



dReport: March 2019

Check out our regular Accounting news newsletter.

Contents

Accounting news	3
Czech Accounting	3
The Difficulty of Making Accounting Estimates – the Impact of Foreign Exchange Rate	3
IFRS	5
Amendments to IAS 28 endorsed for use in the EU	5
Amendments to IAS 19 endorsed for use in the EU	5
Annual Improvements to IFRSs (cycle 2015–2017) endorsed for use in the EU	6
IFRS EU Endorsement Process: March	7
US GAAP	8
FASB clarified implementation guidance and disclosure requirements in the leases standard	8



The Difficulty of Making Accounting Estimates – the Impact of Foreign Exchange Rate

Some accounting estimates are very difficult to assess and evaluate, both for company management and auditors. In addition, even seemingly simple estimates may be of surprise in terms of their partial components such as the development in currency rates. In the past twenty years, the Czech crown's rate towards the euro and the US dollar has seen interesting evolution. Therefore, let us have a look at a number of practical examples from various industries.

Net Realisable Value in Mass Production

One of the important estimates made by company management as part of the closing operations involves assessing the net realisable value under Section 26 (1) of the Accounting Act. Specifically, this refers to provisions against the inventory of finished products.

In some industries, such as the automotive industry, frequently the output (and sometimes also the input) prices are determined in foreign currencies (principally the euro). As such, at the balance sheet date, the company management assesses whether the total inventory of finished products held in stock as of the balance sheet date includes saleable products; also, the stock price in CZK is compared with the anticipated selling price (which is net of the costs of goods sold) denominated in EUR and translated into CZK (principally using the foreign exchange rate promulgated by the Czech National Bank as of the balance sheet date). In some cases, the anticipated selling price may be difficult to determine, and in some cases not. Generally, the selling price may be determined based on the underlying contract, order, price list, or a recent similar transaction. It stands to reason that if the exchange rate development moves towards appreciating the Czech crown, situations may arise in which the anticipated selling price, net of the selling costs, is lower than the stock price (actual internal costs of production), due to which the inventory value has to be decreased through the recognition of a provision.

In day-to-day business, such situations can get even more precarious, when arguing that, in fact, some products are not loss-making, as they are sold together with the profitable ones as part of so-called *car sets*, ie sets of parts for a particular car model, agreed with the relevant customer. For the sake of completeness, let us add that when identifying loss-making products held in stock or in the manufacturing programme, also the eventuality of impairment and/or the creation of a reserve for onerous contracts shall be taken into consideration, both under IFRS and the Czech accounting regulations.

Net Realisable Value in Toll Manufacturing

Conversely, in the construction industry and in some types of cost-intensive toll manufacturing (such as the production of complex asset groups), the output price may be denominated in a foreign currency (however, this practice is less frequent). Such cases typically occur when the customer is a foreign entity. Therefore, increased attention should be paid in such events. As an instance, let us think about a project comprising the construction of a complex structure or the production of a mining machine, which may take several years. During this time, that is between the point at which the contract is concluded with the investor and the point at which the project is completed and an invoice is issued (which is regarded as the key point to account for the income to be reflected in the financial statements under Czech accounting regulations), significant fluctuations in the foreign exchange rate of the Czech crown and the relevant foreign currency may arise. Frequently, construction or project-based companies with complex toll manufacturing programmes maintain in their project databases the contract value in CZK, which is recorded at the inception of the project, using the exchange rate applicable at the point the contract originates. However, as exchange rates change over time, the exchange rates maintained in the databases should be updated. Accordingly, cases may arise in which the Czech crown appreciates over time and, as a result, not all costs get covered at the point of billing, due to which the value of the inventory of work in progress needs to be decreased by way of a provision as of the balance sheet date. Such cases may get even more delicate, if the given project spreads over multiple years, everything goes according to the plan, and ultimately the Czech crown appreciates no earlier than in the last year of the project. Reminiscing Goethe and his metaphor of the *grey theory and the green tree of life*, we can say that this simile quite fits situations of this kind. In regular business, though, companies seek to prevent such risks by way of hedging.

Retroactive Price Adjustments

In some branches of the manufacturing industry, such as the automotive industry or product manufacturing (of metal, wood, essential chemical substances, and others) that serves for additional industrial processing, retroactive price adjustments are a frequent phenomenon. On one hand, determining the prices of such components may be complex in itself (for instance in interdependence of the prices of oil, gas, or non-ferrous metals); on the other hand, such prices may also include the foreign price element. In these cases,



the pricing negotiations can take long, which is typically attributable to the power enjoyed by one of the contractual parties. Given that price adjustments generally affect the whole supply-customer chain, in terms of closing operations, they represent a complicated test both for various departments of the given reporting entity (such as the sales, marketing and planning departments), and a test in terms of good judgemental skills based on prior experience, that is, based on prior price adjustments. In these terms, the best practice to be applied both by professional accountants and auditors is to review the communication that includes the price adjustments per piece or another agreed unit, and to interview the relevant individuals from the company management.

Here is an example of what may seem simple, but in fact is not: There is a list of a certain volume of purchased or manufactured pieces (or other units) of products maintained in an Excel spreadsheet for year X; for these products, an adjustment of EUR 0.50 per piece was made; the adjustment was accounted for in the financial statements for year X as the best estimate of the price to be additionally paid. However, if the price negotiations are long-winded (which in day-to-day business may represent even multiple years), and at the same time, the alternative using the Excel spreadsheet still represents the best estimate (that is, there is a specific volume and financial amount equalling the price adjustment per piece), the “only” thing outstanding to be done is to reflect the foreign exchange rate developments. It shall be noted that in cases like these, revaluation is a step that gets easily omitted (due to the fact that the original Excel list still serves as the best estimate, which has been accounted for based on an internal document, using one financial amount in CZK, and the fact that there has been no progress in the price negotiations). Hence, the impact hereof can be “significantly material” – if intensification of “material” is even possible.

Golden Bricks as Employee Benefits

Another interesting topic are employee benefits in the form of pension insurance schemes and payments or other benefits provided upon life and professional anniversaries or retirement. In connection with these benefits, questions of how they shall be valued with regard to certain variables (such as the salary growth rate or interest rate development) arise. Other queries may relate to the number of served years; the degree to which the provision of benefits is

obligatory (ie how easy full benefit cancellation is in terms of the requirements set by the reporting entity's trade union(s), if any); the number of employees staying with the company in the future with regard to the current (high) fluctuation rate; or how many employees will reach the age at which the benefits fall due (demographic point of view); and the like.

Given the above, a question shall be asked as to whether companies do not tend to neglect reporting reserves if the employee fluctuation rate is high and the year-on-year impact of benefits actually provided remains the same.

It shall be emphasised that transactions of this kind are not only subject to the IFRS (IAS 19) treatment. Frequently, similar queries are tackled under Czech accounting regulations as well.

Therefore, in auditing reserves for employee benefits, clients and auditors often engage actuaries. With regard to golden bricks, it shall be noted that the volume and value of golden bricks determined based on an expert appraisal may be defined, for example, in grams of gold (as translated in terms of purity). Therefore, to determine a reserve in CZK, the price of gold shall be additionally elaborated on. This is due to the fact that gold prices are typically denominated in USD or other foreign currencies. As such, the exchange rate of the Czech crown shall be reflected in determining the amount of the reserve. Accordingly, the reserve amount may vary at individual balance sheet dates. This would be the case even if the volume of gold expressed in grams were the same, as on one hand, the price of gold denominated in a foreign currency alters, and on the other, the exchange rate of the Czech crown towards the relevant foreign currency also changes.

Conclusion

By way of the above cases, we have demonstrated that when reporting accounting estimates, the impact of the development in the Czech crown's exchange rate towards other foreign currencies needs to be duly considered in terms of the client's industry, the transaction itself, and the transaction features. This is attributable to the fact that the exchange rate of the Czech crown can develop over time.

Miroslav Zigáček
mzigacek@deloittece.com



Amendments to IAS 28 endorsed for use in the EU

On 8 February 2019, Amendments to IAS 28 *Long-term Interests in Associates and Joint Ventures* 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 2019). Earlier adoption of Amendments to IAS 28 is permitted.

Amendments to IAS 28 were issued in October 2017 informed you in detail about the new standard in the [Accounting News in November 2017](#). In today's article, we will summarise key changes arising from Amendments to IAS 28.

Background

IFRS 9 *Financial Instruments* excludes from its scope interests in associates and joint ventures accounted for in accordance with IAS 28 *Investments in Associates and Joint Ventures*. There was uncertainty in practice about whether IFRS 9 applies to an entity's long-term interests in an associate or joint venture to which the equity method is not applied but that form part of the entity's net investment in the investee ('long-term interests'). Such long-term interests include long-term loans for which settlement is neither planned nor likely to occur in the foreseeable future.

Changes

The amendment to IAS 28 clarifies that IFRS 9, including its impairment requirements, applies to long-term interests. Furthermore, in applying IFRS 9 to long-term interests, an entity does not take into account adjustments to their carrying amount required by IAS 28 (i.e., adjustments to the carrying amount of long-term interests arising from the allocation of losses of the investee or assessment of impairment in accordance with IAS 28).

The amendments are accompanied by an illustrative example.

Effective date and transition

The amendments are effective in the EU for periods beginning on or after **1 January 2019**. The amendments are to be applied retrospectively. Earlier application is permitted.

Source: www.iasplus.com
[Amendments to IAS 28](#)

Jitka Kadlecová
jkadlecova@deloittece.com

Amendments to IAS 19 endorsed for use in the EU

On 13 March 2019, Amendments to IAS 19 *Plan Amendment, Curtailment or Settlement* 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 2019). Earlier adoption of Amendments to IAS 19 is permitted.

Amendments to IAS 19 were issued in February 2018. We informed you in detail about the new standard in the [Accounting News in March 2018](#). In today's article, we will summarise key changes arising from Amendments to IAS 19.

Changes

IAS 19 *Employee Benefits* specifies how a company accounts for a defined benefit plan. When a change to a plan - an amendment, curtailment or settlement - takes place, IAS 19 requires a company to remeasure its net defined benefit liability or asset.

Plan Amendment, Curtailment or Settlement (Amendments to IAS 19) specifies how companies determine pension expenses when changes to a defined benefit pension plan occur.

The amendments clarify that the past service cost (or of the gain or loss on settlement) is calculated by measuring the defined benefit liability (asset) using updated assumptions and comparing benefits offered and plan assets before and after the plan amendment (or curtailment or settlement) but ignoring the effect of the asset ceiling (that may arise when the defined benefit plan is in a surplus position). IAS 19 is now clear that the change in the effect of the asset ceiling that may result from the plan amendment (or curtailment or settlement) is determined in a second step and is recognised in the normal manner in other comprehensive income.



The paragraphs that relate to measuring the current service cost and the net interest on the net defined benefit liability (asset) have also been amended. An entity will now be required to use the updated assumptions from this remeasurement to determine current service cost and net interest for the remainder of the reporting period after the change to the plan. In the case of the net interest, the amendments make it clear that for the period post plan amendment, the net interest is calculated by multiplying the net defined benefit liability (asset) as remeasured under IAS 19.99 with the discount rate used in the remeasurement (also taking into account the effect of contributions and benefit payments on the net defined benefit liability /asset/).

Effective date and transition requirements

An entity applies the amendments to plan amendments, curtailments or settlements occurring on or after the beginning of the first annual reporting period that begins on or after **1 January 2019**. Early application is permitted but must be disclosed.

Source: www.iasplus.com
[Amendments to IAS 19](#)

Jitka Kadlecová
jkadlecova@deloittece.com

Annual Improvements to IFRSs (cycle 2015–2017) endorsed for use in the EU

On 14 March 2019, the European Commission endorsed the *Annual Improvements (cycle 2015–2017)* for use in the EU. The EU effective date is the same as the IASB's effective date (annual periods beginning on or after 1 January 2019). Earlier application is permitted.

These Annual Improvements were issued in December 2017. We brought detail information in the [Accounting News in February 2018](#). The Annual Improvements include amendments to four IFRSs, which have been summarised below.

IAS 12 Income Taxes

The amendments clarify that an entity should recognise the income tax consequences of dividends in profit or loss, other comprehensive income or equity according to where the entity originally recognised the transactions that generated the distributable profits. This is the case irrespective of whether different tax rates apply to distributed and undistributed profits.

IAS 23 Borrowing Costs

The amendments clarify that if any specific borrowing remains outstanding after the related asset is ready for its intended use or sale, that borrowing becomes part of the funds that an entity borrows generally when calculating the capitalisation rate on general borrowings.

IFRS 3 Business Combinations

The amendments to IFRS 3 clarify that when an entity obtains control of a business that is a joint operation, the entity applies the requirements for a business combination achieved in stages, including remeasuring its previously held interest (PHI) in the joint operation at fair value. The PHI to be remeasured includes any unrecognised assets, liabilities and goodwill relating to the joint operation.

IFRS 11 Joint Arrangements

The amendments to IFRS 11 clarify that when a party that participates in, but does not have joint control of, a joint operation that is a business obtains joint control of such a joint operation, the entity does not remeasure its PHI in the joint operation.

Effective date and transition requirements

All the amendments are effective for annual periods beginning on or after **1 January 2019** and generally require prospective application. Earlier application is permitted.

Source: www.iasplus.com
[Annual Improvements](#)

Jitka Kadlecová
jkadlecova@deloittece.com



IFRS EU Endorsement Process: March

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 18 March 2019.

As of 23 March 2019, 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 References to the Conceptual Framework in IFRS Standards* (issued in March 2018)

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

Jitka Kadlecová
jkadlecova@deloittece.com



FASB clarified implementation guidance and disclosure requirements in the leases standard

On 5 March 2019, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2019-01 that addresses three issues associated with adopting the new leases standard.

ASU 2019-01, Leases (Topic 842): Codification Improvements, amends certain aspects of the new leasing standard (ASU 2016-02, Leases (Topic 842)) which was issued in February 2016.

ASU 2019-01 addresses the following three issues:

1. Determining the fair value of the underlying asset by lessors that are not manufacturers or dealers;
2. Presentation on the statement of cash flows for sales-type and direct financing leases by lessors within the scope of ASC 942; and
3. Clarification of interim disclosure requirements during transition.

1. Determining the Fair Value of the Underlying Asset by Lessors That Are Not Manufacturers or Dealers

These amendments affect all lessors that are not manufacturers or dealers (generally financial institutions and captive finance companies - qualifying lessors). The ASU provides guidance for determining fair value and its application to lease classification and measurement. Specifically, for qualifying lessors, the fair value of the underlying asset at lease commencement would be its cost, including any acquisition costs, such as sales taxes and delivery charges. However, if a significant lapse of time occurs between the acquisition of the underlying asset and lease commencement, lessors would be required to determine fair value in accordance with ASC 820.

2. Presentation on the Statement of Cash Flows for Sales-Type and Direct Financing Leases by Lessors Within the Scope of ASC 942

This amendment affects all lessors that are depository and lending entities within the scope of Topic 942. The ASU requires them to classify principal payments received from sales-type and direct financing leases within “investing activities.” That is, such entities would not follow the guidance in ASC 842-30-45-5, which requires lessors to classify cash receipts from leases within “operating activities.”

Effective Date and Transition

For the two issues above, the ASU is effective:

- For public business entities, certain not-for-profit entities, and certain employee benefit plans, for fiscal years beginning after **15 December 2019**, and interim periods within those fiscal years.
- For all other entities, for fiscal years beginning after 15 December 2019, and interim periods within fiscal years beginning after **15 December 2020**.

Early adoption is permitted for all entities. If an entity early adopts, the ASU will be applied as of the date the entity first applies ASU 2016-02 (i.e., when it adopts the new leasing standard in accordance with ASC 842-10-65-1(c)).

3. Clarification of Interim Disclosure Requirements During Transition

The ASU also includes a Codification improvement to the transition guidance in ASC 842-10-65-1(i) to clarify that entities adopting ASC 842 do not need to provide the interim-period disclosures required by ASC 250-10-50-3, which states:

In the fiscal year in which a new accounting principle is adopted, financial information reported for interim periods after the date of adoption shall disclose the effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), and related per-share amounts, if applicable, for those post-change interim periods.

Accordingly, interim disclosures about the effect on income in the year of adoption of ASC 842 are excluded from the required disclosures in transition, in a manner similar to the annual disclosures in ASC 250-10-50-1(b)(2).

These amendments affect all entities that are lessees or lessors.

Source: www.iasplus.com
[ASU 2019-01](#)
[FASB press release](#)

Gabriela Jindříšková
gjindriskova@deloittece.com



Contacts

Should you have any questions regarding the matters outlined in this publication, please reach out to your contact person from Deloitte's Audit function, Deloitte's technical desk at CZ_TechnicalDesk@deloittece.com or one of the following specialists:

Czech Accounting

Jarmila Rázková

jrazkova@deloittece.com

IFRS and US GAAP

Martin Tesař

mtesar@deloittece.com

Soňa Plachá

splacha@deloittece.com

Gabriela Jindříšková

gjindriskova@deloittece.com

Deloitte Audit s. r. o.

Churchill, Italská 2581/67,
120 00 Prague 2 – Vinohrady,
Czech Republic
Tel.: +420 246 042 500

[Subscribe to dReport and other newsletters:](#)



Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited ("DTTL"), its global network of member firms, and their related entities. DTTL (also referred to as "Deloitte Global") and each of its member firms are legally separate and independent entities. DTTL does not provide services to clients. Please see www.deloitte.com/about to learn more.

Deloitte is a leading global provider of audit and assurance, consulting, financial advisory, risk advisory, tax and related services. Our network of member firms in more than 150 countries and territories serves four out of five Fortune Global 500® companies. Learn how Deloitte's approximately 264,000 people make an impact that matters at www.deloitte.com.

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the "Deloitte Network") is, by means of this communication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional advisor. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this communication.