources.

In response to the SAO's inquiry regarding the benefits of the accounting reform, the MoF stated that the benefits of the reform had not been defined, quantified or evaluated but there had been the political will to implement the accounting reform.

The need for the accounting reform was identified and justified but its benefits were not defined specifically enough.

1.2. The objectives of the accounting reform were not formulated specifically enough, which made their evaluation impossible.

The SAO verified how the objectives of the accounting reform had been set. The SAO relied in its verification on the text of the annex to Resolution 561/2007, which, in addition to defining the objective of state accounting (“*create conditions to ensure the efficient provision of accurate, complete and timely information about the economic position of the state and of the relevant entities*”), also lists the basic principles through which the objective should be attained.

- **Principle of creating appropriate conditions**

Resolution 561/2007 defined the conditions as a set of legislative, technical and other means. However, no detailed specification of these means was provided in Resolution 561/2007. The partial steps specified in the *schedule of work on the creation of state accounting* (Government Ref. No. 1295/07, hereinafter the “Schedule”) can be understood as the definition of these means. The legislative steps mentioned in this document specified the preparation of the proposal for an act amending the Accounting Act and its implementing regulations. Neither the Schedule nor Resolution 561/2007 indicate which areas of accounting the legislative changes would concern. As regards the technical conditions, a technical environment should be created according to the Schedule for working with accounting records, with an emphasis on the subsequent digitalisation of the accounting records including accounting documents. The Schedule indicates that “other means” include methodological management related to the needs for organisational and technical support for the creation of state accounting; Resolution 561/2007 does not provide any details regarding this area. **The means that were supposed to be created were defined ambiguously and only generally in Resolution 561/2007. What specific means they should be only followed from the *schedule of work on the creation of state accounting*. Nevertheless, neither material clearly indicates which areas of accounting the legislative changes should concern.**

- **Principle of efficiency of the selected means**

Efficiency was supposed to be evaluated with regard to the foreseen changes and their impacts and expected benefits. As regards the benefits of the accounting reform, the MoF stated that they had not been defined or evaluated. In addition, Resolution 561/2007 stated that the financial and other demand involved in creating state accounting corresponded to the extent and significance of these changes. It is therefore not apparent how the principle of efficiency of the selected means should be fulfilled because its description in Resolution 561/2007 contains contradictions. As a part of this principle, Resolution 561/2007 emphasises the evaluation of efficiency with regard to the foreseen benefits; however, it continues by stating as a given and previously evaluated fact that the financial and other demand involved in creating state accounting corresponds to the extent and significance of the changes. **Since the benefits of the accounting reform were not defined, the Ministry of Finance could not evaluate its effectiveness.**

- **Principle of faithfulness of the posted information**

It follows from Resolution 561/2007 that accuracy and completeness are the fundamental prerequisites of financial information. **Certain requirements under the principle of faithfulness of the posted information were defined only in general terms in Resolution 561/2007. For example, no details have been provided about how to ensure that the data transmitted in state accounting are true.**

- **Principle of timeliness**

Its definition in Resolution 561/2007 indicates that it should be fulfilled, in particular, by amending the accounting regulations in the sense of timely transmission of the required data as well as by introducing the obligation of reporting information about contingent assets and liabilities, which represent foreseen revenues and expenses in the future. This principle thus provides further details regarding the creation of appropriate (legislative) conditions.

No evaluation criteria were set up for the evaluation of the above-mentioned objectives and principles in Resolution 561/2007. The progress of the accounting reform was to be evaluated by presenting information to the government as at 30 June of each year, starting from 2008 (submitted 3 times in total). With regard to the general nature of the objectives of the accounting reform in Resolution 561/2007, i.e. without any specific criteria to be used for the evaluation of their fulfilment, the information on the progress of the preparation of the accounting reform that was submitted to the government in the period 2008–2010 contained only a summary of the activities conducted in the relevant period rather than any specific evaluation of the fulfilment of the objectives of the accounting reform. **The MoF did not evaluate the objectives of the accounting reform that had been set in Resolution 561/2007.**

2. Creating conditions for the implementation of the accounting reform

2.1. Legislative conditions

One of the basic principles of the creation of state accounting was the principle of creating a system of legislative means in addition to the technical and other means necessary for the creation of state accounting.

2.1.1. The periods of *vacatio legis* of the accounting regulations were not sufficient, especially in the early stages of the accounting reform

In the course of the audit, the SAO verified whether the new and amended accounting regulations related to the accounting reform had been issued well in advance of coming into effect.

The decrees and the Czech Accounting Standards were issued by the MoF mainly at the end of the year and they were usually to come into effect on 1 January of the following year. Given the late date of issue of the new regulations and the significant extent of the changes brought about by the new regulations for organisational units of the state and government subsidised organisations, especially from 2010 to 2012, **these entities had little start at the beginning of the accounting reform to be able to follow the regulations as soon as**

1 January of the following year. The short time to apply the required changes concerned mainly the new accounting methods, the introduction of new items in the balance sheet and profit and loss account, the transmission of accounting records to the Central System of State Financial Information, the statement of changes in equity and ancillary analytical statements, new inventory taking procedures, and the determination of rules for the manner of approval of the financial statements of selected accounting entities. This fact was also indicated by the questionnaire survey conducted. **From 2011 onward the MoF attempted to compensate for this shortcoming with methodological support, through which the representatives of organisational units of the state and government subsidised organisations were informed about the foreseen changes in the accounting regulations before the official amendment procedure and the publication in the *Collection of Laws* or in the *Financial Bulletin*.**

The short period for ensuring correct application of the new obligations related to the creation of state accounting, in particular, in the early stages of the accounting reform, could therefore have a negative impact on ensuring the reliability of the financial information from organisational units of the state and government subsidised organisations, which is crucial for its meaningful utilisation.

2.1.2. Although major ambiguities of the accounting regulations for the selected accounting entities were removed in 2015, certain problem areas still persist.

The SAO verified whether the accounting regulations were unambiguous in the course of the accounting reform, i.e. whether they did not enable the reporting of the relevant information in the financial statements of various selected accounting entities in a significantly disparate manner.

As regards the accounting periods **2010 to 2014, the SAO performed a total of 17 financial audits** to verify the financial statements of the audited entities; in **11 audit conclusions, i.e. in 65 % of the cases, it did not give its opinion on the reliability of the financial statements because of the ambiguity and unclarity of the accounting regulations.** When verifying the financial statements **for the 2015 and 2016, the SAO did not establish any significant ambiguity of the accounting regulations in 5 audits.**

In the above-mentioned 11 cases, the SAO did not issue an opinion on the reliability of the financial statements because of the **ambiguity of the provisions of the accounting regulations which governed the recognition of transfers co-financed from the EU budget and provided in the form of pre-financing from the state budget between 2010 and 2014¹⁴.**

¹⁴ The ministries, being the managing authorities, recognised these resources differently. Some ministries recognised them as their beneficiary and provider, capturing them in both the revenues and expenses; other ministries, being the intermediary, only recognised them in the accounts receivable, accounts payable and cash accounts, i.e. with no impact on the expenses and revenues. Because of this, the reported data did not enable comparison between ministries. The Ministry of Education, Youth and Sports can be mentioned as an example of the impact of the selected role of the method of recognition of the above-mentioned transfers on the reported data because in 2014 it recognised the transfers co-financed from the EU budget and provided in the form of pre-financing from the state budget as being the provider. If it had recognised these transfers as their provider and recipient, the amount reported in the assets in account 471 – *Long-term advances on transfers* would have been CZK 55 billion higher, the amount reported in account 389 – *Accrued liabilities* would have been CZK 65 billion higher and the amount posted in the expenses account 571 – *Transfer expenses incurred by selected certain government institutions* by CZK 14.5 billion higher (see

This significant ambiguity of the accounting regulations was remedied by the amendment to Czech Accounting Standard No. 703 – *Transfers* and the related amendment to Decree No. 410/2009 Coll., effective from 1 January 2015.

However, the SAO believes that certain ambiguous or insufficiently specific areas of accounting regulations still prevail. This concerns reporting on financial corrections¹⁵, state ownership interest in corporations¹⁶, and emission allowances¹⁷.

2.1.3. Especially in the early stages of the accounting reform, there was the absence of accounting regulations to comprehensively cover all the required areas; as at the audit completion date, the Ministry of Finance had failed to create a conceptual framework.

Comprehensive coverage of all the required areas by accounting regulations creates a basis for higher reliability and comparability, and thus for better usability, of the reported financial information.

In the course of the audit, the SAO examined whether the accounting regulations had governed all the required areas.

Czech accounting **lacks a coherently defined foundation to build financial reporting on, i.e. a conceptual framework to clearly define the subject of accounting (e.g. assets, liabilities, expenses or revenues)**. It can be derived only indirectly from a number of provisions of a number of accounting regulations (e.g. the Accounting Act, Implementing Decree No. 410/2009 Coll., or the Czech Accounting Standards). In addition to providing the key

the Audit Conclusion from SAO Audit No. 14/37, available at: <https://www.nku.cz/assets/konzavery/K14037.pdf>).

¹⁵ These are operations carried out in response to the occurrence of the so-called confirmed irregularities or as a result of the violation of budgetary discipline for EU resources. The purpose of the corrections is to cancel the entire contribution to the operational programme from public resources or its part that was supposed to be provided by the EU as co-financing. The corrections are performed either by the Member States as a part of their responsibility or by the European Commission. The state budget is ultimately charged with the amounts of the corrections imposed even though the Czech Republic originally expected their refund from the EU. As regards the recognition of the corrections in the accounting, it is unclear how to capture them faithfully (whether it is a new expense or decreased revenue, or what type of revenue or expense it is).

¹⁶ The regulations governing the accounting and reporting by organisational units of the state have not been applicable unambiguously in the area of state ownership interest in corporations for the entire duration of the accounting reform. This concerns the problem of individual financial statements, where the legislation does not show clearly whether the organisational unit of the state has (or even may have, not being a legal entity) controlling, significant or other influence in the case of the individual ownership interests. This unclarity directly affects the measurement of the ownership interests.

¹⁷ In the opinion of the SAO, the accounting regulations concerning the posting of emission allowances are not certain enough to faithfully report on all the facts relating to the management of the assets defined as the content of the balance sheet item of intangible fixed assets “emission allowances”. These are allowances which, according to Act No. 383/2012 Coll. on the conditions of trading in greenhouse gas emission allowances, are the property of the Czech Republic and the competence for managing these allowances is with the Ministry of the Environment. The nature of these assets is highly specific and is mainly derived from EU legislation. The current Czech as well as the applicable European legislation does not enable the clear determination of the moment at which the emission allowances are created as intangible fixed assets to be managed by the Ministry of the Environment. This is despite the fact that the accurate determination of the moment the emission allowance is created is crucial with regard to the moment at which the allowances are to be recognised and measured as assets of the Czech Republic.

definitions, the **conceptual framework** should also **declare the purpose and objective of financial reporting, the ways to achieve this objective, and the users of the financial statements.**

The evaluation of the comprehensiveness of the accounting regulations shows, in the opinion of the SAO, that, as regards the basic accounting areas, **the areas that are not covered by the Czech Accounting Standards include, for example:**

- long-term financial assets;
- clearing relations (except in special areas);
- expenses and revenues (except in special areas).

The absence of a clear definition of the basic terms and certain accounting procedures may lead to an inconsistent application of the accounting policies by the selected accounting entities, posing a risk to the comparability of the reported information. These facts affect the informative value of the data in the financial statements of the individual selected accounting entities and may also affect the usability of the financial statements for the Czech Republic.

2.2. Except for the contribution for the first compilation of the ancillary analytical statement, the costs related to the accounting reform were borne by the organisational units of the state and government subsidised organisations.

The audit examined what sources had been used to cover the additional financial costs related to the accounting reform.

From the onset, the accounting reform was associated with an increased demand for financial resources in all the selected accounting entities. It was a one-time increase in the operating and capital expenditure related to the implementation of the new policies, staff training, and accounting software modifications. The organisational units of the state and government subsidised organisations covered the costs related to the accounting reform from their current budgets. Only in 2012 they received resources in the amount of CZK 36 million from the chapter of *General treasury management* to partially cover the costs associated with the provision of information for the monitoring and management of public finance in the form of the ancillary analytical statement for 2012. **The course of the accounting reform thus placed increased financial demands on the organisational units of the state and government subsidised organisations.**

2.3. Methodological support was operational only from 2011

Due to the fact that the accounting reform imposed a number of new obligations upon the organisational units of the state and government subsidised organisations, it was desirable for the MoF, being the owner of the accounting reform, to ensure methodological support for the entities concerned. Some activities related to methodological support were provided in the document of the Czech government with Ref. No. 1295/07 of 21 November 2007, which contained the *schedule of work on the creation of state accounting*, seeking to provide concise and clear information about the individual tasks necessary for the creation of state accounting and the completion deadlines for the years 2008 and 2009. The provision of methodological support for state accounting in the implementation of the accounting reform by 1 January 2011 at the latest was then laid down in Government Resolution 921/2010.

According to the MoF, *the schedule of work on the creation of state accounting* was not followed and, in fact, all the activities were carried out as late as around 2010. The accounting reform was divided into stages and the new obligations of the selected accounting entities were spread over a longer period of time.

The MoF failed to proceed in accordance with the schedule specified in government document Ref. No. 1295/07, failing to meet the deadlines set for the tasks regarding methodological management. From 2011 onward, methodological support was implemented in accordance with Government Resolution 921/2010. Methodological support in the area of the accounting reform is provided to the staff of the selected accounting entities by the individual ministries and regions (Level I methodological support). The MoF provides Level II methodological support, which consists in ensuring communication with Level I methodological support (any outstanding questions from Level I) and in providing answers to general questions.

The dysfunctional methodological support in 2009–2010 contributed to the fact that the organisational units of the state and government subsidised organisations were not informed about the changes in the accounting policies early enough to be able to apply certain accounting methods, recognise and report the mandatory data in time and in accordance with the new accounting policies, which may have adversely affected the reliability of the reported information.

3. Reliability of the financial information about the economic position of the state, organisational units of the state and government subsidised organisations

3.1. The control mechanisms implemented by the MoF and the CZSO contribute to improved reliability of the financial information about the economic position of the organisational units of the state and the government subsidised organisations

The requirement for the reliability of public accounting procedures for all sub-sectors of general government is laid down in Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States.

Managed by the MoF, the Central System of State Financial Information was created to collect financial information and financial statements from the selected accounting entities. According to the MoF, the reliability of the financial information transmitted by the organisational units of the state and government subsidised organisations is primarily ensured by the **automated controls**¹⁸ set up in the Central System.

Since 2013, the quality of the reported accounting data has also been influenced by the **CZSO** through the **working group on the ancillary analytical statement**, based in Brno. The objective of this working group is to improve the quality of the accounting data being reported. Its tasks include issues related to the methodology, e.g. the method of recognising certain accounting cases, as well as the technical aspects of data processing, and checks of certain selected parts of the analytical data. These data checks are in addition to the checks performed directly in the Central System. The working group on the ancillary analytical

¹⁸ They include the so-called security checks, syntax checks and, in particular, semantic checks (checks against the plan, code list checks, intra-report checks, inter-report checks, unilateral report checks, informative checks, and cross-checks).

statement also focuses on cross-checks to cross-reference and reconcile the data between the partners in the individual transactions.

The financial statement approval process represents another form of verification of the reliability of the financial information (for details see item 3.3 herein below).

3.2. According to the findings of the SAO audit, the financial information about the economic position of the organisational units of the state is materially inaccurate in some cases.

According to the Accounting Act, entities have the obligation of keeping their accounts so that it can be used to prepare understandable financial statements that provide a faithful and fair representation of the subject of accounting.

The SAO conducted 22 financial audits concerning the accounting periods 2010–2016 with a focus of verifying the reliability of the data provided in the financial statements of the organisational units of the state (see Annex 1). Out of the total 22 audit conclusions for these financial audits, the SAO did not provide its opinion on the reliability of the data reported in the financial statements in 11 audit conclusions because of the crucial ambiguity of the accounting regulations (for details see Section 2.1.2 of this part of the Audit Conclusion). As regards the remaining 11 audit conclusions, the opinion of the SAO on the reliability of the financial statements of the audited entities is provided in the following table.

Table 2: Overview of the types of opinions issued

| SAO opinion on the financial statements | Quantity |
|--|----------|
| Unmodified (positive) opinion | 2 |
| Opinion with reservations due to material inaccuracies | 4 |
| Negative opinion | 4 |
| Opinion denied | 1 |

Source: SAO audit conclusions.

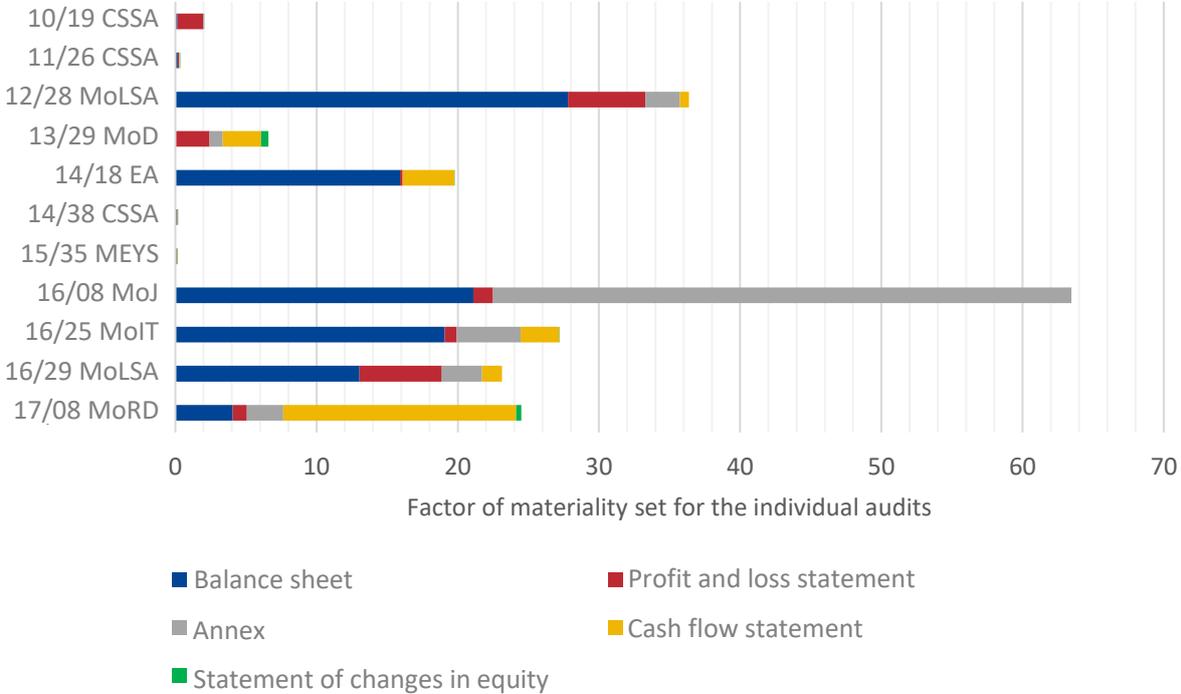
In some of these 11 audits, some of the organisational units of the state were the subject of financial audit for the first time, while multiple audits of this type had been conducted for the other entities.

The following graph shows the evaluation of the inaccuracies found in the individual parts of the financial statements in relation to the materiality¹⁹ determined for the evaluation of the reliability of the financial statements of the individual audited entities. It is clear from the data shown that the lowest materiality values of inaccuracies were found for the Czech Social Security Administration (CSSA) and the Ministry of Education, Youth and Sports (MoEYS), i.e. for entities which are among the most important organisational units of the state and for which financial audits are conducted on a regular basis. It can therefore be

¹⁹ The reliability of the financial statements is measured in terms of significance, or materiality (i.e. the measure of the inaccuracies which can be reasonably expected, whether individually or combined, to influence the economic decision-making by the users of the financial statements). It is usually determined at the level of approximately 2% of the variable which most accurately captures the nature of the entity (this variable is mostly the total costs or net assets).

stated that **systematically repeated audits by the SAO contribute to the reliability of the reported data.**

Graph 1: Inaccuracies in the financial statements in relation to their significance (materiality)



Source: Data from the relevant audit conclusions of the SAO.
Note: The numbers with a slash on the vertical axis are the SAO audit numbers; the acronyms that follow these numbers refer to the individual audited entities.

An overview of the inaccuracies found by the financial audits of the SAO for which the opinion issued by the SAO on the financial statements under verification was other than unmodified (positive) is provided in Annex 2 to the Audit Conclusion.

The SAO’s opinions on the reliability of the audited financial statements of the organisational units of the state show that these **organisational units of the state do not report reliable financial information in some cases. This is despite the fact that the reliability of financial information is a fundamental prerequisite for this information meeting its purpose, i.e. for accountability for the management of the entrusted assets and for decision-making by the users of the financial statements.**

In some cases, the users of the financial information provided by the organisational units of the state thus receive unreliable information which fails to represent the actual financial position and financial results of the organisational unit of the state and may consequently prevent the users of this information from making appropriate decisions.

3.3. The results of the approval of the financial statements of the organisational units of the state according to Decree No. 220/2013 Coll. and the findings of the verification of these financial statements by SAO audits differ significantly

In its audit, the SAO compared the results of the approval of the financial statements of the organisational units of the state with the conclusions of financial audits which focused, among others, on the accuracy of accounting and in which the SAO issued its opinion on the reliability of the financial statements.

The table below contains an overview of the financial audits conducted by the SAO for the period when the organisational units of the state were obliged to approve their financial statements according to Decree No. 220/2013 Coll. (i.e. starting from the accounting period of the year 2012); indicated for each of these audits is the SAO's opinion on the reliability of the financial statements and the opinion of the approving authority on the financial statements as published in the MONITOR information portal on the MoF website.

Table 3: Comparison of the SAO's opinions on the reliability of the audited financial statements with the opinion of the approving authority according to Decree No. 220/2013 Coll.

| Audit | Audited entity | Period under review | SAO opinion on financial statements reliability as per the Conclusion | Financial statements approval status issued by the approving authority |
|-------|--|---------------------|---|--|
| 12/28 | Ministry of Labour and Social Affairs | 2012 | Negative | Approved |
| 13/29 | Ministry of Defence | 2012 | With reservations – due to inaccuracy | Approved |
| 14/18 | Employment Authority of the Czech Republic | 2013 | With reservations – due to inaccuracy | Approved |
| 14/38 | Czech Social Security Administration | 2014 | Unmodified (positive) | Approved |
| 15/35 | Ministry of Education, Youth and Sports | 2015 | Unmodified (positive) | Approved |
| 16/08 | Ministry of Justice | 2015 | Negative | Approved |
| 16/25 | Ministry of Industry and Trade | 2015 | Negative | Approved |
| 16/29 | Ministry of Labour and Social Affairs | 2016 | Denied – due to inconclusive accounting | Approved |
| 17/08 | Ministry of Regional Development | 2016 | Negative | Approved |

Source: SAO audit conclusions; MoF website – MONITOR information portal.

The approving authority had approved the financial statements in all the nine cases in which the SAO issued its opinion on the financial statements under verification. However, the SAO stated that the financial statements provided a faithful and fair representation of the subject of accounting and of the financial position of the entity in only two cases. In another two cases the SAO issued its opinion on the reliability of the financial statements with reservations due to significant inaccuracies. In four sets of financial statements the SAO found crucial inaccuracies and stated that they did not provide a faithful and fair

representation of the subject of accounting and of the financial position of the accounting entity. In one case, the SAO did not give its opinion on the reliability of the financial statements due to the inconclusive nature of the accounting as the Office had been unable to assess whether or not the financial statements provided a faithful and fair representation of the subject of accounting and of the financial position of the accounting entity.

Even though these validation processes contain different degrees of assurance, with the subject of the approval of the financial statements according to Decree No. 220/2013 Coll. being mainly the assessment of the completeness and conclusiveness of the accounting and the evaluation of the foreseeable risks and losses in relation to the faithful and fair representation of the subject of accounting and of the financial position of the accounting entity, on the one hand, and the subject of the SAO's audits being the assessment of the reliability of the financial statements, on the other hand, it is still obvious that the results of the two manners of assessment of the faithfulness and fairness of the representation of the subject of accounting and of the financial position of the entity should not be so disparate.

The validation process set up by Decree No. 220/2013 Coll. did not prevent the users of the financial information about the organisational units of the state from being provided unreliable information that fails to capture the actual financial position and results of the organisational units of the state and may prevent the users of this information from making appropriate decisions.

4. Use of the financial information about the economic position of the state, state organisational units and government subsidised organisation for the purposes of accountability and decision-making

4.1. The MoF publishes financial information about the economic position of the organisational units of the state, the government subsidised organisations, and the state

According to Section 21a (5) of the Accounting Act, the MoF is obliged to publish the financial statements for the organisational units of the state and for the Czech Republic in a manner allowing remote access.

The MoF created the MONITOR information portal²⁰, which enables free access to the budgetary and financial information from the IISSP for all levels of government and self-government, i.e. the above-mentioned obligation is met both for the organisational units of the state and for other types of selected accounting entities. The presented information comes from the IISSP and is updated on a quarterly basis. The MONITOR information portal presents financial information in a user friendly and convenient form and also contains an analytical part which enables a dynamic data analysis using an advanced reporting tool.

The financial statements for the Czech Republic are published by the MoF on its website²¹. That is where the financial statements for the Czech Republic for 2015 (prepared on 30 November 2016) and 2016 (prepared on 2 October 2017) were published. The financial statements for the Czech Republic are also published as a part of the open data of the

²⁰ <http://monitor.statnipokladna.cz/2018/>.

²¹ <http://www.mfcr.cz/cs/verejny-sektor/ucetnictvi-a-ucetnictvi-statu/ucetni-reforma-verejnych-financi-ucetnic/ucetni-vykaznictvi-statu/ucetni-vykazy-za-ceskou-republiku>.

Ministry of Finance²². The financial statements for the individual sub-consolidated groups of the state and for the higher sub-consolidated groups of the state are not published.

4.2. The reported financial information about the economic position of the organisational units of the state, the government subsidised organisations, and the state is appropriate for accountability and decision-making purposes

The accounting reform gradually introduced elements of mature accrual accounting in the public sector of the Czech Republic, making it possible to obtain a more faithful representation of the financial position and performance, undistorted by economic impacts and burdens affecting other periods. For example, while deferred payments of liabilities result in improved income in the current year in cash-based accounting, such a practice does not lead to the same in the current year in accrual-based accounting. The costs are charged at the moment when the liability is created rather than when it is paid. Accrual accounting also provides information about impairment, i.e. the amount of allowances (temporary decrease in the value of assets) and depreciation (permanent decrease in the value of assets), and, at the same time, it informs about the risks incurred in the course of the accounting period (provisions). **Accrual financial information thus shows the actual financial impacts of the decisions made and can contribute to more transparent accountability in managing the states assets and to improved decision-making provided that the information is reliable and comparable.**

The outcomes of the implementation of the above-mentioned elements of accrual accounting in the Czech Republic have also been highlighted in the study prepared by PricewaterhouseCoopers in 2014²³ for the European Commission, where, on page 36, the accounting maturity of the entities of the Member States' central government sector is assessed, with the Czech Republic ranking 6th - 7th.

It should also be noted that the accounting reform was not linked to a reform in the related area of public budget management, where cash-based monitoring continues to prevail.

4.3. Utilisation of the financial information about the economic position of the state, the organisational units of the state and government subsidised organisations.

4.3.1. While the MoF uses mainly the financial information from the balance sheet, profit and loss statement and ancillary analytical statement, it does not do so when compiling the state budget or preparing the state closing account

The audit found that the MoF uses the financial information mainly to prepare **governmental financial statistics** according to the International Monetary Fund guidelines and to prepare the **financial statements for the Czech Republic**²⁴. The financial statements

²² <http://data.mfcr.cz/cs/dataset/ucetni-vykazy-za-ceskou-republiku>.

²³ *Collection of information related to the potential impact, including costs, of implementing accrual accounting in the public sector and technical analysis of the suitability of individual IPSAS standards* (<http://ec.europa.eu/eurostat/documents/1015035/4261806/EPAS-study-final-PwC-report.pdf>).

²⁴ These statements are also referred to as consolidated financial statements for the state. The accounting consolidation of the state represents the preparation of consolidated financial statements that correspond to the financial statements for a group of related entities. As a part of this exercise, the applicable

for the state and for the sub-consolidated groups were first supposed to be prepared for the accounting period of the year 2010. However, that deadline was postponed several times. Decree No. 312/2014 Coll. was issued as late as 2014, effective from 1 January 2015. The financial statements for the Czech Republic were thus first prepared as late as for the year 2015 and only to a limited extent, containing data for selected accounting entities except health insurance companies and government subsidised organisations (7,298 entities). Since 2016 the financial statements for the Czech Republic have been prepared in full, i.e. for all the selected accounting entities and other entities including major business corporations wherein the selected accounting entities hold an ownership interest (a total of 18,103 entities). The following statements were prepared for the Czech Republic at the time of the audit: a summary statement of the assets and liabilities of the state, a summary statement of the expenses and revenues of the state, and an annex.

In addition, the MoF uses the financial information about the organisational units of the state **to compile the so-called management reports**. These reports have been compiled since 2015 Q2 and are used by six ministries, on a quarterly basis in year-on-year terms, to monitor and evaluate mainly the operating costs (current operating costs and labour costs), the number of employees, and average earnings. In addition, the reports from the ministries also include the cost forecasts for the current year and information about the development of the so-called specific costs for the individual ministries. The main objective of the evaluation of the cost developments is to ensure mutual comparability of the operating costs.

As regards the use of the financial information of the organisational units of the state, the government subsidised organisations, and the state for the purposes of drawing up the state budget and closing account, most of the data come from the budgeting system. **Only a small part of the data contained in the closing accounts of the state budget chapters are currently based on accrual accounting**. They are, for example, the free transfers of assets, receivables charged, amounts overpaid and amounts due in case of income payable under administrative fees, or the status of outstanding repayable financial aid, or information about the amount of state debt. This data cannot be established from the budgeting system.

The audit found that the MoF does not use information from the cash flow statement or the statement of changes in equity. It does not use the information from the off-balance sheet accounts that is reported in the annex statement to draw up the budget, either, thus failing to establish the foreseen link between accounting and the budget²⁵. The failure to link the accrual accounting to the budgeting system, and the resulting failure by the MoF to use the accrual financial information to draw up the state budget, the closing accounts of the state budget chapters and the state closing account represents a significant limitation of the foreseen benefits of the accounting reform.

consolidation methods are used to consolidate the assets, equity, liabilities, expenses and revenues of the consolidating entity with its ownership interest in the other entities (consolidated entities of the state) it controls or exercises significant or joint influence in. In the context of the accounting consolidation of the state, the mutual relations between entities which form a part of a group of related entities are eliminated. The consolidated financial statements serve as a source of information about the financial position (assets and liabilities) and financial performance (expenses and revenues) of the Czech Republic as if it were a single accounting entity. (Source: *2016 Report on the Financial Statements for the Czech Republic*.)

²⁵ The explanatory report for Resolution 561/2007 states: *“The state budget, specifically, the link between the information captured in the accounting and the information from the state budget systems, will also become an important subject of accounting.”*

4.3.2. The CZSO uses mainly the financial information from the balance sheet, the profit and loss statement and the ancillary analytical statement

The CZSO compiles the national accounts for the purpose of providing statistical information. The sources of information drawn upon include, among others, administrative data sources including information from the Central System of State Financial Information, in particular, data obtained from the financial statements and ancillary analytical statements.

The audit found that the ancillary analytical statement had been prepared by the MoF in cooperation with the CZSO in connection with the implementation of state accounting. This cooperation is still ongoing and the CZSO continuously analyses the scope and details of the ancillary analytical statement as well as any changes proposed by the MoF and provides its feedback to the MoF. In the course of the audit the CZSO proposed potential reductions in the ancillary analytical statement consisting mainly in merging certain analytical accounts.

The SAO verified whether the CZSO used data from the IISSP taken over from the balance sheet, profit and loss statement, and ancillary analytical statements in the drawing up of the national accounts according to the ESA 2010 methodology. The conversion crosswalks presented by the CZSO in the course of the audit show that the **accrual data from the above-mentioned statements are used for the compilation of the national accounts** (save for minor exemptions where the CZSO prefers other sources than financial information). **However, the CZSO does not use the data from the profit and loss statement, the statement of changes in equity, or the off-balance sheet account data reported in the annex.**

4.3.3. Other users use the financial information about the economic position of the state, the organisational units of the state, and the government subsidised organisations through the MONITOR information portal.

In addition to the **general public**, the other users of such financial information include **the Czech National Bank, the Supreme Audit Office**, and, to a limited degree, **rating agencies**. The **MONITOR information portal** is a key source of financial information for all these users, with its main advantages being free access, easy and convenient navigation to the individual parts of the portal, as well as comprehensive and detailed information presented in a comprehensible manner. The fact that the financial information about the economic position of the selected accounting entities is confirmed by the number of visits to the MONITOR information portal, which reached over 7,500 user accesses per month on average between April 2013 and September 2017.

List of abbreviations used:

| | |
|----------------------------|---|
| CSÚIS | <i>Central System for Financial Information of the State</i> (Czech acronym) |
| CR | Czech Republic |
| CSSA | Czech Social Security Administration |
| CZSO | Czech Statistical Office |
| CAS | Czech Accounting Standard for certain selected accounting entities (Czech acronym: ČÚS) |
| EU | European Union |
| Schedule | Schedule of work on the creation of state accounting (Government document Ref. No. 1295/07) |
| IISSP | <i>Integrated Information System of State Treasury</i> (Czech acronym) |
| IPSAS | International Public Sector Accounting Standards |
| Audit | SAO audit |
| IPSAS Conceptual Framework | Conceptual Framework of the International Public Sector Accounting Standards |
| Conclusion | Audit Conclusion |
| MoF | Ministry of Finance |
| MoRD | Ministry of Regional Development |
| MoD | Ministry of Defence |
| MoIT | Ministry of Industry and Trade |
| MoLSA | Ministry of Labour and Social Affairs |
| MoJ | Ministry of Justice |
| MoEYS | Ministry of Education, Youth and Sports |
| SAO | Supreme Audit Office |
| OSS | organisational units of the state (Czech acronym not used in the English version) |
| PAP | ancillary analytical statement (Czech acronym) |
| SPO | government subsidised organisation(s) (Czech acronym not used in the English version) |
| EA | Employment Authority of the Czech Republic |
| Resolution 561/2007 | Resolution No. 561 of the Government of the Czech Republic of 23 May 2007 |

| | |
|---------------------------|--|
| Resolution 921/2010 | Resolution No. 921 of the Government of the Czech Republic of 22 December 2010 |
| FS | financial statements |
| VÚJ | selected accounting entities (Czech acronym not used in the English version) |
| Decree No. 220/2013 Coll. | Decree No. 220/2013 Coll. on requirements for the approval of the financial statements of certain selected accounting entities |
| Accounting Act | Act No. 563/1991 Coll. on accounting |

List of the financial audits conducted by the SAO after the launch of the accounting reform

| Audit | Audited entity | Period under review | Opinion on the reliability of the financial statements |
|-------|--|---------------------|---|
| 17/08 | Ministry for Regional Development | 2016 | Negative |
| 16/29 | Ministry of Labour and Social Affairs | 2016 | Denied – due to inconclusive accounting |
| 16/25 | Ministry of Industry and Trade | 2015 | Negative |
| 16/08 | Ministry of Justice | 2015 | Negative |
| 15/35 | Ministry of Education, Youth and Sports | 2015 | Unmodified (positive) |
| 15/19 | Ministry of Culture | 2014 | No opinion issued – due to ambiguous regulations |
| 15/07 | Ministry of Health | 2014 | No opinion issued – due to ambiguous regulations |
| 14/38 | Czech Social Security Administration | 2014 | Unmodified (positive) |
| 14/19 | Ministry of the Environment | 2013 | No opinion issued – due to ambiguous regulations |
| 14/18 | Employment Authority of the Czech Republic | 2013 | With reservations – due to inaccuracy |
| 13/39 | Ministry of Transport | 2013 | No opinion issued – due to ambiguous regulations |
| 13/38 | Ministry of Agriculture | 2013 | No opinion issued – due to ambiguous regulations |
| 13/29 | Ministry of Defence | 2012 | With reservations – due to inaccuracy |
| 13/19 | Ministry for Regional Development | 2012 | No opinion issued – due to ambiguous regulations |
| 12/30 | Ministry of Education, Youth and Sports | 2012 | No opinion issued – due to ambiguous regulations |
| 12/28 | Ministry of Labour and Social Affairs | 2012 | Negative |
| 12/15 | Ministry of Agriculture | 2011 | No opinion issued – due to ambiguous regulations |
| 12/14 | Ministry of Transport | 2011 | No opinion issued – due to ambiguous regulations |
| 11/29 | Ministry of Education, Youth and Sports | 2011 | No opinion issued – due to ambiguous regulations |
| 11/26 | Czech Social Security Administration | 2011 | With reservations – due to inaccuracy and ambiguous regulations |
| 10/20 | Ministry of Education, Youth and Sports | 2010 | No opinion issued – due to ambiguous regulations |
| 10/19 | Czech Social Security Administration | 2010 | With reservations – due to inaccuracy |

Overview of the inaccuracies found by the financial audits of the SAO for which the opinion issued by the SAO on the financial statements under verification was other than unmodified (positive)

| Organisational unit Year Audit | Inaccuracies found |
|---------------------------------------|---|
| MoRD 2016 Audit 17/08 | <ul style="list-style-type: none"> - incorrect valuation of ownership interests, - incorrect and incomplete accounting in the area of transfers, - incorrect application of an accounting method – depreciation of fixed assets, - incorrect preparation of the cash flow statement, - failure to report cash in bank outside the budget, - incomplete recognition of contingent assets and liabilities, - incorrect recognition of selected revenues |
| MoLSA 2016 Audit 16/29 | <ul style="list-style-type: none"> - incorrect and incomplete accounting in the area of transfers, - incorrect recognition of complimentary changes, in the competence to manage state assets, - incomplete recognition of contingent liabilities, - incorrect recognition of selected expenses, - incorrect cost accruals and deferrals, - incorrect accounting for advance payments provided, - incorrect application of an accounting method – depreciation of fixed assets |
| MoIT 2015 Audit 16/25 | <ul style="list-style-type: none"> - incorrect and incomplete accounting in the area of transfers, - failure to report cash in bank outside the budget, - incorrect completion of certain items in the cash flow statement, - incomplete recognition of contingent assets and liabilities, - incorrect application of an accounting method – creation of provisions |
| MoJ 2015 Audit 16/08 | <ul style="list-style-type: none"> - incorrect application of an accounting method – depreciation of fixed assets, - incorrect and incomplete accounting in the area of transfers, - incorrect and incomplete accounting concerning off-balance sheet accounts, - incorrect recognition of expenses incurred by acquisition of other small-value assets |
| EA 2013 Audit 14/18 | <ul style="list-style-type: none"> - incorrect application of recognition procedures for the corrections of expenses and revenues of previous years, - incorrectly set-up calculation algorithm for cash flow statement items, - incorrectly reported balances of the off-balance sheet accounts in the annex to the financial statements, - failure to report certain outstanding receivables and the related revenues, - failure to depreciate all the relevant assets |
| MoD 2012 Audit 13/29 | <ul style="list-style-type: none"> - incorrectly reported social benefit costs, - incorrectly reported contingent liabilities due to the use of non-own assets for a charge, - incorrectly reported items in the cash flow statement, - incorrectly recognised penalties paid to specified suppliers, - incorrectly recognised payment into the NATO programme, - incorrectly recognised capitalisation of current assets |
| MoLSA 2012 Audit 12/28 | <ul style="list-style-type: none"> - incorrectly reported assets on asset accounts, - late activation of assets for use, - incorrect recognition of international transfers, - failure to report all the long-term contingent liabilities and assets, - incorrect preparation of the cash flow statement |

| Organisational unit Year Audit | Inaccuracies found |
|--|---|
| <p align="center">CSSA 2011 Audit 11/26</p> | <ul style="list-style-type: none"> - incorrect preparation of the cash flow statement and of the statement of changes in equity, - incorrect recognition of insurance penalties payable by employers, - failure to recognise the prescribed unpaid distraint deductions from the pensions of the liable persons, - incorrect recognition of disability insurance payments |
| <p align="center">CSSA 2010 Audit 10/19</p> | <ul style="list-style-type: none"> - incorrect recognition of the depreciation of uncollectible debt on insurance payments, - incorrect recognition of disability insurance payments, - incorrect recognition of the unused December advance on pensions paid through the pension service, - failure to recognise the prescribed unpaid, i.e. deposited, distraint deductions from the pensions of the liable persons |