

IFRS and Czech GAAP

Similarities and Differences



August 2004



This project „New Concept of Legislative Regulation of Accountancy and Application of IAS“ is funded by the European Union



Implemented by
the Ministry of Finance of the Czech Republic

PRICEWATERHOUSECOOPERS 



Consultants:
PricewaterhouseCoopers, Czech Republic
Association of Chartered Certified Accountants

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Preface

International Financial Reporting Standards (IFRS) will be adopted for the first time in 2005 in many countries around the world including, for listed companies initially, members of the EU. Consequently, the International Accounting Standards Board (IASB) has put in place a set of standards which should regulate the transition to IFRS. The Ministry of Finance of the Czech Republic issued the first Czech Accounting Standards in connection with the amendment to the Act on Accounting which took effect on 1 January 2004. Although in the period after 1 January 1993 a number of modifications to the Czech accounting legislation were made, harmonising the Czech accounting system with EU accounting directives and IFRS, there are still many differences between these frameworks, which this publication seeks to highlight and explain.

Czech companies that have issued debt or equity securities traded in regulated public markets must use IFRS instead of Czech Generally Accepted Accounting Principles (Czech GAAP) for the preparation of their consolidated and stand alone (unconsolidated) financial statements for the financial period commencing on or after 1 May 2004. Other enterprises may use IFRS instead of Czech GAAP for the preparation of consolidated financial statements. The Czech tax base, however, is still based on Czech GAAP regardless of which accounting standards the companies use for the preparation of their financial statements. Consequently, these companies need to understand the similarities and differences between IFRS and Czech GAAP.

There have been many changes in IFRS and Czech GAAP since 2001 when PricewaterhouseCoopers issued the previous version of this publication. This new edition is therefore not only an update, but also a significant extension of the publication, providing a means by which companies can quickly identify and understand key similarities and differences between IFRS (the status as at 31 December 2003, i.e. including the extensive modification of international standards published in December 2003) and Czech GAAP (which took effect on 1 January 2004).

Developments under both frameworks are ongoing, therefore, it is necessary to also take into account changes that occur subsequent to the above dates.

This comparative study has been prepared by the group of consultants of PricewaterhouseCoopers who are working on the EU project "New concept of legislative regulation of accounting and the application of IFRS in the Czech Republic".

I believe that this study will be beneficial not only to companies changing over to IFRS, but also to the users of financial statements prepared in this manner, and last but not least, to the Ministry of Finance for the purposes of adjustment of tax regulations in such a manner that companies using IFRS are not burdened in the future with the requirement to report their pre-tax profit under Czech GAAP.

Petr Kříž

Project Leader

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This publication by PricewaterhouseCoopers is for those who wish to gain a broad understanding of the key similarities and differences between two accounting systems: International Financial Reporting Standards (hereinafter referred to as "IFRS") and Czech Generally Accepted Accounting Principles (hereinafter referred to as "Czech GAAP"). The first section provides a summary of the similarities and differences between the two systems and then refers to individual detailed parts in the second section, where key divergences between the systems are highlighted and the likely impact of recent harmonisation proposals explained.

Obviously, no summary publication can do justice to the many differences of detail that exist between IFRS and Czech GAAP. Although there is already a reasonable degree of affinity between the basic underlying principles of IFRS and Czech GAAP, important differences in the detailed application remain which could have a material impact on the financial statements. In this publication we have focused especially on the differences most commonly found in practice. When applying the individual accounting frameworks, readers must consult all the relevant accounting regulations, standards and, where applicable, their national law. Listed companies must also follow relevant securities legislation, such as the regulations of the Czech Securities Commission.

The International Accounting Standards Board (hereinafter referred to as "IASB") is currently developing a number of projects that will have (often very material) impact on the current standards. The Czech accounting standards are still set by the Ministry of Finance. Further changes towards harmonisation between Czech GAAP and IFRS were made in connection with the amendment to the Act on Accounting which took effect on 1 January 2004. Further movements may be expected in the near future by the anticipated issues of additional Czech accounting standards and amendments to the existing ones, however a key difference in the emphasis on the definition of principles in IFRS and detailed rules (policies) in Czech GAAP remains.

This publication refers to IFRS accounting standards which were effective at the end of 2003 and compares them with Czech GAAP taking effect on 1 January 2004. Basically, the Czech GAAP used in this publication is prescribed for entrepreneurs, any significant differences for banks and other financial institutions, except for insurance companies (hereinafter referred to as "financial institutions"), are explicitly marked in the text.

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Summary of similarities and differences

SUBJECT	IFRS	Czech GAAP	PAGE
General requirements			
Historical cost	Uses historical cost, but intangible assets, property, plant and equipment (PPE) and investment property may be revalued. Derivatives, selected biological assets and most securities must be revalued. Fair value remeasurement is required also for some business combinations.	Uses historical cost, except for specific asset components (for instance derivatives and some securities) that are remeasured at fair value. Fair value remeasurement is also applied to some company transformations.	14
Fair presentation override	In rare cases, entities should override the standards where essential to give a fair presentation.	If in rare cases given accounting policies do not give a true and fair view, an entity is obliged to proceed in such a manner as to give a true and fair presentation.	14
First-time adoption of accounting frameworks	Requires full retrospective application of all IFRSs effective at the reporting date for an entity's first IFRS financial statements.	It is not directly relevant - all entities must since their incorporation use accounting treatment compliant with Czech GAAP .	14
Financial statements			
Reporting currency	Requires the measurement of profit using the functional currency; however, entities may present financial statements in a different currency.	Only the Czech currency.	15
Components of financial statements	Present and comparative balance sheet, income statement, statement of recognised gains and losses (SRGL) or statement of changes in shareholders' equity and cash flow statement, accounting policies and notes.	Present and comparative balance sheet, income statement, statement of changes in shareholders' equity, cash flow statement and notes including accounting policies and comments. Statement of changes in equity and cash flow statement are not required in a number of cases. Information for two years is disclosed for all statements although it is not explicitly required for cash flow statement.	16
Balance sheet format	Does not prescribe a particular format; an entity uses a liquidity presentation of assets and liabilities, instead of a current/non-current presentation, only when a liquidity presentation provides more relevant and reliable information. Certain items must be presented on the face of the balance sheet.	A standard format (structure) prescribed. Only a more detailed analysis or aggregation in specified cases is permitted.	16
Income statement format	Does not prescribe a standard format, although expenditure must be presented in one of two formats (function or nature). Certain items must be presented on the face of the income statement.	A standard format (structure) prescribed, expenditure must be presented in one of two formats (function or nature). Same adjustments as in the case of the balance sheet are permitted.	18
Exceptional items	Does not use the term, but requires separate disclosure of items that are of such size, incidence (impact) or nature that require separate disclosure to explain the performance of the entity. These items must be presented either on the face of the income statement or in the notes.	Does not use the term. General requirement for the explanation of material items disclosed in the financial statements, although it is not permitted to supplement the prescribed format in the primary structure.	18

Summary of similarities and differences

SUBJECT	IFRS	Czech GAAP	PAGE
Financial statements (continued)			
Extraordinary items	Prohibited.	Include unusual operations with regard to usual activities of an entity and cases of random events and changes of accounting methodology.	18
Statement of recognised gains and losses/other comprehensive income	Separate the statement of recognised gains and losses as either in notes or separately highlighted in primary statement of changes in shareholders' equity.	Within the changes in shareholders' equity.	19
Statement of changes in shareholders' equity	Statement showing capital transactions with owners, the movement in accumulated profit and a reconciliation of all other components of equity. The statement must be presented as a primary statement.	Comparable to IFRS , however, entities may replace it by disclosure in the notes.	19
Cash flow statements – format and method	Standard headings, but limited flexibility of contents. Use direct or indirect method.	Only basic categories of cash flows and format are determined, using the indirect method (from operating, investing and financial activities). Use of direct or indirect method.	19
Cash flow statements – exemptions	No exemptions.	Exemptions for all entities without the required audit of financial statements, all banks and financial institutions.	19
Cash flow statements – definition of cash and cash equivalents	Cash includes overdrafts and cash equivalents with short-term maturities (less than 3 months).	Comparable to IFRS .	20
Changes in accounting policies	Restate comparatives and prior-year opening retained earnings.	Effect of changes included in extraordinary items of the current period. The first year of accounting for the deferred tax is an exception. The deferred tax is recorded against retained earnings.	21
Correction of fundamental errors	Restate comparatives, without effect on the identification period.	Included in extraordinary items in the income statement of the current period (except for fundamental errors in the case of financial institutions recorded against prior years' retained earnings).	21
Changes in accounting estimates	Reported in income statement in the current period.	Comparable to IFRS .	21

Summary of similarities and differences

SUBJECT	IFRS	Czech GAAP	PAGE
Consolidated financial statements			
Definition of subsidiary	Based on voting control or actual dominant influence. The existence of currently exercisable potential voting rights also needs to be taken into consideration.	Decisive influence on governance and full control of activities through more than a 50% share in the registered capital or arising from the contract or articles of association of the above entities ("governed" or "controlled" companies). Comparable to IFRS .	22
Special purposes entities ("SPEs")	Consolidate where the substance of the relationship indicates control.	Legal status decisive, subject to consolidation are governed and controlled entities as defined in the Commercial Code.	22
Non-consolidation of subsidiaries	Only if the subsidiary is acquired and held for re-sale in the near future (within one year of use). Dissimilar activities are not a justification. Stated at fair value in both consolidated and stand alone financial statements.	More exceptions than under IFRS . Stated at cost or using the equity method.	23
Definition of associate	Based on significant influence: presumed if 20% interest or participation in entity's affairs.	Comparable to IFRS .	24
Presentation of associate results	Use equity method. Show share of post-tax result. In stand alone financial statements measured at cost or fair value.	Comparable to IFRS . In stand alone financial statements there is an option to account for at cost or using the equity method. In consolidated financial statements the equity method is required.	24
Disclosures about significant associates	Give detailed information on significant associates' assets, liabilities, revenue and results.	Disclosures include names and descriptions of consolidated associates and method of accounting for consolidation.	24
Equity method or proportional consolidation for joint ventures	Both proportional consolidation and equity method permitted.	Use of proportional consolidation mandatorily.	25
Foreign currency translation – individual companies	Translate transactions at rate on date of transaction; monetary assets/liabilities at balance sheet rate; non-monetary items at historical rate.	No definition of monetary assets/liabilities exists. Resolved by specific examples, interests and shares included. Other aspects comparable to IFRS .	27
Foreign entities within consolidated financial statements	Use closing rate for balance sheets; average rate for the period for income statements. Take exchange differences to equity. Include in gain or loss on disposal of a subsidiary.	Use closing rate for both balance sheet and income statement. No detailed guidance.	27
Hyperinflation – foreign entity	Adjust local statements of foreign entity to current price levels prior to translation.	No rules.	28

Summary of similarities and differences

SUBJECT	IFRS	Czech GAAP	PAGE
Business combinations			
Types	Purchase method is the one most frequently used. Uniting of interest/pooling severely restricted, in practice excluded.	Business combinations are not treated as a whole. There is different guidance for consolidations, purchase and contribution of a business and the so-called "company transformation". Individual types are specified in the Commercial Code exclusively in accordance with the legal form.	29
Purchase method – fair values on acquisition	Fair value of assets and liabilities of the acquired entity. Some liabilities relating to plant closures and restructuring liabilities relating solely to the acquired entity may be recognised in fair value, if specific criteria about restructuring plans are met.	Assets and liabilities of the acquired entity are revalued subject to the requirements of the Commercial Code in accordance with the legal form. Banks and other financial institutions: comparable to IFRS . Entrepreneurs: broadly comparable to IFRS .	29
Purchase method – contingent consideration.	Estimated at acquisition then subsequently corrected against goodwill.	No guidance.	30
Purchase method – minority interests at acquisition	State at share of fair value of net assets or at share of pre-acquisition carrying value of net assets.	State at share of equity, split into its individual categories.	31
Purchase method – subsequent adjustments to fair value	Fair values can be corrected against goodwill up to the end of the year after acquisition, if additional evidence of values becomes available. Record subsequent adjustments in income statement. Reversals of acquisition provisions always adjust goodwill.	No detailed rules. No specific rule regulating creation and reversal of provisions at acquisition.	32
Purchase method – disclosure	Disclosures include names and descriptions of combining entities, method of accounting for acquisition, date of acquisition, summary of fair values of assets and liabilities acquired, and impact on results and financial position of acquirer.	Comparable to IFRS , some details are missing.	33
Purchase method – goodwill	Capitalise and amortise over useful life, normally not longer than 20 years. (Modification anticipated subsequent to the issue of IFRS 3 .)	Upon acquisition of an entity or its part capitalise and amortise on a regular basis over 5 years, if an itemised fair value remeasurement of assets was performed, otherwise over 15 years from the acquisition (so-called differences arising upon the acquisition). Completely different rules, close to IFRS , apply to consolidated financial statements and financial institutions.	31
Purchase method – negative goodwill	If it relates to expected future losses/costs, recognise in the income statement when it occurs. Otherwise record as negative asset and recognise over useful lives of identifiable, non-monetary assets. Any excess over the fair value of such assets is recognised in the income statement immediately.	Upon acquisition of an entity or its part record as a negative asset, if an itemised fair value remeasurement of assets was performed, otherwise over 15 years from the acquisition. In consolidated financial statements recognised as a negative asset and amortised on a straight-line basis in income over the period of 20 years as a maximum. Financial institutions recognise it as a negative asset over the period of use of assets to which it relates. If it cannot be ascertained, over the period of 5 years as a maximum.	32
Uniting of interests method	Virtually all business combinations are acquisitions. Entities are required to explore all options to identify an acquirer.	No guidance. In the case of business merger comparatives are not recognised, legal form is decisive for classification purposes.	34

Summary of similarities and differences

SUBJECT	IFRS	Czech GAAP	PAGE
Revenue recognition			
Revenue recognition	Recognise revenue when risks and rewards have been transferred and the revenue can be measured reliably.	No comparable guidance on revenue recognition, formal and legal interpretations prevail.	35
Construction contracts	Revenue and profit on long-term contracts accounted for using the percentage of completion method. Completed contract method prohibited.	Completed contract method prohibited. Accounting treatment depends on the form of contractual arrangement, usually having the form of completed contracts, since the inclusion of unrealised profits is prohibited.	36
Expense recognition			
Interest expense	Interest expense recognised on an accrual basis. Effective yield method used to amortise all finance charges.	Comparable to IFRS , however, effective interest rate only used by financial institutions, with reliefs for short-term (current) assets and fair valued assets.	38
Employee benefits – defined benefit plans	Must use projected unit credit method to determine benefit obligation.	Defined benefit plans are not used in practice and are not regulated by any standard.	38
Employee share compensation	Disclosures required but no guidance or proposal on recognition or measurement. (Standard anticipated after the issue of IFRS 2 .)	No guidance on recognition or measurement of items. Disclosure of shares used as compensation for members of the Board of Directors, Supervisory Board and executives is required.	40
Employee benefits – other	Account for post-retirement benefits as pensions. Rules also given for termination benefits arising from redundancies and other post-employment and long-term employee benefits. Account for termination indemnity plans as pensions.	Post-retirement benefits not covered by standards. In practice usually accounted for on cash-flow basis. Establishing of provisions for post-employment benefits.	40
Assets			
Acquired intangible assets	Capitalise if recognition criteria are met; intangible assets must be amortised over useful life, normally no longer than 20 years. Revaluations are permitted in rare circumstances.	Capitalise if recognition criteria for definition of intangible assets are met, amortise over their useful life. Revaluations not permitted.	41
Internally generated intangible assets	Expense research costs as incurred. Capitalise and amortise development costs only if stringent criteria are met.	Research and development costs are capitalised if the assets are held for sale. Other costs of own intangible fixed assets held for repetitive sale are also capitalised.	42

Summary of similarities and differences

SUBJECT	IFRS	Czech GAAP	PAGE
Assets (continued)			
Property, plant and equipment	Use historical cost or revalued amounts. Frequent revaluations of entire classes of assets are required when revaluation option is chosen.	Use of historical (in certain cases also replacement) cost. Revaluation permitted only upon acquisition of an entity, investment or transformations. Spare parts are not property, plant and equipment.	43
Leases – classification	It is a finance lease if substantially all risks and rewards of ownership transferred. Substance rather than form is important.	Form over substance is applied. Consequently, there is no difference in accounting for financial leases and operating leases.	45
Leases – lessor accounting	Record amounts due under finance leases as a receivable. Allocate gross earnings to give constant rate of return based on (pre-tax) net investment method.	The leased assets (both finance and operating) are capitalised and depreciated by lessor for both finance and operating leases. Revenue is accrued over the lease agreement period on a straight line basis.	45
Capitalisation of borrowing costs	Permitted, but not required, for qualifying assets.	Comparable to IFRS . Interest on loans for the acquisition of securities and interests is not capitalised.	47
Impairment of assets	If impairment indicated, write down assets to higher of net selling price and value in use based on discounted cash flows. If no loss arises, reconsider useful lives of those assets. Reversals of losses permitted in certain circumstances.	Only general requirement to reflect possible impairment. No detailed guidance given for the measurement, in practice sometimes the treatment under IFRS is used. Permanent and temporary impairment are distinguished (recognised by a one-off write-off) or temporary impairment (provisions are created that may be reversed).	46
Investment property	Measure at depreciated cost less accumulated amortisation or fair value and recognise changes in fair value in the income statement.	No specific guidance, treated as property, plant and equipment.	47
Inventories	Carry at lower of cost and net realisable value. Use FIFO or weighted average method to determine cost. LIFO prohibited. Reversal is required for subsequent increase in value of previous write-downs.	Comparable to IFRS .	48
Biological assets	Measured at fair value less estimated point-of-sale costs (marketing costs).	No specific guidance. Treated as inventories, fair value not permitted.	49
Financial assets – measurement	Depends on classification of investment – if held to maturity or such investment is a loan or a receivable, then carry at accrued cost (cost of acquisition and accrued interest) otherwise at fair value. Unrealised gains/losses on trading securities are recognised in the income statement and on available-for-sale investments recognised in equity.	Comparable to IFRS . Financial institutions record available-for-sale securities in the income statement, other securities in equity. The definition of portfolios that are compliant with IAS 39 prior to its amendment differ (trading portfolio, receivables created by an entity, including traded securities acquired in primary issues).	50
Derecognition of financial assets	Derecognise financial assets based on risks and rewards first; control is secondary test.	Accounting treatment follows legal form. Financial institutions derecognise financial assets based on control test.	53

Summary of similarities and differences

SUBJECT	IFRS	Czech GAAP	PAGE
Liabilities			
Provisions – general	Record the provisions relating to present obligations from past events if outflow of resources is probable and can be reliably estimated.	Broadly comparable to IFRS , but under Czech GAAP for instance provisions for future repairs of property, plant and equipment are created (not permitted under IFRS). Financial institutions comparable to IFRS .	54
Provisions – restructuring	Recognise restructuring provisions if detailed formal plan announced or implementation effectively begun.	Based on the approved restructuring plan a provision for this restructuring may be created.	55
Contingencies	Disclose unrecognised possible losses and probable gains.	Comparable to IFRS .	55
Deferred income taxes – general approach	Use full provision (liability) method driven by balance sheet temporary differences. Recognise deferred tax assets if recovery is probable.	Comparable to IFRS . Disclosure of a deferred tax liability/asset compulsory only for companies which are part of a group, financial institutions and companies with required audit of financial statements.	56
Deferred income taxes – main exceptions	Non-deductible goodwill and temporary differences on initial recognition of assets and liabilities that do not impact on accounting or taxable profit.	No guidance. Financial institutions in accordance with IFRS do not take into account non-deductible goodwill.	56
Government grants	Recognise as deferred income and amortise. Entities may offset capital grants against asset values.	Comparable to IFRS . Capital grants must always be offset against asset values.	58
Leases – lessee accounting	Record finance leases as asset and obligation for future rentals. Normally depreciate over useful life of asset. Apportion rental payments to give constant interest rate on outstanding obligation. Generally charge operating lease rentals on straight-line basis.	In general the lessee does not capitalise the asset nor recognise liability. Accounting for finance and operating leases is the same; generally charge rentals on a straight-line basis.	58
Leases – sale and leaseback transactions	For a finance lease, defer and amortise profit arising on sale and finance leaseback. If an operating lease arises then profit recognition depends on sale proceeds compared to fair value of the asset. Also need to consider substance/linkage of the transactions.	Sale and leaseback not addressed specifically, but legal form of transaction takes precedence over commercial substance., i.e. both transactions are recorded separately.	59
Financial liabilities – classification	Classify capital instruments depending on substance of the issuer's obligations. Mandatorily redeemable preference shares are generally classified as liabilities, rather than equity.	Accounting treatment follows the legal form. Instruments that are neither shares nor equity interests classify as liabilities.	60
Convertible debt	Account for convertible debt on split basis, allocating proceeds between equity and debt.	Implicitly comparable to IFRS due to the provision on embedded derivatives, in practice rarely used financial instrument.	60
Derecognition of financial liabilities	Derecognise liabilities when extinguished. The difference between the carrying amount and the amount paid is recognised in the income statement.	Accounting treatment follows the legal form. Financial institutions comparable to IFRS .	61

SUBJECT	IFRS	Czech GAAP	PAGE
Equity instruments			
Capital instruments – purchase of own shares	Stated at cost as deduction from equity.	Comparable to IFRS , state at cost as deduction from equity.	61
Derivatives and hedging			
Derivatives and other financial instruments – measurement of financial instruments and hedging activities	<p>Measure derivatives and hedge instruments at fair value; recognise changes in fair value in income statement except for effective cash flow hedges, where the changes are deferred in equity until effect of the underlying transaction is recognised in the income statement.</p> <p>Gains/losses from hedge instruments that are used to hedge future non-financial assets are included in cost of an asset/liability (basis adjustment), for financial assets are retained in equity and released in the income statement, together with effects of the hedged item.</p>	Comparable to IFRS . For effectivity testing comparison of changes in fair values explicitly required, which however for cash flow hedging is often not viable in practice.	62
Derivatives and other financial instruments – measurement of hedges of foreign entity investments	<p>Gains/losses on hedges of foreign entity investments are recognised in equity, including hedge ineffectiveness on non-derivatives. For derivatives, record hedge ineffectiveness in the income statement.</p> <p>Gains/losses held in equity must be transferred to the income statement on disposal of investment.</p>	Comparable to IFRS .	64
Other accounting and reporting topics			
Earnings per share – diluted	Use weighted average potential dilutive shares as denominator for diluted EPS. Use "treasury stock" method for share options/warrants.	No standard (guidance) or disclosure requirements for EPS (except for investment funds and mutual funds and financial institutions registered on the regulated market which recognise the basic earnings per share in the notes).	65
Related party transactions – definition	Determine by level of direct or indirect control, joint control and significant influence of one party over another or common control of both parties.	No definition of the "control concept" comparable to IFRS exists. The definition for financial institutions is based on the Act on Banks which differs from IAS 24 in a number of details.	66
Related party transactions – disclosures	<p>Disclose name of related party and nature of relationship and types of transaction. For control relationships, give disclosures regardless of whether transactions occur.</p> <p>Some exemptions available for separate financial statements of subsidiaries.</p>	Receivables from and payables to group companies, as well as emoluments, loans, and other benefits provided to directors and statutory representatives should be disclosed in notes to financial statements. Loans to related parties to be disclosed by banks. No exemptions specified, the mandatory scope of recognition is more limited.	66

Summary of similarities and differences

SUBJECT	IFRS	Czech GAAP	PAGE
Other accounting and reporting topics (continued)			
Segment reporting – scope and basis of formats	For public entities only (shares of which are listed on the Stock Exchange): report primary and secondary (business and geographic) segments based on risks and returns and internal reporting structure.	No specific standard. All entities must report split of revenue from ordinary activities by main activities divided also between domestic and export sales.	66
Segment reporting – accounting policies	Use group accounting policies.	No standard.	67
Segment reporting – disclosures	Disclosures for primary segment include revenues, results, capex, total assets and liabilities, and other items. For secondary segment, report revenues, total assets and capex.	Only split of revenue from ordinary activities by main activities divided between revenue from domestic and export sales required.	67
Discontinuing operations – definition	Separate major component.	No standard.	68
Discontinuing/discontinued operations – measurement	Make provisions for some costs when criteria for recognising a restructuring provision are met. Write down assets to lower of net selling price and value in use based on discounted cash flows.	No specific standard for discontinuing operations. There exists a requirement to provide for restructuring costs and a general requirement to provide for losses.	68
Discontinuing/discontinued operations – presentation and main disclosures	Give details of discontinuing operation. Disclose (on face of the income statement) pre-tax gain or loss from discontinuance.	No standard. No presentation on face of income statement required. Should be described in the notes.	68
Post balance sheet events	Adjust financial statements for subsequent events, providing evidence of conditions at balance sheet date and materially affecting amounts in financial statements (adjusting events). Disclose non-adjusting events.	Comparable to IFRS .	68
Interim financial reporting	Not mandatory to prepare interim statements but must use the standard if to be prepared. Basis should be consistent with full year statements and include comparatives.	Mandatory for issuers of publicly traded securities (half-yearly). Minimum requirements stipulated by the Act on Securities (full scope balance sheet and income statement, but not the notes). Treatment not comparable to IAS 34, especially comparable income statement for the period ended by the opening balance of the current period.	69
Operating and financial review	No mandatory standard – suggested features include analytical discussion of business and financial information.	Obligation to disclose in the annual report information on the anticipated future and past development of activities, company position and other information. More detailed requirements for companies with traded securities. Financial institutions have prescribed information for the annual report – comment on performance, risk management, capital adequacy, etc.	–

CONCEPTUAL FRAMEWORK

IFRS includes a conceptual framework. The principles set out in this framework provide a basis for setting accounting standards, and a point of reference for the preparation of financial information where no specific guidance exists. **Czech GAAP**'s basis is in the Act on Accounting. This Act stipulates basic accounting principles and requirements for bookkeeping, however, there is no conceptual framework prepared on a coherent basis, including definitions of basic terms.

Qualitative characteristics of financial information

IFRS Financial information must possess certain characteristics for it to be useful. The **IFRS** framework requires that financial information be understandable, relevant, reliable and comparable.

Czech GAAP Information disclosed in the financial statements must be understandable, reliable, comparable and is considered from the viewpoint of materiality (comparable to **IFRS**). A general rule applies that entities are obliged to maintain their books of account correct, complete, conclusive, understandable, clearly arranged and in the manner ensuring permanence of accounting records. The substance over form principle is replaced by the requirement for selection of a method providing true and fair presentation of substance within legal form, however not beyond it (see accounting for finance leases).

Reporting elements

IFRS The **IFRS** framework presents five reporting elements: assets, liabilities, equity, income (includes revenues and gains) and expenses (includes losses).

Assets are resources controlled from a past event. Liabilities are present obligations arising from a past event. Assets and liabilities are recognised in the balance sheet when it is "probable" that economic benefits will flow in to or out from the entity, and those benefits must be able to be measured reliably.

Equity is the residual interest in the assets after deducting the entity's liabilities.

Income is increases in economic benefits that result in increases in equity other than those relating to contributions from equity participants. Expenses are decreases in economic benefits that result in decreases in equity other than those relating to distributions to equity participants.

Czech GAAP The Czech accounting legislation refers to the same components of accounting recognition (i.e. property, including assets, payables, including liabilities, equity, income and expense) – however, well-developed definitions of these basic terms are not available. Certain items of these basic components have been defined in Czech accounting standards, especially for financial institutions.

HISTORICAL COST

IFRS Historical cost is the main accounting convention. However, **IFRS** permits the revaluation of intangible assets, property, plant and equipment (PPE) and investment property. **IFRS** also requires fair valuation of certain categories of financial instruments and certain biological assets.

Czech GAAP Historical cost convention is applied to most asset and liability components. Only securities (except for held-to-maturity securities, bonds acquired in primary issues, securities not held for trading by an entity, securities representing an ownership interest with dominant or significant influence and securities issued by an entity), derivatives, financial placements and technical reserves of insurance companies, assets and liabilities in the case of transformations of companies or cooperatives (except for changes in the legal form or in other cases under a special legal regulation) and the portion of assets and liabilities secured by derivatives, are measured at fair value. This is similar to receivables held for trading and commitments to return securities which the entity has alienated and by the moment of valuation still has not recovered. This remeasurement is performed at the balance sheet date (or another moment of preparation of the financial statements) for financial institutions on an ongoing basis.

FAIR PRESENTATION OVERRIDE AND PRIORITY OF SUBSTANCE OVER LEGAL FORM

IFRS For assessment and presentation of information the business substance is taken into account, not just its legal form. Entities may depart from a standard in extremely rare circumstances, in which compliance with a requirement in an **IFRS** would result in the preparation of misleading financial statements. **IFRS** requires disclosure of the nature of and the reason for the departure and the financial impact of the departure. The override does not apply where there is a conflict between local company law and **IFRS**; in such a situation, the **IFRS** requirements must be applied.

Czech GAAP If it is possible to choose between more options of a required accounting method and the option chosen would obscure the real status, an entity shall choose the one that corresponds to the real status. If in very rare cases the application of accounting methods is inconsistent with "fair presentation", an entity shall proceed in such a manner to ensure adherence to the above principle. This fact, including the justification and disclosure of the impact on assets, liabilities, financial position and profit/loss, is disclosed in the notes to financial statements.

FIRST-TIME ADOPTION OF ACCOUNTING FRAMEWORK

IFRS First-time adoption of **IFRS**, as the primary accounting basis, requires full retrospective application of all IFRSs effective at the reporting date for an entity's first **IFRS** financial statements, with exemptions primarily for property, plant and equipment and other assets, business combinations and pension plan accounting. Comparative information (except for financial instruments) must be prepared and presented on the basis of **IFRS**. Almost all adjustments arising from the first-time application of **IFRS** must be adjusted against opening retained earnings of the first period presented on an **IFRS** basis. Some adjustments are made against goodwill or against other classes of equity.

Czech GAAP This issue is not directly relevant – all Czech accounting entities must since their incorporation maintain their books of account in compliance with the Act on Accounting and other regulations. If the Act and accounting policies are updated, the transition to new policies is regulated by the relevant transitional provisions. Normally, the impact of updating is recognised in the extraordinary income. There is no explicit guidance on the transition to **IFRS**, **Czech GAAP** is relevant for tax purposes even in this case.

REFERENCES: **IFRS:** Conceptual framework, IAS 1, IAS 16, IAS 38, IAS 39, IAS 40, IAS 41, SIC-8, **IFRS 1.** **Czech GAAP:** Act on Accounting, Decree 500/2002 Coll., Czech accounting standards

FINANCIAL STATEMENTS

GENERAL REQUIREMENTS

Compliance

IFRS Entities must disclose that financial statements comply with **IFRS**. Financial statements must not disclose compliance with **IFRS** unless they comply with all the requirements of each applicable standard and each applicable interpretation.

Czech GAAP Entities that are issuers of securities registered in regulated securities markets in EU Member States will use **IFRS** for their accounting for and preparation of financial statements and consolidated financial statements. Other entities must account for and prepare their financial statements in compliance with the Act on Accounting and related regulations; for consolidated financial statements **IFRS** may be used.

Reporting currency for presentation of financial statements

IFRS **IFRS** specifies the functional currency as the currency of the primary economic environment in which the entity operates or a currency that has a material impact on the entity.

An entity may choose to present its financial statements in a different currency from the functional currency. The method of translating from the functional currency to presentation currency is all balance sheet items except retained earnings at closing rate. Retained earnings and all income statement items are translated at actual rates on dates of transactions or average rates for practical purposes.

Czech GAAP Books of account are maintained in monetary units of the Czech currency, in certain cases also in a foreign currency. Financial statements must be prepared in the Czech currency. For translations of foreign branches and consolidated investments, normally rates at the end of the balance sheet date are used (also for the income statement).

Reporting in a hyperinflationary economy

IFRS Where the reporting entity itself reports in the currency of a hyperinflationary economy, it must prepare financial statements based on the measuring unit current at the balance sheet date. Comparative amounts for prior periods are also restated into the measuring unit at the current balance sheet date. Any gain or loss on the net monetary position arising from the restatement of amounts into the measuring unit current at the balance sheet date must be included in net income and separately disclosed.

Czech GAAP No standard exists. (There was never a hyperinflationary economy in the Czech Republic.)

GENERAL REQUIREMENTS (continued)**Components of financial statements**

A set of financial statements under **IFRS** and **Czech GAAP** comprises the following components.

COMPONENT	PAGE	IFRS	Czech GAAP
Balance sheet	16	✓	✓
Income statement	18	✓	✓
Statement of changes in shareholders' equity	19	✓ (a)	✓ (b)
Statement of recognised gains and losses	19	✓ (a)	Not applicable
Cash flow statement	19	✓	✓ (b), (d)
Accounting policies	–	✓	✓ (c)
Notes to financial statements	–	✓	✓

✓ Mandatory

- (a) Under **IFRS** recognised gains and losses can be presented in the statement of recognised gains and losses with the changes in equity displayed in a note. Alternatively, the other recognised gains and losses can be separately highlighted in the statement of changes in shareholders' equity, which is presented as a primary statement.
- (b) Financial institutions do not prepare it mandatorily.
- (c) Mandatory, but within the notes to financial statements.
- (d) Not mandatory, however, for larger companies. It is commonly prepared in order to present complete information.

Comparatives

IFRS Requires one year of comparatives for all numerical information in the financial statements, with small exceptions.

Czech GAAP Requires one year of comparatives for all numerical information in the financial statements and the annual report, with small exceptions.

BALANCE SHEET

Both accounting systems require the submission of the balance sheet as the primary financial statement.

Format

IFRS Does not prescribe a particular balance sheet format, except that **IFRS** requires separate presentation of total assets and total liabilities. Management may use judgement regarding the form of presentation in many areas. Entities present current and non-current assets, and current and non-current liabilities, as separate classifications on the face of their balance sheet except when a liquidity presentation provides more relevant and reliable information. In such cases, all assets and liabilities shall be presented broadly in order of liquidity. However, as a minimum, **IFRS** requires presentation of the following items on the face of the balance sheet:

BALANCE SHEET (continued)**Format (continued)**

Assets: property, plant and equipment (PPE), investment property, intangible assets, financial assets, investments accounted for using the equity method, biological assets, inventories, trade and other receivables, current and deferred tax assets and cash and cash equivalents; and

Equity and liabilities: issued share capital and other components of shareholders' equity, financial liabilities, provisions, current and deferred tax liabilities, other payables and minority interests.

Czech GAAP Mandatory minimum scope, structure and classification of balance sheet items are prescribed in accordance with the 4th EU Directive. These items may be specified in more detail or aggregated, if the conditions prescribed by a standard are met. Zero items, similarly as in **IFRS**, are not disclosed. Financial institutions have a separate format in compliance with the relevant EU Directive.

Current/non-current distinction

IFRS The current/non-current distinction is not optional (except when a liquidity presentation is used). Where the distinction is made, assets must be classified as current assets where they are held for sale or consumption in the normal course of the operating cycle. Both assets and liabilities are classified as current where they are held for trading, or expected to be realised within 12 months of the balance sheet date. Interest-bearing liabilities are classified as current when they are due to be settled within 12 months of the balance sheet date, even if the original term was for a period of more than 12 months; and an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the balance sheet date and before the financial statements are authorised for issue.

Czech GAAP The current/non-current distinction, except for accruals/deferrals, is mandatory. For tangible and intangible assets their useful life (within 1 year or more than 1 year) and valuation determined by an accounting entity, taking into account true and fair presentation, are decisive. Non-current financial assets include financial assets not held for trading. For receivables and payables (including loans) residual maturity at the end of the balance sheet date (within 1 year or more than 1 year) is decisive. No distinction is applied to financial institutions that disclose mandatorily the residual maturity analysis in the notes to financial statements.

Offsetting assets and liabilities

IFRS Assets and liabilities must not be offset, except where specifically permitted by a standard. Financial assets and financial liabilities may be offset where an entity has a legally enforceable right to set off the recognised amounts and intends to settle transactions on a net basis.

Czech GAAP Offsetting assets and liabilities, expense and income is not permitted, except for:

- credit notes or refunds relating to a particular expense or income item and pertaining to an accounting period in which such expense or income was settled;
- income tax re-assessments and refunds, indirect taxes and fees, including accounting for the deferred tax;
- differences ascertained during stocktaking that have arisen in the same stocktaking period provably by unintentional confusion of individual types, in the case of which such confusion is possible due to the nature of individual types of inventories;
- provisions (general and specific), and deferred comprehensive expenses; and
- foreign exchange differences (gains/losses), profits and losses on revaluation of assets and liabilities, mutual netting-off, receivables from and payables to third parties.

INCOME STATEMENT

Both accounting frameworks require prominent presentation of an income statement as a primary statement (in this study and in the **IFRS** context the term "profit and loss account" is used).

Format

IFRS **IFRS** does not prescribe a standard format for the income statement. The entity must analyse its expenditure by function or nature.

As a minimum, **IFRS** requires presentation of the following items on the face of the income statement: revenue; finance costs; share of after-tax results of associates and joint ventures accounted for using the equity method; tax expense; pre-tax gain or loss from disposal of assets or discontinuing operations; and net profit or loss for the period. A portion of the net income attributable to the minority interest should be disclosed in the income statement separately by one amount.

Czech GAAP Mandatory minimum scope, structure and classification of income statement items are prescribed. These items may be specified in more detail or aggregated if the conditions prescribed by a standard are met. Zero items, similarly as under **IFRS**, are not disclosed. Expenditure must be presented in one of two formats (function or nature). In the case of the function format the prescribed nature items are disclosed in the notes similarly as under **IFRS**.

Exceptional items

IFRS Does not use the term exceptional items but requires the separate disclosure of items of income and expense that are of such size, nature or impact that their separate disclosure is necessary to explain the performance of the entity for the period. Disclosure may be on the face of the income statement or in the notes.

Czech GAAP Comparable to **IFRS**, **Czech GAAP** does not use this term and in practice exceptional items are disclosed either within extraordinary items (see below) or in the notes only.

Extraordinary items

IFRS Prohibited.

Czech GAAP The concept of extraordinary expenses and income is broadly defined. These items are defined as transactions of an unusual nature, i.e. activities other than the ordinary activities of the enterprise, as well as "extraordinary events" which occur incidentally, for instance: change of accounting method, restructuring provisions and provisions for other extraordinary expenses (costs), material adjustments (corrections) to previous accounting periods, income and expenses on assignment or discontinuance of business activity and claims for insurance compensation for extraordinary damage. Also, disposals of an enterprise or its part are recorded in extraordinary expense/extraordinary income accounts on the part of the seller. Extraordinary items are disclosed on the face of the income statement after profit on ordinary activities after tax, but before minority interests in consolidated financial statements. Disclosure of the tax impact is also on the face of the income statement. Any changes in accounting method must also be explained in the notes together with the reason for the change and an assessment of the effect on the financial statements.

The scope of extraordinary items for financial institutions is considerably limited and its treatment is close to the approach applied by **IFRS**.

STATEMENT OF RECOGNISED GAINS AND LOSSES

Presentation

IFRS Recognised gains and losses can be presented either in the notes or separately highlighted within the primary statement of changes in shareholders' equity.

Czech GAAP Statement of recognised gains and losses is not required as one of primary financial statements. However, disclosure of movements in equity is prepared, although a separate summarised measurement of recognised profits and losses is not required. The statement of changes in equity is not prepared by individual entrepreneurs and companies not required to have financial statements audited. Other companies usually prepare the statement although, except for financial institutions, it is not explicitly mandatorily required.

Format

IFRS The total of gains and losses recognised in the period comprises net income and the following gains and losses recognised directly in equity:

- fair value gains/losses on remeasurement of land and buildings, available-for-sale investments and certain financial instruments;
- foreign exchange translation differences;
- the cumulative effect of changes in accounting policies; and
- changes in fair values on certain financial instruments if designated as cash flow hedges, net of tax, and cash flow hedges reclassified to income and/or the relevant hedged asset/liability.

Czech GAAP Material items increasing or reducing individual components of the entity's equity are disclosed in the statement of changes in shareholders' equity.

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

IFRS The statement must be presented as a primary statement. The statement shows capital transactions with owners, the movement in accumulated profit and a reconciliation of all other components of equity.

Czech GAAP Comparable to **IFRS**. The statement of changes in equity is not prepared by individual entrepreneurs and companies not required to have their financial statements audited. Other companies usually prepare the statement although, except for financial institutions, it is not explicitly mandatorily required.

CASH FLOW STATEMENT

Exemptions

IFRS No exemptions.

Czech GAAP Financial institutions and enterprises without required audit of their financial statements do not prepare the statement. Other companies prepare the statement although it is not explicitly mandatorily required.

CASH FLOW STATEMENT (continued)**Direct/indirect method**

IFRS Requires that the cash flow statement reports inflows and outflows of "cash and cash equivalents". The cash flow statement may be prepared using either the direct method (cash flows derived from aggregating cash receipts and payments associated with operating activities) or the indirect method (cash flows derived from adjusting net income for transactions of a non-cash nature such as depreciation). The latter is more common in practice.

Czech GAAP Comparable to **IFRS**. Both methods, direct and indirect, are permitted. The latter is almost exclusively used in practice.

Definition of cash and cash equivalents

IFRS Cash includes overdrafts repayable on demand but not short-term bank borrowings, which are considered to be financing flows. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value. An investment normally qualifies as a cash equivalent only when it has a maturity of 3 months or less from its acquisition date.

Czech GAAP The definition of cash and cash equivalents is, in practice, comparable to **IFRS**.

Format

IFRS Requires separate classification of cash flows from operating, investing and financing activities.

Czech GAAP Comparable to **IFRS**. Requires separate classification of cash flows relating to transactions that constitute extraordinary profit/loss, cash flows relating to the collection and disbursement of interest and dividends or share in profit and payment of the income tax.

Classification of specific items

IFRS and **Czech GAAP** require the classification of interest, dividends and tax within specific categories of the cash flow statement. These are set out below:

ITEM	IFRS	Czech GAAP
Interest paid	Operating or financing	Operating, financing (investing) (a)
Interest received	Operating or investing	Comparable to IFRS
Dividends paid	Operating or financing	Financing
Dividends received	Operating or investing	Comparable to IFRS
Taxes paid	Operating – unless specific identification with financing or investing	Operating

(a) Paid capitalised interest is shown as a separate item of cash flows from investing activities or as a disclosure in the notes.

CHANGES IN ACCOUNTING POLICIES AND OTHER ACCOUNTING CHANGES

Changes in accounting policies

IFRS Changes in accounting policies should be accounted for retrospectively with comparative information restated and the amount of the adjustment relating to prior periods adjusted against the opening balance of retained earnings of the earliest year presented. An exemption applies when changing comparative information is impracticable.

Policy changes made on the adoption of a new standard must be accounted for in accordance with that standard's transitional provisions. If transitional provisions are not specified then the method described above must be used.

Czech GAAP Changes in accounting policies must be shown as extraordinary items for the current period. Material changes in valuation methods, depreciation policies and accounting policies against the previous accounting period should be disclosed, justifying such changes having effect on the amount of assets, liabilities and the profit/loss, if it is practicable to determine them. Changes in accounting policies for the purposes of accounting for the deferred tax are recorded against prior years' retained earnings/losses.

Corrections of fundamental errors

IFRS Requires same method as for policy changes. An entity must restate comparatives.

Czech GAAP Prior period material errors are recorded as extraordinary items for the current period, comparative amounts are not remeasured, but reclassified (if relevant). Financial institutions record fundamental corrections against prior years' retained earnings/accumulated losses, normal corrections are recorded within operating result in compliance with **IFRS**.

Changes in accounting estimates

IFRS Changes in accounting estimates are accounted for in the income statement when identified. **IFRS** treats changes in depreciation method and revised asset life as a change in accounting estimate.

Czech GAAP Comparable to **IFRS**. No explicit guidance on changes in depreciation method.

REFERENCES: **IFRS:** IAS 1, IAS 7, IAS 8, IAS 21, IAS 29, SIC-18, SIC-19. **Czech GAAP:** Act on Accounting, Decree 500 and 501/2002 Coll., Czech accounting standards

CONSOLIDATED FINANCIAL STATEMENTS

PREPARATION

IFRS Requires the preparation of consolidated financial statements by a parent entity that includes all subsidiaries. An exemption applies exclusively to a parent that is wholly owned by another entity or provided that it obtains consent of minority owners and its securities are not publicly traded; it is not in the process of issuing securities in public securities markets; and the immediate or ultimate parent publishes consolidated financial statements that comply with **IFRS**.

Czech GAAP An entity is liable to prepare consolidated financial statements if that entity is a business company having subsidiaries. An exemption from consolidation is possible in cases where at the balance sheet date of the accounting period for which consolidated financial statements are prepared, at least 2 of the 3 following limits are not exceeded:

- aggregate value of balance sheets designed for consolidation must not exceed CZK 350,000,000 (net of accumulated depreciation, provisions and other corrections),
- turnover must not exceed CZK 700,000,000,
- average adjusted number of employees for the period must not exceed 250 people.

This exemption does not apply to entities that are issuers of securities registered in the regulated market and to banks and companies that follow different criteria. Further, exempt from the obligation to prepare consolidated financial statements is a parent that is at the same time a subsidiary included in the consolidation whole of another parent and does not issue marketable securities.

SUBSIDIARIES

Definition

The definition of a subsidiary, for the purpose of consolidation, is an important distinction between the two frameworks.

IFRS Focuses on the concept of the power to control in determining whether a parent/subsidiary relationship exists. Control is the parent's ability to govern the financial and operating policies of a subsidiary to obtain benefits. Companies acquired (disposed of) are included in (excluded from) consolidation from the date control passes. Also need to consider presently exercisable potential voting rights.

Czech GAAP A subsidiary is an enterprise in which the parent ("governing" or "controlling" person) effectively or legally exercises either direct or indirect actual dominant influence on the governance or operation of the enterprise.

Special purpose entities (SPE)

IFRS Requires the consolidation of special purpose entities (SPEs) where the substance of the relationship indicates that an entity controls the SPE, regardless of whether it has a direct or indirect interest. Indicators of control arise where:

- the SPE conducts its activities on behalf of the entity; or
- the entity has the decision-making power or other rights to obtain the majority of the benefits of the SPE; or
- the entity has the majority of the residual or ownership risks of the SPE, or of its assets.

SUBSIDIARIES (continued)**Special purpose entities (SPE) (continued)**

Czech GAAP No specific guidance given on this issue, except for reference to Section 66a of the Commercial Code, from which the necessity arises to consolidate controlled or governed parties. In practice, special purpose entities without an interest of a parent are not consolidated.

Subsidiaries excluded from consolidation

IFRS Subsidiaries should be excluded from consolidation if the parent acquires the subsidiary and holds it exclusively for subsequent re-sale within one year. Dissimilar activities between a parent and subsidiary are not grounds for excluding the subsidiary from consolidation. Requires entities excluded from consolidation to be classified as either available-for-sale or held-for-trading financial assets and measured at fair value.

Czech GAAP A subsidiary is excluded from consolidation if: its revenue or equity amount is considered insignificant compared to the relevant amounts of the group (especially in terms of the aggregate amount of the balance sheet, net turnover and equity) and from the perspective of all unconsolidated (stand alone) entities as a whole; significant strict and long-term limitations prevent the parent from exercising its rights relating to the disposal of subsidiary's assets or its governance, or in rare circumstances, if it may be proved that the cost of obtaining information necessary for the preparation of consolidated financial statements would be inappropriately high; its shares are held exclusively for subsequent re-sale in the immediately following accounting period; or again in rare circumstances, if it conducts activity dissimilar to such an extent that its inclusion in the consolidation whole would be inconsistent with true and fair presentation. Certain diversions apply to financial institutions.

Reduction of an interest in a subsidiary

IFRS The gain or loss on a partial disposal must be calculated by comparing the reduction in the group's interest in the carrying amount of the subsidiary's net assets before and after the sale, with the proceeds received.

Czech GAAP No explicit guidance on this issue, practice comparable to **IFRS**.

Uniform accounting policies

IFRS Consolidated financial statements must be prepared using uniform accounting policies for all of the entities in a group.

Czech GAAP Comparable to **IFRS**.

Reporting periods

IFRS Consolidated financial statements of the parent and the subsidiary are usually drawn up at the same reporting date. However, **IFRS** does permit the consolidation of subsidiary accounts, drawn up at a different reporting date provided the difference between the reporting dates is not more than 3 months. Adjustments must be made for significant transactions that occur in the gap period.

Czech GAAP Comparable to **IFRS**. The period between the dates on which financial statements subject to consolidation are prepared must not be more than 6 months for insurance companies.

REFERENCES: IFRS: IAS 27, SIC-12. **Czech GAAP:** Act on Accounting, Decree 500/2000 Coll., Czech accounting standard 020.

INVESTMENTS IN ASSOCIATES

Definition

IFRS An associate is an entity over which the investor has significant influence – that is, the power to participate in, but not control, the associate's financial and operating policies. Participation in the entity's financial and operating policies and/or representation on the entity's board may demonstrate significant influence. A 20% or more interest by an investor in an entity's voting rights leads to a presumption of significant influence.

Czech GAAP An associate is an entity over which the parent directly or indirectly exercises significant influence, i.e. holds a minimum 20% and maximum 50% shareholding and from contractual relations with the majority owner a different ownership structure does not arise, or if significant influence on the control of an associate does not arise from other facts, which is, in practice, comparable to **IFRS**.

Equity method

IFRS An investor must account for an investment in an associate using the equity method. The investor presents its share of the associate's profits and losses in the income statement. **IFRS** further specifies that this must be shown at a post-tax level. The investor recognises in equity its share of changes in assets of the associate's equity that have not been recognised in the associate's profit or loss (income statement). The investor must account for the difference, on acquisition of the investment, between the cost of the acquisition and investor's share of fair value of the net identifiable assets, as goodwill.

The investor's investment in the associate is stated at cost, less goodwill amortisation, plus share of post-acquisition profits or losses, plus share of post-acquisition movements in reserves, less dividends received. Losses that reduce the investment below zero are applied against any long-term interests that, in substance, form part of the investor's net investment in the associate; for example, preference shares and long-term receivables and losses. Losses recognised in excess of the investor's investment in ordinary shares are applied to the other components in reverse order of seniority. Further losses are provided for as a liability only to the extent that the investor has incurred legal or constructive obligations or made payments on behalf of the associate.

Disclosure of information is required about the results, assets and liabilities of significant associates.

Czech GAAP Comparable to **IFRS**, however, **Czech GAAP** does not require adjustment of the valuation for goodwill at the acquisition date (except for financial institutions). In practice, both methods are used. The investor's share in the associate's profits and losses is always stated at a post-tax level. Requires information about the name and place of registration of the associate, percentage of the shares held by the parent, method of consolidation used, balance sheet date of the consolidated associate and also names and places of registration of those associates which have been excluded, including the reason for such treatment. Furthermore, certain information from the financial statements of the associate itself has to be disclosed.

INVESTMENTS IN ASSOCIATES (continued)**Impairment**

IFRS Apply the general impairment requirements of **IFRS**. In estimating future cash flows the investor may use its share of the future net cash flows from the underlying entity, or the cash flows expected to arise from dividends.

Czech GAAP No specific guidance given on this issue, however, general requirement to reflect possible asset impairment applies.

INVESTMENTS IN JOINT VENTURES**Definition**

IFRS Defines a joint venture as a contractual agreement whereby two or more parties undertake an economic activity that is subject to joint control. Joint control is the contractually agreed sharing of control of an economic activity.

Czech GAAP A joint venture is defined as an entity that is controlled in concert with another party or parties, if such parties have the same share in the registered capital of the controlled or governed party.

Types of joint ventures

IFRS Distinguishes between 3 types of joint venture:

- jointly controlled entities, where the arrangement is carried on through a separate entity (company or partnership);
- jointly controlled operations, in which each venturer uses its own assets for a specific project; and
- jointly controlled assets, a project carried on with assets that are jointly owned.

Czech GAAP Types of joint venture are not defined, but only a jointly controlled entity as defined under **IFRS** is considered to be a joint venture.

Jointly controlled entities

IFRS For jointly controlled entities, use either the proportionate consolidation method or the equity method. Proportionate consolidation requires the venturer's share of the assets, liabilities, income and expenses to be combined on a line-by-line basis with similar items in the venturer's financial statements, or reported as a separate line item in the venturer's financial statements.

Czech GAAP The proportionate consolidation method is prescribed, in unconsolidated (stand alone) financial statements valuation at cost or at equity (using the equity method).

Contributions to a jointly controlled entity

IFRS Where a venturer contributes non-monetary assets, such as shares or fixed assets, to a jointly controlled entity in exchange for an equity interest in the jointly controlled entity, the venturer must recognise in the income statement the portion of the gain or loss attributable to the equity interests of the other venturers, except when:

- the significant risks and rewards of the contributed assets have not been transferred to the jointly controlled entity; or
- the gain or loss on the assets contributed cannot be measured reliably; or
- the asset is similar to those contributed by other venturers.

In addition, where a venturer receives assets dissimilar to those it contributed, the venturer must recognise an appropriate proportion of the gain in the income statement.

INVESTMENTS IN JOINT VENTURES (continued)

Contributions to a jointly controlled entity (continued)

Czech GAAP No specific guidance given on this issue.

Jointly controlled operations

IFRS Similar to jointly controlled entities without a specific incorporated structure. A venturer must recognise in its financial statements: the assets that it controls; the liabilities it incurs; the expenses it incurs; and its share of income from the sale of goods or services by the joint venture.

Czech GAAP No specific guidance given on this issue – this type of joint venture is not defined, in practice it is treated in accounting records similarly as in **IFRS**, disclosure in the notes is not required.

Jointly controlled assets

IFRS Venturer must account for its share of the jointly controlled assets and any liabilities it has incurred.

Czech GAAP No specific guidance given on this issue – this type of joint venture is not defined, normally it is accounted for and recognised according to the legal form.

REFERENCES: IFRS: IAS 1, IAS 28, IAS 31, SIC-13, SIC-20. **Czech GAAP:** Act on Accounting, Decree 500/2002 Coll., Czech accounting standard 020.

EMPLOYEE SHARE OWNERSHIP PLANS

Employee share ownership plans (ESOPs) are designed to facilitate employee shareholdings. Often they are combined with separate trusts that buy shares to be given or sold to employees.

Accounting

IFRS No specific guidance on such plans (status in January 2004).

Czech GAAP No specific guidance on employee share ownership plans. Employee shares are no longer a special type of shares.

Recent proposals - IFRS

The IASB has issued an exposure draft, ED2 - Share-based Payments. The ED requires that share-based payments to employees result in compensation expense to reflect the receipt and consumption of employee services and issue of equity instruments. The ED also requires recognition of a charge over the employees' service period to vesting date, measured on the basis of the fair value of the option at the grant date.

FOREIGN CURRENCY TRANSLATION

Translations – the individual entity

IFRS and **Czech GAAP** have similar requirements regarding the translation of transactions by an individual entity. In **Czech GAAP** the definition of monetary and non-monetary items does not exist; the accounting treatment is based on specific examples (enumeration), which is different from **IFRS** in its detailed application.

- Translation of transactions denominated in a foreign currency is at the exchange rate in operation on the date of the transaction.
(**Czech GAAP** specifies that the exchange rate published by the Czech National Bank must be used, or the fixed exchange rate set in advance by the internal guideline of an accounting entity for one accounting period as a maximum; basically, the rate published by the Czech National Bank as at the first day of the period for which the fixed rate is used serves as its basis, and in the case of devaluation or revaluation of the Czech crown the fixed rate must be always changed.)
- Monetary assets and liabilities denominated in a foreign currency are translated at the closing (year-end) rate.
(**Czech GAAP** specifies that the exchange rate published by the Czech National Bank must be used.)
- Non-monetary foreign currency assets and liabilities are translated at the appropriate historical acquisition rate.
- Income statement amounts are translated using historical rates of exchange at the date of transactions or a weighted average rate as a practical alternative. (**Czech GAAP** specifies that the exchange rate published by the Czech National Bank must be used, or the fixed exchange rate set in advance for one accounting period as a maximum; in the case of devaluation or revaluation of the Czech crown the fixed rate must be always changed, the weighted average rate must not be used.)
- Non-monetary items denominated in a foreign currency and carried at fair value are reported using the exchange rate that existed when the fair value was determined (**IFRS**). Monetary items carried at fair value under **Czech GAAP**, as opposed to **IFRS**, are always reported together with a change in fair value (except for debt securities in financial institutions).
- Exchange gains and losses arising on an entity's own foreign currency transactions are reported as part of the profit or loss for the year from ordinary activities. This includes long-term loans, which in substance form part of an entity's net investment in a foreign operation. (See page 64 – the hedge of a net investment).

Translation – consolidated financial statements

IFRS requires that where the operations of a foreign consolidated entity are largely independent of the investing (parent) entity's reporting currency, amounts in the foreign entity's balance sheet are translated using the closing (year-end) rate, with the exception of equity balances, for which the historical rate is used. Amounts in the income statement are usually translated using the average rate for the accounting period. The translation differences arising are reported in equity.

Where a foreign operation is integral to the reporting entity, its individual balances are translated as if all the transactions had been carried out by the reporting entity itself. Under **Czech GAAP** the balance sheet and the income statement of a foreign consolidated entity are translated at the rate ruling at the balance sheet date. Exchange gains and losses arising from the translation of equity between the opening and the closing balance sheet of the period also form part of the equity of the group (consolidation whole).

FOREIGN CURRENCY TRANSLATION (continued)

Tracking of translation differences in equity

IFRS These must be separately tracked and the cumulative amounts disclosed. On disposal of a foreign entity (operation), the appropriate amount of cumulative translation difference relating to the entity is transferred to the income statement and included in the gain or loss on sale.

Czech GAAP No specific guidance on this issue.

Translation of goodwill and fair value adjustments on acquisition of foreign entity

IFRS and Czech GAAP Translate at closing rates.

Foreign entity in hyperinflationary economy

IFRS Restate to current purchasing power prior to translation into the reporting currency of the reporting entity.

Czech GAAP No guidance on this issue.

Reporting entity in a hyperinflationary economy

IFRS Where the reporting entity itself reports in the currency of a hyperinflationary economy, the financial statements must be stated in terms of the measuring unit current at the balance sheet date.

Czech GAAP No guidance on this issue.

REFERENCES: IAS: IAS 21, IAS 29. **Czech GAAP:** Act on Accounting, Decree 500/2002 Coll., Czech accounting standard 006 and 020, Notice of the Ministry of Finance on accounting for establishments in Slovakia (281/69 813/93).

BUSINESS COMBINATIONS

Types

A business combination involves the bringing together of separate entities into one economic entity. Three types of business combination occur in practice. An acquisition is where one of the combining entities obtains control over the other, enabling an acquirer to be identified; this is the most common type of combination. A uniting of interests (pooling) occurs where it is not possible to identify an acquirer; instead, the shareholders of the combining entities join in substantially equal arrangements to share control. A group reorganisation can arise from transactions among entities that operate under common control.

IFRS Business combinations are almost always accounted for as acquisitions. **IFRS** requires that the purchase method of accounting is used to portray the financial effect of an acquisition. **IFRS** severely restricts the circumstances in which transactions can be recognised as a uniting of interests. Specific **IFRS** guidance about business combinations excludes from its scope transactions among entities under common control.

Czech GAAP When accounting for business combinations, a treatment that corresponds to the purchase method is normally used, strictly respecting the legal form of a transaction which often results in a different recognition of an acquisition on the purchase of an entity (enterprise) and its merger. In the case of the legal merger, fusion or demerger of an entity, Czech legislation also uses the term "company transformations" (conversions) – individual types of transformations, requirements for the preparation of financial statements, and valuation of enterprises are specified by the Commercial Code and the relevant accounting regulations.

ACQUISITION

Date of acquisition

IFRS The date on which the acquirer obtains control over the acquired entity.

Czech GAAP Comparable to **IFRS**. Often interpreted on the basis of the legal form, i.e. passage of ownership.

Cost of acquisition

The cost of acquisition is the amount of cash or cash equivalents paid (or fair value of non-monetary assets exchanged). Where consideration comprises an exchange of shares, specific guidance applies under **IFRS**.

IFRS Shares issued as consideration are recorded at their fair value as at the date of the exchange – the date when the acquirer obtains control over the acquiree's net assets and operations. When the acquisition occurs in stages, the fair value of the shares issued as purchase consideration is determined at each exchange date.

In an active market, the published price of a share at the date of exchange is the best evidence of fair value.

Czech GAAP No guidance on this issue.

ACQUISITION (continued)

Contingent consideration

IFRS If part of the purchase consideration is contingent on a future event, such as achieving certain profit levels, **IFRS** requires an estimate of the amount to be included as part of the cost at the date of the acquisition where it is probable that it will be paid. Any revision to the estimate is subsequently adjusted against goodwill.

Czech GAAP No guidance on this issue.

Recognition and measurement of identifiable assets and liabilities acquired

IFRS and **Czech GAAP** require separate recognition, by the acquirer, of the acquiree's identifiable assets and liabilities that existed at the date of acquisition. These assets and liabilities must be recognised at fair value at the date of acquisition. In **Czech GAAP** for financial institutions this requirement is not explicitly expressed. The two frameworks apply different criteria to the recognition of acquired intangible assets and restructuring provisions.

Restructuring provisions

IFRS The acquirer must satisfy the following criteria to recognise a restructuring provision:

- at or before the acquisition date, the acquirer must have developed the main features of a plan that involves terminating or reducing the activities of the acquiree;
- at or before the acquisition date, the acquirer must raise an expectation in those affected by the plan (constructive obligation) by announcing its main features to those affected; and
- by the earlier of 3 months after the acquisition date or the date of the nearest financial statements the acquirer must have developed the main features of the plan into a detailed formal plan.

Czech GAAP No specific rule given on creation of acquisition provisions, except for financial institutions, where a necessary prerequisite for the creation of a provision is an official irrevocable detailed restructuring plan; however, strict time limits similar to **IFRS** have not been determined.

Intangible assets

IFRS Only record separate intangible assets if they meet the definition of and recognition criteria for an intangible asset - see page 41. Otherwise, intangible assets must be subsumed within goodwill and amortised accordingly. Acquired in-process research and development is recognised as an intangible asset provided it meets the IAS 38 recognition criteria.

Czech GAAP Comparable to **IFRS**, but applying **Czech GAAP** rules for the definition of intangible assets.

ACQUISITION (continued)**Minority interests at acquisition**

IFRS Where an investor acquires less than 100% of a subsidiary, **IFRS** requires the minority interest to be stated at either: its share of the pre-acquisition carrying value of net assets; or its share of the fair value of the net assets. Whichever method is followed, no goodwill is attributed to the minority interest.

Czech GAAP Minority interests recognised as equity interests must be included in the consolidated financial statements from the date of acquisition.

GOODWILL

Arises as the difference between the cost of the acquisition and the fair value of identifiable assets and liabilities acquired. It may be positive or negative. Goodwill is capitalised as an intangible asset. In the event that an itemised fair value remeasurement of identifiable assets and liabilities is not performed, the difference is classified under **Czech GAAP** in unconsolidated (stand alone) financial statements as "differences arising upon the acquisition" and is recognised as part of PPE; in consolidated financial statements as a "consolidation difference" and is recognised under a separate item. **Czech GAAP** does not address the issue of whether a negative consolidation difference should be recognised as a liability or a negative asset.

Useful life

IFRS There is a rebuttable presumption that the useful life of goodwill does not exceed 20 years. In very rare cases, goodwill may be demonstrated to have a useful life in excess of 20 years. If the useful life exceeds 20 years, amortisation is still mandatory and the reasons for rebutting the presumption must be disclosed.

Czech GAAP Goodwill (in consolidated financial statements labelled as consolidation difference) is amortised on a straight-line basis over the useful life not exceeding 20 years. In unconsolidated (standalone) financial statements so-called differences arising upon the acquisition of assets (if the assets are not remeasured at fair value) are amortised on a straight-line basis over a period of 15 years and goodwill (if assets are remeasured at fair value) over a period of 5 years. For financial institutions amortisation of goodwill is comparable to **IFRS**.

Impairment

IFRS Requires an impairment review of goodwill whenever events or changes in circumstances indicate that the carrying amount may not be recoverable and annually if the estimated useful life exceeds 20 years. On subsequent disposal of the acquired entity, any attributable goodwill not yet amortised, or recognised in equity reserves prior to the adoption of IAS 22, must be transferred to the income statement and included in the gain or loss on sale.

Czech GAAP No specific standard that would regulate the requirements for methods of reviewing impairment of assets. There is only a general requirement to reflect possible impairment but no detailed guidance is given for the measurement.

GOODWILL (continued)

Negative goodwill

IFRS Negative goodwill relating to expected future losses or expenses identified in the acquirer's plan for the acquisition must be recognised in the income statement when those losses/expenses occur. Otherwise negative goodwill not exceeding the fair value of acquired identifiable non-monetary assets must be recognised in the income statement on a systematic basis over the useful lives of such assets. Where negative goodwill exceeds the fair value of non-monetary assets, it must be immediately recognised in the income statement.

Negative goodwill is presented as a "negative" asset, alongside positive goodwill.

Czech GAAP Negative goodwill is treated in the same way as positive goodwill. Negative goodwill is recognised in the balance sheet in the same way as under **IFRS**; presentation of "passive consolidation difference" is not addressed in consolidated financial statements.

SUBSEQUENT ADJUSTMENT TO ASSETS AND LIABILITIES

IFRS Permits adjustments to original fair values recognised at acquisition as additional evidence becomes available to estimate those values. Adjustments are recognised as changes to goodwill, provided they are made before the end of the first full accounting period beginning after the acquisition. Subsequent adjustments must be recognised in the income statement.

The reversal of restructuring provisions made on acquisition should be recognised as changes to goodwill.

Czech GAAP No specific standard for subsequent adjustment to assets and liabilities. On acquisition of a set of assets the acquirer may subsequently remeasure individual assets based on an expert opinion and adjust a provision accordingly. However, if the acquisition is performed within 3 months before the balance sheet date, the remeasurement may also be performed in the subsequent period.

SUBSEQUENT ADJUSTMENTS TO DEFERRED TAX

IFRS If a deferred tax asset relating to the acquiree is identified but not recognised at the time of the acquisition and is subsequently recognised in the acquirer's consolidated financial statements, the deferred tax income is recognised in the income statement. The acquirer must also adjust goodwill and accumulated amortisation, as if the deferred tax asset had been recognised at the acquisition date. The subsequent reduction in the net carrying amount of goodwill is recognised in the income statement as an expense.

Czech GAAP No specific standard for subsequent adjustments to deferred tax.

DISCLOSURE

ITEM	IFRS	Czech GAAP
General		
Names and descriptions of the combining entities	Mandatory	Mandatory
Method of accounting for the business combination	Mandatory	Mandatory
The effective date of the combination for accounting purposes	Mandatory	Mandatory
The cost of acquisition and the form of the consideration given, including any deferred and contingent consideration	Mandatory	Not required
Operations to be disposed of	Mandatory	Not required
The % of voting shares acquired	Mandatory	Not required
Goodwill		
Goodwill – method & amortisation period	Mandatory	Mandatory
Goodwill – impairment charge	Mandatory	Not required
Total amount of goodwill – amount expected to be tax deductible – the amount of goodwill by reportable segment	Not specified	Not required
Reconciliation of the goodwill between opening and closing amount	Mandatory	Not required
Other financial disclosures		
Summary of fair value of assets and liabilities acquired with separate disclosure of cash equivalents	Mandatory	Not required
Provisions for terminating or reducing activities of acquiree	Mandatory	Not required
Effect of acquisition on the financial position at the balance sheet date and on the results since the acquisition	Mandatory	Not required
Amount of purchased research and development assets acquired and written off in the period	Not applicable	Not required
If the purchase price had not been finalised, disclose that fact and the reasons. In subsequent periods, adjustments made to the initial allocations must be disclosed	Not specified	Not required
Details of amounts allocated to intangible assets including total amounts, amortisable/non-amortisable, residual values and amortisation periods by assets	Not specified	Not required
For a series of individually immaterial business combinations that are material in the aggregate: <ul style="list-style-type: none"> • the number of entities and brief description • the aggregate cost, the number of entity interests issued or issuable and value • aggregate amount of any contingent payments options or commitments 	Required	Not required

UNITING OF INTERESTS

Under **IFRS** it is very rare to account for a business combination as a uniting of interests. Under **Czech GAAP** this issue is not addressed and the accounting treatment is based on the legal form of transformation (conversion).

The criteria under **IFRS** focus on the substance of the transaction. The uniting of interests method only applies where an acquirer cannot be identified. Control must not pass from one entity to another; the parties must come together in substance to create a new reporting entity and to share in its future risks and benefits.

New standard for business combinations **IFRS 3** will not permit the uniting of interests method. It also changes accounting for business combinations in many other areas.

Accounting for uniting of interests

Under **IFRS**, the uniting of interests does not involve an acquisition but a continuation of the business that existed before the transaction. The financial statements of the combining parties are simply added together. The combined assets, liabilities and equity are recognised at their existing carrying amounts (after adjustments necessary to conform the accounting policies and practices). The results are combined from the earliest year reported and comparatives are restated. No goodwill is recognised on the transaction; any difference arising is adjusted against equity. Expenses relating to the uniting of interests are recognised in the income statement in the period in which such expenses are incurred.

COMMON CONTROL TRANSACTIONS

IFRS Does not specifically address such transactions. In practice, such combinations are generally accounted for at predecessor cost (with the choice of using fair value), reflecting the carrying amount of the assets and liabilities transferred, including any goodwill relating to the transferred entity previously recognised in the transferor's financial statements.

Czech GAAP This issue is not addressed. In practice, it is treated as if no common control exists.

REFERENCES: **IFRS:** IAS 12, IAS 22 (amended), SIC-9. **Czech GAAP:** Act on Accounting, Decree 500/2002 Coll., Czech accounting standard 020.

REVENUE RECOGNITION

Definition

IFRS Income is defined in the **IFRS** Framework to include revenues and gains. A specific standard on revenue recognition defines revenue as the gross inflow of economic benefits during the period arising from the ordinary activities of an enterprise when the inflows result in an increase in equity, other than increases relating to contributions from equity participants.

Czech GAAP There is no well-developed definition of revenues and generally the legal form is followed, i.e. revenues are recognised at the date of passage of ownership or the rendering of a service.

Measurement

IFRS requires measurement of revenues at the fair value of the consideration received or receivable. This is usually the amount of cash or cash equivalents received or receivable. In practice, the treatment under **Czech GAAP** is usually identical. Where the inflow of cash or cash equivalents is deferred, discounting to a present value is required under **IFRS** (except for contractual interest, not permitted under **Czech GAAP**).

Revenue recognition

IFRS IAS 18 describes specific revenue recognition criteria for the sale of goods and for the rendering of services and interest, royalties and dividends. The revenue recognition criteria common to each of these are the probability that the economic benefits associated with the transaction will flow to the entity and that the revenue and related costs can be measured reliably.

Additional recognition criteria apply to revenue arising from the sale of goods. **IFRS** requires that the seller has transferred the significant risks and rewards of ownership to the buyer and retains no control over the goods. Revenue from the rendering of services must be recognised by reference to the state of completion of the transaction at the balance sheet date. Interest revenue must be recognised on a basis that takes into account the asset's effective yield (interest rate). Royalties are recognised on an accrual basis and dividends are recognised when the shareholder's right to receive payment is established.

Czech GAAP Concentrates on formal aspects of the transaction and does not require explicitly reliable determination of related expenses. Revenue which relates to a different accounting period is deferred or accrued in the balance sheet (rentals, insurance premiums, etc.). The effective interest method is only required in the case of financial institutions for instruments measured at the accrued value; in other cases it is not specifically addressed.

Revenue recognition criteria

IFRS

- it is probable that economic benefits will flow to the entity,
- the entity has transferred to the buyer the significant risks and rewards of ownership of the goods,
- the amount of revenue can be measured reliably,
- the entity retains no effective control over the goods,
- the costs incurred or to be incurred in respect of the transaction can be measured reliably and,
- the stage of completion of the transaction can be measured reliably.

Czech GAAP does not stipulate comparable criteria and the form of a transaction is decisive, which in the case of a number of non-standard transactions causes practical problems.

SPECIFIC REVENUE RECOGNITION ISSUES

Warranty and product maintenance contracts

IFRS When a product's selling price includes an identifiable component for subsequent servicing, the latter is deferred and recognised over the warranty period.

Czech GAAP Not addressed specifically; in practice, provisions are often created for warranty repairs.

Barter transactions – advertising

IFRS An advertising barter arrangement exists when two companies enter into a non-cash transaction to exchange advertising services. Under **IFRS**, revenue may generally be recognised on the exchange of dissimilar goods and services if the amount of revenue can be measured reliably. The transaction must be measured at the fair value of goods or services received; however, where the fair value of goods or services received cannot be measured reliably, the fair value of the goods and services given up is used. The fair value of advertising received or provided in a barter transaction is generally measured by reference to equivalent non-barter (i.e. cash) transactions.

Czech GAAP No guidance given on this issue.

CONSTRUCTION CONTRACTS

Scope

IFRS Applies to fixed-price and cost-plus construction contracts of contractors (not defined), for the construction of a single asset or combination of assets.

Czech GAAP No special accounting guidance for construction contracts exists.

Recognition method

IFRS Requires the percentage of completion method to recognise revenue and expenses if the outcome can be measured reliably. The criteria necessary for a cost-plus contract to satisfy reliable measurement are less restrictive than for a fixed-price contract. When the final outcome cannot be estimated reliably, **IFRS** permits the use of the zero-profit method, which recognises revenue only to the extent of contract costs incurred that are expected to be recovered. Provides limited guidance on the use of estimates.

Czech GAAP The percentage of completion method is not permitted. Accounting treatment is dependent on the terms of the contract, usually has the form of the completed contract method and in the case of work in progress, supplies are usually stated at direct cost, production and administrative overheads. If there is partial invoicing agreed in the contract, the revenue and related costs are recognised in the income statement based on invoicing. If progress payments are agreed in the form of advance payments, advances paid by customers on long-term contracts before the fulfilment of the commitment to the customer are recorded as a liability with revenue, and costs and profit on the project are deferred until completion. Anticipated losses should be recognised and provided for earlier, in the period when ascertained.

CONSTRUCTION CONTRACTS (continued)**Applying the percentage of completion method**

IFRS When the outcome of the contract cannot be estimated reliably, revenue and costs must be recognised by reference to the stage of completion of the contract activity at the balance sheet date. When it is probable that total contract costs will exceed total contract revenue, the expected loss must be recognised as an expense immediately.

Czech GAAP Not relevant; in the case of anticipated loss a provision for work in progress needs to be created. The manner of its calculation has not been determined.

Completed contract method

IFRS Prohibited.

Czech GAAP Depends on the form of contractual arrangement, in practice usually used.

Combining contracts and segmenting a contract

IFRS Requires contracts to be combined when part of a package, or segregated when each contract is part of a separate proposal and when revenues and costs can be clearly identified.

Czech GAAP No guidance on this issue.

REFERENCES: IFRS: IAS 11, IAS 18, **Czech GAAP** - Act on Accounting, Decree 500/2002 Coll., Czech accounting standard 019, 015.

EXPENSE RECOGNITION

Definition

IFRS Expenses are defined in the **IFRS** Framework to include losses. Expenses are decreases in economic benefits that result in a decrease in equity.

Czech GAAP No specific definition of expenses exists.

SPECIFIC EXPENSE RECOGNITION ISSUES

INTEREST EXPENSE

IFRS Interest expense is recognised on an accrual basis. Where interest expense includes a discount or premium arising on the issue of a debt instrument, the discount or premium is amortised using the effective interest rate method. The effective interest rate is the rate that discounts the estimated future cash payments through the expected life of the debt instrument to the carrying amount of the debt instrument.

Czech GAAP Interest expense is recognised on an accrual basis applying the straight-line interest rate method. Financial institutions use mandatorily effective interest rate in cases described by the Decree; however, they may apply the straight-line rate for current assets and fair valued assets.

EMPLOYEE BENEFITS – PENSIONS

IFRS Requires the cost of providing these benefits to be recognised on a systematic and rational basis over the period during which employees provide services to the entity. Separates pension plans into defined contribution plans and defined benefit plans.

Czech GAAP Currently, no specific guidance (standard) on this issue is available in the Czech Republic. There is a state pension system with possible supplementary private pension schemes (contributory pension plans) run by pension funds. Business companies contribute to the state pension system and can possibly also contribute on behalf of their employees to the private pension funds.

Defined contribution plans

Defined contribution plans are post-employment benefit plans that require the entity to pay fixed contributions into a fund. The entity is under no legal or constructive obligation to make further contributions to the fund even if losses are sustained. Under these plans it is the employee who is exposed to the risk attributable to the plan assets. **IFRS** requires that pension cost is measured as the contribution payable to the fund on a periodic basis.

Defined benefit plans

Defined benefit plans oblige the employer to provide defined post employment benefits of set amounts to employees. The risks associated with plan assets rest with the employer.

Czech GAAP So far, it is not common practice in the Czech Republic for employers to have defined benefit plans and no guidance on such plans is available under **Czech GAAP**. Defined contribution plans are recorded in accordance with **IFRS**.

Defined benefit plans (continued)

The key features of the methodology for accounting for defined benefit plans under **IFRS** are:

ITEM	IFRS
Determination of pension and post-retirement expense	Use projected unit credit actuarial method.
Discount rate for obligations	Based on market yields for high quality corporate bonds. Government bond yields should be used when there is no deep market in high quality corporate bonds.
Valuation of plan assets	Measure at fair value or using discounted cash flows if market prices unavailable.
Recognition of actuarial gains and losses	Immediate recognition and amortisation over expected remaining working lives of participating employees. At a minimum, a net gain/loss in excess of 10% of greater of defined benefit obligation or actual (fair) value of plan assets at beginning of year must be recognised.
Expected return on plan assets	Based on market expectations at the beginning of the period for returns over the entire life of the related obligation. Reflects changes in the fair value of plan assets as a result of actual contributions and benefits paid.
Balance sheet asset limitation	Asset limited to the lower of: a) the asset resulting from applying the standard, and b) the net total of any unrecognised actuarial losses and past service cost and the present value of any available refunds from the plan or reduction in future contributions to the plan.
Past-service cost	Positive and negative past-service cost recognised over remaining vesting period. Where benefits have already vested, recognise past-service cost immediately.
Multi-employer plans	Use defined benefit accounting unless sufficient information available.
Subsidiary's defined benefit pension plan forming part of a group plan	No exemption. The plan is accounted for as a defined benefit plan.
Curtailed/settlement (timing of recognition)	Gains and losses on curtailments are recognised when curtailments/settlements occur.
Curtailed/settlement (calculation of gains and losses)	Gains and losses on curtailments/settlements include changes in the present value of the defined benefit obligation, any resulting changes in the fair value of the plan assets and any related actuarial gains and losses and past service cost that had not previously been recognised.

REFERENCES: IFRS: IAS 19, IAS 39.

EMPLOYEE SHARE COMPENSATION

There are no current requirements in **IFRS** or **Czech GAAP** (status in January 2004) for recognising and measuring employee share compensation, although specific rules for disclosure in the financial statements (notes) apply.

Recognition

IFRS Not required.

Czech GAAP No guidance on this issue.

Measurement

IFRS Not applicable, as recognition is not currently required.

Czech GAAP No guidance on this issue.

Employer's payroll tax payable on exercise of share options by employee

IFRS No specific guidance regarding the recognition and measurement of payroll tax payable by entities (employers) in connection with the benefit accruing to employees from the award of share options. In practice, the employer's social security liability arising from the payment of share options must be accrued based on the latest enacted national insurance rate and the current market value of the gain to the employee. This charge is spread over the performance period.

Czech GAAP No guidance on this issue.

REFERENCES: **IFRS**: IAS 19, IAS 37.

COMPENSATED ABSENCES

Includes long-term compensated absences such as long-term disability, long service and holidays. These benefits typically accumulate over the employee's service period. **IFRS** requires that the liability be recognised, as the employee provides the service that gives rise to the right to the benefit. Under **Czech GAAP**, in practice a provision for untaken holiday is recorded.

TERMINATION BENEFITS

IFRS Termination benefits arising from redundancies are accounted for in a similar way to restructuring provisions. In the event of an offer made to encourage voluntary redundancy, the measurement of termination benefits should be based on the number of employees expected to accept the offer.

Termination indemnities are generally payable regardless of the reason for the employee's departure. The payment of such benefits is certain (subject to any vesting or minimum service requirements) but the timing of their payment is uncertain. **IFRS** requires that termination indemnities be accounted for consistently with pension obligations (i.e., including expected salary progression element).

Czech GAAP It is recorded as a component of the restructuring provision.

REFERENCES: **IFRS**: IAS 19. **Czech GAAP**: Czech accounting standard 004.

ASSETS

INTANGIBLE ASSETS

Definition

IFRS An identifiable non-monetary asset without physical substance controlled by the entity and held for use in the production or supply of goods or services, for rental to others, or for administration purposes. May be acquired or internally generated.

Czech GAAP There are specifically defined assets that are classified as intangible assets – establishment costs, research and development, software, royalties (for instance know-how and licences) and goodwill with a useful life longer than one year.

Recognition – acquired intangibles⁽ⁱ⁾

IFRS General **IFRS** asset recognition criteria apply. Recognise if future economic benefits attributable to the asset are probable and the cost of the asset can be measured reliably.

Czech GAAP Intangible assets are capitalised and amortised if they are consistent with the defined examples of intangible assets, their cost is higher than the amount determined by the internal company guideline and an anticipated useful life is longer than one year.

⁽ⁱ⁾ For accounting of intangible assets acquired in a business combination see the chapter Business combinations (page 29).

Recognition – additional criteria for internally generated intangibles

IFRS Requires classification of the costs associated with the creation of intangible assets between the research phase and the development phase. Costs in the research phase must always be expensed. Costs in the development phase are expensed unless the entity can demonstrate all of the following:

- the technical feasibility of completing the intangible asset,
- the intention to complete the intangible asset,
- the ability to use or sell the intangible asset,
- how the intangible asset will generate future economic benefits. The entity must demonstrate the existence of a market or, if for internal use, the usefulness of the intangible asset,
- the availability of adequate resources to complete the development and to use or sell the intangible asset,
- the ability to measure reliably the expenditure attributable to the intangible asset during its development.

Czech GAAP Internally generated intangible assets are not capitalised. Research and development costs for assets held for sale are capitalised.

Recognition – website development costs (website)

IFRS Costs incurred during the planning stage must be expensed. Costs incurred for activities during the website's application and infrastructure development stages must be capitalised and costs incurred during the operation stage must be expensed as incurred.

Czech GAAP No guidance on this issue.

INTANGIBLE ASSETS (continued)**Measurement – acquired intangibles**

IFRS The cost of a separately acquired intangible asset at the date of acquisition is usually self-evident, being the fair value of the consideration paid.

Czech GAAP Comparable to **IFRS** – acquired intangible assets are recognised (stated) at cost, including incidental attributable costs.

Measurement – internally generated intangibles

IFRS The cost comprises all expenditure that can be directly attributed or allocated to creating, producing and preparing the asset from the date when the recognition criteria are met.

Czech GAAP Recognised (stated) at cost.

Subsequent measurement – acquired and internally generated intangibles

IFRS Intangible assets are recognised at cost less accumulated amortisation/impairment, or at fair value less subsequent amortisation/impairment. Subsequent revaluation of intangible assets to their fair value must be based on prices in an active market. Where an entity adopts this treatment (extremely rare in practice), the revaluations must be regularly performed and a revaluation of the entire class of intangible assets must take place at the same time.

Czech GAAP Intangible assets are recognised (stated) at cost or at cost less accumulated amortisation. Fair value remeasurement is not permitted.

Amortisation – acquired intangibles

IFRS **IFRS** has a rebuttable presumption that the useful life does not exceed 20 years from the date on which the asset is available for use. In rare cases an entity may demonstrate that an intangible asset has a finite useful life in excess of 20 years, but an indefinite useful life is not permitted. The amortisation method must reflect the pattern in which the asset's benefits are consumed.

Czech GAAP Amortised gradually over the asset's useful life based on the depreciation plan.

Impairment – acquired and internally generated intangibles

IFRS Requires impairment reviews whenever changes in events or circumstances indicate that an intangible asset's carrying amount may not be recoverable. Annual reviews required, if the 20-year useful life presumption is rebutted or if the intangible asset is not yet ready for use.

Czech GAAP Impairment is reflected either by a provision or an extraordinary write-off of an asset; no standard treatment is available for the determination of impairment in value.

REFERENCES: IFRS: IAS 36, IAS 38, SIC-32. **Czech GAAP:** Act on Accounting, Decree 500/2002 Coll., Czech accounting standard 005, 013.

PROPERTY, PLANT AND EQUIPMENT

Definition

IFRS PPE are tangible assets that are held by an entity: for use in the production or supply of goods or services; for rental to others; or for administrative purposes. They are expected to be used during more than one period.

Czech GAAP There are specifically defined assets that are classified as property, plant and equipment, basically comparable to **IFRS**, except for assets acquired under finance lease contracts and a separate category of differences arising upon the acquisition (of assets).

Recognition

IFRS General **IFRS** asset recognition criteria apply. Recognise if future economic benefits attributable to the asset are probable and the cost of the asset can be measured reliably.

Czech GAAP Tangible fixed assets (PPE) are capitalised if their cost is higher than the price determined by the entity and they have an anticipated useful life longer than 1 year. Economic benefits are not a criterion for asset recognition.

Initial measurement

IFRS Comprises the costs directly attributable to the asset's acquisition and bringing to the location and working condition necessary for it to be capable of operating in the way management intends and includes costs of testing whether the asset is functioning properly. Start-up and pre-production costs must not be capitalised unless they are a necessary part of bringing the asset to its working condition. The following are also included in the initial measurement of the asset:

- the costs of site preparation,
- initial delivery and handling costs,
- costs of employee benefits arising from construction or acquisition of the asset,
- costs of testing whether the asset is functioning properly,
- professional fees,
- fair value gains/losses on qualifying cash flow hedges relating to the purchase of PPE in a foreign currency (see page 62),
- the entity has the policy option to include the borrowing costs incurred during the period of acquiring, constructing or producing the asset for use (see page 47).

Government grants received in connection with acquisition of PPE may be offset against the cost or recognised separately (see page 58).

Czech GAAP Similar to **IFRS**, recognises costs directly attributable to the asset acquisition, however, net of dismantling costs, asset removal and the resumption of the original condition of the site. Interest expense (borrowing costs) for tangible assets in the course of construction of PPE are capitalised, should an entity decide so (identical to **IFRS**). After inception into use, capitalised interest is amortised over the asset's useful life.

PROPERTY, PLANT AND EQUIPMENT (continued)**Subsequent expenditure**

IFRS Subsequent maintenance expenditure is expensed as incurred. Replacement of parts can be capitalised when specific criteria are met. The cost of a major inspection or overhaul occurring at regular intervals is capitalised where the recognition criteria applicable to PPE are satisfied; however, usually these are accrued over the period when the repair produces additional benefits.

Czech GAAP PPE valuation is increased by so-called property enhancements (technical improvements), if aggregate expenses for the period exceed the amount stipulated by the Income Taxes Act (i.e. for 2004: CZK 40,000) and if the PPE assets are put into use in a given period.

Depreciation

IFRS The depreciable amount of an item of PPE must be allocated on a systematic basis over its useful life, reflecting the pattern in which the entity consumes the asset's benefits. Any change in the depreciation method used is treated as a change in an accounting estimate being reflected in the depreciation charge for the current and future periods.

Czech GAAP Comparable to **IFRS**.

Subsequent measurement

IFRS The benchmark treatment requires an asset to be carried at cost less accumulated depreciation and impairment. However, revaluation of PPE at fair value is permitted under the alternative treatment.

The increase of an asset's carrying amount as a result of a revaluation must be credited directly to equity under the heading "revaluation surplus", unless it reverses a revaluation decrease for the same asset, previously recognised as an expense; then it must be recognised as income in the income statement. A revaluation decrease must be charged directly against any related revaluation surplus for the same asset, with any excess being recognised as an expense.

Disclosure of the historical cost equivalent (cost and accumulated depreciation) of assets carried at revalued amounts (fair value) is required.

Czech GAAP Revaluation not permitted, recognised at cost less accumulated depreciation and impairment.

Frequency of revaluations

IFRS Revaluations must be kept sufficiently up to date so that the carrying amount does not differ materially from the fair value. This requires regular revaluations of all PPE when the revaluation policy is adopted. Management must consider at each year end whether the fair value is materially different from the carrying amount.

Czech GAAP Not applicable.

PROPERTY, PLANT AND EQUIPMENT (continued)

Impairment of revalued PPE

IFRS An impairment loss (downward revaluation) may be offset against revaluation surpluses to the extent that it relates to the same asset; any uncovered deficit in excess of the existing revaluation surpluses must be accounted for in the income statement.

Czech GAAP All impairments are accounted for in the income statement.

REFERENCES: IFRS: IAS 16, IAS 23, IAS 36, SIC-23. **Czech GAAP:** Act on Accounting, Decree 500/2002 Coll., Czech accounting standard 005, 013.

LEASES

Classification

While substance rather than legal form is applied under **IFRS**, definite form-driven requirements are present in **Czech GAAP**.

A finance (capital) lease exists under **IFRS** if the agreement transfers substantially all the risks and rewards associated with ownership of the asset to the lessee. **IFRS** provides certain indicators for determining the classification of a lease. These are presented below.

Finance lease indicators under **IFRS**:

- ownership is transferred to the lessee at the end of the lease term, or
- the lessee has the option to extend the lease over the additional, secondary period, where he pays rental below the market rate,
- a bargain purchase option exists,
- the lease term is for the majority of the leased asset's economic life,
- the present value of minimum lease payments is equal to substantially all of the fair value of the leased asset,
- the leased asset is of a specialised nature so that only the lessee can use it without major modification,
- on cancellation, the lessor's losses are borne by the lessee,
- gains and losses from the fluctuation in the fair value of the residual value fall to the lessee.

Under **Czech GAAP**, the transfer of ownership must be agreed at the end of the lease term for a finance lease.

Recognition of the investment in the lease

IFRS: The amount due from a lessee under a finance lease is to be recognised as a receivable at the amount of the net investment in the lease. At any point in time, this will comprise the total of the future minimum lease payments less gross earnings allocated to future periods. Minimum lease payments for a lessor include guarantees from a third party related to the leased assets under **IFRS**. The present value of minimum lease payments would generally use the implicit rate in the lease for discounting under **IFRS**.

The lessor's gross earnings are allocated between the receipt of the capital amount (principal) and receipt of finance income (interest) on a basis so as to provide a constant rate of return. **IFRS** requires the use of the net investment method to allocate gross earnings, which excludes the effect of cash flows arising from taxes and financing related to the lease transaction.

Under **Czech GAAP** the fact that the lessee controls the asset is not reflected. The method of accounting for finance and operating leases is basically the same. The asset is recorded in the lessor's balance sheet.

LEASES (continued)**Recognition of the investment in the lease (continued)****Operating leases (lease)**

Both frameworks require an asset leased under an operating lease to be recognised by the lessor as PPE and depreciated over its useful life. Rental income is generally recognised on a straight-line basis over the lease term.

Incentives

IFRS requires the lessor to recognise the aggregate cost of incentives given as a reduction of rental income over the lease term on a straight-line basis, unless another systematic basis is more representative of the time pattern over which the benefit of the leased asset is diminished.

This issue is not specifically addressed by **Czech GAAP**; in practice the treatment under **IFRS** is used.

REFERENCES: IFRS: IAS 17. **Czech GAAP:** Decree 500/2002 Coll., Czech accounting standard 013.

IMPAIRMENT OF ASSETS**Recognition**

IFRS An entity must assess annually whether there are any indications that an asset may be impaired. If there is any such indication, the assets must be tested for impairment. An impairment loss must be recognised in the income statement when an asset's carrying amount exceeds its recoverable amount.

Czech GAAP There is only a general requirement to reflect possible impairment. No detailed guidance for the measurement is provided. Permanent and temporary impairment are distinguished. Permanent impairment leads to direct write-off of an asset, provision is created for temporary impairment.

Measurement

IFRS The impairment loss is the difference between the asset's carrying amount and its recoverable amount. The recoverable amount is the higher of the asset's net selling price and its value in use. Value in use is the future cash flows to be derived from the particular asset, discounted to present value using a pre-tax market-determined rate that reflects the current assessment of the time value of money and the risks specific to the asset.

Czech GAAP No guidance on this issue.

Reversal of impairment loss

IFRS Requires reversal of impairment losses when there has been a change in economic conditions or in the expected use of the asset.

Czech GAAP No specific guidance given on this issue - however, reversal of the provision due to temporary impairment of an asset's value through the income statement is permitted (basically comparable to **IFRS**).

REFERENCES: IFRS: IAS 16, IAS 36. **Czech GAAP:** Act on Accounting, Decree 500/2002 Coll., Czech accounting standard 005.

CAPITALISATION OF BORROWING COSTS

Recognition

IFRS An entity can choose to capitalise borrowing costs where they are directly attributable to the acquisition, construction or production of a qualifying asset. A qualifying asset is one that necessarily takes a substantial period of time to get ready for its intended use or sale.

Czech GAAP Under **Czech GAAP**, borrowing costs are capitalised, if an entity decides to do so. After commissioning of the assets and commencement of their use, borrowing costs are included in the cost of the asset and amortised over its estimated useful life.

Measurement

IFRS The amount of interest eligible for capitalisation is either the actual cost incurred on a specific borrowing or an amount calculated using the weighted average method, considering all the general borrowings outstanding during the period for that entity. Interest can include foreign exchange differences, but only if they arise from the translation of the interest expense. Any interest earned on the temporary investment of funds borrowed to finance the asset's production is netted with the interest expense to be capitalised. Capitalisation of interest must cease once the asset is ready for its intended use or sale.

Czech GAAP Not specified.

REFERENCES: IAS: IAS 23. Czech GAAP: Decree 500/2002 Coll.

INVESTMENT PROPERTY

Definition

IFRS Property (land and buildings) held in order to earn rentals and/or for capital appreciation. Does not include owner-occupied property or property held for sale.

Czech GAAP Not specifically defined, guidance given on tangible assets should be followed.

Initial measurement

IFRS Requires the same cost-based measurement for both acquired and self-constructed investment property. The cost of a purchased investment property comprises its purchase price and any directly attributable costs such as professional fees for legal services, property transfer taxes and other transaction costs. Self-constructed property must be accounted for as PPE until construction is complete, at which time it becomes an investment property. Property held under a finance or operating lease can also be classified as investment property.

Czech GAAP No specific guidance given on this issue. These assets are classified as PPE (page 43). Real estate transfer taxes and gift taxes are not capitalised.

INVESTMENT PROPERTY (continued)**Transfers to/from investment property**

IFRS When there is a change in use of the investment property, the standard provides detailed guidance for subsequent classification. Investment property to be sold is re-classified as inventories, and investment property to be owner-occupied is reclassified as PPE.

Czech GAAP Not applicable – this specific category has not been defined.

Frequency and basis of revaluations

IFRS The fair value of investment property must reflect the actual market conditions and circumstances as at the balance sheet date. The standard does not require an independent and qualified valuer, but it is encouraged. Fair value is based on the so-called highest and best use concept. Revaluations must be made with sufficient regularity that the carrying amount does not differ materially from fair value.

Czech GAAP Not applicable.

REFERENCES: IFRS: IAS 40.

INVENTORIES**Definition**

Both frameworks define inventories as assets that are: held for sale in the ordinary course of business; in the process of production or for sale in the form of materials; or supplies to be consumed in the production process or in rendering services.

Measurement

IFRS Carried at the lower of cost or net realisable value (sale proceeds less all further costs to bring the inventories to completion). Reversal (limited to the amount of the original write-down) is required for a subsequent increase in value of inventory previously written down. Inventories of producers and dealers of agricultural and forest products and mineral ores are allowed to be recorded at net realisable value, even if above cost.

Czech GAAP Basically comparable to **IFRS**, however, no guidance for the measurement of potential impairment.

Formula for determining cost

Method	IFRS	Czech GAAP
LIFO	x	x
FIFO	✓	✓
Weighted average cost	✓	✓

✓ Permitted
x Prohibited

INVENTORIES (continued)

Consistency of the cost formula for similar inventories

IFRS Requires that an entity use the same cost formula for all inventories that have a similar nature and use to the entity.

Czech GAAP Comparable to **IFRS**.

Allocation of fixed overheads

IFRS Any allocation of fixed production overheads is based on normal capacity levels, with unallocated overheads expensed as incurred.

Czech GAAP Basically comparable to **IFRS**, but no detailed requirements. In the case of bulk production within a short-cycle, production overheads are not capitalised.

REFERENCES: IAS: IAS 2, SIC-1. **Czech GAAP:** Act on Accounting, Decree 500/2002 Coll., Czech accounting standard 015.

BIOLOGICAL ASSETS

Under **IFRS** a biological asset should be measured on initial recognition and at each balance sheet date at its fair value less estimated point-of-sale costs. All changes in fair value should be recognised in the income statement in the period in which they arise. Under **Czech GAAP** no specific guidance on this issue, general treatment of accounting for inventories applies, i.e. fair value in excess of cost may not be applied.

FINANCIAL ASSETS

IFRS **IFRS** outlines the recognition and measurement criteria for all financial assets, defined to include derivatives.

Czech GAAP The rules (policies) effective since 2004 have substantially harmonised this area with the rules (policies) applied under **IFRS**. However, certain differences remain, especially for entrepreneurs. The policies applicable to financial institutions have been substantially harmonised with those applied under **IFRS**.

Definition

IFRS and **Czech GAAP** define a financial asset in a similar way to include: cash; a contractual right to receive cash or another financial asset from another entity or a contractual right to exchange financial instruments with another entity under conditions that are potentially favourable; and equity securities (an equity instrument) of another entity. Financial assets include derivatives. Accounting for derivatives is dealt with on page 62. However, **Czech GAAP** excludes from financial assets deferred income and, in a number of specific provisions, receivables.

Recognition and initial measurement

IFRS **IFRS** requires that an entity recognise a financial asset only when the entity becomes a party to the contractual provisions of a financial instrument. The initial cost of the financial asset is the fair value of the consideration given, including directly related transaction costs (transaction costs are not taken into account in the case of financial assets measured at fair value against the income statement).

FINANCIAL ASSETS (continued)**Recognition and initial measurement (continued)**

Czech GAAP Under **Czech GAAP** financial assets are upon initial recognition measured at cost, including transaction costs, which in normal practice (apart from an exemption mentioned in the brackets above) results in the same treatment as under **IFRS**.

Classification and subsequent measurement

IFRS defines 5 financial asset categories, whereas **Czech GAAP** defines 4. Classification criteria and requirements for subsequent measurement are presented in the table below.

Under **Czech GAAP** somewhat different rules (policies) apply for financial institutions on one hand (more substantial harmonisation with **IFRS**) and entrepreneurs on the other.

CLASSIFICATION	IFRS	Czech GAAP
Financial assets at fair value through profit or loss		
This category has two sub-categories: financial assets held for trading, and those designated to the category at inception. Any financial asset may, on initial recognition, be classified as fair value through profit or loss.	An irrevocable decision to classify a financial asset as fair value through profit or loss.	Not defined.
Held-for-trading financial assets		
Debt and equity securities held for sale in the short term. Mandatorily includes derivatives.	The positive intent must be to hold the financial asset for a relatively short period, or as part of a portfolio for the purpose of short-term profit-taking. Subsequent measurement at fair value. Unrealised and realised gains and losses recognised in the income statement.	Comparable to IFRS . Fair value is measured only at the balance sheet date or another point of time in the preparation of financial statements. Any changes in fair value are recorded in the income statement. For financial institutions the treatment is comparable to IFRS .

FINANCIAL ASSETS (continued)

Classification and subsequent measurement (continued)

CLASSIFICATION	IFRS	Czech GAAP
Held-to-maturity investments		
Financial assets held with a positive intent and ability to hold to maturity. Includes assets with fixed and determinable payments and maturities. Does not include equity securities because they have an indefinite life.	<p>Entity must have the "positive intent and ability" to hold a financial asset to maturity, not simply a present intention.</p> <p>When an entity sells more than an insignificant amount of assets, classified as held-to-maturity, it is prohibited from using the held-to-maturity classification for 2 full annual reporting periods (known as tainting). The entity must also reclassify all its held-to-maturity assets as available-for-sale assets.</p> <p>Recognised at amortised (accrued) cost using the effective yield method.</p>	<p>Comparable to IFRS.</p> <p>Comparable to IFRS.</p> <p>Comparable to IFRS. The effective yield method only required for financial institutions.</p>
(In Czech GAAP: Loans and receivables originated by the entity)		
<p>Financial assets created by providing money, goods and services directly to the borrower e.g. bonds, customer loans and trade receivables.</p> <p>May include loans and receivables purchased (acquired by assignment), provided their intention is similar.</p>	<p>In IFRS it includes all receivables and loans, including receivables and loans acquired by assignment. However, it must not include marketable financial assets.</p> <p>Reported at amortised cost.</p>	<p>In Czech GAAP also includes debt securities acquired in primary issues, regardless of whether they are marketable or not.</p> <p>Reported at amortised cost.</p>
Available-for-sale financial assets		
All debt/equity financial assets not covered by above categories. Includes equity securities, except those classified as held-for-trading and may also include purchased receivables.	<p>Reported at fair value.</p> <p>Changes in fair value are recognised net of tax effects in equity and recycled to the income statement when sold, impaired or collected.</p>	<p>Comparable to IFRS.</p> <p>Changes in fair value in the case of financial institutions (except for regulated funds) are recorded in the income statement, whereas in the case of entrepreneurs and regulated funds are reported in equity.</p>

FINANCIAL ASSETS (continued)**Reclassification of assets between categories**

IFRS Reclassifications between categories are relatively uncommon under **IFRS** and in the case of financial assets are strictly prohibited into and out of the fair value through profit or loss category.

Reclassifications from the held-to-maturity category as a result of a change of intent or ability are treated as sales and the whole category is being "tainted". The most common reason for a reclassification out of the category, therefore, is when the whole category is tainted and has to be reclassified as available-for-sale for 2 years (3 balance sheet dates). In such circumstances, the assets are remeasured to fair value, with any difference recognised in equity.

A financial instrument may be reclassified into the category where the tainted held-to-maturity portfolio has been "cleansed". In this case, the financial asset's carrying value (in practice, fair value) at the date of reclassification is recharacterised as acquisition cost. Any unrealised gains and losses already recognised remain in equity until the asset is impaired or derecognised.

Czech GAAP Reclassifications from the held-for-trading category to the held-to-maturity or the available-for-sale categories are not permitted. Reclassifications from the available-for-sale category to the held-for-trading category are rare. Reclassifications from the available-for-sale category to the held-to-maturity category are permitted, provided that certain conditions are met. Valuation policies (methods) are not prescribed, in practice the treatment in accordance with **IFRS** is used.

IMPAIRMENT

IFRS requires an entity to consider impairment when there is an indicator of impairment, such as: the deterioration in the creditworthiness of a counterparty; an actual breach of contract; a high probability of bankruptcy; or the disappearance of an active market for an asset.

IFRS requires that, for financial assets carried at amortised cost, the impairment loss is the difference between the asset's carrying amount and its estimated recoverable amount (defined as present value of expected future cash flows discounted at the instrument's original effective interest rate). For financial assets carried at fair value, the recoverable amount is usually based on quoted market prices, or if unavailable, the present value of the expected future cash flows discounted at the current market rate. If a loss has been deferred in equity, it must be transferred to the income statement on impairment.

IFRS requires changes in the fair value of available-for-sale debt securities, identified as reversals of previously recognised impairment, to be recognised in the income statement. **IFRS** prohibits reversals of impairment on available-for-sale equity securities through the income statement.

Czech GAAP does not give any specific guidance on the measurement of impairment of financial assets carried at amortised cost. Only general requirements to reflect the impairment of assets apply. Banks are subject to special regulations governing the creation of provisions for loans that is not fully consistent with IAS 39. Regulated funds are obliged to reflect permanent impairment, originally recognised in equity, through the income statement.

DERECOGNITION OF FINANCIAL ASSETS

Under **IFRS** an entity discloses in its balance sheet the assets that it controls, whereas assets that are not subject to the entity's control are derecognised. **Czech GAAP** currently does not contain any specific provision relating to this issue, except for financial institutions for which, after derecognition, control, as a secondary test, is used.

- IFRS** A financial asset (or part) is derecognised when:
- the rights to the asset's cash flows expire,
 - the rights to the asset's cash flows expire and substantially all risks and rewards of ownership are transferred,
 - an obligation to transfer the asset's cash flows is considered to be the case where substantially all risks and rewards are transferred and the following conditions are met:
 - no obligation to pay cash flows unless it collects equivalent cash flows from the transferred asset,
 - prohibition from selling or pledging the asset,
 - obligation to remit (return) income without material delay on assets the control of which has been transferred,
 - substantially all the risks and rewards are neither transferred nor retained but control of the asset is transferred.

If an entity transfers substantially all the risks and rewards of ownership of the asset (e.g., an unconditional sale of a financial asset), the entity derecognises the asset. If an entity retains substantially all the risks and rewards of ownership of the asset, the entity continues to recognise the asset (the transaction is accounted for as a collateralised borrowing). If an entity neither transfers nor retains substantially all the risks and rewards of ownership of the asset, the entity has to determine whether it has retained control of the asset. Control is based on the transferee's practical ability to sell the asset. If the entity has lost control, the asset is derecognised. If the entity has retained control, it continues to recognise the asset to the extent of its continuing involvement.

If the asset is derecognised on sale to a special purpose entity (SPE), there may nevertheless be a requirement to consolidate that SPE (see SIC 12).

On derecognition, the difference between the amount received and the carrying amount of the asset is recognised in the income statement. Any fair value adjustments on the assets formerly reported in equity are recycled to the income statement. Any new assets or liabilities arising from the transaction are recognised at fair value.

Czech GAAP It currently contains no specific standard addressing this subject. Accounting treatment generally follows the legal form and the legal transfer of ownership. The rules (policies) for repo and reverse repo operations are not available. However, a number of entities apply the treatment applicable to financial institutions which is the same as under **IFRS**. For accounting for sales (disposals) and acquisitions of securities mostly the date of settlement is used. For financial institutions the treatment comparable to **IFRS** is prescribed, which is, however, based on the control test, rather than on the assessment of risks and rewards. Accounting for repo and reverse repo operations is in the case of financial institutions in accordance with **IFRS**.

REFERENCES: IFRS: IAS 39, SIC-12. **Czech GAAP:** Decree 500/2002 Coll., Decree 501/2002 Coll.

LIABILITIES

PROVISIONS

IFRS has a specific standard on accounting for provisions. **IFRS** prohibits recognition of provisions for future costs, including costs associated with compliance with proposed but not yet effective legislation. Under **Czech GAAP** in practice a similar treatment is used, but accounting policies for entrepreneurs for the time being allow broader interpretation due to its general requirement for the creation of provisions against risks and losses on business activities, including provisions for the repair and maintenance of PPE.

Recognition

IFRS Requires recognition of a provision only when:

- the entity has a present obligation to transfer economic benefits (legal or constructive) as a result of past events (events prior to the balance sheet date); and
- it is probable that the entity's assets will be required to settle the obligation; and
- a reliable estimate of the amount of the obligation can be made.

A present obligation arises from an obligating event and may take the form of either a legal obligation or a constructive obligation. An obligating event leaves the entity no realistic alternative other than to settle the obligation created by the event. If the entity can avoid the future expenditure by its future actions, it has no present obligation and a provision is not recognised.

Czech GAAP Broadly comparable to **IFRS**, but not explicitly defined. Accounting policies for entrepreneurs only stipulate a general requirement to create provisions against risks and losses on business activities and for restructuring. The only exceptions are "legal provisions", which are set aside (created) for example for future expenditures for the repairs of property, plant and equipment (PPE). Creation and usage of these provisions are regulated by the Act on Income Taxes and their creation is not limited by any general accounting definition of a provision (creation of these provisions is a tax-deductible expense). Similar provisions are not permitted under **IFRS**. The treatment of financial institutions is comparable to **IFRS**, however, until 2005, the existing accounting treatment of general provisions is still applicable and is inconsistent with **IFRS**.

Measurement

IFRS The amount recognised as a provision must be the best estimate of the minimum expenditure required to settle the present obligation at the balance sheet date. The entity must discount the anticipated cash flows using a pre-tax discount rate that reflects the current market valuation of the time value of money and those risks specific to the liability, if the effect is material. If a range of estimates is predicted and no amount in the range is more likely than any other amount in the range, the "mid-point" of the range must be used to measure the liability.

Czech GAAP Financial institutions must discount provisions if the effect is material. This issue is not addressed for entrepreneurs.

PROVISIONS (continued)

Restructuring provisions

IFRS In the case of a restructuring, a present obligation exists only when the entity is "demonstrably committed" to the restructuring. An entity is usually demonstrably committed when there is a binding sale agreement (legal obligation), or when the entity has a detailed formal plan for the restructuring and is unable to withdraw because it has started to implement the plan or announced its main features to those affected (constructive obligation). However, if there will be a delay before the restructuring begins, or the restructuring will take an unreasonably long time to complete, then a provision is unlikely to be justified.

Czech GAAP Based on the formal restructuring plan approved by the body competent to do so under a special regulation, or by the entity's partners, the entity may create a restructuring provision. The restructuring means a plan whereby the entity's business or the manner of its performance is substantially changed. The restructuring may involve especially the relocation of business activities into another region, plant closures or scaling down or discontinuation of a part of business activities. A restructuring provision may be created and used only for direct costs necessarily required for the implementation of the restructuring plan unrelated to the continuing activities of the entity.

Onerous contracts

IFRS Prohibits provisions for future operating losses. However, if an entity is party to a contract that is onerous (the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under the contract), the present obligation under the contract must be recognised and measured as a provision. One of the most common examples relates to leasehold property that has been left vacant.

Czech GAAP No specific guidance on onerous contracts, general requirements for the creation of provisions against anticipated risks and losses apply.

REFERENCES: IFRS: IAS 37. **Czech GAAP:** Act on Accounting, Czech accounting standard 004.

CONTINGENCIES

Contingent asset

IFRS This is a possible asset that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events, not wholly within the entity's control. When the realisation of the associated benefit, such as an insurance recovery, is virtually certain, the item is recognised as an asset.

Czech GAAP Detailed rules (policies) comparable to **IFRS** do not exist; in practice the treatment is similar to **IFRS**, while anticipated insurance recovery is usually accounted for at the level of the recorded damage with regard to the insurance cover or estimates made by the insurance company.

CONTINGENCIES (continued)**Contingent liability**

IFRS This is a possible obligation whose outcome will be confirmed only on the occurrence or non-occurrence of uncertain future events outside the entity's control. A contingent liability can also be a present obligation that is not recognised because it is not probable that there will be an outflow of economic benefits, or the amount of the outflow cannot be reliably measured. Contingent liabilities are disclosed unless the probability of outflows is remote.

Czech GAAP An entity must describe in the notes material potential losses for which a provision has not been created and the realisation of which depends on (is contingent on) the materialisation of contingent future events.

REFERENCES: IFRS: IAS 37. Czech GAAP: Decree 500/2002 Coll.

DEFERRED TAX

Although both frameworks require full provision for deferred tax on all so-called temporary differences, there are differences in the methodology as set out in the table below. **Czech GAAP** requires the recognition of the deferred tax only for those entities that constitute the consolidation whole and entities with required audit of their financial statements.

ISSUE	IFRS	Czech GAAP
General considerations		
General approach	Full provision on all temporary differences.	Comparable to IFRS .
Basis for deferred tax assets and liabilities	Temporary differences, i.e., the difference between carrying amount and tax base of assets and liabilities (see exceptions below).	Comparable to IFRS .
Exceptions (i.e., deferred tax is not provided on the temporary difference)	Goodwill, which is not deductible for tax purposes, does not give rise to a taxable temporary difference. Similarly, negative goodwill does not give rise to a deductible temporary difference.	No exemption (deferred tax is provided on goodwill). In the case of financial institutions comparable to IFRS .
	Initial recognition of an asset or liability in a transaction that (i) is not a business combination and (ii) at the time of the transaction, affects neither accounting nor taxable profit.	No exemption.
Specific applications		
Unrealised intra-group profits, e.g., on inventory	Deferred tax recognised at the buyer's tax rate.	Not specified.
Revaluation of PPE and intangible assets	Deferred tax recognised in equity.	Comparable to IFRS in cases where fair value remeasurement against the equity is performed (for instance on company transformations).
Revaluation of financial assets	Deferred tax is recognised in the income statement unless changes in the carrying amount of available-for-sale assets are taken to equity, in which case deferred tax is taken to equity.	Comparable to IFRS .

DEFERRED TAX (continued)

ISSUE	IFRS	Czech GAAP
Specific applications (continued)		
Foreign exchange differences on financial statements prepared in a foreign currency on foreign transactions that are part of the operations of the parent company (for instance, a foreign branch)	Deferred tax is recognised on the difference between the carrying amount determined using the historical rate of exchange and the tax base determined using the balance sheet date exchange rate.	No specific guidance.
Investments in subsidiaries, joint ventures and associated companies: treatment of undistributed profit	Deferred tax is recognised except when the parent (reporting entity) is able to control temporary differences and if it is probable that the temporary difference will not be reversed in the foreseeable future.	No specific guidance, no exemption determined.
Measurement of deferred tax		
Tax rates	Tax rates and tax laws that have been enacted or substantively enacted for the period of anticipated realisation of temporary differences apply.	Tax rates and tax laws that have been enacted for the period of anticipated realisation of temporary differences.
Recognition of deferred tax asset	Deferred tax asset must be recognised if it is probable that sufficient taxable profit will be available against which the temporary difference can be utilised.	Comparable to IFRS .
Discounting	Prohibited.	Prohibited.
Business combinations – acquisitions		
Step-up of acquired assets/liabilities to fair value	Deferred tax is provided unless the tax base of asset is also stepped up.	Comparable to IFRS .
Previously unrecognised tax losses of the acquirer	Deferred tax asset is recognised if, as a result of the acquisition, the recognition criteria for the deferred tax asset are met.	No specific guidance.
Tax losses of the acquiree	Similar requirements as for the acquirer.	Comparable to IFRS .
Post-acquisition recognition of an acquiree's tax losses that existed at the date of acquisition	Recognition of deferred tax asset that reduces goodwill and reduces tax expense. No time limit for recognition of this deferred tax asset.	No specific guidance.
Presentation of deferred tax		
Offset of deferred tax assets and liabilities	Permitted only when the entity has a legally enforceable right to set off, and the balance relates to tax levied by the same authority.	Comparable to IFRS .
Current/non-current classification	The deferred tax assets and liabilities must only be classified as non-current.	Comparable to IFRS .
Reconciliation of actual and expected tax expense	Required. Computed by applying the applicable tax rates to accounting profit, disclosing also the basis on which the applicable tax rates are computed.	Not explicitly required.

REFERENCES: IFRS: IAS 12. **Czech GAAP:** Decree 500/2002 Coll., Czech accounting standard 003.

GOVERNMENT GRANTS

IFRS Government grants (or contributions) received as compensation for expenses already incurred are recognised in the income statement once the conditions for their receipt have been met and there is reasonable assurance that the grant will be received. Revenue-based grants are deferred in the balance sheet and released to the income statement to match the related expenditure that they are intended to compensate. Capital-based grants must be deferred and matched with the depreciation on the asset for which the grant arises.

Grants that relate to recognised assets must be presented in the balance sheet either as deferred income, or by deducting the grant in arriving at the asset's carrying amount, in which case the grant is recognised as a reduction of depreciation. Specific rules apply for biological assets.

Czech GAAP Grants for the coverage of expenses are recorded in income consistently in terms of time and substance, with the recognition of expense for the determined purpose. Grants for the payment of interest not included in the acquisition of fixed assets are credited to financial income. Grants for the acquisition of fixed assets (including grants for the payment of interest included in the acquisition cost) reduce the cost of acquired assets or own costs. In the case of grants at 100% assets are recorded in off-balance sheet accounts. The recording of investment grants through deferred income is not permitted.

Grants – biological assets

IFRS An unconditional government grant related to a biological asset measured at its fair value must be recognised in income statement, when the grant becomes receivable. If a government grant relating to a biological asset measured at its fair value is conditional, the grant must be recognised when the conditions are met. If a grant relates to a biological asset measured at cost, then the accounting treatment specified for government grants generally is applied.

Czech GAAP Not specified (biological assets are not measured at fair value).

REFERENCES: IFRS: IAS 20, IAS 41. Czech GAAP: Decree 500/2002 Coll., Czech accounting standard 017.

LEASES – LESSEE ACCOUNTING

Finance leases

IFRS Requires recognition of an asset held under a finance lease (see classification criteria on page 47) with a corresponding obligation to pay future rentals, at an amount equal to the lower of the fair value of the asset and the present value of the minimum lease payments (MLPs) at the inception of the lease. The asset is normally depreciated over its useful life. However, under **IFRS** the shorter of the lease term and the useful life is permitted to be used if there is no reasonable certainty of the lessee obtaining ownership of the asset. The interest rate implicit in the lease must normally be used to calculate the present value of the MLPs. If the implicit rate is unknown, the lessee's borrowing rate may be used.

Czech GAAP The lessee does not capitalise the asset, nor recognise a liability. Accounting for finance and operating leases is the same. On subsequent acquisition the asset is recognised by the lessee at the residual value determined at the inception of the lease.

LEASES - LESSEE ACCOUNTING (continued)

Operating leases

Under both **IFRS** and **Czech GAAP** the rental expense under an operating lease must generally be recognised on a straight-line basis over the lease term.

Incentives

A lessor often provides lease incentives to encourage the lessee to renew a lease arrangement. Under **IFRS**, the lessee must recognise the aggregate benefit of incentives as a reduction of the rental expense over the lease term. The incentive must be amortised on a straight-line basis unless another systematic basis is more representative of the pattern of the lessee's benefit from the use of the leased asset.

No specific guidance on this issue is given under **Czech GAAP**.

SALE AND LEASEBACK TRANSACTIONS

In a sale and leaseback transaction, the seller-lessee sells an asset to the buyer-lessor and leases the asset back. There are certain differences in the rules on dealing with profits and losses arising on sale and leaseback transactions across both frameworks. These are highlighted in the table below:

ISSUE	IFRS	Czech GAAP
Finance lease		
Profit or loss on sale	Deferred and amortised over the lease term.	No guidance on this issue. Czech GAAP does not define specific rules for finance leases and the accounting treatment follows the legal form.
Operating lease		
Sale at fair value	Immediate recognition.	No specific guidance.
Sale at less than fair value	Immediate recognition unless the difference is compensated by lower future rentals, then defer the difference over the period over which the asset is expected to be used.	No specific guidance.
Sale at more than fair value	Defer the difference (profit) over the period for which the asset is expected to be used.	No specific guidance.

REFERENCES: **IFRS**: IAS 17, SIC-15. **Czech GAAP**: Decree 500/2002 Coll.

FINANCIAL LIABILITIES

Definition

IFRS defines a financial liability as a contractual obligation to deliver cash or a financial asset to another entity, or to exchange financial instruments with another entity under conditions that are potentially unfavourable. Financial liabilities include derivatives (under **IFRS**, these include many contracts that will or may be settled in the entity's own equity instruments). Derivatives are dealt with on page 62.

Classification

IFRS Where there is a contractual obligation (or economic compulsion) of the issuer of an instrument to deliver either cash or another financial asset to the holder, that instrument meets the definition of a financial liability, regardless of the manner in which the contractual obligation will be settled.

Preferred shares that are not redeemable, or that are redeemable solely at the option of the issuer, and where distributions are at the discretion of the issuer, are classified as equity. However, preferred shares requiring the issuer to redeem for a fixed or determinable amount at a fixed or determinable future date, or where the holder has the option of redemption, are classified as liabilities.

Where the settlement of a financial instrument such as a preferred share is contingent on uncertain future events beyond the control of both the issuer and the holder, the issuer must classify the financial instrument as a liability. However, an instrument that is settled by an entity's own equity shares is classified as a liability if the number of shares varies in such a way that the fair value of the shares issued equals the obligation.

Puttable instruments (financial instruments that give the holder the right to put the instrument back to the issuer for cash or another asset) are liabilities.

Split accounting is applied to convertible debt - see below.

Czech GAAP No specific definitions available at the level corresponding to **IFRS**. Certificates of open-ended mutual funds are classified as equity.

Convertible debt

IFRS "Split accounting" is used whereby the proceeds of issuing debt are allocated between the 2 components: the equity conversion rights (recognised in equity); and the liability, recognised at fair value calculated by discounting at a market rate for a non-convertible debt (recognised in liabilities).

Czech GAAP No explicit requirement for "split accounting". However, the necessity of such treatment apparently arises from the rules on embedded derivatives.

Measurement

IFRS The treatment of financial institutions is similar to **IFRS**. The treatment of entrepreneurs is not specifically defined, except for derivatives, which are always measured at fair value through the income statement.

FINANCIAL LIABILITIES (continued)

Derecognition of financial liabilities

IFRS A financial liability must be derecognised when: the obligation specified in the contract is discharged; cancelled or expires; or the primary responsibility for the liability is legally transferred to another party. The difference between the carrying amount of a liability (or a portion thereof) extinguished or transferred and the amount paid for it must be recognised net in profit or loss for the period.

Czech GAAP Specific guidance for financial institutions only – comparable to **IFRS**.

REFERENCES: IFRS: IAS 32, IAS 39. **Czech GAAP:** Czech accounting standard 101.

EQUITY INSTRUMENTS

Recognition and classification

IFRS An instrument is classified as equity when it does not contain an obligation to transfer economic resources. Preference shares, which are not redeemable, or redeemable solely at the option of the issuer, and where distributions are at the issuer's discretion, are classified as equity. Only derivative contracts that result in the delivery of a fixed amount of cash, or other financial asset for a fixed number of an entity's own equity instruments, are classified as equity instruments. All other derivatives on own equity are treated as derivatives.

Czech GAAP Equity is split between share capital (registered capital), capital contributions and other equity categories. There is no "mezzanine" category. Preference shares with liability elements in practice do not exist. The legal form is decisive; certificates of open-ended mutual funds are therefore treated as equity.

Purchase of own shares

IFRS When an entity's own shares are repurchased, the shares are shown as a deduction from shareholders' equity. Any profit or loss on the subsequent sale of the shares is shown as a change in equity.

Czech GAAP Comparable to **IFRS**. The acquisition of own shares is recorded at the date of arranging an acquisition deal.

Dividends on ordinary shares

IFRS and Czech GAAP Presented as a deduction in the statement of changes in shareholders' equity.

REFERENCES: IFRS: IAS 32, IAS 39, SIC-16. **Czech GAAP:** Czech accounting standard 012, 108.

DERIVATIVES

IFRS and **Czech GAAP** both specify rules for the recognition and measurement of derivatives.

Definition

IFRS defines a derivative as a financial instrument whose value changes in response to a specified index; requires little or no net investment and is settled at a future date.

The definition under **Czech GAAP** is comparable to **IFRS**.

Initial measurement

Under **IFRS** and **Czech GAAP**, all derivatives are recognised in the balance sheet as either financial assets or liabilities. Under **IFRS**, they are initially measured at fair value, whereas under **Czech GAAP** they are initially measured at cost. Under **IFRS**, the direct external transaction costs are excluded, whereas in **Czech GAAP** direct external transaction costs are included but exclude the internal allocation of overheads.

Subsequent measurement

IFRS and **Czech GAAP** require subsequent measurement of all derivatives at their fair value, regardless of any hedge relationship that might exist. Changes in a derivative's value are recognised in the income statement as they arise, (in accordance with **Czech GAAP** applicable to entrepreneurs at the end of the balance sheet date) unless they satisfy the criteria for hedge accounting outlined below. Under **IFRS** and **Czech GAAP**, a derivative whose fair value cannot be measured reliably is carried at cost less impairment or amortisation until settlement.

Under both **IFRS** and **Czech GAAP** fair value excludes transaction costs.

HEDGE ACCOUNTING

Under **IFRS** and **Czech GAAP**, detailed guidance is set out in the respective standards dealing with hedge accounting.

Criteria for hedge accounting

Under both **IFRS** and **Czech GAAP**, hedge accounting is permitted (not required) provided that an entity meets specific qualifying criteria in relation to documentation and hedge effectiveness. Both frameworks require documentation of the entity's risk management objectives and strategies and how the effectiveness of the hedge will be assessed. Hedge instruments must be highly effective in offsetting the exposure of the hedged item to changes in the fair value or cash flows, and the effectiveness of the hedge must be measured reliably on a continuing basis.

IFRS does not require 100% effectiveness of a hedge to allow the use of hedge accounting. Under **IFRS**, a hedge qualifies for hedge accounting if the expectation is that changes in fair values or cash flows of the hedged item are almost fully offset (i.e., nearly 100%) by the changes in the fair value or cash flows of the hedging instrument ("prospective" test) and "actual" results are within a range of 80% to 125% ("retrospective" test). The **Czech GAAP** rules basically correspond to **IFRS** rules. However, for the "prospective" test under **Czech GAAP** a range of 80% to 125% is also used and a comparison of changes in fair values is explicitly required, which is, however, meaningless for cash flow hedging purposes and in a number of cases cannot be complied with. Nevertheless, regulatory authorities consider **Czech GAAP** as fully compliant with **IFRS** in this respect.

HEDGE ACCOUNTING (continued)

Hedged items

In addition to the general criteria for hedge accounting, **IFRS** outlines rules for the designation of specific financial assets and liabilities as hedged items. These are outlined below.

- Held-to-maturity investments cannot be designated as a hedged item with respect to interest-rate risk, because changes in interest rates are not recognised for held-to-maturity investments.
- If the hedged item is a financial asset or liability, it may be designated as a hedged item only in relation to those risks where effectiveness can be measured.
- If the hedged item is a non-financial asset or liability, it may be designated as a hedged item only for foreign currency risk, or for all risks entirely because of the difficulty of isolating other risks.
- If similar assets or similar liabilities are aggregated and hedged together as a group, the change in fair value attributable to the hedged risk for individual items must be proportionate to the change in fair value of the group.

Under **Czech GAAP**, a detailed explanation is available in the Czech accounting standards which is comparable to **IFRS**. Hedged items (instruments) may be balance sheet assets or liabilities (or their parts), legally enforceable contracts that are not recorded in balance sheet accounts, and anticipated future transactions that are not covered by contracts and the realisation of which is highly probable. Assets and liabilities with similar characteristics, which are subject to hedging the same type and category of risk, may be aggregated and hedged as a group.

Hedging instruments

In most cases only a derivative instrument can qualify as a hedging instrument. However, **IFRS** and **Czech GAAP** permit a non-derivative (such as a foreign currency borrowing) to be used as a hedging instrument for foreign currency risk.

Under **IFRS** a written option cannot be designated as a hedging instrument unless it effectively secures a purchase option. Similar interpretation is used in practice in **Czech GAAP**.

Hedge relationships

Exposure to risk can arise from: changes in the fair value of an existing asset or liability; changes in the future cash flows arising from an existing asset or liability; or changes in future cash flows arising from a transaction that is not yet recognised.

IFRS Recognises several types of hedge relationships: a fair value hedge where the risk being hedged is a change in the fair value of a recognised asset or liability; a cash flow hedge where the risk being hedged is the potential volatility in future cash flows; a hedge of a net investment in a foreign entity, where a hedge instrument is used to hedge the currency risk of a net investment in a foreign entity; a hedge of unrecognised fixed liability treated, after the revision of IAS 39, as a cash flow hedge. A forecasted transaction must be highly probable to qualify as a hedged item.

Czech GAAP Comparable to **IFRS**, except for a hedge of unrecognised fixed liability that is treated as a cash flow hedge.

HEDGE ACCOUNTING (continued)

Fair value hedges

IFRS Hedging instruments are measured at fair value. The hedged item is adjusted for changes in its fair value, but only due to the risks being hedged over the duration (term) of the hedge relation. Gains and losses on fair value hedges, for both the hedging instrument and the item being hedged, are recognised in the income statement.

Czech GAAP Comparable to **IFRS**.

Cash flow hedges

IFRS Hedging instruments are measured at fair value, with gains and losses on the hedging instrument, where they are effective, initially deferred in equity and subsequently released to the income statement concurrent with the earnings recognition pattern of the hedged item. Gains and losses on financial instruments used to hedge forecasted asset and liability acquisitions may be included in the cost of the non-financial asset or liability – so-called "basis adjustment" – but this is not permitted for financial assets or liabilities. In the case of financial assets or liabilities the equity balance is gradually transferred to the income statement against the effects of an item's hedge.

Czech GAAP Comparable to **IFRS**, except for financial assets and liabilities where the basis adjustment is used as well.

Hedging of net investments in foreign operations

IFRS Similar treatment to cash flow hedges; the hedging instrument is measured at fair value with gains/losses deferred in equity, to the extent that the hedge is effective, together with exchange differences arising on the entity's investment in the foreign operation. These gains/losses are transferred to the income statement on disposal of the foreign operation. **IFRS** allows the full gains and losses on hedges of a net investment in a foreign operation to be deferred in equity (including any hedge ineffectiveness), provided the hedging instrument is a non-derivative (e.g., a borrowing).

Czech GAAP Comparable to **IFRS**.

HEDGE ACCOUNTING (continued)**Disclosure**

The extensive disclosure requirements in **IFRS** apply to all entities. The disclosures include general information about the entity's use of financial instruments, fair value information, details of hedging activities and liquidity information.

In **Czech GAAP** the requirements for disclosure of information on derivatives are not, in comparison with **IFRS**, so specific. More detailed and more extensive disclosures are required from financial institutions.

IFRS requires further disclosures on fair values, including the extent to which fair values are determined by reference to published price quotations, or are estimated using valuation techniques. If a fair value is estimated using a valuation technique and this is sensitive to valuation assumptions that are not supported by observable market prices, a statement of this fact and the effect on the fair value of using a range of reasonably possible alternative assumptions may need to be disclosed.

The IASB has made proposals to allow a new form of fair value hedge accounting for a portfolio hedge of interest-rate risk. Further details can be found in updated IAS 39 that the IASB issued in March 2004.

REFERENCES: IFRS: IAS 32, 39. **Czech GAAP:** Decree 500/2002 Coll., 501/2002 Coll., Czech accounting standards.

EARNINGS PER SHARE

Under **IFRS**, earnings per share (EPS) must be disclosed for listed entities and entities that are in the process of listing (quoting) their shares. **Czech GAAP** does not require disclosure of earnings per share in the financial statements, except for financial institutions where basic EPS is required for listed companies.

Basic EPS

IFRS Basic EPS is calculated as profit available to common shareholders, divided by the weighted average number of shares in issue during the period. Shares issued as a result of a bonus issue (the issue covered by the issuer's equity) are treated as if in issue for the whole year. Bonus issues occurring after the year-end must be incorporated into the calculations. For rights issues, a theoretical ex-rights formula is used. Comparative EPS for past periods is adjusted for bonus issues and rights issues.

Diluted EPS – basis

IFRS There is no "de minimis" dilution threshold below which diluted EPS need not be disclosed. For diluted EPS, earnings are adjusted for the after-tax amount of dividends and interest is recognised in the period in respect of the diluted potential ordinary shares and for any other changes in the income statement or expense that would result from the conversion of the diluted potential ordinary shares. The conversion is deemed to have occurred at the beginning of the period or, if later, the date of the issue of potential diluted ordinary shares.

Diluted EPS – share option

IFRS The "treasury stock" method is used to determine the effect of share options and warrants. The assumed proceeds from the issue of the diluted potential ordinary shares are considered to have been used to repurchase shares at fair value. The difference between the number of shares issued and the number of shares that would have been issued at fair value is treated as an issue of ordinary shares for no consideration (i.e., a bonus issue) and is factored into the denominator used to calculate the diluted EPS. The earnings figure is not adjusted for the effect of share options/warrants.

EARNINGS PER SHARE (continued)

Diluted EPS - share option (continued)

Czech GAAP No guidance on the subject of diluted EPS, bonus issues and rights issues.

REFERENCES: IFRS: IAS 33. **Czech GAAP**: Decree 501/2002 Coll.

RELATED PARTY TRANSACTIONS

The objective of the disclosures required by **IFRS** in respect of related party relationships and transactions is to ensure that users of financial statements are made aware of the extent to which those statements might be influenced by the existence of related parties.

Under **IFRS**, related party relationships are generally determined by reference to the control or indirect control of one party by another or by the existence of joint control or significant influence by one party over another.

Under **Czech GAAP**, no specific definition of related parties is available. Financial institutions use the definition of a special relationship party stipulated in the Act on Banks that is partly different from **IFRS**. If the relationship is one based on control, certain disclosures are always required under **IFRS** (regardless of whether transactions between the parties have taken place); these include the existence of the related party relationship, the name of the related party and the name of the ultimate controlling party.

Under **IFRS**, there are some exemptions from disclosure available for certain subsidiaries and transactions.

Disclosures and exemptions

IFRS There is no specific requirement in **IFRS** to disclose the name of the related party (other than the ultimate parent entity) or the amounts involved in individual transactions. There is a requirement to disclose balances for each major category of related parties. However, the above-mentioned disclosures would appear to be needed in specific cases in order to meaningfully present the "elements" of the transaction.

IFRS also requires disclosure of the compensation of key management personnel in total and by category of compensation.

Exemptions from disclosures about related party transactions in the financial statements of subsidiaries are limited: the subsidiary must be wholly owned and the parent must have its registered office in the same country and prepare consolidated financial statements.

State-controlled entities are required to disclose related party transactions under **IFRS**.

Czech GAAP Disclosure requirements for related party transactions under **Czech GAAP** are limited compared to **IFRS** and include the following: receivables from and payables to group companies and all remuneration/compensation (including benefits in kind) to directors, shareholders and members of statutory bodies. All loans, guarantees and other benefits to those persons must also be disclosed in the notes. The amounts involved need not be disclosed individually; aggregate disclosure on behalf of individual statutory bodies and groups of persons is sufficient. Financial institutions are required to provide certain more detailed disclosures (for instance shares and share options provided to directors, members of statutory bodies and employees).

REFERENCES: IFRS: IAS 24. **Czech GAAP**: Decree 500/2002 Coll., 501/2002 Coll.

SEGMENT REPORTING

IFRS has specific requirements for identification, measurement and disclosure of segment information. Similarities and differences are reflected in the following table. **Czech GAAP** only requires reporting of

the split of revenue from ordinary activities (divided also between ordinary activities and domestic and export sales), though the definition of a "segment" is not available in **Czech GAAP**. Financial institutions are required to split assets by individual main segments and geographical sectors, but without giving a more detailed definition of these terms.

SEGMENT REPORTING (continued)

ISSUE	IFRS
General requirements	
Scope	Listed entities and entities in the process of listing. Non-listed entities may choose full compliance.
Format	Business and geographical – one as primary format, the other as secondary. Choice will depend on impact on business risks and returns. Secondary format requires less disclosure.
Identification of segment	
General approach	Based on profile of risks and returns and internal reporting structure.
Aggregation of similar business/operating segments	5 factors given to determine whether products and services are similar.
Aggregation of similar geographical segments	As for business/operating segments: 6 factors given, focusing on economic and political conditions, special risks, exchange control regulations and currency risks.
Threshold for reportable segments	Revenue, result or assets are 10% or more of all segments. If revenues of reported segments are below 75% of total, report additional segments until 75% threshold is reached.
Segments not reported	Segments not identified as above included as unallocated items.
Maximum number of reported segments	No limits.
Measurement	
Accounting policies for segments	The same requirements as the rules applied in consolidated financial statements. Based on internal rules additional segment information may be disclosed.
Symmetry of allocation of assets/liabilities, revenues/ expenses	Symmetry required.
Main disclosures	
Factors used to identify reportable segments	No specific disclosure required.
Composition of segments	Disclose types of products and services included in each reported business segment and the composition of each geographical segment.
Profit	Required.
Assets and liabilities	Assets required. Liabilities for primary segment format only.
External and inter-segment revenue	External revenue required. Inter-segment revenue primary segment format only.
Depreciation and amortisation expense and other significant non-cash expenses	Required only for primary segment format.
Exceptional items	Encouraged but not required, must be reported for primary segment format only.
Capital expenditure on an accrual basis	Required.
Profit/loss from investments in equity method investees	Required if operations of associate are substantially all within a single segment.
Reconciliation of total segment revenue, total segment measures of profit or loss, total segment assets, total segment liabilities and any other significant segment totals to the corresponding totals of the entity.	Required.

REFERENCES: IFRS: IAS 14. Czech GAAP: Decree 500/2002 Coll.

DISCONTINUING/DISCONTINUED OPERATIONS

Czech GAAP does not specifically define discontinuing/discontinued operations.

ISSUE	IFRS
Definition	Separate major component.
How discontinued	Either substantially in its entirety or piecemeal or through abandonment.
Envisaged timescale	Over several months or longer but pursuant to a single plan.
Starting date for disclosure	From the date on which a formal plan of disposal has been announced.
Measurement	Follow other standards, e.g., on provisions and impairment.
Presentation	Continue to consolidate as normal until discontinuance completed, with additional disclosures on the face of the income statement or in the notes – see below.
Ending date of disclosure	Until completion of the discontinuance.
Disclosures – where	Face of the income statement or in notes.
Disclosures – what	<ul style="list-style-type: none"> • Description of component and segment of which the operation is part • Date and nature of initial disclosure event • Expected timescale for completion of discontinuance • Carrying value of total assets/liabilities to be disposed of • Revenue, expenses, pre-tax result, tax and cash flows for the current period.
Disclosures once completed	Pre-tax gain or loss (face of the income statement).
Comparatives	Restate for effects of discontinuing operations.

Czech GAAP does not provide specific instructions for valuation (measurement) of discontinuing/discontinued operations and their disclosure. In practice, for disclosures in the notes to financial statements **IFRS** may be used as the benchmark treatment.

REFERENCES: IFRS: IAS 35, IAS 36, IAS 37.

POST BALANCE SHEET EVENTS**Adjusting events after the balance sheet date**

IFRS Adjusting events that occur after the balance sheet date are defined as events that provide additional evidence of conditions that existed at the balance sheet date and materially affect the amounts included. The amounts recognised in the financial statements must be adjusted to reflect adjusting events after the balance sheet date.

Czech GAAP For the period commencing on the balance sheet date and ending at the point of time of completion of financial statements, entities are obliged to report in the notes disclosure of facts that provide additional evidence of conditions or situations that existed at the balance sheet date and of facts that as contingent conditions or situations existed at the balance sheet date, the outcome of which materially change the view of the entity's financial position.

POST BALANCE SHEET EVENTS (continued)**Non-adjusting events after the balance sheet date**

IFRS Non-adjusting events after the balance sheet date are defined as material events that occurred after the balance sheet date and are indicative of conditions that arose after the balance sheet date. The nature and estimated financial effects of such events are disclosed to prevent the financial statements being misleading.

Czech GAAP See above.

The announcement of a dividend relating to the financial year just ended

IFRS This event is a non-adjusting event.

Czech GAAP The same treatment as under **IFRS**.

REFERENCES: IAS: IAS 10. **Czech GAAP:** Act on Accounting, Decree 500/2002 Coll.

INTERIM FINANCIAL REPORTING**Stock exchange requirements**

IFRS The IASB does not mandate that public entities whose shares are listed produce interim statements, but does encourage interim reporting – see additional guidance below.

Czech GAAP Required for entities with securities traded on the Prague Stock Exchange, or for other entities subject to regulation. (Note: the concept of interim financial statements under the Act on Accounting is significantly narrower, because it includes only statutory financial statements.)

Additional guidance (IFRS)

Additional guidance under **IFRS** includes the following:

- consistent and similar basis of preparation of interim statements with previously reported annual data and from one period to the next;
- use of accounting policies consistent with the previous annual financial statements, together with adoption of any changes to accounting policies that it is known will be made in the year-end financial statements (for example, application of a new standard);
- preparation of the interim statements using a "discrete approach" to revenue and expenditure recognition; that is, viewing the interim period as a distinct accounting period, rather than part of the annual cycle. Hence incomplete transactions must be treated in the same way as at the year end. For interim results, the tax charge is based on an estimate of the annual effective tax rate applied to the interim results;
- summarised income statement (including segment revenue/profit), balance sheet, cash flow statement, selected notes and statement of recognised gains and losses; and
- a narrative commentary.

INTERIM FINANCIAL REPORTING (continued)

ADDITIONAL GUIDANCE (IFRS) (continued)

Under **IFRS**, comparatives for the balance sheet in interim financial statements are taken from the last annual financial statements (basically, the opening balance sheet of the current period). Under **IFRS**, quarterly interim reports must contain comparatives (other than for the balance sheet) for the cumulative period to date and the corresponding period of the preceding year to the same date. Under **Czech GAAP**, no additional guidance on the disclosure of comparatives in interim financial statements is available and in practice information taken from the income statement for the six months preceding the current period is used. The concept of interim financial statements under the Act on Accounting is considerably narrower, since it only includes financial statements, the preparation of which is prescribed by law or other regulations.

REFERENCES: **IFRS:** IAS 34. **Czech GAAP:** Act on Undertaking on Capital Market, Act on Accounting.

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Act on Income Taxes	Act No. 586/1992 Coll., on Income Taxes, as amended
Act on Securities	Act No. 591/1992 Coll., on Securities, as amended
Act on Undertaking on Capital Market	Act No. 256/2004 Coll., on Undertaking on Capital Market
Commercial Code	Act No. 513/1991 Coll., the Commercial Code, as amended
Czech accounting standards	Czech accounting standards issued by the Ministry of Finance of the Czech Republic
Decree 500/2002 Coll.	Decree No. 500/2002 Coll., implementing certain provisions of Act No. 563/1991 Coll., on Accounting for entities that are entrepreneurs, using the double-entry bookkeeping, as amended by Decree No. 472/2003 Coll.
Decree 501/2002 Coll.	Decree No. 501/2002 Coll., implementing certain provisions of Act No. 563/1991 Coll., on Accounting for entities that are banks and other financial institutions, as amended by Decree No. 473/2003 Coll.
Decree 502/2002 Coll.	Decree No. 502/2002 Coll., implementing certain provisions of Act No. 563/1991 Coll., on Accounting for entities that are insurance companies, as amended by Decree No. 474/2003 Coll.
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFRIC	International Financial Reporting Interpretation Committee
IFRS	International Financial Reporting Standards
SIC	Standing Interpretation Committee

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