

DOING  
BUSINESS  
IN

THE  
CZECH  
REPUBLIC



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# *foreword*

This booklet has been prepared for the use of clients, partners and staff of HLB International member firms. It is designed to give some general information to those contemplating doing business in the Czech Republic and is not intended to be a comprehensive document. You should consult us, therefore, before taking further action. PROXY, a.s. and HLB International cannot be held liable for any action or business decision taken on the basis of information in this booklet.

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## WEB CONTACTS

In the Czech Republic it is possible to verify validity of the VAT Number of the VAT tax payer within the EU through the following www pages:

- [www.europa.eu.int/comm/taxation\\_customs/vies/en/](http://www.europa.eu.int/comm/taxation_customs/vies/en/)

Specific www pages exist for verifying and possible free of charge printing extracts from the Business Company Register :

- [www.justice.cz](http://www.justice.cz)

Other suitable www pages within Czech Republic:

- [www.mfcr.cz](http://www.mfcr.cz) (Ministry of Finance)
- [www.kdpr.cz](http://www.kdpr.cz) (Chamber of the Tax Advisers)
- [www.kacr.cz](http://www.kacr.cz) (Chamber of the Auditors)
- [www.mpo.cz](http://www.mpo.cz) (Ministry of Industry and Trade)
- [www.czechinvest.cz](http://www.czechinvest.cz) (Investment and Development Business Agency)

# *about HLB International*

HLB International is a worldwide organisation of professional accounting firms and business advisers, each providing clients with a comprehensive and personal service relating to auditing, taxation, accounting and general and financial management advice.

Formed in 1969, HLB can assist clients to do business in over 100 countries, with more than 1,660 partners and over 10,440 staff in 430 offices.

Up-to-date information and general assistance on international matters can be obtained from any of the partners of PROXY, a.s. listed in this booklet or from the Executive Office in London:

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# general information

## LOCATION AND CLIMATE

The Czech Republic is located in the centre of Europe and has shared borders with Germany, Austria, Poland and the Slovak Republic.

## CONSTITUTION

Following the Velvet Revolution of 1989, Czechoslovakia promoting democracy, changed into a market economy.

The Czechoslovak economic reforms – price liberalization, liberalization of foreign trade, small-scale and large-scale privatization were introduced between 1990-1992.

On 1<sup>st</sup> January 1993, the Czech Republic, with a population of 10,3 million, and the Slovak Republic, with a population of 5,3 million became the successor states of Czechoslovakia.

The Czech Republic is a parliamentary democracy. The parliament consists of two Houses, a House of Representatives and a Senate. The President, elected by Parliament, is a head of the state.

## LEGAL SYSTEM

As of 1989 a new legal system in the Czech Republic has been set up. The legal system is based on written laws. Judges are appointed by the President. Businesses are subject to the commercial law system.

## FACTS AND FIGURES

<b>Area</b>	78.865 sq. km
<b>Population</b>	10,3 million
<b>Capital</b>	Prague
<b>Currency</b>	CZK (1crown=100heller)
<b>Language</b>	Czech
<b>Time</b>	CET (Central European Time)

## BUSINESS HOURS AND PUBLIC HOLIDAYS

8 a.m. – 6 p.m.

Opening hours vary depending on the type of business and locations. Most offices and businesses are closed all day on Sunday. Some major stores are open on Sunday and in the bigger cities there are an increasing number of hypermarkets open around the clock.

Public holidays are: January 1<sup>st</sup>, May 8<sup>th</sup>, July 5<sup>th</sup>, July 6<sup>th</sup>, September 28<sup>th</sup>, October 28<sup>th</sup> and November 17<sup>th</sup>.

Other holidays are: Easter Monday, May 1<sup>st</sup>, December 24<sup>th</sup>, December 25<sup>th</sup> and December 26<sup>th</sup>.

## ECONOMY AND TRADE AGREEMENTS

The Czech Republic is a member of the European Union (1<sup>st</sup> May 2004) and a member of NATO (1999). The Czech Republic is also a member of the General Agreement on Tariffs and Trade (GATT), of the OECD and of the United Nations.

## TAXATION OF FOREIGN CORPORATIONS

- Trading branches are usually taxable on actual profits as is recorded in their double-entry bookkeeping, in the same manner as Czech companies (corporate income tax).
- Non-trading branches of foreign companies may be liable to corporate income tax on anticipated profits. The basis on which anticipated profits are calculated must be negotiated in advance with the local Financial Authority.
- Dividends, interest, royalties and rental payments paid by a Czech subsidiary to a foreign parent are generally subject to withholding tax, except in situations where these payments are exempt under the EU Directives regime.
- Dividends from EU subsidiaries (at least 24 months 20% share of capital. As of 1<sup>st</sup> January 2007 the relevant percentage shall be 15% and as of 1<sup>st</sup> January 2009 it shall be 10%) are tax exempt when received. Dividends received from other entities from the EU and subsidiaries from non-EU countries are subject to 15% tax when received.

## VALUE ADDED TAX (VAT)

VAT in the Czech Republic is a tax on transactions and is essentially a tax on consumption. The final consumer bears the tax on the purchase of goods or services. Due to Czech accession to the European Union, the new VAT Act, effective as of 1<sup>st</sup> May 2004, is a complete rewrite of Czech VAT law.

## REGISTRATION

- VAT registration is mandatory for a person who has a registered seat, place of business, or establishment in the Czech Republic, if their turnover exceeds CZK 1 million in twelve consecutive calendar months.
- A person that has no seat, place of business, or establishment in the Czech Republic is obliged to register for Czech VAT when it conducts its first economic activity in the Czech Republic, subject to some exceptions. In this case there is no

set registration threshold for foreign entities.

- It is also possible to apply for voluntary VAT registration before the threshold is reached.
- VAT is administered by the relevant Financial Authority. Complete and detailed records must be kept for VAT purposes for 10 years after the end of a taxable period.

## TAX RATES

VAT in the Czech Republic is charged at two rates:

- The standard rate of 19 % on the sale of goods and services
- The reduced rate of 5 % on the sale of certain goods such as food products, pharmaceuticals used for health care, nappies, printed books and periodicals etc and certain services such as the land, waterway and air transport of passengers, health care, certain cultural activities etc.

## RECOVERY PROCEDURE

VAT can be recovered by businesses on all goods and services. However there are certain exceptions, when VAT is not deductible (restaurant expenses etc.). Also specific conditions must be met (e.g. deadline date to send application by 30<sup>th</sup> June following year and the minimum amount claimed should exceed CZK 1,000 for the calendar year). Institute of VAT tax representative (tax agent) does not exist from 2005 in the Czech Republic. Representation before Financial Authorities is permitted generally by the Administration of Taxes Act (tax advisers, jurists, on behalf of power of attorney representative).

## INTRASTAT AND EC SALES SYSTEM

With EU accession, a new Intrastat system of collecting intra-Community trade information has been introduced into Czech legislation. The system replaces the customs and VAT statistics on trade with EU member states. The obligation to file Intrastat reports arises on exceeding the stated threshold for arrival (CZK 2 million) or dispatches (CZK 4 million). The EC Sales List is required for all intra-Community sales.

supporting at least one dependent child, would be allowed to use family taxation if certain other conditions are fulfilled.

Czech tax residents are liable to personal income tax on all sources of income, regardless of where it is received.

Tax non-residents are liable to Czech income tax on income arising in the Czech Republic – work, activities through a permanent establishment, business, technical or other consultancy services, dividends, interest, licence fees and rents.

Reference should be made with regard to any relevant Double taxation agreements which may override these rules.

#### ECONOMIC EMPLOYER

An economic employer is a Czech employer that has foreign individuals working for it without a Czech employment contract. Such individuals are typically employed by a foreign company. In such cases, the economic employer is obliged to act as a payroll agent and must transfer the appropriate income tax payments to the Financial Authority.

#### CHAMBER OF TAX ADVISERS OF THE CZECH REPUBLIC

The profession and activities of Tax Advisers in the Czech Republic are governed by the Act No. 523/92 Coll. Only those persons listed on the List of the Chamber of Tax Advisers can be considered as Tax Advisers. The List is a public deed, also published on the Web: [www.kdpcr.cz](http://www.kdpcr.cz).

The Chamber of Tax Advisers of the Czech Republic is a member of the European profession association of Tax Advisers known as the "Confederation Fiscale Européenne".

#### CORPORATE INCOME TAX

Corporate income tax is levied on corporate entities, including joint-stock companies, limited liability companies and limited partnerships.

Taxable profit is based on accounting profit, which is calculated according to Czech accounting laws and practice. However, tax liability is calculated using the taxable profit with adjustments made for certain items (tax losses, tax depreciation etc.)

The corporate income tax rate is 26% in 2005, and this rate is also applies to economic years

that began in 2004 and finished in 2005.

Year	Tax rate
2004	28 %
2005	26 %
2006	24 %

#### CARRYING FORWARD LOSSES

Tax losses incurred in one period prior to the 2004 taxable period may be carried forward and offset against profits made in the following seven tax periods. For losses generated in 2004 and onwards, carry-forward is possible only in the subsequent five years under fulfilment of certain conditions.

#### THIN CAPITALISATION & TRANSFER PRICING

The maximum allowable related party debt-equity ratio is 4:1 (6:1 for banks and insurance companies).

Interest paid on loans in excess of the maximum permitted debt-equity ratios is tax non-deductible and, if paid to foreign creditors, may be re-characterised as a dividend and taxed as such.

A wider definition of associated persons, including sister companies, is introduced effective from 1<sup>st</sup> January 2005. However, these new rules will not apply to interest paid on loans and credits concluded prior to 1<sup>st</sup> January 2004. Related party transactions must take place at usual market prices.

#### LIQUIDATION

Profits arising on liquidation are taxed as corporate income at the normal corporate income tax rate of 26% in 2005. Distribution of liquidation proceeds to shareholders is subject to withholding tax in the same way as dividends. The EU Parent/Subsidiary regime does not apply to liquidation proceeds.

# investment factors

#### SPECIAL FEATURES

There are currently no "tax free" zones in the Czech Republic for the purposes of direct taxation.

Transaction between related parties must take place at market value (anti-avoidance measures). There is no anti-avoidance legislation applicable to subsidiaries operating in low-tax areas.

#### GOVERNMENT INCENTIVES

Investment projects in the Czech Republic may be financed from three main public sources:

##### A) Local investment incentives

The Czech Republic has been offering investment incentives since 1998.

Investment incentives are available to all manufacturing investments with some exceptions (e.g. mining, production and distribution of electricity, gas and water, repairs of motor vehicles and other).

When eligibility criteria and specific conditions are met the following incentives are available:

- Income tax relief over a ten-year period
- Training and retraining grants
- Job creation grants
- Transfer of land in the State's possession at reduced prices

The local investment incentives programme should be closed in 2006.

##### B) Structural Funds, Cohesion Fund

During the first three years (2004-2006), the Czech Republic may utilise 2.63 billion EUR within Structural Funds, the Cohesion Fund and European Community Initiatives.

##### C) EU Central Funds

The EU distributes some funds centrally. Some examples include: Sixth Framework programme for R&D (17.5 billion EUR), Marco Polo for transportation, Life programme for environmental protection etc. Funds for the financing of these programme are not included in B).

#### EXCHANGE CONTROL & SOURCES OF FINANCE

The main purpose of foreign exchange regulation is to protect the state's balance of payments and foreign exchange economy. In spite of the progressing liberalization of the Czech financial markets, there is still CNB (Central Bank) supervision.

The foreign exchange regime was liberalized on the authority of the Foreign Exchange Act No. 219/1995 Coll. and amended versions. There are no monetary restrictions, money can be transferred in and out of the country without any limit. All branches of worldwide major banks and financial institutions operate in the Czech Republic.

# employment regulations

## THE LABOUR CODE

The Labour Code is a key governing mutual relations between employers and employees.

Under the Labour Code, all employers in the Czech Republic are obliged to conclude a written employment contract with their employees. It is mandatory for the employment contract to contain e.g. the type of work, the place where he or she will perform his or her work and the day when the employee will start working. The employment contract usually also covers matters like the gross monthly wage and the length of the probationary period.

In case of doing work within the EU, an employee shall be subjected to the legislation of the member state where the work (job) is performed as regards: the length of working time and rest periods; the length of an annual leave; the minimum wage; work safety and equal treatment.

## WAGES & HOLIDAY

Wages in the Czech Republic are paid in Czech crowns and in cash, unless agreed in the employment contract to the contrary. The minimum monthly wage for 2004 is set by government regulations at CZK 7,185 (EUR 240, USD 294)

Average monthly wage for 1<sup>st</sup> quarter 2005 is at CZK 17,678 (EUR 590, USD 722). The minimum annual leave is four weeks. Supplementary leave of one week is standard with well-established companies.

## WORK PERMITS

All non EU residents must have work permits (pracovní povolení) and resident permits (povolení k pobytu). Certain EU citizens must have resident permits (e.g. statutory representative). Work permits are issued for a minimum period of one year.

## SOCIAL & HEALTH INSURANCE

The statutory social and health insurance premiums payable by employers and employees are very high in the Czech Republic and complicated to calculate. There are differences in health insurance duties calculations between small companies with up to 25 employees (calculated by Social Insurance Authority) and large companies – over 25 employees (calculated by company).

Type of Insurance	Paid by		Total (percentage)
	Employer (%)	Employee (%)	
Social Insurance	26.0	8.0	34.0
Health Insurance	9.0	4.5	13.5
<b>Total</b>	<b>35.0</b>	<b>12.5</b>	<b>47.5</b>

# taxation

## GENERAL

The tax year runs from January 1<sup>st</sup> to December 31<sup>st</sup> as a calendar year or as an "economic year" which shall start on the first day of a month other than January and run for twelve successive months.

The Czech tax system consists of the following types of taxes:

### Direct taxes

- Personal income tax
- Corporate income tax
- Inheritance tax, Gift tax and real estate transfer tax
- Real estate tax
- Road tax

### Indirect taxes

- Value added tax (VAT)
- Excise duty

### Other taxes

Other taxes include stamp duty and withholding tax.

## DOUBLE TAX TREATIES

Czech Republic has signed a number of double tax treaties with more than 60 countries following the OECD model (e.g. Austria, Belgium, Canada, Cyprus, Denmark, Estonia,

Finland, France, Germany, Greece, Hungary, Ireland, Italy, the Netherlands, Poland, the Slovak Republic, Switzerland, the United Kingdom and the United States of America). The purpose of these treaties is the avoidance of double taxation on income earned in those countries.

## TAXATION OF SHAREHOLDERS

Dividends paid by a Czech subsidiary to an the EU parent company are tax exempt provided conditions of the EU Parent/Subsidiary Directive are met. The Directive has been implemented into the Czech legal system. Dividends paid by a Czech company in all other cases are subject to withholding tax.

Royalties (licence fees) arising to a company, which is a tax resident of another EU member state are tax exempt under the EU Licence Directive with legal effect in the Czech Republic as of 1<sup>st</sup> January 2011.

## PERSONAL TAXATION

All individuals who have tax residence in the Czech Republic are subjected to tax on their worldwide income.

The Czech tax residence of foreign individual is determined according to their permanent residence or the length of their stay in the Czech Republic. Individuals are subject to taxation at progressive rates ranging from 15% to 32%.

As of the 2005 taxable period, married couples

Tax base			Tax Payable
over CZK		to CZK	CZK
0	-	109,200	15%
109,200	-	218,400	16,380 + 20% of the excess over 109,200
218,400	-	331,200	38,200 + 25% of the excess over 218,400
331,200		and more	66,420 + 32% of the excess over 331,200

# accounting

1<sup>st</sup> January 2005 represents the main change of the reporting framework to the International Financial Reporting Standards (IFRS) for listed companies.

All companies incorporated in the Czech Republic with listed shares or bonds in any European Union country are required to prepare their financial statements in accordance with the IFRS for financial years commencing on or after 1<sup>st</sup> May 2004.

For companies using the calendar year-end 31<sup>st</sup> December, this is applicable for the year commencing on 1<sup>st</sup> January 2005.

## ACCOUNTING LEGISLATION AND PRINCIPLES

- The framework for accounting in the Czech Republic is given in the Accounting Act. Detailed accounting guidance is given in the Ministry of Finance Provisions on Accounting and Czech Accounting Standards. There are separate accounting rules for businessmen (entrepreneurs), banks, insurance, municipalities, non-profit organization, political parties and other.
- The threshold for compulsory usage of double-entry accounting rules has been increased from CZK 6 million to CZK 15 million (effective from 2005). Sole traders whose turnover is less than this amount are not subject to the Accounting Act and use only a "tax evidence" system.
- Foreign persons (individuals and entities) may engage in business activities in the Czech Republic under the same conditions as Czech persons. But the authorization to set up a business activity within the Czech Republic takes effect from the day of entry in the Commercial Register (Obchodní rejstřík). Such persons must use double-entry accounting rules. This shall not apply to individuals who have a permanent home address in a Member State of the

European Union or in some other state of the European Economic Area

- Companies can adopt a different financial year end, provided they inform the Financial Authority at least three months in advance.
- Financial statements must be drawn up and submitted, together with the income tax return, to the Financial Authority within first three months of the next financial year. This deadline is extended to six months for all companies with compulsory audit or which use the services of a registered tax adviser.

## STATUTORY FINANCIAL STATEMENTS & ANNUAL REPORTS

Under the provision Decree on Accounting, companies with the compulsory statutory audit should prepare a full set of notes to the financial statements. The financial statements and notes must be filed with the Financial Authority as an appendix to the income tax return.

Additionally, all such companies must prepare an annual report, make it publicly accessible and file with the Commercial Register. Since 2001, entities controlled by another party must attach to their annual reports a "Report on relationships with related parties" (prescribe form in section 66a Commercial Code).

These reports are also subject to review by the auditors.

# types of business organizations

## PRINCIPAL FORMS OF BUSINESS

A business company in the Czech Republic is a legal entity formed for the purpose of carrying on a business activity, unless the legislation of the European Communities or the law provides for otherwise.

The term "company" refers in the Czech Republic to:

- Limited liability company (s.r.o.)
- Joint stock company (a.s.)
- Unlimited partnership (v.o.s.)
- Limited partnership (k.s.)
- Societas Europea (evropská společnost)
- European Economic Interest Grouping (EEIG; evropské hospodářské a zájmové sdružení)

There is no mixed legal type of business companies as we can find out within another EU countries. A company is incorporated in the Czech Republic on the day as of which is entered in the Commercial Register.

## LIMITED LIABILITY COMPANY (s.r.o.)

It is a very popular legal form for small- and medium-sized businesses in the Czech Republic.

The company may be formed by one person or more persons (individuals, entities), but the maximum number of its members is 50. Members of the company are liable for the company's obligations (debts) up to the amount of their as yet unpaid investment contributions, as recorded in the Commercial Register.

The registered capital must be no less than CZK 200,000 (EUR 6,600, USD 8,164). The amount of a member's investment contribution may not be less than CZK 20,000. Where a company is formed by one person, it may be

entered in the Commercial Register only when its registered capital has been fully paid up. One or more executive officers („jednatel“) represent the company's statutory body. If there is more than one executive officer, each of them may act independently, unless the deed of association or the statutes provide for otherwise.

The supreme body is the general meeting which shall be convened by the company's executive officers at least once a year. The general meeting which approves ordinary financial statements must be convened no later than six months after the last day of the accounting period.

## JOINT STOCK COMPANY (a.s.)

A joint stock company may be formed by one legal entity, of by two or more individuals and/or entities. Once a shareholder has fully paid up his investment contribution, he or she is not liable for the company's obligations (debts) during its existence.

The minimum amount of registered capital required by the Commercial Code is CZK 2,000,000 (66,600 EUR, USD 81,633).

The Board of directors represent the company's statutory body. The Board of directors is a collective statutory body (minimal three members) deciding all company matters. Unless the statutes provide for otherwise, any member of the board of directors may act in the name of the company. A share may be issued as a registered share (i.e. registered in shareholder's name) or as a bearer share. The transferability of registered shares may be restricted. Bearer shares are transferred without restrictions.

## UNLIMITED PARTNERSHIP (v.o.s.)

An unlimited partnership is an entity in which at least two persons (individual, legal entities) carry on a business activity under a common commercial name and bear joint and several

liability for the obligations (debts) of the partnership with all their property. This differs from the laws of some other countries, which do not regard a partnership as an entity and require a partnership to be formed only by individuals.

The statutory body is formed by all its partners, unless the partnership agreement regulates the statutory body differently.

The minimum amount of registered capital is not given, voluntary formation of the capital is possible. The transferability of the investment contributions is not allowed.

#### LIMITED PARTNERSHIP (k.s.)

It can be also only formed to carry on a business activity or activities.

The partners may be both individuals and legal entities. During its existence a limited partnership must have at least one general partner („komplementář“) and one limited partner („komanditista“).

The general partner is liable for the partnership's debt with all his or her property. Investment contribution is mandatory, its amount cannot be less than CZK 5,000 (EUR 160 , UDS 204) and must be agreed in the partnership agreement.

Only general partners can form the statutory body. The partnership agreement may provide that only some of the general partners will be authorized to act for the partnership.

#### BRANCH OFFICE

A Branch office of a foreign entity comes into being on its entry in the Commercial Register. The recorded name of the manager (head, director) in the Commercial Register, becomes the statutory body for the branch. A branch office within the Czech Republic is not treated as a legal entity. There is a legal obligation to maintain double entry accounting records.

Other legal obligations are similar to those of the companies referred to above.

# audit

Audit in the Czech Republic are regulated by the Act on Auditors, effective from 1<sup>st</sup> January 2001.

Responsibility for regulation of the auditing profession in the Czech Republic has been delegated to the Chamber of Auditors.

The Chamber of Auditors has moved to compulsory adoption of International Standards on Auditing (ISA) since 2005.

The accounting Act regulates the obligation to have annual financial statements audited by a statutory auditor as follows:

#### A) joint stock companies

That have exceeded at least one of the following criteria for the current and previous periods:

- turnover of CZK 80 million (EUR 2.7 million USD 3.3 million)
- total assets (gross-without adjustments for depreciation and impairment) of CZK 40 million (EUR 1.33 million , USD 1.63 million)
- average number of employees of 50

This is a new rule applicable to accounting periods commencing on or after 1<sup>st</sup> January 2004. Until 2003, all joint stock companies were subject to a compulsory statutory audit.

#### B) all banks and regulated financial institutions

#### C) foundations and certain other non-profit organizations

#### D) other businesses

that have, for the current and previous periods, met or exceeded at least two of the three criteria stated in letter a) above.

All consolidated financial statements and

annual reports that include audited financial statements must also be audited.

#### CONSOLIDATION

Companies in the Czech Republic must prepare consolidated financial statement if their group has met or exceeded at least two of the following criteria:

- turnover of CZK 700 million (EUR 23.3 million , USD 28.6 million)
- total assets (gross) of CZK 350 million (11.7 million , UDS 14.3 million)
- average number of employees of 250 (until 2003 - 500 employees)

All companies with listed shares or bonds within EU have to use IFRS for their consolidated financial statements.