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dReport: October 2018

Check out our regular Accounting news newsletter.

Contents

Equity in the annual financial statements

In today's article, we will focus on equity and selected aspects of its review in the annual financial statements prepared under Czech accounting legislation.

Entities with their reporting periods being calendar years slowly start planning the preparation of their annual financial statements. Preparation of the financial statements includes namely the planning of asset and liability counts, closing operations, such as calculations of deferred or due income tax or a reserve for the tax, recognition of estimated balances and accruals and deferrals, a review of entity classification as part of the reporting entity categorisation rules and other activities.

Is an inventory count of equity necessary?

The Accounting Act does not explicitly require equity to be counted. The reason for "omitting" equity in the list of items that are subject to inventory taking is the fact that the amount of equity results from the difference between assets and liabilities. If assets and liabilities that are subject to inventory taking pursuant to the Act are duly reviewed and any inventory differences are duly accounted for, the value of equity should be reported correctly as far as its amount is concerned.

Fortunately, entities and their management often review equity in terms of its structure rather than being satisfied just with the above indirect review of its amount. The review is based on the entity's key documents, resolutions of the entity's top bodies (the general meeting, the Board of Directors), the company's decisions, records in the Register of Companies, company transformation projects, documents on fair value measurement, donation contracts, etc.

Registered share capital

When reviewing the registered share capital, its increase or decrease, if any, is examined. A record to the Register of Companies is crucial in accounting for the increase or decrease on the account of the share capital. Before the record in the Register of Companies, group account 41 – Changes in share capital is provisionally used.

In verifying the share capital item, attention should be paid to receivables for subscribed capital. Business corporations such as limited liability companies must pay in the subscribed capital within the deadline agreed in the Memorandum of Association, no later than within five years from the establishment of the company or from the assumption of the contribution obligation during the company's existence. In business corporations such as joint-stock companies, the establishment of the company is effective if all founders pay the share premium that may arise and in aggregate, at least 30% of the nominal or net book value of subscribed shares within the period stipulated in the Articles of Association, no later than on the date on which a motion to make a record in the Register of Companies is made. A shareholder is obliged to pay up the issue rate of the shares subscribed by it within the period stipulated in the Articles of Association or in a decision of the general meeting on the increase of the share capital, no later than within one year from the date of the company's formation or from the effective date of the increase in the share capital.

Closing activities should include a review to determine whether the entity creates a reserve or other funds under the Memorandum of Association or the Articles of Association, or based on a decision of the general meeting.

Distribution of profit of a limited liability company

Pursuant to Section 161 of the Business Corporations Act, the amount of profit to be distributed to partners should not exceed the amount of profit of the most-recent completed reporting period increased by retained earnings brought forward and reduced by the loss of prior periods and contributions to the reserve and other funds in line with the Business Corporations Act and the Memorandum of Association.

Pursuant to Section 181 of the Business Corporations Act, the general meeting discusses financial statements no later than six months from the last day of the prior reporting period.

Distribution of profit of a joint-stock company

Pursuant to Section 350 of the Business Corporations Act, a joint-stock company shall not distribute profit or any other internal funds to shareholders if at the date of completion of the most-recent reporting period the company's equity resulting from the regular or extraordinary financial statements or the share capital after the distribution falls below the level of the subscribed share capital increased by the funds that may not be distributed to shareholders pursuant to the Act or the Articles of Association.

Pursuant to Section 403 of the Business Corporations Act, the general meeting will discuss the financial statements no later than within 6 months from the latest date of the previous reporting period.

Reporting profit or loss for the previous reporting period as of the balance sheet date

As of the balance sheet date, Account 431 Profit or loss reported at the end of the previous reporting period in item "A.V. Profit or loss for the current period" should be settled. In the current period, the general meeting should decide on the treatment of the profit or loss generated or incurred, as appropriate, in the prior period. If the general meeting fails to make a decision, the next steps are defined by Czech Accounting Standard No. 018 Capital accounts and long-term liabilities, Section 3.1.11. There should be no balance on this account when the books are closed. If no decision is made on the use of the profit or loss, the balance of this account is credited (in case of profit) or debited (in case of loss) to the relevant account of accounting group 42 – Funds from profit and transferred profit or loss disclosed in item "A.IV.1. Accumulated profit or accumulated loss brought forward (+/-)".

This provision is practical for reporting entities; however, it may be in conflict with the general meeting's responsibility in connection with the approval of the financial statements and profit distribution or the settlement of loss. This is the last recourse, the natural situation is for the general meeting or the sole owner or shareholder to make the decision during the reporting period. At the same time, an error may occur if a sufficient amount of funds from profit is not created (pursuant to the Articles of Association or Memorandum of Association) to settle the loss or in respect of holding treasury shares.

Bankruptcy

In the end, it should be reviewed that the circumstances specified in Section 182 of the Business Corporations Act did not materialise. According to the provision, a statutory executive is obliged to call a general meeting as soon as he/she learns that the company is at risk of bankruptcy or if the goal pursued by the company is at risk and shall propose to the general meeting to adopt another appropriate measure or liquidate the company in the last resort.

Pursuant to Section 403 of the Business Corporations Act, the Board of Directors will call a general meeting if it learns that the amount of the company's total loss based on the financial statements is so high that if paid from the company's available funds the accumulated loss would amount to half of the share capital, or such a situation may be expected with respect to all circumstances, and shall propose an appropriate measure or the company's liquidation in the last resort.

If the reporting entity reports a deficit on its equity it should be considered whether it is not bankrupt pursuant to the Insolvency Act. If the entity is bankrupt, it should file an insolvency motion.

Conclusion

The above specified shows that although the Accounting Act does not explicitly require equity counting it makes sense, namely for the company's management, to pay attention to the item. Financial statements provide sufficient support to make a detailed analysis.

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Invitation to a Seminar

News in Czech Accounting

Prague, Brno, Ostrava, Pilsen and Hradec Kralove

We would like to invite you to Deloitte's traditional autumn seminar focusing on the possible obstacles in preparing financial statements. The seminar will comprise practical examples and tips in the areas where, as advisors and auditors, we come across the most findings. Furthermore, we will discuss the changes to the Czech Accounting Legislation effective as of 1 January 2018. The programme will also include new tax developments and their impact on companies' financial statements.

The seminar is predominantly intended for accountants, economists and financial managers preparing or involved in the preparation of financial statements under Czech accounting legislation and the related tax and legal regulations, and for all of you who want to learn more about Czech accounting and the most recent tax and legal developments.

The seminar is not intended for the employees of companies engaged in accounting advisory.

Seminars will be held in Czech in November and December in Prague, Brno, Ostrava, Pilsen and Hradec Kralove and will be delivered by our professionals.

Dates

Prague:	14 November 2018 and 11 December 2018
Brno:	27 November 2018
Ostrava:	28 November 2018
Pilsen:	5 December 2017
Hradec Kralove:	28 November 2018

More information on:
www.akce.deloitte.cz

Everything You Wanted to Know about IFRS 15 but Were (Not) Afraid to Ask – Part 4

IFRS 15 *Revenue from Contracts with Customers* became effective on 1 January 2018. As the new standard introduces significant changes in revenue recognition in comparison with the existing regulation, we would like to resume our series of articles focusing on IFRS 15 in greater detail.

Our Accounting News of May 2017 discussed the issues relating to the sequence of revenue steps and the application of the portfolio approach.

In September 2017, the Accounting News elaborated on the requirements of IFRS 15 relating to the identification of contracts with customers.

In our Accounting News of September 2018 we looked into the transition provisions of IFRS 15.

By way of a reminder, please note that detailed articles focusing on IFRS 15 were also published in the Accounting News of July 2014, October 2014 and December 2016.

In this issue we will look into the rather problematic Step 2 of the five-step model because proper identification of the performance obligations in a contract is critical to achieving the core principle in IFRS 15.

Step 2 – Identification of performance obligations

Once an entity has established that it has a contract to which the five-step model can be applied, the next step is to assess whether there are goods or services promised in the contract that represent separate performance obligations. This process is sometimes referred to as 'unbundling'. According to IFRS 15.22, a separate performance obligation can be either:

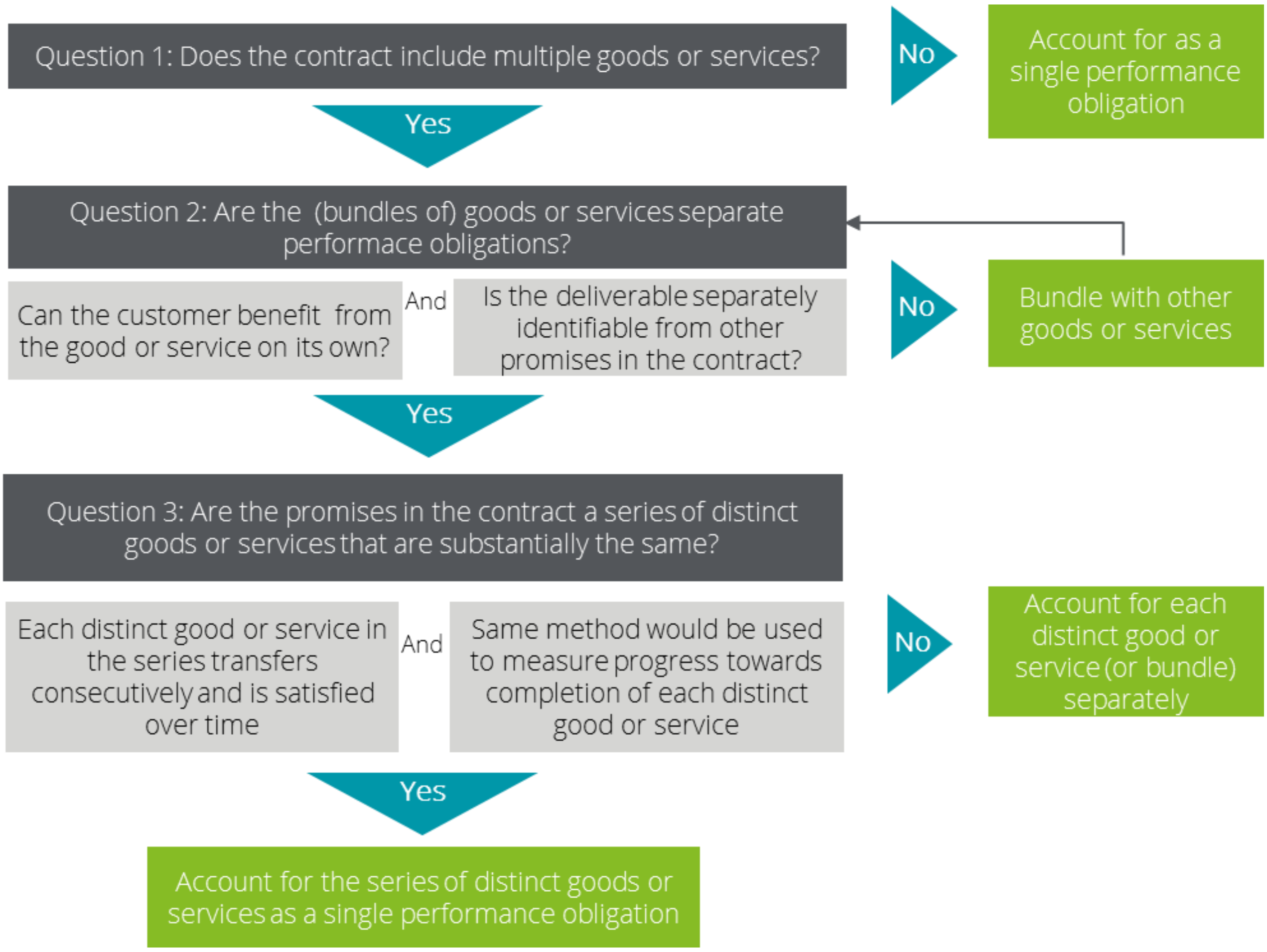
a. a good or service (or a bundle of goods or services) that is 'distinct'; or
b. a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

> Note:
> Term 'distinct goods and service' is in detail discussed in sections 26 – 30 of IFRS 15:d
>
> *"A good or service that is promised to a customer is distinct if both of the following criteria are met:*
> *a. the customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer (ie the good or service is capable of being distinct); and*
> *b. the entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract (ie the promise to transfer the good or service is distinct within the context of the contract)."*

IFRS 15.23 specifies the criteria that must be met for an entity to conclude that a series of distinct goods or services have the same pattern of transfer to the customer - both of the following criteria should be met:

a. "each distinct good or service in the series that the entity promises to transfer to the customer meets the criteria in IFRS 15.35 to be a performance obligation satisfied over time; and
b. in accordance with IFRS 15.39 and 40, the same method would be used to measure the entity's progress towards complete satisfaction of the performance obligation to transfer each distinct good or service in the series to the customer."

The following diagram sets out the key questions to be assessed by entities to identify whether there are separate performance obligations.



Question 1

Is unbundling optional?

Answer

No. Proper identification of the performance obligations in a contract is a critical aspect of the Standard's core principle, which is to "recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services". Failure to identify and account for the separate performance obligations in a contract could result in the incorrect timing of revenue recognition.

As a practical matter, it may not be necessary to apply the Standard's detailed requirements on unbundling if the amounts recognised and disclosed in the financial statements will be the same irrespective of whether unbundling is applied. For example, when control of two or more goods or two or more services is transferred at exactly the same time, or on the same basis over the same period of time, and if those items do not need to be segregated for disclosure purposes, then it will not be necessary to unbundle each of those concurrently delivered items because the amount and timing of revenue recognised and disclosed under the model would not differ if the items were unbundled. For example, imagine the situation when a company sells during one order and delivery skirt and trousers through its e-shop. Although there are two distinct goods, it is not necessary to unbundle these items because revenue for both items will be recognised at exactly the same time.

Question 2

If an entity concludes that a series of distinct goods or services meet the requirements of IFRS 15.22(b), is it required to treat that series as a single performance obligation or may it choose to regard the distinct goods or services in the series as individual performance obligations?

Answer

An entity that reaches this conclusion is required to account for the series of goods or services as a single performance obligation. IFRS 15.BC113 clarifies the boards' intent to mandate the use of this simplification, which enables the entity providing the same good or service consecutively over a period of time (e.g. A repetitive cleaning service) to account for a single performance obligation instead of each hour of cleaning. IASB states that they "decided to specify that a promise to transfer a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer would be a single performance obligation if two criteria are met".

Question 3

For an entity to determine that the series requirement in IFRS 15.22(b) is met and, specifically, that goods or services have the "same pattern of transfer to the customer", must the goods or services be transferred consecutively?

Answer

No. The series requirement is intended to simplify the application of the revenue model in IFRS 15 and to promote consistency in the identification of performance obligations. Neither of the criteria in IFRS 15.23 refers to the consecutive transfer of goods or services to the customer and, therefore, the applicability of IFRS 15.22(b) does not depend on whether the goods (services) will be delivered (performed) consecutively.

For example, an entity might enter into a contract to provide the same package of cleaning services each consecutive week for 52 weeks. Alternatively, the cleaning contract might envisage that some services are not provided in certain weeks but are provided in other weeks on an overlapping basis whereby cleaning begins before the previous week's work has been completed. Both of the criteria in IFRS 15.23 could be met in each of the cleaning contract examples.

Question 4

For distinct goods or services to be considered substantially the same, and therefore accounted for as a series under IFRS 15.22(b), do the tasks in each increment of service need to be substantially the same?

Answer

No, it is not necessary for the tasks in each increment of service to be substantially the same.

The evaluation of whether distinct goods or services are substantially the same requires significant judgement based on the relevant facts and circumstances of the contract.

An entity should first determine the nature of the promised goods or services to be provided under the contract by evaluating whether the nature of the arrangement is to provide the customer with a specified quantity of distinct goods or services or to stand ready to provide an undefined quantity of goods or services over the duration of the contract period.

If the nature of the promise is the delivery of a specified quantity of a service, then the evaluation should consider whether each service is distinct and substantially the same. If the nature of the entity's promise is the act of standing ready or providing a single service for a period of time (because there is an unspecified quantity to be delivered), the evaluation would focus on whether each time increment is distinct and substantially the same, rather than the underlying activities.

Examples below illustrate different circumstances in which an entity determines that a series of distinct goods or services are substantially the same.

Example 1 - Series of distinct goods or services that are substantially the same – specified quantity of distinct goods or services

Company ALFA provides Customer Z with monthly payroll processing services for one year and concludes that each monthly service (1) is distinct, (2) meets the criteria for recognising revenue over time, and (3) has the same method for measuring progress. In addition, it is concluded that the arrangement is to provide the customer with a specified quantity of distinct goods or services (i.e. 12 distinct instances of monthly payroll processing).

Having determined that it is to provide 12 distinct services, ALFA determines that even though the exact volume of employee payroll data processed may vary each month, the benefit consumed by the customer (i.e. The processing of payroll for that month) is substantially the same for each monthly transaction.

Therefore, ALFA concludes that the monthly payroll services are substantially the same and satisfy the requirements of IFRS 15.22(b) to be accounted for as a single performance obligation.

Example 2 - Series of distinct goods or services that are substantially the same – undefined services over the contract period (hotel management services)

Company BETA provides hotel management services to Customer Y that include hiring and managing employees, procuring goods and services, and advertising and marketing the hotel. On a given day, BETA could clean guest rooms, perform marketing efforts to increase occupancy, and operate the concierge desk.

BETA concludes that the nature of the contract is to provide integrated hotel management services over the term of the contract and not a specific quantity of specified services (i.e. it is not specified that 100 guest rooms must be cleaned per day). The underlying activities in providing the hotel management services can vary significantly from day to day; however, the daily services are activities that are required to satisfy BETA's obligation to provide an integrated hotel management service. Therefore, the integrated service of hotel management transferred to the customer is substantially the same during each period because Customer Y receives substantially the same benefit each period (i.e. there is the same pattern of transfer to the customer).

BETA concludes that each increment of service (i.e. day or week) is distinct, meets the criteria for recognising revenue over time, and has the same method for measuring progress and, therefore, that the hotel management services satisfy the criteria in IFRS 15.22(b) to be accounted for as a single performance obligation.

Example 3 - Series of distinct goods or services that are substantially the same – undefined services over the contract period (IT outsourcing services)

Company DELTA provides information technology (IT) outsourcing services to Customer X for a five-year period. The IT outsourcing services include providing Customer X with server capacity, maintenance of the customer's software portfolio, and access to an IT help desk.

DELTA considers the nature of the promise to Customer X and concludes that it is to provide continuous access to an integrated outsourced IT solution and not to provide a specified quantity of services (e.g. processing 100 transactions per day). The underlying activities in providing IT outsourcing services can vary significantly day to day; however, the daily services are activities performed to fulfil DELTA's integrated IT outsourcing service and are, therefore, substantially the same.

DELTA concludes that, for each period, (1) it is providing an integrated IT outsourcing service; (2) the customer is continuously receiving substantially the same benefit, which is distinct (i.e. there is the same pattern of transfer to the customer); and (3) each increment of time is substantially the same (i.e. The same integrated IT outsourcing solution is provided in each time period).

DELTA concludes that each distinct increment of time meets the criteria for recognising revenue over time and has the same method of measuring progress. Therefore, DELTA concludes that the IT outsourcing services satisfy the criteria in IFRS 15.22(b) to be accounted for as a single performance obligation.

Source: Deloitte's guide to IFRS 15
www.iasplus.com

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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 12 September 2018.

As of 25 September 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 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)
- *Amendments to References to the Conceptual Framework in IFRS Standards* (issued in March 2018)

Interpretation

- IFRIC 23 *Uncertainty over Income Tax Treatments* (issued in June 2017)

Click here for the Endorsement Status Report

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Invitation to Autumn Seminars

IFRS News 2018

We would like to invite you to Deloitte's autumn webcast on International Financial Reporting Standards (IFRS).

From the comfort of your office, you will gain a full and lightning-quick overview of new and amended standards. We will give you a short summary of the nature of changes to enable you to identify whether the changes affect your company. You will also learn how much time is left for their potential implementation.

In the webcast, you will have an opportunity to ask questions.

This on-line seminar will not cover in detail the new IFRS 9 *Financial Instruments*, IFRS 15 *Revenue from Contracts with Customers*, and IFRS 16 *Leases*, which will be the topics of specialised seminars organised in the autumn.

The webcast is predominantly intended for accountants, economists and financial managers working on projects relating to IFRS and for all who want to know more about IFRS.

The webcast will be held in the Czech language and will be delivered by our professionals.

Date

- 16 October 2018 from 10 to 11 a.m.

More information is available at: www.akce.deloitte.cz

IFRS 16 for Advanced Users

We would like to invite you to Deloitte's autumn seminar on International Financial Reporting Standards, this time dedicated to new IFRS 16 *Leases*. IFRS 16 replaces IAS 17 *Leases* and the related interpretations and will be effective for the reporting periods starting on 1 January 2019. The new standard introduces major changes in terms of lessees as operating leases will newly be recognised in the balance sheet.

We will follow up on our seminar *IFRS 16 – the New Leases* Standard, which was held last December and this May. This time, we will place a greater focus on the problematic areas that will require a greater degree of judgement in applying the new standard. More detailed attention will also be given to the different expedients that may be used during the transition to the new standard.

You will learn how to prepare for the implementation of the standard and what new disclosures will need to be made in the notes.

We will be happy to answer any of your questions, for which there will be sufficient time.

The seminar is predominantly intended for accountants, economists and financial managers of projects relating to IFRS and for all who want to know more about IFRS.

The seminar will be held in Prague in the Czech language and will be delivered by our professionals.

Date

- Prague: 6 November 2018

More information is available at: www.akce.deloitte.cz

Most Frequent Errors in Financial Statements Prepared under IFRS

We would like to invite you to Deloitte's autumn seminar on International Financial Reporting Standards (IFRS), this time dedicated to the errors that we most frequently encounter in auditing the annual accounts of our clients and that often recur in the financial statements. We will also focus on missing disclosures in the notes.

In addition, we will provide you with an overview of the standards and interpretations effective for reporting periods starting on or after 1 January 2018. We will address how the implementation of the new standards IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers* should be reflected in the financial statements for the year ended 31 December 2018.

We will also present the possible approaches to the transition to IFRS 16 *Leases*, which will become effective on 1 January 2019.

We will be happy to answer any of your questions, for which there will be sufficient time.

The seminar is predominantly intended for accountants, economists and financial managers of projects relating to IFRS and for all who want to know more about IFRS.

The seminar will be held in Prague in the Czech language and will be delivered by our professionals.

Date

- Prague: 21 November 2018

More information is available at: www.akce.deloitte.cz

Deloitte's new publications on US GAAP

We are proud to share with you updates on new publications issued by Deloitte covering various accounting and presentation areas of US GAAP.

As you may have noticed, Deloitte is very active in publishing numerous publications covering various areas of US GAAP. We informed about publications issued in 2017 in our Accounting News of December 2017. During 2018 there have been several new publications published and are now available here.

The series of the Roadmaps publications from 2018 now offers to readers the following topics:

- A Roadmap to Consolidation — Identifying a Controlling Financial Interest (2018);
- A Roadmap to Distinguishing Liabilities From Equity (2018);
- A Roadmap to Initial Public Offerings;
- A Roadmap to Segment Reporting (2018);
- A Roadmap to the Preparation of the Statement of Cash Flows (2018);
- A Roadmap to SEC Reporting Considerations for Business Combinations;
- A Roadmap to Accounting for Environmental Obligations and Asset Retirement Obligations (2018);
- A Roadmap to SEC Reporting Considerations for Equity Method Investees;
- A Roadmap to Applying the New Leasing Standard (2018);
- A Roadmap to Accounting and Financial Reporting for Carve-Out Transactions (2018); and
- A roadmap to accounting for income taxes (2017).

In case you look for any of the topics listed above, you will certainly find our publication useful as it contains references to the codification, various examples as well as an executive summary of individual sections.

While the publications are not intended to supplement the judgements and assumptions made by the company, neither are they intended to supplement consultations of Deloitte's specialists on specific and complex matters, they may certainly support you in your accounting and reporting considerations.

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