



**dReport: December 2018**

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# Restructuring Reserve

**Restructuring refers to a programme that significantly changes an entity's subject of business or the way it operates. If the entity enters the restructuring process, it should create a restructuring reserve in line with applicable legislation as of the effective date of the restructuring. This article will provide you with more details about when the restructuring reserve should be accounted for, what items it should involve, including the specification of the respective legal regulation.**

The restructuring process may include in particular the relocation of business activities to another region, the closing down of operation as well as reduction or discontinuation of business activities.

## Restructuring reserves in Czech legislation

The legal regulation of restructuring reserves is based on the general provisions of accounting for reserves as defined in Act No. 563/1991 Coll., on Accounting, as amended (hereinafter the "Act"). Section 25 (3) of the Act stipulates that entities shall consider, as of the balance sheet date, all foreseeable risks and potential losses relating to assets and liabilities which are known to them as of the date of preparing the financial statements regardless of whether the entity recorded operating profit or loss. In addition to provisions and depreciation of assets, reserves are also defined in this Section. Pursuant to Section 26 (3) of the Act, reserves are intended to cover liabilities and expenditure the nature of which is clearly defined and which are either likely to be incurred or certain to be incurred as of the balance sheet date but uncertain as to their amount or as to the date on which they will arise.

Basic principles of creating and using reserves are stipulated in Accounting Standard No. 004 Reserves with a reference to Regulation No. 500/2002 Coll. (hereinafter the "Regulation") implementing certain provisions of the Accounting Act.

Reserves are addressed in greater detail by International Financial Reporting Standards, specifically IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, from which certain rules that are applicable in the Czech accounting environment and included in this article may be deducted.

## Content definition of the restructuring reserve

Item B.4 'Other Reserves' primarily includes a restructuring reserve that may only be created and used in respect of expenditure necessary for realising the restructuring programme which, however, do not relate to the entity's ongoing activities, the nature of which is clearly defined and which are likely to be incurred but uncertain as to their amount or as to the date on which they will arise.

The definition of the restructuring reserve is *de facto* contained in a single provision – Section 16 (4) of the Regulation with effect from 1 January 2016 when a more-detailed definition of restructuring reserves was removed from Czech Accounting Standard No. 004 Reserves.

The provision which is no longer part of the current Regulation but is still used in accounting practice also included a list of expenditure ruled out from the accounting reserve; this specifically relates to the retraining or relocation costs of employees who will remain to be employed at the entity or marketing costs.

The restructuring reserve must include solely expenses which have been, or will be, incurred in the restructuring process and as such would not be incurred without the restructuring being performed.

As an example, expenses to be included in the restructuring reserve include the costs of advisory services, legal and tax advisory necessary for the restructuring process to be realised in line with legal regulations, costs of crisis management ensuring that the restructuring process is governed in accordance with the set schedule, costs of disassembly of the existing production equipment, fines and penalties for premature termination of contracts with sub-suppliers and customers, severance pay to dismissed employees etc.

On the other hand, the restructuring reserve must not include the costs of project work and advisory services concerning the entity's future operation model or relocation, investments in distribution networks and systems to ensure the future subject of the entity's activities, bonuses and remuneration to employees who will remain to be employed at the entity, and employee requalification costs as these costs relate to the entity's "ongoing activities" and must be recognised in the accounting records in the period in which they were incurred.

Restructuring may also involve additional steps that, by their nature, arise from the restructuring process, being rather uncustomary, such as additional provisions against fixed assets and inventory due to a decline in a certain segment and the resulting "forced" sale, disposal of assets and inventory or physical liquidation (scrapping) etc.

Furthermore, we would like to draw attention to the term reorganisation as a regime within insolvency proceedings. Reorganisation may, but does not have to, have similar implications as restructuring.

## Timing of the recognition of the restructuring reserve

The restructuring reserve is created by an entity based on the restructuring programme approved by a relevant body pursuant to a specific legal regulation, or by shareholders in a business corporation. The restructuring programme shall constitute a formal plan of changes in the entity, defining areas and employee positions to be affected by the restructuring and the budget, i.e. calculation of anticipated expenses to be incurred in relation to the restructuring process. The affected parties must be notified of the restructuring programme and all steps on the part of the entity must be aimed at the fulfilment of the plan



to generate real expectations about realisation.

### Creation and use of the restructuring reserve

Restructuring reserves are created and used in line with Sections 27 and 57 of the Regulation and Art. 4.2. Of Accounting Standard No. 004 Reserves.

The creation of reserves is recognised in the relevant account within account group 45 – Reserves by a corresponding entry in the relevant expense account within account group 55 – Depreciation, reserves, comprehensive deferred expenses and operating provisions. The use of reserves or their reversal due to redundancy is recognised in the relevant account within account group 45 – Reserves by a corresponding entry in the relevant expense account within account group 55 – Depreciation, reserves, comprehensive deferred expenses and operating provisions.

The creation and use of reserves is disclosed by the entity in its notes to the financial statements. Similarly to other reserves, the restructuring reserve is subject to reconciliation in which the amount and appropriateness of the reserve is assessed, or the budget for the restructuring programme costs is updated for the reserve to be the best estimate of expenditure which are likely to be incurred, or, in the event of payables, an amount necessary for settlement. For the sake of clear arrangement, the reserve is recommended to be maintained in a stand-alone analytical account.

### Tax aspects of accounting for restructuring reserves

The restructuring reserve is not a tax-deductible expense. For corporate tax calculation purposes, the tax base must be increased by the amount of the restructuring reserve. Expenses become tax-deductible when they are actually incurred in relation to the restructuring process – i.e. in the period in which they incur. On those grounds, a temporary tax difference, i.e. A deferred tax asset, arises in respect of the restructuring reserve in the calculation of a deferred tax, similarly as in the accounting for other tax non-deductible reserves.

Furthermore, we would like to note that a reserve for various items related to employee remuneration in restructuring may not necessarily include its current component of social security and health insurance, such as when severance pay is concerned. For this reason, we consider it necessary to pay attention to individual items of which the reserve is composed.

### Creation and use of reserve as a non-cash transaction

In addition, we would also like to emphasise that although the creation and use of a restructuring reserve affects the entity's profit or loss, it does not have a direct influence on an increase or decrease in financial resources. The line 'Change in provisions and reserves' in the statement of cash flows, part Cash flows from ordinary activities (operating activities), prepared using the indirect method must be adjusted by the amount corresponding to the creation and use of the reserve.

### Approach to the presentation in the financial statements

The balance, creation and use of reserves have their required positions in the balance sheet, or the profit and loss account. If the restructuring in the reporting period in which the restructuring reserve is recognised for the first time has implications to other areas (such as depreciation or recognition of provisions for fixed assets or inventory), it is appropriate to disclose relevant information on the effect of the restructuring in the notes to the financial statements in a comprehensive and cohesive manner, including a summary of implications for other areas concerned. Furthermore, restructuring will, by its nature, be usually an extraordinary activity, i.e. The costs of restructuring (and also revenues, if any) will typically be presented as extraordinary – in the operating or financial areas, according to their nature.

### Conclusion

The restructuring process entails uncertainty and significant expenses, substantially affecting the entity's operation. In creating the restructuring reserve, the prudence concept as one of the basic accounting principles needs to be taken into account. Simultaneously, the calculation of the amount of the reserve shall only include expenses which are necessary for realising the restructuring and do not relate to the entity's ongoing activities.

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# Invitation to a Seminar

## News in Czech Accounting

### Prague, 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 December in Prague, Pilsen and Hradec Kralove and will be delivered by our professionals.

### Dates

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**Prague:** 11 December 2018

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**Pilsen:** 5 December 2017

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**Hradec Kralove:** 13 December 2018

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[www.akce.deloitte.cz](http://www.akce.deloitte.cz)



# IASB issued amendments to IFRS 3 regarding the definition of a business

On 22 October 2018, the IASB issued 'Definition of a Business (Amendments to IFRS 3)' aimed at resolving the difficulties that arise when an entity determines whether it has acquired a business or a group of assets. The amendments are effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2020.

## Background

The post-implementation review of IFRS 3 *Business Combinations* revealed that entities have difficulties when determining whether they have acquired a business or a group of assets. As the accounting requirements for goodwill, acquisition costs and deferred tax differ on the acquisition of a business and on the acquisition of a group of assets, the IASB decided to issue narrow scope amendments aimed at resolving the difficulties that arise when an entity is determining whether it has acquired a business or a group of assets.

## Changes

The amendments in *Definition of a Business* (Amendments to IFRS 3) are changes to Appendix A Defined terms, the application guidance, and the illustrative examples of IFRS 3 only.

### Minimum requirements to meet the definition of a business

The amendments clarify that while businesses usually have outputs, outputs are not required for an integrated set of activities and assets to qualify as a business. However, to meet the definition of a business, an integrated set of activities and assets must include, as a minimum, an input and a substantive process that together significantly contribute to the ability to create output. The IASB also clarifies that outputs in and of themselves are not sufficient to determine that an integrated set of activities and assets is a business. Instead, the entity needs to demonstrate that both an input and a substantive process have been acquired.

To clarify that a business can exist without including all of the inputs and processes needed to create outputs, the IASB replaced the term 'ability to create outputs' with 'ability to contribute to the creation of outputs'.

### Assessing whether an acquired process is substantive

To determine whether an acquired process is substantive, different criteria apply, depending on whether there are outputs at the acquisition date. New guidance and illustrative examples are added to help entities assess whether a substantive process has been acquired.

### Market participant's ability to replace missing elements

Before the amendments, IFRS 3 stated that a business did not need to include all of the inputs or processes that the seller used in operating the business if market participants are capable of acquiring the business and continuing to produce outputs, for example, by integrating the business with their own inputs and processes.

The IASB has now removed this reference and instead, as described above, decided to focus on whether acquired inputs and acquired substantive processes together significantly contribute to the ability to create outputs.

### Narrowed definition of outputs

To narrow the definition of outputs, the IASB has amended the definition of a business in Appendix A of IFRS 3 as well as the definition of outputs in the Application Guidance to IFRS 3. These amendments put the focus of outputs on goods and services provided to customers. By that, the IASB wants to achieve consistency with the notion of outputs in IFRS 15 *Revenue from Contracts with Customers*.

The amendments remove from the new definitions references to returns in the form of lower costs and other economic benefits provided directly to investors or other owners, members or participants. In the IASB's view, the reduction of costs is not a helpful concept to distinguish between acquisitions of a business and asset acquisitions. Many asset acquisitions that do not include a substantive process may also be made with the motive of lowering costs.

### Optional test to identify concentration of fair value

The IASB has introduced an optional test that provides a simplified assessment of whether an acquired set of activities and assets is not a business (the concentration test). If the concentration test is met, the set of activities and assets is determined not to be a business and no further assessment is needed. If the test is not met, an entity performs the assessment set out above to determine whether or not the acquired set of activities and assets is a business.

An example of how the test is performed is added to the Illustrative Examples that accompany IFRS 3.

### Interaction with the FASB

IFRS 3 and the corresponding US GAAP requirements (SFAS 141(R)) are substantially converged. With regard to the definition of a business, the PIR of SFAS 141(R) revealed similar issues as the PIR of IFRS 3. Consequently, in 2017 the US Financial Accounting Standards Board (FASB) amended US GAAP.



Although the IASB's amendments to IFRS 3 are based on similar conclusions as the US GAAP amendments, they differ in some respects. However, the IASB expects that the amendments will lead to more consistency in applying the definition of a business across entities applying IFRS and entities applying US GAAP.

### Effective date and transition requirements

The amendments are effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after **1 January 2020** and to asset acquisitions that occur on or after the beginning of that period. Earlier application is permitted.

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## IASB issued amendments to IAS 1 and IAS 8 regarding the definition of materiality

On 31 October, the International Accounting Standards Board (IASB) issued 'Definition of Material (Amendments to IAS 1 and IAS 8)' to clarify the definition of 'material' to make it easier for companies to make materiality judgements.

### Background

The materiality project arose as part of the IASB's Disclosure initiative started in 2012. A draft practice statement on materiality was published on 28 October 2015, however, subsequently it became clear that some of the proposed guidance needed to be authoritative to have the desired effect, so the project was split up into a part that would see a practice statement published and a part that was intended to result in amendments to IAS 1 and IAS 8. The finalised Practice Statement *Making Materiality Judgements* was published in September 2017 at the same time as an exposure draft ED/2017/6 *Definition of Material (Proposed amendments to IAS 1 and IAS 8)*, which is being finalised now.

### Changes and reasoning behind the changes

The definition of material, an important accounting concept in IFRS Standards, helps companies decide whether information should be included in their financial statements. The updated definition amends IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

The amendments are a response to findings that some companies experienced difficulties using the old definition when judging whether information was material for inclusion in the financial statements.

- **Old definition of 'material':** *Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements (IAS 1 Presentation of Financial Statements).*
- **New definition of 'material':** *Information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity.*

Three new aspects of the new definition should especially be noted:

- **Obscuring.** The existing definition only focused on omitting or misstating information, however, the Board concluded that obscuring material information with information that can be omitted can have a similar effect. Although the term obscuring is new in the definition, it was already part of IAS 1 (IAS 1.30A).
- **Could reasonably be expected to influence.** The existing definition referred to 'could influence' which the Board felt might be understood as requiring too much information as almost anything 'could' influence the decisions of some users even if the possibility is remote.
- **Primary users.** The existing definition referred only to 'users' which again the Board feared might be understood too broadly as requiring to consider all possible users of financial statements when deciding what information to disclose.

During redeliberations, the Board spent a lot of time on discussing what constitutes obscuring information. The amendments stress especially five ways material information can be obscured:

- if the language regarding a material item, transaction or other event is vague or unclear;
- if information regarding a material item, transaction or other event is scattered in different places in the financial statements;
- if dissimilar items, transactions or other events are inappropriately aggregated;
- if similar items, transactions or other events are inappropriately disaggregated; and
- if material information is hidden by immaterial information to the extent that it becomes unclear what information is material.

The new definition of material and the accompanying explanatory paragraphs are contained in IAS 1 *Presentation of Financial Statements*. The definition of material in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* has been replaced with a reference to IAS 1.



### Effective date

The amendments are effective for annual reporting periods beginning on or after **1 January 2020**. Earlier application is permitted.

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## IFRIC 23 endorsed for use in the EU

On 23 October 2018, IFRIC 23 *Uncertainty over Income Tax Treatments* was 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 2019). Earlier adoption of IFRIC 23 is permitted.

IFRIC 23 was issued in June 2017. We informed you in detail about the new standard in the [Accounting News in July 2017](#).

In today's article, we will summarise key changes arising from IFRIC 23.

### Background

A question has arisen in practice as to how uncertainty about the acceptability by a tax authority of a particular tax treatment used by an entity in its income tax filings ('uncertain tax treatment') should be reflected in the financial statements. As a consequence, the Interpretations Committee decided to develop an interpretation.

### Scope

The interpretation is to be applied to the determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates, when there is uncertainty over income tax treatments under IAS 12 *Income Taxes*.

### Issues and consensus

#### Whether tax treatments should be considered collectively

An entity is required to use judgement to determine whether each tax treatment should be considered independently or whether some tax treatments should be considered together. The decision should be based on which approach provides better predictions of the resolution of the uncertainty.

#### Assumptions for taxation authorities' examinations

An entity is to assume that a taxation authority with the right to examine any amounts reported to it will examine those amounts and will have full knowledge of all relevant information when doing so.

#### Determination of taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates

An entity has to consider whether it is probable that the relevant authority will accept each tax treatment, or group of tax treatments, that it used or plans to use in its income tax filing.

- If the entity concludes that **it is probable** that a particular tax treatment is accepted, the entity has to determine taxable profit (tax loss), tax bases, unused tax losses, unused tax credits or tax rates consistently with the tax treatment included in its income tax filings.
- If the entity concludes that **it is not probable** that a particular tax treatment is accepted, the entity has to use the most likely amount or the expected value of the tax treatment when determining taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates. The decision should be based on which method provides better predictions of the resolution of the uncertainty.

#### Effect of changes in facts and circumstances

An entity has to reassess its judgements and estimates if facts and circumstances change.

#### Disclosures

The interpretation does not contain any new disclosure requirements. Instead it highlights existing disclosure requirements in IAS 1 and IAS 12.

#### Effective date and transition

An entity applies IFRIC 23 for annual reporting periods beginning on or after **1 January 2019**. Earlier application is permitted.

Entities can apply the Interpretation using either of the following approaches:

- **Full retrospective approach:** this approach can be used only if it is possible without the use of hindsight. The application of the new Interpretation will be accounted for in accordance with IAS 8, which means comparative information will have to be restated; or
- **Modified retrospective approach:** no restatement of comparative information is required or permitted under this approach. The cumulative effect of initially applying the Interpretation will be recognised in opening equity at the date of initial application, being the beginning of the annual reporting period in which an entity first applies the Interpretation.

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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 2 November 2018.

As of 28 November 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 3 *Definition of a Business* (issued in October 2018)
- 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 1 and IAS 8 *Definition of Material* (issued in October 2018)
- 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)

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

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# Invitation to Autumn Seminar

## IFRS News 2018

Webcast took place on 16 October 2018.  
Its record is available [here](#).

## 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: 17 December 2018 **NEW DATE!**

More information is available at:  
[www.akce.deloitte.cz](http://www.akce.deloitte.cz)



# Cyber threat considerations related to implementation of internal accounting controls

**In response to the continued increase in cybercrime, the United States Securities and Exchange Commission (SEC) issued an investigative report on 16 October 2018 that cautioned companies to consider cyber threats when they are implementing their internal accounting controls.**

The report focuses on the internal accounting controls of nine issuers in a range of sectors “that were victims of one of two variants of schemes involving spoofed or compromised electronic communications from persons purporting to be company executives or vendors,” commonly referred to as business e-mail compromise (BEC) scams. According to the SEC’s report each of the nine issuers lost at least \$1 million; two lost more than \$30 million. In total, the nine issuers lost nearly \$100 million to the perpetrators, almost all of which was never recovered.

## What Is a BEC Scam?

As described in the SEC’s report, a BEC scam occurs when attackers use compromised or fraudulent e-mail addresses to target specific employees within organizations and ask them to participate in what appear to be legitimate transactions or to make changes to key payment or vendor information.

The scam typically involves the hacking of an individual’s e-mail account, which is then used to send e-mails to other individuals within an organization or outside of it (e.g., to customers). This occurs more commonly in hosted e-mail solutions that are not protected by multifactor authentication (MFA). It also occurs in scenarios in which hackers are able to set up rules for e-mail forwarding and deleting to monitor and remove communications that may be used to detect the unauthorized use of the e-mail address. Fraudulent or spoofed e-mails commonly look similar to or have domain names that are similar to legitimate correspondence.

## The SEC’s Check of Internal Accounting Controls

The SEC considered whether the companies affected by the BECs complied with the requirements of Sections 13(b)(2)(B)(i) and (iii) of the Securities Exchange Act of 1934, under which certain issuers are required to “devise and maintain a system of internal accounting controls

sufficient to provide reasonable assurances that transactions are executed with, or that access to company assets is permitted only with, management’s general or specific authorization.” Further, the report emphasized that “while the cyber-related threats posed to issuers’ assets are relatively new, the expectation that issuers will have sufficient internal accounting controls and that those controls will be reviewed and updated as circumstances warrant is not.”

The full version of the SEC’s Report on investigation is available [here](#).

You can find more information about BEC Scams in [Heads Up](#) (Volume 25, Issue 18) issued by Deloitte on 30 October 2018. The following topics are covered in the article in detail:

- How does a BEC Scam occur?
- How Can BEC Scams Be Identified and Avoided?
- What Controls May Help Companies Prevent or Detect These Types of Cybercrimes?
- SEC’s Focus on Cybersecurity

The cybersecurity landscape continues to evolve, and schemes like the ones described in the SEC’s report are increasing as more economic activities take place through digital technology and electronic communications. The BEC examples described above underscore the importance of devising and maintaining a system of internal accounting controls to address this kind of cyber-related fraud. Training and user security awareness play critical roles in both the implementation and operating effectiveness of controls.

## Sources:

*Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding Certain Cyber-Related Frauds Perpetrated Against Public Companies and Related Internal Accounting Controls Requirements*

*Heads Up — Cyber threat considerations related to implementation of internal accounting controls*

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