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From the Soviet to the French Accounting System[#]

(History of Czechoslovak Accounting before
collapse of communist regime and then before
division of Czechoslovakia)

Vladimír ZELENKA* – Marie ZELENKOVÁ**

This paper¹ deals with the history of accounting from the middle of 1960's to the fall of communist regime in Czechoslovakia. There are only some few works engaged in history of the Czechoslovak accounting of the second middle of the past century (Králíček (1983), Klozar (1994), Zelenka – Zelenka (1992), Zelenka – Zelenková (2003)). This paper divides the time into distinct periods and sub-periods in order to provide a description of the main characteristics of each:

- 1953 to 1965, National-Economic Evidence,
- 1966 to 1971, Singular System for Economic Information,
- 1972 to 1976, Singular System for Socio-Economic Information,
- 1977 to 1990, Singular System for Socio-Economic Information continued,
- 1990 to 1992, post-communist Czechoslovak accounting.

Although this paper is concerned primarily with the period beginning in the mid-1960's, it is necessary, for the sake of historical context, to briefly turn back describe earlier accounting. Therefore, this paper starts with a brief view of accounting system *Book-Keeping Evidence* that

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existed in the pre-1966 period within the scope of national economic information system called a *National-Economic Evidence*.

‘National-Economic Evidence’ (Národohospodářské evidence) (1953 to 1965)

Since 1953 the accounting system known as the 'Book-Keeping Evidence' functioned within the National Economic information system known as the 'National-Economic Evidence'. It replaced the previously used 'Singular System for Business Accounting', which was significantly affected by the accounting system of the German type. In contrast, 'Book-Keeping Evidence' is derived from the accounting system typical for the Soviet Union (Fiala (1954), Fireš – Vihan (1963), Hoffmann (1964), Peroutka – Zavadil (1954), Zelenka – Zelenková (2013)). The main features of the 'Book-Keeping Evidence', which distinguish it from the previous system, are:

- The system of accounting valid since 1953 did not include the cost accounting, therefore it was only about the financial accounting. The functions of the cost accounting were met outside accounting.
- The accounting was based on one set of assets and liabilities accounts, there was no set account for expenses and revenues. Expenses were accounted for by using the account ‘Production’ or ‘Non-productive expenses’ or by account 'Result of Operations' (P/L account). Revenue was accounted for via ‘Realization’ account.
- Productive costs were primarily broken down by function of expense. Classification of expenses was made by nature of expense outside from accounting.
- Valuation was consistently applied on the basis of historical cost.
- Profit or loss (Result of operations) was collected as the difference between revenues from sales of products and cost of products sold. Revenues and expenses were charged a ‘Realization’ Account, which was then closed to a ‘Result of operations’ account from which the state charges were deducted.
- The accounting system allowed comparison of the actual cost of products sold with planned (estimated) cost of these products.
- The intangibles are no longer presented.
- Financial statements included only one statement: balance sheet. Profit or loss statement was not prepared.

New charts of accounts have been developed for various courses, different from the previous unified chart of accounts. There was a large number of charts of accounts differing by sectors and industries of the national economy. There were valid 31 charts of accounts in January 1, 1954. The structure and the content of charts of accounts was almost literal translation of the Soviet charts of accounts. These curricula were in their arrangement largely illogical and confusing, and with regards to the various sectors they were totally inconsistent. This situation lasted until 1957, when there was a significant reduction in the number of existing charts of accounts.

State was beginning to have problems living up to its own economic expectations in the late 1950's. This became especially evident after 1958 when almost immediately after it was passed, it became clear that the current five-year plan could and would not be met. In an attempt to rectify this situation, several changes were made to the central planning system. The gist of these changes was to delegate more operational authority to company managers but, since the system of ridged price controls was left in place, individual managers, trying to maximize reported performance in as reported by the new accounting system, quite rationally shifted production from consumer to producer products. The resulting masses shortages of even the most basic consumer necessities and vast surpluses of items that no one wanted to buy. In 1961, strict central planning was reintroduced. These economic problems influenced huge changes in Czechoslovak Accounting in the middle of 1960's.

After 1961, things went from bad to worse. Since both the central planning and accounting systems lacked a single set coherent, unifying principles, charts of account, financial statements and accounting procedures changed often and in an ad-hoc manner and the system started to degenerate into chaos.

By 1965, it was clear that system of *National-Economic Evidence* was not working. Thus the former *Singular System for Business Accounting* was brought it back, dusted it off, fixed up and reintroduced under the new and improved name of the *Singular System for Economic Information*. Also, since it became patently obvious that no five-year plan would ever be met the institution was scrapped and replaced by the one-year plan (which had the distinct advantage that it did not require much planning at all).

‘Singular System for Economic Information’ (Jednotná soustava ekonomických informací) (1966 to 1971)

After a careful examination of the failure of *National-Economic Evidence* to produce an enviable economic system, it was decided that the old system failed because it did not exactly spell out to managers how they were to manage their people’s businesses. The *Singular System for Economic Information* thus reintroduced² management accounting into the financial accounting system (Klozar (1968), Partyk – Marček – Kleisner (1966)). The task of drafting this chart of accounts was given to the People’s Central Commission for Control and Statistics. In total the new system provided guidance on:

- Financial accounting and reporting;
- Internal, control accounting (*vnitropodnikové účetnictví*);
- Cost accounting – costing;
- Budgeting;
- Business statistics and analysis.

Among the most prominent reforms brought about by the *Singular System for Economic Information* was the reintroduction of a single standard chart of accounts (and also a single standard general ledger and set of financial statements). This chart contained the following major classifications:

- 0 Property, plant and equipment and PPE in progress;
- 1 Inventories;
- 2 Customer/supplier relationships;
- 3 Expenditures, expenses and income distribution;
- 4 Revenues and earned income;
- 5-8 Undefined accounts (used for cost center accounting);
- 9 Reserves, accumulated gross income, off balance sheet accounts.

While most of the features *Singular System for Economic Information* were the comparable to *Singular System for Business Accounting* (1946-1952, see Zelenka, Zelenková, 2013), some interesting differences nevertheless deserve comment. The strict adherence to historical cost was abandoned, with evidentiary entities allowed to cost according to estimates generated by the managerial accounting system. The managerial accounting concept of *cost centers* (which, since both revenue and expenses were evaluated at this level, were, in fact, profit centers) was

² These changes were implemented by various directives issued from 1965 and 1967.

reintroduced. However, since both producer and consumer prices continued to be regulated, the concept of profit was merely theoretical.

To reconcile the fact that evidentiary entities often had to sell consumer goods for less than the cost of producer goods, a special charge, called an *expense*, was introduced. Also, while the term *accounting* and the income statement were again part of the officially sanctioned accounting system, it was not politically correct to call the difference between revenue and expense income, the term *hrubý důchod* (gross income) was used. Since the nature of expense method was reintroduced and since no difference was drawn between sales revenue and the 'revenue' resulting when a company records the change in inventory or self-manufactured assets, it is not even logically correct to refer to *hrubý důchod* income. Nevertheless, the state treated *hrubý důchod* as income, since this was the amount that the company transferred over to the state when it came time to disgorge profits.

The reforms did not stop with changes to the accounting system. Based on the work of economists (such as Ota Šik), certain 'market-oriented' reforms were introduced. These reforms, known by the title of Principles for Improved State Economic Management, were implemented in 1965. While not strictly having to do with the topic at hand, these 'reforms,' since they do provide interesting examples of the law of unintended consequences, are interesting enough to briefly mention:

- a) The use of *hrubý důchod* was introduced as the primary measure of economic effectiveness for both evidentiary entities and their management.

While state planners had high hopes that the concept of 'earning an income' would have a positive effect on company management they did not foresee the problem caused by the fact that the concept 'earning' was not understood as buying low and selling high, but rather as producing. Thus, even though the state evaluated a company on the basis of *hrubý důchod*, the company recorded the cost of goods produced both as an expense and as an offsetting increase in inventory (classified as a revenue in the income statement) until the good were sold. The result was that, while management was theoretically given the 'income' motive, it did not motivate management to minimize labor costs by, for example, looking for ways to improve productivity (since these were expenses that were not a part of production and thus brought down income). Instead management had the motive to employ as many workers as possible, produce as many goods as

possible, and do so in an as inefficient way as possible.

In short, the concept of *hrubý důchod* (where changes in inventory are considered revenue) was logically consistent with Karel Marx's interpretation of the labor theory of value ('A use-value, or useful article, therefore has value only because human labour in the abstract has been embodied or materialized in it'³) but in the real world it led companies to produce vast quantities of things no one wanted in an as inefficient manner as possible.

- b) The state, to better regulate economic activity, introduced as whole new scale of special taxes and fees.

For example, companies were taxed at a rate of 18% of their gross income. This charge was reduced for the (depreciation) charges paid for using the state's assets (equal to 6% of every asset's purchase acquisition even if those assets were still in construction), holding the state's products and (equal 2% inventory on hand). The state also charged companies a so-called *stabilization* fee that was intended to force companies to act as if they were paying market prices while they were paying regulated prices.

Companies were required to finance their working capital needs through 'loans' from state banks. Thus, even though the state owned everything, state banks gave state companies loans. Companies, whose only owner was the state, also paid the state taxes and interests. Each new regulation also brought added complication until no one understood exactly how the system worked.

The main consequence of this system thus was that it enriched the dishonest, smugglers, black marketers and company managers and workers using the complexity inherent in the system to enrich themselves at their company's expense. It is also not surprising that during the period the phrase 'he who does not steal from the state is only stealing from his own family' was first coined.

Unfortunately, tentative economic liberalization did nothing to improve economic results. It did, however, provide the impetus for *Prague Spring*, during which time the Czechoslovak political scene engaged in heated policy debates while the intellectual scene was consumed by debates about the role of the individual and the state in

³ Karl Marx *Capital* translated from 3rd German edition by Samuel Moore and Edward Aveling, reprinted by Random house, 1906

society and economics. Unfortunately, these times ended at the point of the gun in August 1968 when the armies of the Warsaw pact decided it was time to *normalize* relations.

During the first years of *normalization*, no major accounting changes occurred. Among the changes having some impact on accounting worth mentioning are: the increase in the tax rate on gross income to 65%, and the implementation of an asset tax (5% of total assets) and the implementation a social security tax (25% of gross wages).

‘Singular System for Socio-Economic Information’ (Jednotná soustava sociálně ekonomických informací) (1st period: 1972 to 1976)

This and the following period was, as can be expected, characterized by an attempt to return to the purely collectivist model that was, with limited success, attempted in the 1950s.

The new system implemented on January 1, 1972 was implemented in:

- Law # 21/1971 Sb. that created a singular system for socialist economic information.
- Governmental directive # 153/1971 Sb. dealing with general company recordkeeping.
- Ministerial directive # 154/1971 Sb. also dealing with general company recordkeeping.
- Ministerial directive # 155/1971 Sb. dealing with company recordkeeping for long-lived assets.
- Ministerial accounting guide for managerial accounting.
- Ministerial accounting guide for national statistics and financial statement preparation.

The accounting during this period was characterized by the following features (Klozar, 1974, Peřina, 1972):

- Certain aspects of financial and managerial accounting (forecasting and budgeting) are again integrated, but the remainder is kept separate.
- Financial accounting thus continues to use the ‘nature of expense’ expense classification while managerial accounting uses ‘function of expense’ classification applied to individual cost centers.
- Historical cost continues to be used in financial accounting while managerial accounting is based on ‘budgeted costs.’

- Cost as applied to long-lived assets is limited to purchase price only. All other acquisition costs (such as transportation and installation) are expensed as incurred.
- Both a balance sheet and income statement are prepared.
- The changes do not affect the standard chart of accounts introduced in 1967 (which remains in effect until 1976).
- Income is calculated as the difference between revenue and expenses.

The changes evident in this period can be summarized as follows (Libnar – Špaček, 1983):

- A return to centralized economic planning which undid much of the liberalization of the past decade.
- Gross income as an economic indicator was abandoned and was replaced by profit.
- A new tax structure was implemented. Profit tax was raised to 75% and a series of other charges were implemented.

The reason that purchase price, and only purchase price, was used to measure the acquisition price of assets was that the state required comparable information in order to draft a central plan. It did not have the time, or manpower to evaluate each company's specific situation.

'Singular System for Socio-Economic Information continued' (2nd period: 1977 to 1990)

This period was a continuation down the same path as before. The only reason to divide this and the former into two periods is that several new laws and directives, directly affecting the mechanics of accounting, were introduced in 1976 (Báča – Třetina, 1981, Báča, 1989, Klozar, 1981, Laučík, 1980).

In 1976 the single standard chart of accounts was replaced by 4 different charts again organized along industry lines. Expenses were again classified by function at the cost center level and by nature at the company wide level. An interesting feature of this system is that it used two methodologies for calculating income: the *gross* and *net* methods.

The gross method is comparable to the generally method usually used to calculate income under the nature of expenses method: revenue (including changes in productive inventory and self-manufactured assets) less expenses.

The net method can be summarized as follows: realized income + intercompany income + other income – other expenses. These were defined as:

Realized income equals to total revenue plus changes in inventory and self-manufactured assets less manufacturing costs (material, wages, purchased services). The manufacturing costs calculated using 'budgeted standard costs' and thus were not measured at historical cost.

Intercompany income (the income generated by the various cost centers). This was the difference, at the cost center level, between actual costs and budgeted standard costs.

Other income and expenses not attributable to individual cost centers.

The accumulated income account was used only to accumulate income and was not used, as in the 1966 to 1975 period to distribute income.

The Czechoslovak accounting system used from 1976 to 1990 is unique in that it combines financial and cost accounting) in one compact unit. To illustrate this system see the scheme of this system (see Fig 1).

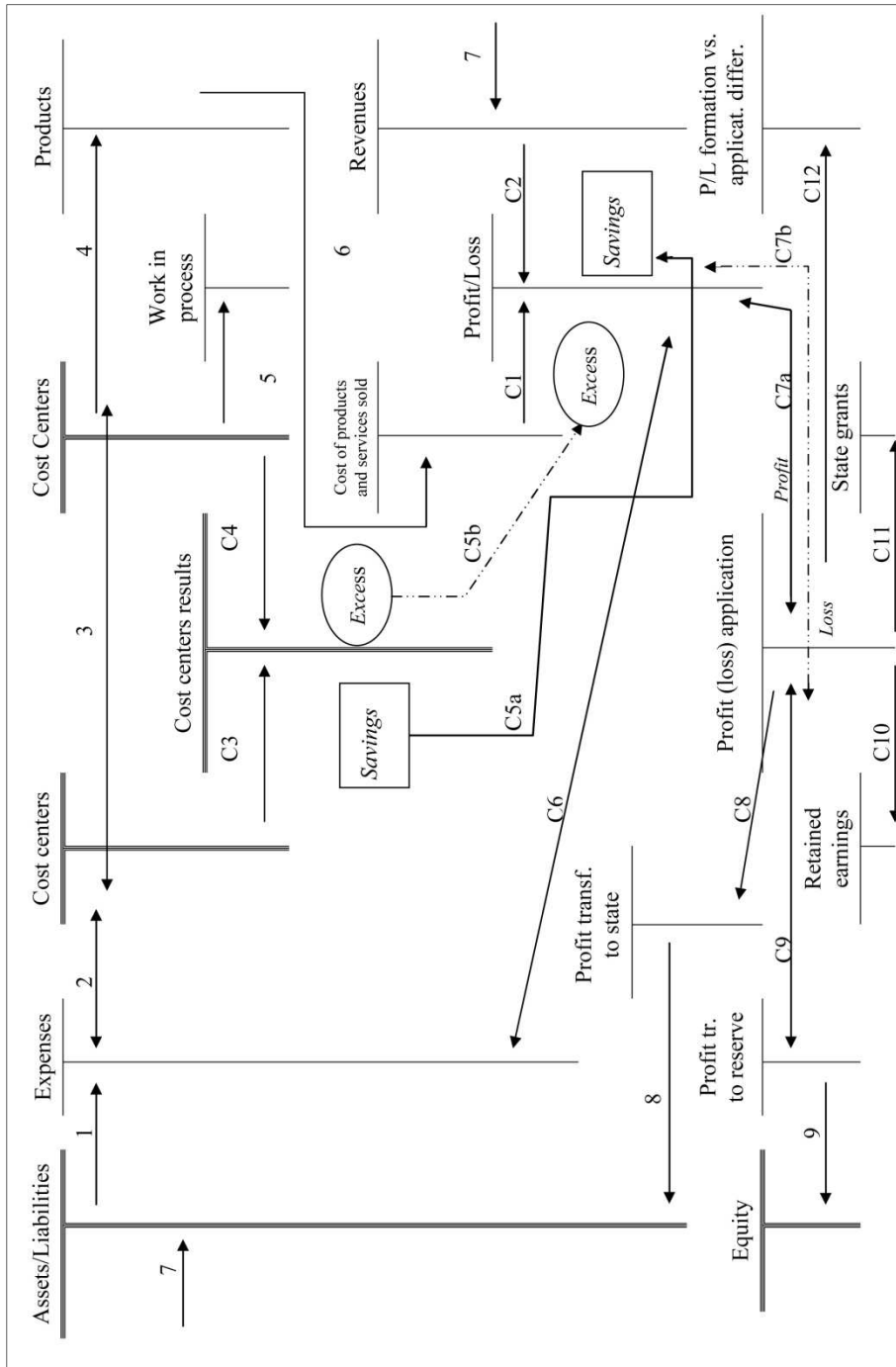
Post communism Czechoslovak accounting (1990 to 1992)

After the fall of communism, the new government had much to do and so the accounting system introduced during the period of 'normalization' remained in effect until 1992 with certain adjustments caused by the first steps of transition from centrally planned communist economy to the market economy.

During 1992, the Czechoslovakia made the transition to an accounting system consistent with EU directive 4. It did so by taking the French accounting system and translating it. The influence of French accounting system was caused by several objective and subjective factors:

French accounting and financial reporting was (and still is) closely regulated by the state to the level of book-keeping procedures and chart of accounts. Strict detailed public accounting regulation was reality in Czechoslovakia of that time. Therefore, the inspiration by genuine French accounting practices was considered proper by the accounting professionals and academics (Ryneš, 1993, Klozar – Kněžů, 1993).

Fig. 1: Accounting in Singular System for Socio-Economic Information



Explanatory notes to the Fig. 1:

Transactions: 1 = Expenses, 2 = Transfer of expenses to cost centers (in historical costs), 3 = Production and services among cost centers (estimated costs), 4 = Estimated costs of products, 5 = Estimated costs of work in process, 6 = Estimated costs of goods manufactured and services sold, 7 = Revenue, 8 = Advanced transfers of profit to the state, 9 = Advanced transfers of profit to reserves.

Closing entries: C1 = Transfer of estimated costs of goods manufactured and services sold to P/L account, C2 = Transfer of revenues to P/L account, C3 = Transfer of cost centers historical costs to Cost centers results account, C4 = Transfer of cost centers estimated costs to Cost centers results account, C5a = Savings – excess of estimated costs over historical costs, C5b = Excesses – excess of historical costs over estimated costs, C6 = Other expenses (excluded from cost centers), C7a = Transfer of profit to Application P/L account, C7b = Transfer of loss to Application P/L account, C8 = Distribution of profit, C9 = Transfers of profit to other reserves, C10 = Retained earnings, C11 = State subsidies, C12 = Excess of profit or loss over application of profit or loss.

French accounting specialists and academics were the first after the fall of communism in Czechoslovakia to take the lead in the transition from the old to the new accounting system, accounting and financial reporting appropriate for the market environment. The methodical help to the Federal Ministry of Finance and their educational activities were particularly significant for our professionals.

Experience has shown that the French inspiration to the Czechoslovak, and later Czech, accounting made it consequently more difficult to move to the transnationally accepted standards of financial reporting represented by the International Accounting Standards.

Conclusion

It was not acceptable for the communist political regimen to continue to use the earlier accounting model of Germanic type in practice – it evoked too much the early capitalist economic order. Therefore, in 1953, the stage of ‘Book-Keeping Evidence’ according to the Soviet model came in operation. The accounting system in our environment never became naturalized. With regards to the economic problems and certain political relaxation the ‘Book-Keeping Evidence’ has been replaced by the new accounting system ‘Singular System for Economic Information’, later modified to ‘Singular System for Socio-Economic Information’. ‘Singular System of Economic Information’ and later ‘Singular System of Socio-Economic Information’ (in its two developmental stages) differed mainly in how the financial and cost center accounting is integrated to financial accounting system.

Accounting according to the ‘Singular System for Socio-Economic Information’ was used in a modified form in Czechoslovakia after the fall of communism until 1992. From the following year accounting under the strong influence of the French state regulated accounting was implemented. By this, our accounting got into accordance with the 4th Directive of the European Communities. It was only later, at the turn of the millennium, when the financial reporting in the Czech Republic gradually moved away from the French model and closer to the international standardization of accounting.

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From the Soviet to the French Accounting System (History of Czechoslovak Accounting before Collapse of Communist Regimen and then before Division of Czechoslovakia)

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ABSTRACT

In the period between 1953 – 1965 the system of Book-Keeping Evidence of the National-Economic Evidence was used in Czechoslovakia, based strictly on the Soviet model of accounting. This system was replaced in 1966 by Singular System for Economic Information. The content followed the post-war Singular System for Business Accounting, which was heavily influenced by Germanic Accounting System. Singular System of Economic Information and later Singular System for Socio-Economic Information (in its two developmental stages) differed mainly by how to integrated financial accounting system and financial and cost center accounting. After the fall of communism in 1989 and the beginning of economic changes, a slightly modified accounting system from before 1990 is being used. It was only in 1993 that the financial system is replaced by a completely new one, based on French accounting.

Key words: Accounting History; Czechoslovak Accounting; Socialist Accounting.

JEL classification: M41.