

Problems Linked to Cross-Border Mergers: Focused on the Company Located in the Czech Republic

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Abstract— To allow free movement of capital among the Member States, European Committee published the 10th European Directive no. 2005/56/EC about cross-border mergers. However there are still some big differences, which can disallow preceding this type of mergers. This paper points out barriers, which causing disability of cross-border mergers between the Merger States and points to some significant problems that may be for the candidate of merger interesting and complicate the process from the Czech perspective.

This paper also describes types of mergers, merger process and reasons for mergers. After short introduction it describes differences in implementation of 10th European Directive into national laws of Merger states. Paper is extended from mergers to foreign entities enterprise branches, permanent establishments and organizational units settled by the Czech company broad or foreign company in the Czech Republic.

Huge part of this paper is pointed at problems linked to cross-border merger, exactly problems with valuation and revaluation differences, which occurs at the merger process. Paper also describes international regulation of mergers, accurately aimed to IFRS 3 – business combinations.

Keywords— cross-border, decisive day, IFRS, merger, valuation

I. INTRODUCTION

CROSS-BORDER mergers have become regulated by EU as a result of free movement of capital among Member States. The first Directive was accepted in 1990 and its aim was to require Member States to remove the tax barriers that might prevent these transactions. In 2005 was issued the European Directive no. 2005/56/EC about cross-border mergers. This directive requires Member States to write down the cross-border merger into national law. This Directive allows the Member States relatively high freedom with its implementation so we can find in different countries different regulation. This difference causes not only one complication in the possibility of transferring cross-border mergers. The aim of this paper is to show areas in which the legislation in the Czech Republic differs from the rest of the world. These differences cause complications in cross-border merger with a company located in the Czech Republic.

In the year 2002, the European Parliament and the Council of the European Union issued Regulation 1606/2002 whereby it stipulated certain duties on the part of companies listed on

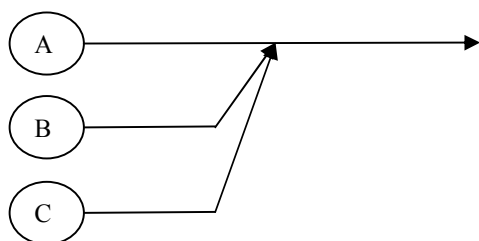
European stock exchanges to compile their consolidated accounting statements in accordance with IFRS. Therefore, beginning from 2005, a large number of listed enterprises, exhibiting significant heterogeneity in size, capital structure, ownership structure and accounting sophistication, started to apply international standards for the first time. In addition to the use of IFRS by listed companies, many countries adopt international standards for unlisted companies or model their domestic standards on the basis of international standards. The requirements for group listed enterprises to prepare IFRS reports from 2005 were established in most transitional economies, but it is still unclear to what extent other enterprises will prepare IFRS financial statements[21]. Because of this IFRS importance I mention regulation of cross-border mergers in separate chapter.

In the market economy, there are rise of joining of companies all around the world. The merger is one of the most frequently type of joining companies. The definition of merger by [5] is a combination of two or more companies in which all but one of the combining companies legally cease to exist and the surviving company continues in operations under its original name.

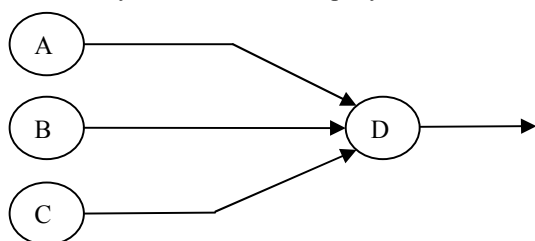
Definition of cross-border merger is simple. By [3] cross-border merger is a transaction in which two firms with their home operations in different countries agree to an integration of the companies on the relatively equal basis.

According to European business law, we can divide mergers (national or cross-border) into two types. These types are distinguished by how the merger is financed:

Purchase Mergers – this kind of merger occurs when one company purchases another. The purchase is made by cash or more often through the issue of some kind of debt instrument. In this type of merger one or more companies disappears and another (the buyer) is a successor. The example shows the company A as a successor company and companies B and C as dissolving companies.



Consolidation Mergers - With this type of merger, a new company is formed and all participating companies are bought and combined under the new entity. The tax terms are the same as those of a purchase merger. The example shows participating companies A, B, C as dissolving companies and a D as a new entity, the successor company.



Overall, we can say, that all mergers and acquisitions follow some aim. During the research of reasons of mergers, we can find more goals and their historical change. According to the literature [1] and my option I would like to mention the main reasons for mergers and acquisitions:

- start a new activity,
- strive for market power,
- retentions of earnings saves investor taxes,
- leads to an acquisition of resources,
- risk diversification,
- synergy effect,
- tax implications,
- growth and size.

Actually, I mentioned just the most important reasons. I am sure that we can find many different reasons in real live. I cannot mention which of these mentioned reasons is the most common and the most important. I am going to describe just a few of them.

An effort of each company is to build a good position in the market, get new customers and expand into new geographical area. If the company has sufficient funds, one way how to expand is a merger with a company with a strategic geographical position.

Sometimes is very difficult for companies to establish a new company abroad. Easily way how to start a new enterprise abroad is to process a merger with another company situated in the destined country.

For main tax implication I consider an effort to reduce tax liability by merger with a company with a tax loss. This reason should not be the only one, because the tax law of participated country may require paying the tax savings back to state. Regarding the tax reasons, I should mention the state donation

or tax holidays used in some countries. Tax donation is typical for not development countries where state financially support merger if this merger saves failing company. Tax holiday means remission of tax payments for several years for new strategic investors in the country.

By acquisition of resources I mean exactly the know-how of merged company. The successor company can get also management talent, products, markets, cash or debt capacity, plant and equipment, raw materials, patents and other.

Risk diversification as a reason of a merger process is a method how to stabilize revenues and financial situation.

One of the main reasons for providing mergers is synergy effect. This effect we can show as an equation $1 + 1 = 3$. Two firms joined together may be worth more than they are worth individually. After merger successor company saves expenses for administration, research and development, supply inventories.

According to goals of mergers we can divide it into three types:

- horizontal,
- vertical,
- conglomerate.

Horizontal merger means a merger between two or more companies with the same or similar activities. Usually this type of merger is used by a merge with two competed companies. The amalgamation of Daimler-Benz and Chrysler is a popular example of a horizontal merger.

Vertical merger is a type of merger between companies with complementary activities. It could be a merger between companies with its supplier or distributor. An example should be a merger between a car and a tire producer. This type of mergers significantly falls down in recent period.

Conglomerate merger is a merger between two independent companies. There is no buyer-seller relationship. The reason for this type of merger is to insure against failure or fall down of sales in one area or against seasonal decline.

On the other side, mergers should not be the best way how to achieve a success. In praxis we can find poisoned mergers, which did not help participated countries. The same names of financial statements should not mean the same for different companies. So merger process is not easy and cannot be based only on the values and numbers. Join of two or more companies which are not appropriate causes decrease in performance, quality of products and sales.

II. THE IMPLEMENTATION OF THE DIRECTIVE IN EU MEMBER STATES: FOCUSED ON THE CZECH REPUBLIC

The various implementation of European Directive no. 2005/56/EC did not destroy barriers of cross-border mergers, it caused even greater complications. Although the regulation of cross-border mergers should be similar in every Member State, the variance gave by implementation of European Directive causes that it is hard to find synchronization in each Member State. Member States were obliged to put this

directive into their legal systems until the 15th December 2007. The following table shows that the Member States were not disciplined and Directive did not meet on time. These various possibilities of implementation of the Directive, which could hinder the cross-border merger with the Czech companies, are exactly:

- different time of legal and accounting effects of the merger (i.e. the applicable date),
- pricing in the process of merging,
- legal forms of companies involved,
- time of financial statements.

First, it is necessary to describe the process of cross-border mergers in the Czech Republic. As shows the table in previous chapter, the Czech Republic implemented the Directive later than it was ordered by EU. A business law form which regulates cross-border mergers came in force on the 1th July 2008 in the Czech Republic. The domestic and the cross-border mergers in the Czech Republic regulate Act No. 125/2008 Coll. about transformations of the companies and business cooperatives. Every cross-border merger with the Czech company must follow this Act.

The legislation of cross-border mergers is based on the principle that the involved companies have to follow at least two different laws. The preparatory phase will be regulated for each participating company according to the domestic law where the company has its headquarters. The completion of the merger itself will follow the rules of that state, where the successor company will have its placement. "It is valid that the cross-border merger of the participating Czech companies and successor companies which will be established in the Czech Republic has to follow Czech business and accounting regulations." [14].

A. Establishment Foreign Entity's Enterprise Branch

The cross-border merger must attend at least two companies located in different countries. Consequently, in the context of headquarters of involved companies may occur following situations:

- The successor company will be established after the merger in the country of one of the participating companies and the dissolving company moves all its assets and liabilities to this successor company.
- The successor company will be established after the merger in the country of one of the participating companies, but the dissolving company will continue to operate in the country where it has its office - there is established a Foreign Entity's Enterprise Branch in the country where the dissolving company was situated.
- The successor company will be located in a country where none of the participating companies have its headquarters. If there is no transfer of equity, there are established two Foreign Entity's Enterprise

Branches.

In case of cross-border mergers where there is no transfer of equity between the companies, there is established the Foreign Entity's Enterprise Branch. This Branch, if it is created in the Czech Republic, is still governed by the Czech commercial law, tax obligations and maintains accounts according to existing regulations in the Czech Republic.

In the next few articles I would like to mention some important information about foreign entities regulated by Czech commercial law:

We can classify the issues practically into two areas whereas we will make difference between the approach at the founder (Czech) company and at the foreign branch office, which we will designate according to the company law as an organizational unit of a foreign founder. Furthermore, we will add the following distinction to the individual types of issues:

The Czech company as a founder and its organizational unit abroad:

- 1) the way the foreign organizational unit is recorded in the accounting of the Czech company;
- 2) exchange rate conversion of the foreign organizational unit currency into the national currency of the Czech company;
- 3) approach to exchange rate differences;
- 4) other issues.

If I speak about the Czech Republic company and its organizational unit abroad (usually Legal Entity Branch), I would like to mention two solutions accepted in the past:

The first solution presupposed centralized accounting for the accounting unit as a whole, it means that all documents of the foreign establishment were entered in Czech crowns in the headquarters of the accounting unit or they were possibly carried to account at least once a month using the exchange rate of the last day of the accounting month. The foreign establishment could keep its own records in its national currency, which served as documents for tax reasons.

The second method presupposed separate accounting of the foreign establishment in its national currency and a conversion of data into the Czech currency once a year, using the exchange rate at the date of the annual financial statement and further the inclusion of converted initial balances, monthly turnovers and final balances of the individual accounts of the establishment in the accounting of the Czech accounting unit.

At present the only basic concept is the accounting kept centrally at the founder company, i.e. at the Czech company, regardless of the accounting of the country where the foreign establishment has its seat.

On the other side, for organizational unit of the foreign founder in the Czech Republic is typical:

- 1) duty to keep accounting;
- 2) non-existence of the own capital;
- 3) possibility to show the relations with the founder company;
- 4) financial results;
- 5) obligation to the audit, the annual report, the report on

connected persons, obligation to publish;

6) obligation to taxation.

Under these circumstances, when the objective of the foreign founder is not to establish a legally independent company provided with capital, but e.g. the so called direct entrepreneurship not by means of an independent legal subject like an established business company, it is, according to the Czech legislation, an organizational unit of a company that has the duty to register in the business register. At this date the right to do business in the Czech Republic, but also the obligation to keep accounting of this organizational unit comes into effect.

Finally, when I speak about organizational unit of the foreign founder company in the Czech Republic, I should mention important facts:

- it is a subject with neither legal independence nor authorization to legal acts;
- an important document can be also the so called decision of the foreign founder on establishing an organizational unit;
- the foreign founder participates in proceedings with other subjects, e.g. with state authorities and simultaneously he bears all legal responsibility. It authorizes its deputy (organizational unit leader recorded in the business register) for the territory of the Czech Republic for securing other duties;
- there is an obligation to abide both by the law of the country of the origin of the foreign founder and simultaneously by the law of the Czech Republic. The organizational unit gets the identification number including tax registration and other registration duties towards state authorities;
- organizational unit founded in the Czech Republic is a part of the all-company structure of the foreign founder company, internal unit or center. The foreign legal person in the role of a founder of the organizational unit in the Czech Republic and the organizational unit itself are still one legal subject;
- the organizational unit has no equity;
- the foreign founder provides the organizational unit e.g. with material or financial aid such as advance payment, i.e. with a contribution that is settled internally with the founder on the territory of the other state;
- if the organizational unit achieves a business result from its activities, it is however a business result of its founder. The foreign founder makes the decision on the internal settlement of this internal result according to its company rules;
- it is a subject that generates its revenue on the basis of the Czech law, thus the tax basis and liability are decided by the tax collector;

- as far as the organizational unit meets the criteria for the obligatory audit in the framework of the Czech taxation system, its financial statement will be a subject to the audit. From this follows the obligation to compile the annual business report and to publish it.

The following text focuses its attention on areas that support mentioned issues relating to the Czech company and its organizational unit abroad on one hand and to the organizational unit of a foreign founder in the Czech Republic on the other hand.

B. Possible combinations of legal forms

In accordance with the Directive the Czech law allows all Czech companies and cooperatives to participate in cross-border merger. In contrast to some other States, where the Directive was implemented, the Czech Republic allows cross-border mergers [10]. This means that, the cross-border merger is possible between different legal forms as well as the domestic mergers in the Czech Republic. So if the country where the second participating company is located do not prohibit criss-cross-border, this type of merger is possible. The law in the countries, where both participating companies operate, has to allow it. It is not possible to merge private with capital company in the Czech Republic.

The Czech law expected that the legal forms in the Czech Republic do not match to legal forms in other countries and therefore indicates that it may be used on "similar" legal forms. The exact interpretation of this concept is not clear. It is about the similar companies in different countries which have developed differently but have identical features.

If the law of one of the participating countries does not allow criss-cross-border merger, the merger shall not be made. The companies should easily avoid this problem by changing the legal form before planned merger process. I don't think this problem is one of the major which would prevent the merger with the company having its seat in the Czech Republic.

There are major problems in the transformation of the directive, which I consider important, and without removing them, the cross-border merger is very difficult sometimes it's not impossible. When you submit your final version, after your paper has been accepted, prepare it in two-column format, including figures and tables.

III. PROBLEMS LINKED TO CROSS-BORDER MERGERS

As I mentioned in the previous chapters, the variance by the Directive given to Member States causes the diversity and inconsistency in certain areas of cross-border mergers. This freedom causes disharmony in the transformation of the Directive, which primary goal was to unify the process of cross-border mergers and remove barriers to free movement of the capital between Member States.

The whole process of cross-border mergers is based on the

“Common draft terms, “i.e. sort of agreement, which must provide all the details of the merger process. Through this contract it is possible to resolve irregularities, what different legislation reflected in their law.

Let me refer the main problems which may be critical for potential candidates for cross-border merger with the Czech company.

A. *Legal and accounting effects of cross-border mergers*

During the merger process it is necessary to distinguish two important dates. The Directive's and all Member States laws have to differentiate the validity of cross-border mergers according to accounting and legal view. The date of legal validity of cross-border merger is governed by the law of the State where the successor company is established. Like in the most EU countries, in the Czech Republic the merger becomes valid at the date issued by the Commercial Register. On the same day, the successor company is legally created by the law (if it is based as a new one) and the dissolving company ceases to exist. Since the regulation of legal effects is similar in most countries, i.e. Cross-border merger shall enter into force at the date issued by registers; I will not mention it in the further text. The difference in the harmonization of cross-border mergers is in the setting of the second important date. This is the day of capture the accounting and tax effects of cross-border mergers. The Directive in its Article 5 f) says that Common draft term must include "The date from which the transactions of the merging companies will be treated for accounting purposes as being those of the company resulting from the cross-border merger." This day is called "decisive day" according to Czech law and it is placed into past. In according to the Act no. 125/2008 Coll, this day may not predates more than 12 months the date of filing the application for registration of cross-border mergers in the commercial register. In the Czech Republic the accounting effects of cross-border merger predates legal effects. The day before the “decisive day”, all participating companies are obliged to prepare its financial statements.

The “decisive day” set in the past means that all transactions after that date shall be recorded in the accounting of successor Company. All these economic transactions are recorded separately, because officially (legally) the company ceases to exist at the date of the change in the Commercial Register.

The difference can be traced in the harmonization in the requirements laid down for the day, from which arises the accounting effects of the merger. We can find regulation in some Member States, where the “decisive day” is the same as the date of entry in the Commercial Register and thus equals the legal effects of cross-border mergers. Disharmony in the harmonization causes considerable complications in the process of mergers and especially in the timing of the process.

We can divide the countries participating in cross-border mergers into three groups:

1) countries such as the Czech Republic, Austria and Germany, which put the accounting effects of mergers in the past,

2) countries such as Croatia, Poland, Hungary, Romania, where the accounting effects of mergers take place in conformity with the laws and

3) countries such as Slovakia, where there is possible to determine movement the “decisive day” back to the past without restrictions according to the amendment of accounting law valid from 01/01/2010 [7]

We can say that the legislation in force in Slovakia is the most accessible for cross-border mergers, because the Slovak merged company can adapt to the accounting effects so that they are consistent with the other States. Thus, the problem is completely removed.

The company situated in the Czech Republic has not this opportunity. Accounting effects of cross-border merger has to be valid from the date predates legal effects and date of registration in the Commercial Register.

With respect to this date, an entity in the Czech Republic gives rise to various other obligations, such as to construct the final financial statements the day before the "decisive day". In the case when the successor company will be located in the Czech Republic it is necessary to prepare an opening balance sheet of the company. These financial statements and opening balance sheet are documents, which have to be placed in the headquarters of participated companies one month before the General meeting and must be available to shareholders, who validate the cross-border merger [9].

The problem in the process of cross-border mergers occurs in cases where the State law of the participating company has the day of accounting effects at the same day as of the legal effects and the date of incorporation. The cross-border merger of this company with the Czech is almost impossible.

It is almost impossible to prepare cross-border merger between Czech and Hungarian or Poland company. In case that the successor company will be settled in the Czech republic, it is difficult to establish opening balance sheet on the "decisive day" under Czech law, if for the second participating company that date is not important and has no reason to join equity and report all transactions to the Czech Republic. Otherwise, when a Czech company will cease to exist, it is not possible to fulfill the provisions of the Act that from the "decisive day" relevant operations of the acquired company are transferred to the account of the acquiring company, as this operation does allow law of Successor Company.

In the case of preparation the Czech-Polish cross-border merger with the acquiring company in Poland, according to the Czech law should be the "decisive day" in the past and the company should act in the name of the successor company. Under the Polish law it is still not possible because Polish law does not take over the decisions and transactions of the successor prior to entry into the commercial register, this is certainly later than the day „decisive day“ in the Czech Republic.

I see the solution of this problem only in the amendment of laws in countries where the day of accounting effects equals

the date of the registration in the Business Register. In this case, the owners of companies don't have time to comment on the financial statements prepared the day before the "decisive day" as required by the Directive. I think the best solution is the law enacted in Slovakia, where the limit for accounting effects is not fixed and thus can be easily adapted to the law in force in another participating company. This date according to Slovak law could be any time before the date of registration of cross-border merger into Business Register.

B. Valuation during cross-border mergers process

By [17] Transaction value – what the company is sold for – is never quite so simple a concept as it might first appear. Determining transaction value often is very complicated, requiring enormous care. In financial services agreements, the language used to define transaction value tends to be very specific, complex and extensive.

Significant differences arise during the implementation of Directive at the issue of valuation of assets and liabilities of companies which are participated in cross-border merger. According to the Czech commercial law the dissolving company is required to leave equity valued by an expert. This valuation is required due to some sort of control to the successor company, which issue new shares to dissolving company in corresponding value. It is a type of assurances. This valuation is not a reason to be recorded into accounts of the successor entity. The Directive obliges in the "common draft term" to provide details of the valuation of assets and liabilities transferred to the successor company resulting from cross-border merger. However, it does not specify method how should be the equity valued. There are two options:

- 1) maintenance of assets and liabilities at their book values or
- 2) revaluation of assets and liabilities at fair value.

The Czech Republic may under certain conditions take over assets in the book values or it must be revalued to fair value. If the following conditions are met, the revaluation to fair value is obligatory:

- assets and liabilities are revaluated at the acquired entity,
- the successor entity will issue new shares for the acquired entity,
- legal form of company is limited (PLC or LTD).

In other cases, the Czech commercial law doesn't allow any revaluation during the cross-border process. There might be a conflict with other countries, in which commercial law requiring the revaluation of assets and liabilities at any time, even if there are no new shares issued.

As an example we can show cross-border merger between the Czech and Bulgarian company. Czech company will cease to exist, but the capital remains in the Czech Republic and the Bulgarian company will be the successor. There are sisters companies owned by one parent company with 100% share. The Bulgarian company is establishing Foreign Entity's Enterprise Branch in the Czech Republic. Bulgarian

commercial law requires revaluation for all companies involved in the merger process. The Czech commercial law doesn't allow revaluation when there are no new shares issued and the company does not increase the Bulgarian equity. According to the Czech Republic law the dissolved company will be changed from the Legal Entity to the Bulgarian Entity's Branch. How to solve this situation? According to the Czech business law the revaluation is not permitted, so a successor entity will have to use book values for Czech final reporting and determine the tax. This entity has to use fair value for reporting to parent company and has to keep two accounts.

This disharmony can be solved by the successor company, which will increase its capital base or issue new shares and thus becomes a revaluation of the dissolved company compulsory for the Czech company according to the Czech business law. The second option is a simplified assumption that the dissolving entity has in its assets only cash, bank account and other assets which don't change its value after revaluation process. Values after revaluation will be the same like before it.

So, another problem which may occur during cross-border merger process with a company situated in the Czech Republic can also be solved. It is necessary to think ahead and adapt the requirements for cross-border merger so that problems with revaluation don't occur.

C. Financial statements during the cross-border mergers

The third disharmony in the implementation of the Directive into the laws of Member States is in the actual process of cross-border merger and preparation of the financial statements. There are two methods of preparation of financial statements in the process of cross-border mergers:

- 1) under the law in the Czech Republic and Germany, which requires at the day preceding "decisive day" to prepare the financial statements of all participating companies and at this date it is necessary to prepare opening balance sheet of the acquiring company,
- 2) for example according to the law in Slovakia, when the financial statement on the day preceding the "decisive day" is prepared only by dissolving company. Successor Company does not close their accounts and takes over the assets and liabilities of the acquired company during its financial year as a normal transaction.

The problem of this disharmony can be solved easily. It is possible to determine the "decisive day" on the 1st January in case that the companies which are participated on the cross-border merger process use calendar year as their accounting period.

D. Reporting of revaluation differences by successor company

I feel it is important to note one more difference in the harmonization which relates to valuation. If the dissolving entity revalued its assets and liabilities, we can find two interpretations, where the revaluation surplus captures:

- in the financial statements of the dissolved company,

which compiled the day before the “decisive day”,

- in the opening balance sheet of the successor entity.

According to the rules applicable in the Czech Republic it is possible the first mentioned method, but for example in Germany, they have to show the revaluation surplus in the opening balance sheet of the successor entity.

On the other side, when we report assets increased by revaluation surpluses, we have to show this revaluation in the liabilities, directly in owner’s equity. Place where we shows sum of surpluses in owner’s equity is called “Gains and losses from revaluation on transformation”.

From this area I have to mention huge problem, which occurs according to Czech and other European law. This problem is based on the Directive, which allows transformation of these gains into other items of owner’s equity.

Czech legislation allows transforming the revaluation differences in accordance with the merger project into other capital funds or into the share capital. Most often the companies use the possibility to report the revaluation differences in opening balance sheet as retained earnings from previous years.

Before I begin to criticize this option it is necessary to realize that the valuation which I am writing about in this paper expresses the unrealized profit. In my opinion it is unacceptable to transfer the unrealized profit to retained earnings from previous years and pay profit shares or dividends. The reason is simple. The unrealized profit is not the company cash-flow and thus the company doesn’t have cash to pay dividends (assuming that the company does not generate cash).

However, there is one option which allows paying dividends and the companies’ managers use it often. This is in a case of possible restructuring of owner’s equity when the company takes the loan to finance the revalued assets. The result of this restructuring is that the company will have money that can be used to pay dividends. Economically it is unacceptable because the bank would provide a loan to the company to pay dividends. The company has not produced the money by its own activities and also the money are not intended for production from which the money should be return back some time. Despite what I mentioned, this procedure is very popular.

The transformation of revaluation differences into retained earnings from previous years has far-reaching consequences. As for these far-reaching consequences we can mention that this transformation changes information in opening balance sheet and shows increased amount of retained earnings from previous years, in which according to my opinion should be only the amount of actually generated profit from previous years, so called realized profit.

Consider a situation in which the successor company will not pay the dividends and after the merger the successor company will report the increased amount by the revaluation differences mentioned above in retained earnings from previous years in the financial accounting statement.

This financial accounting statement may confuse the potential investors which don’t know without any other additional information, that there is also the unrealized profit in the retained earnings from previous years and the potential investors could make wrong decisions from the distorted information found in financial accounting statement.

So the question is how to transform the revaluation differences into the opening balance sheet so it is in accordance with the law. According to the current valid legislation it would be the most ideal possibility to transform the revaluation differences to other capital funds. It is possible that there can appear a disadvantage concerning various rate of taxation. For example sometimes it can happen that the other capital funds are taxed at a rate for legal entity while the retained earnings from the previous years can be taxed at the lower withholding tax rate. Therefore this option is not very popular.

In a case of transforming the revaluation differences to the retained earnings from previous years I think it is necessary to know how much from the amount of retained earnings from previous years the part of revaluation differences is and mention it in notes of financial accounting statement and in notes of opening balance sheet. Because the potential investor may acquire an opinion that the company generated a profit in the past from which the company will be able to pay dividends.

Let’s think about mentioned problems and try to connect it with actual financial crises. We can find more papers about financial crisis and fair value measurement, for example by [18] the concept of fair value has the role to bring us as close as possible to reality, fact that could be realized through a correct implementation and a greater transparency and author also means, the process of fair value determination itself has to be advertised to the investors, to gain their trust, fact required by the actual regulation that solicits a series of supplementary information.

So the question is if the fair value accounting is appropriate for merger process or not. There are some arguments for and against fair value or historical cost valuating. According to Mustata and other authors[20] even under their particular case, the obvious advantage of value relevance information offered by fair value accounting is recognized, but argued that the development of a hybrid accounting system in which historical cost accounting and fair value accounting are used simultaneously distorts the coherency of the reporting system, increases potential income management and “window dressing”, and nullifies the effectiveness of the existing control systems.

IV. REGULATION OF CROSS-BORDER MERGERS BY IFRS

In the year 2002, the European Parliament and the Council of the European Union issued Regulation 1606/2002 whereby it stipulated certain duties on the part of companies listed on European stock exchanges to compile their consolidated

accounting statements in accordance with IFRS. Therefore, beginning from 2005, a large number of listed enterprises, exhibiting significant heterogeneity in size, capital structure, ownership structure and accounting sophistication, started to apply international standards for the first time. The demand for detailed application guidance will increase substantially, as will the demand for uniform financial reporting enforcement throughout the European Union [11, 12].

The proposed single objective of IFRS financial statement – the objective to help present and potential investors in taking decisions on whether to sell, to hold or to buy shares – requires information on the entity's ability to generate future cash flows. [13] points out that in an accounting regime that is based on principles only many individual transactions and events are not explicitly dealt with in any standard. In such cases, management is supposed to select and apply appropriate accounting policies by exercising professional judgment. [2] further note that in a principles-based regime enforcing agencies are only allowed to second-guess management's professional judgment if the selected accounting policies are not in conformity with the high-level principles or if the judgment was not made "in good faith" [6].

In accounting theory the quest for consistency as regards the application of accounting principles is reasoned with the requirement for comparability of financial statements [8]. Some believe that there is another reason, which is of equal importance: Apart from providing decision-useful information, accounting is also frequently used in contracts, e.g. in employment contracts and debt covenants, in order to calculate annual bonuses or to limit future debt levels [15, 16]. They argue that flexibility in the choice of accounting policies increases costs and thus decreases contract efficiency. That is because lenders either price-protect themselves against management's "creative accounting" or they restrict the number of available accounting treatments by using fixed GAAP provisions, which are costly to negotiate and monitor for the lender and costly for the borrower because he needs to prepare an extra set of financial statements for contracting purposes [4, 15] international standards.

The real state of facts is that nowadays European Directives actually incorporate a great deal of the foresights of IFRS which shouldn't therefore be blamed for all the wrongs in the international financial arena. It is also true that the prudence, so highly valued by continentals, seems to have saved some of the damages of the financial crisis in some cases, but prudence itself can be thought of as professional judgment amidst sound accounting principles. The fighting to designate a scapegoat for the actual financial crisis not only wastes valuable time and efforts, but might even raise obstacles for further developments of appropriate solutions[19]. It is necessary briefly characterize regulation of cross-border mergers by IFRS.

The cross-border mergers are regulated in IFRS 3 - Business combinations, which in 2008 and 2009 passed significant amendments. We can use this standard only if it is a cross-

border merger of two independent companies. "IFRS 3 does not apply to the formation of a joint venture, combinations of entities or businesses under common control." Therefore, the most commonly applied cross-border mergers between parent and subsidiary or between subsidiaries; we cannot proceed in accordance with IFRS. The application is possible only to transactions between unrelated parties, which issue new shares or equity. In this process must be an acquirer identified. IFRS 3 define "the date of acquisition" (accounting effects) as the date on which the acquirer obtains control over the assets acquired. It is the same date as the registration of merger in the commercial register by the Czech law. In cross-border mergers of independent companies according to IFRS 3 accounting and legal effect of merger occur at the same day and this date equals to the date of incorporation.

Goodwill is intangible asset which belongs to mergers and acquisitions. It is very broad topic and it is not part of this paper. Reader could find out information about it in many different literature and papers for example [23]. Goodwill pursuant to IFRS 3 should be disclosed only in the event that the goodwill was generated by acquisition [22].

The usability of IFRS 3 during cross-border is minimal. The most of cross-border merger are between related companies for example subsidiaries or parent and subsidiary. If we prepare the merger between independent companies, the process is based on individual financial statements of participated companies. These companies prepare financial statements in according to national law and not according to IFRS. Mandatory individual financial statements under IFRS in the EU are only in Cyprus and Malta. On the other hand, in most countries like the Czech Republic, Germany, Austria, Belgium, France or Spain and Sweden the use of international standards on the level of individual accounts is prohibited.

V. CONCLUSION

The Czech Republic follows the EU regulation. The Directive no. 2005/56/EC was implemented into its national law in effort to allow and simplify process of cross-border mergers. Only after time, we can see consequences of various differences in the implementation of this Directive into Member States.

If any foreign company wants to enter into the process of cross-border merger with the Czech company, it is necessary to study carefully business law of the Czech Republic exactly the Act no. 125/2008 Coll. This paper points to some significant problems that may be for the candidate of merger interesting and complicate the process.

It should be noted that the process of cross-border mergers in the world and EU is not uniform and therefore the effort of the European Commission to allow free movement of capital between countries and eliminate all barriers of cross-border mergers didn't satisfy its aim.

It is necessary to require more stringent regulation of critical aspects of the process of cross-border mergers to prevent situations in which this process is limited, or unrealizable.

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