

IMPACTS OF NEWLY ACQUIRED ITEMS WITHIN BUSINESS COMBINATIONS ON THE ITEMS OF THE FINANCIAL STATEMENTS

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Abstract

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This paper is focused on the operations with the company (business combinations). These are those operations that are associated with the formation or dissolution of companies or reorganization of their ownership structure. They are often referred as equity transactions. In the concept of Czech accounting legislation, these are the purchase, sale, investment (deposit) of firms or their parts, and various forms of transformation of enterprises. There are analyzed the accounting practices of recording of these issues under the Czech accounting legislation and International Financial Reporting Standards. Consequently there are identified newly acquired assets and liabilities arising directly in connection with the business combinations. In the conclusion of this paper there are examined the effects of different reporting of newly acquired items in the context of business combinations according to Czech accounting legislation and in accordance with International Financial Reporting Standards on the significant items of balance sheet and profit and loss statement from the material and time point of view.

Keywords: business combinations, Czech accounting legislation, international accounting standards, newly acquired items, valuation, goodwill, difference in valuation on acquired assets, gain on bargain purchase

INTRODUCTION

The globalization of economic activities is the most visible level of the current globalization. It represents the interconnection of production and markets of different countries through the trade in goods and services, capital and information movement and interrelated networks of ownership and management of multinational companies (Vítek, 2013).

The formation and existence of such companies is relatively independent field which is known as operations with business or eventually in accordance with commercial law – the transformation of commercial companies and cooperatives within the accounting legislation in the Czech Republic. According to the International Financial Reporting Standards this area is called business combinations. These are such operations, whose consequence is the creation (formation) or reorganization of

the ownership structure of enterprises within the national as well as international scope.

The purpose of accounting is also in this area the true picture of reality that is based on the merits of the various forms of transactions with businesses. These operations are often referred as capital, which results from the practical facts of termination or creation of businesses, or changes in the legal form of businesses or changes in the ownership structure of businesses. These are such operations so if they occur, so it is at least during the existence of an accounting entity, basically once. In accordance with generally accepted principles, it is necessary to record these transactions in the accounting of the concerned business in the complex form.

The problem of the operations with the business (business combinations) is one of the very complex areas of theory and practice. The actual process of a wide variety of these operations is

a multidisciplinary problem. In the Czech Republic it is regulated by commercial law, accounting and tax legislation. From this reason, it can be stated that the Czech regulation is highly fragmented. Extensive knowledge of all mentioned regulations is necessary for successful management of the operations with business. In practice, the operations with businesses are subject to complex approval process, theoretical solutions are not always clear. There have been changes within the study area, which are solved in the present paper, as a result of new legislation of the corporate law and also recodification of private law from 1. 1. 2014 in the Czech Republic. The studied subject was examined in many studies namely in Paseková (2006), Pelcl (2014).

International Financial Reporting Standards are one of the most important financial reporting standards in the world. However this is not a generally accepted norm, but an accounting system based on principles. Definition of business combinations from the perspective of International Financial Reporting Standards is broader and more general. Especially if we compare them only with accounting law in the Czech Republic that is impossible in this area.

Both accounting systems are often very different. Each is based on other priorities and principles. Comparison of the two systems is therefore very difficult.

AIM AND METHODS

The aim of this paper is to define the effects of the accounting methods of reporting the business combinations (operations with business) on the significant items of financial statements – in particular on the amount of assets, equity and income from operations and to identify the effects of different reporting, particularly for newly acquired items in the context of business combinations according to Czech accounting legislation and in accordance with International Financial Reporting Standards. In case of newly created items with respect to the method of their accounting within the two accounting systems to determine their impacts on the individual parts of the financial statements in relation to the time aspect.

Execution of a comparative analysis of accounting regulation of the business combinations (operations with business), analysis of accounting methods of reporting particularly for newly acquired items in connection with the business combinations, and also the comparison of their reporting by both of these accounting systems are the prerequisites for the fulfillment of the aim. A substantial part for the fulfillment of the aim is to define concepts and their content within the studied accounting systems. The paper also identifies and subsequently compares the procedures in business combinations in both accounting systems.

The starting point for the exploration of the outlined problem is the analysis of the legislation

regulating the issue of the operations with the business in the Czech Republic, especially the Accounting Act No. 563/1991 Coll. in the current version, as well as Decree No. 500/2002 Coll., the Ministry of Finance, which implements certain provisions of Act No. 563/1991 Coll., on Accounting, as amended, for accounting entities that are businesses maintaining double-entry accounting, as amended, and Czech Accounting Standard No. 011 – Operations with the enterprise for accounting entities that accounts according to Decree No. 500/2002 Coll.

There are also used the International Financial Reporting Standards – especially IFRS 3 – Business Combinations.

Other used sources are mainly specialized publications addressing the observed issues in the Czech Republic.

In the paper there are used methods based on the principles of logical thinking, particularly the method of deduction, in addition to the scientific methods, which are methods of description, comparison and mainly analysis. In the conclusion of the paper there is used the method of synthesis for the purpose of the formulation of own conclusions.

RESULTS AND DISCUSSION

Comparative Analysis of the Accounting Regulation for Business Combinations Within the Czech Accounting Legislation (CAL) and International Financial Reporting Standards (IAS/IFRS)

International Financial Reporting Standard 3 – Business combinations aims to establish requirements for accounting reporting in the case of an entity that performs a business combination. Originally, the issue was regulated by IAS 22 – Business Combinations subsequently there has been an update of the standard and the issues was regulated in IFRS – 3, which was already amended once, in 2008, with effect from 1. 7. 2009. It includes two additions, the first of them, unlike the Czech accounting legislation, exactly defines the content of the terms that arise and are used in the case of business combinations. The second one is an explanation of several diverse factors which may occur in case of realization of business combinations, as well as the procedure for preparing and presenting consolidated financial statements.

The Czech accounting legislation compared with IAS/IFRS (see Tab. I) does not define starting terms, such as business, parent and subsidiary unit. These terms are defined in the Civil Code and the Law on Business Corporations. In the current legislation the concept of business is replaced by commercial institution which is defined by § 502 of the Civil Code. Business institution is an organized collection of assets that the entrepreneur has created and is used by his will to carry on its activities. It is understood that the institution consists of

I: *Definition of selected terms in accordance with CAL and IAS/IFRS*

Term	Czech accounting legislation	International Financial Reporting Standards
Business (Enterprise)	Not defined	A comprehensive set of activities and assets managed for the purpose of providing revenue to investors or lower costs to participants
Business combinations	Term – Operations with business – is defined by the Czech Accounting Standard No. 011 – Operations with the company as operations during the sale of the business or its part, lease of enterprise or its part and transformations of entities under the relevant provisions of the Commercial Code	Merge of separate entities into one reporting entity. All of the combining entities are controlled and control is not temporary
Parental unit	Not defined	An entity that has one or more subsidiaries of units
Subsidiaries unit	Not defined	An entity that is controlled by another entity (known as the parent)
Goodwill	Positive or negative difference between the valuation of the business, or its part within the meaning of the Commercial Code, mainly acquired by purchase, deposit or valuation of assets and liabilities within the transformation of company and the sum of individually revaluated assets of property decreased by assumed liabilities (MoF Decree No. 502/2002 Coll., as amended)	Future economic benefits arising from assets that are not possible to individually identified and separately reported

Source: Own elaboration on the basis of legal standards

everything what is usually used for its operation. Concepts of parent and subsidiary units are defined by § 74 of the Business Corporations Act. Parent commercial corporation is defined as controlling commercial corporation and subsidiary commercial corporation as controlled corporation.

As a significant fact in the Czech accounting legislation it is necessary to consider its certain not topicality in terms of response to related regulations. As shows Tab. I, the implementing decree of the Ministry of Finance for accounting and also Czech Accounting Standard refer to the provisions of the Commercial Code, which, however, expired on 31. 12. 2013 and its provisions, with effect from 1. 1. 2014, were transferred to the Civil Code and the Law on Business Corporations.

IFRS 3 clearly defines the forms of business combinations, which are based on legal, tax or other reasons. This means that the entity buys the equity share of another entity, all net assets of another entity, it takes over the liabilities of another entity or purchase some of the net assets of another entity. These interactions can occur between the shareholders of the combining entities or between one entity and the shareholders of another entity. It can also be formed a new entity that will control the combining entities or transferred net assets or the restructuring of one or more of the combining entities. Business combinations can include such business combinations in which one entity obtains control over another entity but the date of obtaining the control (i.e. the acquisition date) does not coincide with the date or dates of acquiring the ownership interest (i.e. the date of exchange). This is the case when the firm concludes with some of its investors a repurchase agreement about its shares and as a consequence of realization of this fact there is a change of control over the entity.

Some business combinations may result in mutual parent and subsidiary relations. These are the cases where the acquirer is the parent unit and the business that was acquired is a subsidiary unit of the acquirer. In this case, the acquirer its interest in the acquired business includes within its individual financial statements into assets as expression of the financial investment assets in the subsidiary unit. In contrast, the business combination in the form of purchase of the share in equity of the other entity and the purchase of the net assets of another entity does not result in a mutual relation of parent and subsidiary.

The Czech accounting legislation does not define forms of business combinations, which are defined by the Act on transformation of commercial companies and cooperatives. In accordance with this Act, the companies and cooperatives may be transformed by a merger (combination or merger), division (demerger or cleavage), and transfer of assets to a partner or changing the legal form of the company.

Quite detailed description of the accounting method for business combinations is logically absolutely essential part of IFRS 3. The only method of accounting for all business combinations is the method of acquisition (previously known as the purchase method), which is trying to evaluate the purchased company by its fair value determined at the acquisition date, i.e. the date of obtaining the control over the purchased company. The starting point of this method is the view on the business combination from the perspective of the combining entity, i.e. from the acquirer. From this reason, the application of the purchase method pays attention to three factors:

1. Identification of the acquirer.

2. Determining the acquisition cost of the business combination.
3. Allocating the acquisition cost of the business combination to the acquired assets and liabilities and contingent liabilities at the acquisition date.

Identification of the acquirer is the primary condition whose fulfillment is required in all business combinations. Acquirer is combining accounting entity that obtains control over the other combining entities or businesses. Sedláček (2013) states that the control means the control of financial and operating activities of the accounting entity in order to obtain benefits from their activities.

The control represents the power to manage the financial and operating policies of an entity or business in order to obtain benefits from its activities. It is assumed that the combining entity obtains control over another combining entity, if it acquires a majority of the voting rights in this another accounting entity. Standard specifies exceptions in cases, if one of the combining entities would not acquire a majority of the voting rights in another combining entity, but however it may still gain control over another entity.

The standard also draws attention to cases where it is difficult to identify the acquirer and for these cases it defines specific indications of the acquirer. It can be e.g.: significantly higher fair value of one of the combining entities in comparison with the other combining entity or the fact when the management of one of the combining entities is dominated in assembling the management team of the resulting combined entity.

The acquirer subsequently determines the date of acquisition. Usually it is the moment in which he obtains control over the acquired business. Normally, it is the date on which the acquirer transferred the payment, he acquires the assets and assumes the liabilities of the acquired business, i.e. the settlement date. However, the acquirer can gain control earlier or later than the settlement date (Jílek, Svobodová, 2012).

Acquisition cost of the business combination is defined by the acquirer as the sum of the fair values at the date of exchange of transferred assets, incurred or assumed liabilities and issued instruments of the equity which the acquirer exchanges for the control over the acquired company and all costs directly attributable to the business combination. The initial (acquisition) costs of a business combination includes any costs directly attributable to the combination, such as

professional fees paid to accountants, legal advisers, expert for valuation and other consultants which carry out a business combination. In contrast, the general administrative costs, including the costs for running the acquisition department, and other costs that cannot be directly attributed to the particular accounted business combination, are not included in the acquisition cost of the combination. From this reason, they are reported as an expense in the tax period in which they were incurred.

At the acquisition date, the acquirer allocates the acquisition cost of a business combination so that he reports identifiable assets, liabilities and contingent liabilities of the acquired business (see Tab. II) at their fair values (International Financial Reporting Standards, 2013).

Only non-current assets classified as held for the purpose of sale in accordance with IFRS 5, non-current assets held for sale and discontinued operations, are reported at fair value, which are reduced by the costs of sell. And also any deferred tax claims and liabilities are evaluated at their nominal values (Krupová, Černý, 2008).

All identifiable assets and liabilities are assets and liabilities of the acquired company that the acquirer purchases or assumes, including financial assets and liabilities. They include e.g. tax benefit arising from tax losses of the acquired company that the acquired company had not reported before the business combination.

Any differences between the acquisition cost of the business combination and the share of the acquirer on the net fair value of identifiable assets, liabilities and contingent liabilities recognized in such way, will be accounted for either in assets as goodwill or eventually for the liabilities as a positive income from operations.

At the date of acquisition, the acquirer is liable to report goodwill acquired in a business combination as an asset and evaluated it at the amount of excess of purchase cost of the business combination over the share of acquirer in the net fair value of identifiable assets, liabilities and contingent liabilities. Only under these conditions it can be reported in the balance sheet (Dvořáková, 2011). Goodwill acquired in a business combination represents a payment made by the acquirer in anticipation of future economic benefits from assets that cannot be individually identified and separately reported. Goodwill is therefore evaluated as the residual purchase cost of the business combination

II: The criteria that must be fulfilled by given items

Item	Intangible asset, contingent liability	Liability	Other assets (not intangible)
Criteria	Their fair value can be reliably determined, the intangible asset must be separable from the accounting entity	For its compensation it will be required outflow of resources representing economic benefits, and it is possible to reliably determine its fair value	It is probable that any associated future economic benefits will flow to the acquirer, and its fair value can be reliably determined

Source: Own elaboration on the basis of IFRS 3 – Business Combinations

after reporting the identifiable assets, liabilities and contingent liabilities of the acquired company.

Goodwill arising in the business combination is not amortized. The acquirer is testing it for the impairment in value in accordance with IAS 36 – Impairment of assets once a year or more frequently if the events or changes in circumstances indicate that its value could be reduced (Krupová, 2009). In the positive case, it is necessary to report the loss from this impairment as part of the income from operations of the relevant accounting period.

If the share of acquirer in the net fair value of identifiable assets, liabilities and contingent liabilities exceeds the purchase cost of the business combination, the acquirer is liable to reassess the identification and evaluation of the identifiable assets, liabilities and contingent liabilities of the acquired company and the evaluation of the purchase cost of the business combination (may cause incorrect evaluation) and in case of confirmation of this relation to immediately report any income remaining any after this reassessment through the income in the profit. It is a non-recurring income, which is called a benefit (gain) on a bargain purchase. Gain reported in such a manner should consist of one or eventually more items.

From the above mentioned facts, it results in the pragmatic approach in a business combination during the application of the purchase method (Deloitte, 2010):

1. Identification of the acquirer, which is the combining entity that obtains control over the acquired company;
2. Determination of the acquisition date, i.e. the date on which the acquirer obtains control over the acquired company;
3. Reporting and evaluating the acquired identifiable assets, the assumed liabilities and any non-controlling interests in the acquired company;
4. Reporting and evaluating goodwill or benefit from bargain purchase.

Procedure in Czech accounting legislation is based on the Accounting Act. According to Skálová, Čouková (2009) the basic obligations for maintaining accounting in accordance with Accounting Act during the conversions are following:

1. closing the books,
2. valuation issues,
3. the possibility of taking over the accounting prices of the ceasing company or individual evaluation of the individual items,
4. reporting of differences in valuation on acquired assets and goodwill.

Vomáčková (2009) also emphasizes the importance of extraordinary financial statements which are prepared in connection with the extraordinary days or extraordinarily terminated and initiated accounting periods, which may be very common for conversions.

IAS/IFRS set that the acquirer determines the acquisition date in business combinations. CAL is based on commercial law in this field, which defines the so-called the effective date of transformation. Act on Transformation of Commercial Companies and Cooperatives defines the effective date as the day from which the transactions of ceasing companies or cooperatives or split up companies or cooperatives are considered from an accounting perspective, to be made on behalf of successor companies or cooperatives or the accepting shareholder. The effective day is the moment of opening accounts of “newly created” – the successor company.

According to Josková, Šafránka, Čouková, Podškuby (2012) there are three options of the determination of the effective date in practice. The first option is the effective day preceding the elaboration of the transformation project. Two alternatives are possible – the effective day is identical to the beginning of the accounting period or it varies. The second option for the effective day – choosing any day after the elaboration of the conversion project, but it must precede the date of incorporation into Commercial Register and the last option is the day that coincides with the date of registration of the transformation in the Commercial Register.

Identifying Differences in Regulation of Business Combinations Within the CAL and IAS/IFRS

There can be defined several key differences that are summarized in Tab. III. within these two accounting systems.

As a starting point for business combinations it is necessary to consider a clear definition of basic concepts, which include enterprise (business), business combinations, the parent company, subsidiary, control, and other. CAL do not address their factual definition, they are regulated by commercial law – Business Corporations Act No. 90/2012 Coll., in current version, and in particular the Act No. 125/2008 Coll. on Transformations of commercial companies and cooperatives, in current version. In contrast, IAS/IFRS consistently define the content of these concepts through the amendment to IFRS 3 – Business Combinations.

CAL separately defines accounting procedures for the purchase and sale of business, particularly for individual types of transformations, while IAS/IFRS generally describes the procedure for all business combinations without more specific definition within accounting.

The prevailing formal view on the issue of the business combinations in CAL means that the researched facts are handled solely from the point of view of accounting, which results from its lack of a factual definition.

Also the moment of evaluation may be different within the business combinations. In CAL this moment is associated with effective

day and according to the law on transformation of commercial companies and cooperatives, the ceasing company is liable to let evaluate its assets at the date of the last financial statements, which compiles prior the project of the relevant operation with the company. Subsequently, this evaluation is reflected in the opening balance sheet of the successor company. According to IFRS 3 – the moment of evaluation is defined as the moment of acquisition of the business (acquisition date).

As regard the valuation of the acquired assets there is completely different approach. According to IFRS 3 – it is necessary to perform evaluation of all assets and liabilities at fair value. According to CAL acquirer has a possibility of choice. The first option is to take over the accounting value from the statements of the ceasing company, the second option is an individual revaluation of assets and liabilities through the expert evaluation.

CAL determines the exact methodology for accounting for newly acquired items (goodwill and differences in valuation of the acquired assets), while the IAS/IFRS in the case of newly acquired items (goodwill and gain on bargain purchase) provides a framework procedure without a specific definition of the method used for the accounting of these items.

Within the framework of accounting the IFRS 3 allows, in case that the initial accounting for a business combination is not complete by the end of the accounting period, in which the business combination occurs, that the acquirer would report outstanding items in the provisional valuation in the financial statements. Then, he has the option to modify this provisional evaluation during the following 12 months. The CAL is missing similar provision.

The last significant regulation of business combinations, which provides only for IFRS – 3 Business Combinations, not Czech accounting legislation, is mandatory information for reporting. The reason for publishing (reporting) the information about the business combination is to fulfill the basic requirement, which is that the financial statements are to provide users with all the information relevant to their decisions. Standard presents an accurate list of the requirements for the reporting that enable users of financial statements to evaluate the nature and financial effects of the business combination.

Effects of Different Accounting Practices Within the CAL and IAS/IFRS in the Field of the Business Combinations to the Significant Items of Financial Statements

Tabs. IV and V summarize the impacts of method of accounting for the newly acquired items in the context of business combinations to the significant items of the financial statements under both accounting systems.

The starting point of these impacts is particularly the different view of the recognition of newly acquired items in both accounting systems and consequently the method of accounting of their reporting in the financial statements in relation to the time aspect.

Either the difference in valuation on acquired assets as part of tangible fixed assets or goodwill as part of intangible assets may be the newly acquired items within the transactions with the company according to CAL. Both possible newly acquired items are therefore part of the assets of the balance sheet. Difference in valuation on the acquired assets has not the opposite according to IAS/IFRS, which do not allow the successor company to take over

III: Fundamental differences between CAL and IAS/IFRS

Definition of the facts (difference)	Czech accounting legislation	International Financial Reporting Standards
Basic concepts (terms)	Not define, they are solved within Commercial Law	Precisely defined content
Scope of the issue of business combinations	Separately dealt with purchase and sale, especially transformation	Treated as a whole
Transactions under common control	Part of business combinations	Not a part of business combinations
Essence of solved facts	Prevails formal view	Prevails factual (content) view
Definition of acquirer	From a formal point of view	From a factual point of view
Moment of evaluation	Results from the effective day	The moment of acquisition of the business
Method of evaluation	Either at accounting remaining cost of ceasing companies or in individual revaluation based on expert opinion	Identifiable assets, liabilities, contingent liabilities are evaluated at fair value
Different view of the recognition of newly acquired items	Always part of assets (goodwill or difference in valuation of the acquired assets)	According to nature they can be part of assets (goodwill), or liability – gain (benefit from purchase)
Method of accounting for goodwill	Gradually amortized	Tested on impairment of fair value

Source: Own elaboration based on CAL and IAS/IFRS

the assets and liabilities in the evaluation by the accounting net book values of the original owner (valuation must be only at fair value).

Difference in valuation on the acquired assets and also goodwill in the CAL may be of active (in practice mostly) or passive character. Active difference in valuation on the acquired assets arises when the total revaluation of an acquired business exceeds the sum of the accounting remaining prices of assets and liabilities of the ceasing company. Passive difference in valuation arises in the case of the opposite relation. This newly acquired item is amortized using the indirect method in the case of an active character 180 months equally into operating costs, in the case of a passive character into operating incomes.

Depreciation of the difference in valuation on acquired assets of the active character is reflected in the balance sheet as the decrease in assets indirectly through the accumulated depreciations to the difference in valuation to the acquired assets and in profit and loss statement in costs. Therefore it has an impact on decrease in income from operations. Depreciation of difference in valuation on acquired assets of the passive character is reflected in the balance sheet in assets as their increase indirectly through their accumulated depreciations to the goodwill and in profit and loss statement in revenues. Therefore it has the effect of increasing the income from operations.

As already mentioned, also the goodwill may have an active possibly passive character. Active goodwill is in the case that a total revaluation of an acquired business is higher than the sum of the individually revalued components of the assets and liabilities of this company. It is equivalent to goodwill that arises under IAS/IFRS. The passive goodwill arises in case of the opposite relation of the given valuation under CAL. However this item is in accordance with IAS/IFRS recorded quite differently in the financial statements - as a gain from a bargain purchase under liabilities in the balance sheet, once in the year of the acquisition.

Another significant difference occurs in the accounting method of accounting for goodwill. Within CAL goodwill is amortized using the indirect method in the case of active goodwill 60 months evenly into operating costs, in the case of passive goodwill into operating incomes. It is possible a longer amortization period than 60 months, which has to be justified in the notes (annex) to the financial statements.

Depreciation of active goodwill is reflected in the balance sheet as the decrease in assets indirectly through the accumulated depreciations to goodwill and in the profit and loss statement in costs. Therefore it has an impact on reducing the income from operations. Depreciation of passive goodwill is reflected in the balance sheet in assets as their increase indirectly through their accumulated depreciations to the goodwill and in profit and loss statement in income. Therefore it has the effect of

increasing income from operations (Glaser, 2014). These impacts can be identified and quantified for a fixed period of amortization at maximum. If there would be removal of the last component of fixed assets during the specified time of amortization of goodwill which was part of the acquired business, there would be single depreciation of the goodwill in the appropriate accounting period and its subsequent withdrawal from the accounting.

According to IAS/IFRS goodwill arising during business combination and is consistent with active goodwill under item CAL, is not depreciated. The acquirer tests it for impairment in the fair value usually once a year. Subjects of the test are items of the acquired business, which are evaluate at fair value. In the case of demonstrating the decrease in the fair value of these items it is necessary to report the loss from this reduction as part of the income from operations of this accounting period. Otherwise there will be no accounting case. Standard does not address the accounting method of reporting the loss from the impairment in fair value. Direct method of the decrease in goodwill or indirectly through adjustments can be considered. IAS/IFRS do not define specific method of accounting reporting the reduction in goodwill. In my opinion, the direct method is more appropriate in this case, since it is the impairment in the fair value, never again in the future there will be the opposite situation - the increase in fair value. Therefore it is not necessary to maintain information about the original evaluation in the accounting.

Ultimately the goodwill according to IAS/IFRS will be reported as an item of the balance sheet as long as the purchaser will possess the items of the acquired business, which are evaluated at fair value, and there will not be a decrease in amount, which would lead to the complete removal of the goodwill.

Passive goodwill according to CAL corresponds to gain on bargain purchase within IAS/IFRS. In the year of the acquisition, it will appear in the full amount to the revenues and therefore it is reflected (once) in the liabilities of financial statements in the own resources as profit.

Consequences both in the field of newly acquired items in the context of business combinations, and subsequently in their subsequent settlement and impacts on the financial statements are quite different in both accounting systems. CAL in the case of conventional business entities has not implemented some procedures of IAS/IFRS, which causes these differences within the study area. CAL does not require the valuation of assets and liabilities strictly at their fair value as it is ordered by IAS/IFRS. Also the possible way of determining the fair value can be fragmented. Accounting residual price of assets and liabilities of the original owner may be in practice significantly different from their fair value, causing substantial initial difference between the both systems. Another difference is the creation of passive goodwill (CAL) and a gain from a bargain purchase (IAS/IFRS) as a result of the same

IV: *Impacts of the accounting method of the newly acquired items in the context of business combinations on significant balance sheet items*

The newly acquired item	Czech accounting legislation	IAS/IFRS
Goodwill (active) Difference in valuation (active)	Decrease in assets under the indirect method on a regular basis every year in accordance with the established depreciation period	X
Goodwill	X	Decrease in assets once (irregularly), always in the year of the positive result of test on the decrease in fair value (method is not defined)
Goodwill (passive) Difference in valuation (passive)	Increase in the assets under the indirect method on a regular basis every year in accordance with the established depreciation period	X
Gain from a bargain purchase	X	Increase in own resources in the item of profit (once) in the year of acquisition

Source: own processing

V: *Impacts of accounting method of newly acquired items in the context of business combinations on significant items of profit and loss statement*

The newly acquired item	Czech Accounting Law	IAS/IFRS
Goodwill (active) Difference in valuation (active)	Decrease in income from operations by the settlement into the costs on a regular annual basis in accordance with a fixed depreciation period	X
Goodwill	X	Decrease in income from operations by settlement into costs (irregularly) always in the year of the positive result of the test on the decrease in fair value
Goodwill (passive) Difference in valuation (passive)	Increase in income from operations by the settlement into the revenues on a regular annual basis in accordance with a fixed depreciation period	X
Gain from a bargain purchase	X	Increase in income from operations by the settlement into revenues once in the year of acquisition

Source: own processing

operation. Passive goodwill may affect the income from operations in terms of its increase up to 180 following months, while the gain from a bargain purchase will increase the income from operations once in the year of acquisition (incidence of this item). The last major difference is the subsequent

settlement of the newly created item that is goodwill. Procedure of IAS/IFRS (goodwill testing on the impairment in the real value) is clearly in line with the principle of prudence than CAL procedure (amortization of goodwill over a specified period of time, based on accounting policies).

CONCLUSION

Business combinations (operations with the business) are very complex processes, covering many different areas. They need to be addressed from the perspective of accounting, taxation and law. This is a very administratively expensive and time-consuming process.

Currently the business combinations are regulated by the individual IFRS 3 – Business Combinations from the perspective of International Financial Reporting Standards. In case of legislative of the business combinations in the Czech Republic it is not possible to be based only on accounting legislation, which specifically addresses the accounting reporting of effects of business combinations, but the primary basis is mainly the commercial law. These are namely the Business Corporations Act, the Act on the transformation of companies and cooperatives, but also the Civil Code that defines the initial specific terms and procedural processes of the business combinations.

Excessive fragmentation in the Czech legislation was found out by the methods of analyzing the existing legislation of the examined issues in the Czech Republic. Examined issue is therefore not addressed in all their connections within the accounting law (as it is in the case of the IAS/IFRS),

which is the reason of the very difficult orientation at practical application of studied topic also for accountants and tax professionals.

International Financial Reporting Standards were created without political influences and their distribution is worldwide. They are not bound to any legal system of the state, accounting practices are solved comprehensively and separately. Another advantage is their independence of taxes. Czech accounting system is in many areas closely linked to tax requirements. Financial income from operations is consequently transformed to the tax base, which may lead to the fact that the entity is trying to reduce the income from operations in order to report the income tax base in a lower amount. The principle of true and fair picture of reality is violated as a result of this procedure and thus the explanatory power of accounting for users of the financial statements is greatly reduced. Financial statements in terms of International Financial Reporting Standards give more relevant information that is used to make decisions and comparisons.

International Financial Reporting Standards and the national accounting system often show large differences. It is different within the examined issue the very concept of business combinations, accounting procedure for their recording, which is manifested especially in the valuation of the assets and liabilities, the creation and subsequent accounting reporting of the newly acquired items in the context of business combinations, as well as in the requirements for reporting. The International Reporting Standards are based mainly on principles, the examined issue is solved generally, the specific method of settlement is often left on the choice of accounting entity. While the Czech accounting regulation is based on precise rules, accounting procedures are specifically defined in the relevant regulations.

The most important difference in the business combinations between International Financial Reporting Standards and Czech Accounting Legislation is the valuation of the assets and liabilities. In accordance with International Financial Reporting Standards it can be used the fair value for the valuation of the assets and liabilities in business combinations. Czech accounting legislation gives entities the option, either they can use the fair value according to expert opinion, or the accounting value taken from the ceasing company. This fact leads to the non comparability of financial statements compiled by various companies both in the national as well as in multinational scale. Also in terms of honest and fair presentation of reality it appears more appropriate the option of valuation at fair value according to expert opinion.

The valuation methods are related to the subsequent creation of newly acquired items in the accounting, which are goodwill, difference in valuation on acquired assets or gain from a bargain purchase.

The main objective of this paper was to identify the impact of differences in reporting, particularly for the newly acquired items in the context of business combinations according to Czech accounting legislation and in accordance with International Financial Reporting Standards and subsequently to determine their impacts on the individual parts of the financial statements in relation to the time aspect.

Newly acquired items, which are reported excluding goodwill (IAS/IFRS) and active goodwill (CAL) in different parts of the balance sheet, are arising within both accounting systems in case of business combinations. Totally different is the subsequent settlement of all newly acquired items that cause different impacts on the balance sheet and profit and loss statement, both in terms of time and fact.

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