



dReport: April 2018

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Amendments to IFRS 2 endorsed for use in the EU

On 26 February 2018, Amendments to IFRS 2 Classification and Measurement of Share-based Payment Transactions were endorsed by the European Commission for use in the European Union. The EU effective date is the same as the IASB's effective date (annual periods beginning on or after 1 January 2018).

Amendments to IFRS 2 Share-based Payment that clarify the classification and measurement of share-based payment transactions were issued by the IASB in June 2016.

The amendments to IFRS 2 contain the following clarifications and amendments:

- The accounting for cash-settled share-based payment transactions that include a performance condition;
- The classification of share-based payment transactions with net settlement features;
- The accounting for modifications of share-based payment transactions from cash-settled to equity-settled.

More information about Amendments to IFRS 2 can be found in our [Accounting Newsletter from September 2016](#). The full version of the Amendments is available [here](#).

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Amendments to IAS 40 endorsed for use in the EU

On 14 March 2018, Amendments to IAS 40 *Transfers of Investment Property* were endorsed by the European Commission for use in the European Union. The EU effective date is the same as the IASB's effective date (annual periods beginning on or after 1 January 2018).

The Amendments to IAS 40 were issued by the IASB in December 2016 to clarify transfers of property to, or from, investment property.

The amendments newly state that an entity shall transfer property to, or from, investment property when, and only when, there is evidence of a change in use. A change of use occurs if property meets, or ceases to meet, the definition of investment property. A change in the management's intentions for the use of property by itself does not constitute evidence of a change in use.

Examples of evidence of a change in use include:

- a. commencement of owner-occupation, or of development with a view to owner-occupation;
- b. commencement of development with a view to sale;
- c. end of owner-occupation;
- d. inception of an operating lease to another party.

An entity applies the amendments to changes in use that occur on or after the beginning of the annual reporting period in which the entity first applies the amendments. Retrospective application is also permitted if that is possible without the use of hindsight.

More information about Amendments to IAS 40 can be found in our [Accounting Newsletter from January 2017](#). The full version of the Amendments is available [here](#).

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IFRS EU Endorsement Process

The European Financial Reporting Advisory Group (EFRAG) updated its report showing the status of endorsement of each IFRS, including standards, interpretations, and amendments, most recently on 15 March 2018.

As of 25 March 2018, the following IASB pronouncements are awaiting European Commission endorsement for use in the EU:

Standards

- IFRS 14 *Regulatory Deferral Accounts*

(issued in January 2014) - the European Commission has decided not to launch the endorsement process of this interim standard and to wait for the final standard

- IFRS 17 *Insurance contracts* (issued in May 2017)

Amendments

- Amendments to IFRS 9 *Prepayment Features with Negative Compensation* (issued in October 2017)
- Amendments to IFRS 10 and IAS 28 *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* (issued in September 2014)



- Amendments to IAS 19 *Plan Amendment, Curtailment or Settlement* (issued in February 2018)
- Amendments to IAS 28 *Long-term Interests in Associates and Joint Ventures* (issued in October 2017)
- *Annual Improvements to IFRS Standards 2015–2017 Cycle* (issued in December 2017)

Interpretation

- IFRIC 22 *Foreign Currency Transactions and Advance Consideration* (issued in December 2016)
- IFRIC 23 *Uncertainty over Income Tax Treatments* (issued in June 2017)

Click here for the [Endorsement Status Report](#)

US GAAP

Roadmap on non-GAAP measures issued by the CAQ

Are you preparing an annual report and hesitating if the non-GAAP information to be included is presented and calculated meaningfully?

The CAQ has issued a new publication advising on how to best handle the process preparation and approvals of the non-GAAP measures for US public companies and their audit committees. The general principles may, however, be found relevant and meaningful to any public company.

While the GAAP information provides a reliable basis for investors and other readers of the financial statements in respect to the company's performance, the non-GAAP financial measures are also becoming more and more important and valuable to the users.

Examples of such non-GAAP financial information may be:

- EBITDA,
- adjusted operating income,
- adjusted EPS,
- FFO (Funds from Operations) used in real estate industry and many others.

For the US public companies the non-GAAP measures are defined by the SEC (US Securities and Exchange Commission).

Published non-GAAP measures are key to users if prepared in a balanced and comparable way.

The Center for Audit Quality (CAQ) which is an autonomous, nonprofit public policy advocacy organization based in Washington, DC affiliated with the American Institute of CPAs, issued a Roadmap for Audit Committees in the area

of non-GAAP measures in order to provide audit committees with suggestions, considerations and best practices to follow when assessing the non-GAAP information to be disclosed in order to get a balanced picture of the company.

The Roadmap can be found on the CAQ's webpage [here](#).

Key considerations pointed out by the CAQ are among others:

- Suggest to try:
 - "Putting itself in the investor's shoes.."
 - "Asking management whether it has an internal policy ..."
 - "Discussing with management how the company makes changes to non-GAAP measures it presents...."
 - "Asking the company to compare or benchmark to the peers"
 - "Finding out what disclosure controls... Are in place..."
 - "Consulting with external auditors on their responsibilities in the area, on their prospective and their views of the company's performance if consistent with the auditor's understanding and knowledge of the company".

Companies may as well consider involving external advisors and auditors to support them when implementing processes and policies related to preparation and review of non-GAAP measures.

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Categorisation of Reporting Entities

Two Years Later

The extensive amendment to Act No. 563/1991 Coll., on Accounting, as amended (the "Accounting Act"), has introduced "categorisation of reporting entities", effective since 1 January 2016.

A more detailed classification should allow for more appropriate adjustment of obligations in the reporting and presentation of accounting information. Micro entities continue to be "protected" by the EU Directive and Member States are not allowed to increase the entities' administrative obligations. On the contrary, this does not apply to large entities from which a Member State may require, in justified cases, more information, more extensive reporting etc. Legislation defines minimum requirements for information to be disclosed in notes to the financial statements for various categories; however, it is at an entity's discretion to disclose more information than the required minimum.

Categorisation also relates to the statutory audit of financial statements.

Since **1 January 2016**, new criteria have been applied to categorise reporting entities, whereby two criteria out of three have to be met in order to classify an entity within a category:

Reporting entity	Total assets (net)	Total annual turnover	Average headcount
Micro	Up to 9 million	Up to 18 million	Up to 10
Small	Up to 100 million	Up to 200 million	Up to 50
Medium-sized	Up to 500 million	Up to 1 billion	Up to 250
Large	Over 500 million	Over 1 billion	Over 250

Two years after the implementation of the Act, it has become relatively clear that the legislator required assets to be assessed using their net values. Let me just remind you that the definition of turnover is hidden at the very end of Appendices 2 and 3 to Regulation No. 500/2002 Coll., providing implementation guidance on certain provisions of the Accounting Act, as amended, for entities that are businesses maintaining double-entry accounting records ("Regulation"). The turnover is defined as the sum of Sales of goods + Sales of services + Other operating income + Income from non-current financial assets + Income from other non-current financial assets + Interest income + Other financial income.

In practice, however, we are often asked how to classify a specific reporting entity appropriately and when to change its category.

Section 1e of the Act stipulates that if a reporting entity

exceeds or ceases to exceed two limit values under Sections 1b and 1c as of two subsequent balance sheet days of regular financial statements the reporting entity changes the category under which the scope and method of preparation of the financial statements is defined starting from the beginning of the immediately following reporting period.

The frequent source of incorrect classification or a premature change of the reporting entity's category is the inconspicuous interim provision of the Act stipulating how reporting entities are arranged on the starting line after the adoption of the amended Act and from which date the reporting periods are counted.

In the reporting period started in 2016, a reporting entity follows the legal regulations for a category of reporting entities and a category of groups of reporting entities the conditions of which were met as of the balance sheet date immediately preceding the reporting period.

This means that in the first year of the amendment application (ie in 2016), the requirements as of 31 December 2015 were applied and the reporting entity was categorised accordingly. **The first classification is not included in the calculation of the "number of limit value excesses".**

Example 1

	Total assets (net)	Total turnover	Number of employees	Reporting entity category
31 Dec 2015	300 000 000	17 000 000	12	Small
31 Dec 2016	455 600 000	240 000 000	20	Small (Medium-sized)
31 Dec 2017	460 000 000	250 000 000	49	Small (Medium-sized)
31 Dec 2018				Medium-sized

At the start (as of 1 January 2016), the reporting entity is classified as a "small" entity according to the results as of 31 December 2015. This first classification is not included in the number of periods in which the excess of limit values is monitored.

Even though the entity was doing well in the following two years and exceeded two limit values (assets and turnover) to be reclassified as "medium-sized" as of two subsequent balance sheet days, it continues to report as a small entity in 2016 and 2017. Only after exceeding two out of the three limit values in two subsequent years it starts reporting under another category, in our example as a medium-sized entity. This consideration is not complex and most people reading the Act carefully enough will have no problem to apply it correctly.



Let us give you a more complicated example:

Example 2

	Total assets (net)	Total turnover	Number of employees	Reporting entity category
31 Dec 2015	500 000 000	12 000 000	18	Small
31 Dec 2016	800 000 000	650 000 000	137	Small (medium-sized)
31 Dec 2017	950 000 000	2 150 000 000	260	Small (large)
31 Dec 2018				Medium-sized

In this example, the reporting entity has grown rapidly. At the start, it was classified as “small” according to its results in 2015 and continued to report as “small” in 2016 and 2017. As of the first tested balance sheet date on 31 December 2016, it exceeded two out of the three categories to become a “medium-sized” entity. As of the second balance sheet date on 31 December 2017, it even achieved the values attributable to the “large” category. It is obvious in this case that the reporting entity has to change its category in 2018; the question may be what classification is appropriate – is it a medium-sized or a large entity? The reporting entity exceeded two limit values for the “medium-sized” category as of two subsequent balance sheet dates of regular financial statements and the values for the “large” category as of the latter balance sheet date. In applying Section 1e of the Act, we have to come to the conclusion that the reporting entity exceeded limit values for the “medium-sized” category as of two balance sheet dates (for the “large” category only once) and thus in the 2018 reporting period it will report as a “medium-sized” entity.

In conclusion, there is the most interesting example:

Example 3

A small entity merges by amalgamation with a large entity. The small entity is the successor. If we strictly applied

the letter of the law we would come to the following conclusion:

- No establishment or start of activities under Section 1e occurred, ie the category of the reporting entity is not estimated and the original category of a “small” entity continues to apply.
- Two limit values were not exceeded under Sections 1b and 1c as of two subsequent balance sheet dates of regular financial statements, ie the category of the reporting entity will not be changed for two years.

The large entity that merged by amalgamation with the small entity thus becomes small with all of the advantages for financial statements presentation and other reporting.

We believe that such treatment would violate the correctness principle that prevents avoiding the purpose of the law. Section 8 (2) of the Act stipulates that accounting books are considered correct if maintained by the reporting entity in compliance with and without avoiding the purpose of the Act and other legal regulations. It is contrary to this principle if in fact a large entity takes advantages of small entity reporting through a formal transaction.

As stated at the beginning, the purpose of reporting entity categorisation is to determine the corresponding related obligations contained in other sections of the Act, or legal regulations directly relating to accounting, such as the Act on Auditors. Meeting relevant obligations is assumed by law starting from the establishment of an entity, or from the date on which the entity starts its activities. If the obligations are applicable to newly established entities or entities starting their activities the more they apply to entities that undergo transformations.

Although there is no doubt that the approach to similar transactions will be adjusted in practice over time we recommend changing the category in similar situations depending on the evidence available after the transformation in the financial statements for previous periods, taking into account the “substance over form” principle and in our example, we would change the category to “large”.

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