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Amended Interpretation of the National Accounting Council for the Accounting Treatment of the Sale of Investments in Subsidiaries

In this issue of the Accounting News, we will briefly summarise the main features of Interpretation I-38 of the National Accounting Council entitled "Accounting Treatment of the Sale of Equity Investments in Subsidiaries in Consolidated Financial Statements".

About the National Accounting Council

The National Accounting Council (the "NAC") is an independent professional institution promoting professional competencies and ethics in the development of accounting professions and in respect of accounting and financing policies. Its members include the representatives of significant professional organisations (the Czech Chamber of Auditors, the Czech Chamber of Tax Advisors, the Accountants' Union) and academia (University of Economics).

The National Accounting Council's primary mission is to cooperate with the Ministry of Finance, and other governmental, legislative and other institutions in drafting legislation and the related norms on accounting. Also, the Council's task is to create, update, publish and distribute the Czech Accounting Standards and interpretations of the National Accounting Council.

Interpretations of the National Accounting Council

The interpretations express the expert opinions of the National Accounting Council on hands-on application of Czech accounting rules. The interpretations are not legally binding. Their aim is to contribute to the formation of optimal and unified accounting and financial reporting procedures. They namely focus on issues that are either not addressed by Czech accounting regulations or that are not tackled sufficiently. Also, the focus is on areas for which no unified treatment is applied in day-to-day accounting practice.

Interpretation I-38 – Accounting Treatment of the Sale of Equity Investments in Subsidiaries in Consolidated Financial Statements

Interpretation I-38 (hereinafter the "Interpretation") was issued in February 2019 in response to the query as to what accounting and presentation treatment should be applied to the sale of 100% equity investments held in subsidiaries consolidated financial statements. The Interpretation does not deal with the partial sale of investments.

The Interpretation is based on the premise that "from the perspective of consolidated financial statements, the substance of the sale of equity investments held in subsidiaries is similar to transactions constituted by the sale of business under the perspective of single financial statements". The sale of business is dealt with by Czech Accounting Standard No. 011 - Transactions related to Businesses.

The general results arising from the Interpretation are as follows:

- The subsidiary has been consolidated from the date of acquisition to the date of the sale of the full (100%) equity investment.
- In the event that the full equity investment is sold in the course of the reporting period, as of the balance sheet date the assets and liabilities of the subsidiary are no longer included in the consolidated assets and liabilities.
- The subsidiary's assets and liabilities at a value determined at the sale date are reported (derecognised) in the consolidated profit and loss, specifically in other operating expenses (or other operating income, if the net assets sold have a negative value).
- The reserves and provisions reported by the subsidiary are not released (as opposed to the treatment applied on the sale of business under Czech Accounting Standard 011). Conversely, the reserves and provisions are included in the net assets sold. Therefore, as of the sale date, together with other components of net assets, they are reported in other operating expenses.
- Other items to be derecognised are the book value of goodwill arising on consolidation, minority interests, and any deferred taxes.
- It is advisable to obtain the values of the assets and liabilities sold, of derecognised goodwill and of minority interest from interim financial statements.
- The income from the sale of equity investments is recognised in other operating income. Therefore, it shall be reclassified from the financial profit or loss (under which it was reported as part of single financial statements of the parent company).

Given that income and expenses related to the sale of equity investments are not transactions that occur regularly, in line with the requirements of Regulation 500/2002 Coll., the Interpretation includes a list of items that ought to be disclosed separately in the notes to the financial statements.

In addition, the Interpretation includes a comprehensive illustrative example.

The full wording of the Interpretation can be found on the National Accounting Council's website.

Source: www.nur.cz

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Cryptocurrencies under IFRS

In this article we make some observations about cryptocurrencies and the current accounting requirements under IFRSs for those holding, using for payments for goods or services or issuing cryptocurrency.

The first cryptocurrency - Bitcoin - came into existence in 2008. It was created to facilitate peer-to-peer exchanges, using Blockchain technology. Its use of cryptography to control how it is created and managed led to it being called a cryptocurrency.

Nowadays, there are more than 1,400 'cryptocurrencies' (sometimes referred to as 'digital currencies') in existence (e.g. Bitcoin, Ethereum, Litecoin, Bitcoin cash and Ripple). Cryptocurrencies have the following common characteristics:

- They are created through cryptography, often with a maximum possible number of 'coins' that can exist through solutions to a complex algorithm (e.g. there can only ever be 21 million Bitcoins in existence).
- They are decentralised, with no single party (government or otherwise) regulating their use.
- Although values for a cryptocurrency may sometimes be quoted in a particular currency, a 'coin' in one country is indistinguishable from a 'coin' in another.
- Their value is supported only by the laws of supply and demand.
- Cryptocurrencies can be obtained by 'mining' (use of computing power to solve the relevant algorithm) or by purchase on a peer-to-peer basis and can, if both parties agree, be exchanged for goods or services.

The increased use of, and exposure to, cryptocurrencies raises issues about the financial reporting implications for those who receive, hold, issue or trade in them.

Holdings of Cryptocurrencies

The holding of cryptocurrencies have been discussed by the International Accounting Standards Board (IASB) and the IFRS Interpretations Committee (IFRIC Committee) since 2018. In November 2018 the IASB decided not to issue a separate standard on cryptocurrencies and ask the IFRIC Committee to publish a tentative agenda decision that explains how IFRSs apply to holdings of cryptocurrencies.

The IFRIC Committee published this tentative agenda decision at its meeting in March 2019. The IFRIC Committee noted that a range of cryptoassets exist. For the purposes of its discussion, the IFRIC Committee considered only a subset of cryptoassets—cryptocurrencies—with the following characteristics:

- A cryptocurrency is a digital or virtual currency that is recorded on a distributed ledger and uses cryptography for security.
- A cryptocurrency is not issued by a jurisdictional authority or other party.
- A holding of a cryptocurrency does not give rise to a contract between the holder and another party.

Nature of a cryptocurrency

According to the IFRIC Committee, cryptocurrencies meet the definition of intangibles in IAS 38 Intangible Assets since they typically:

- are capable of being separated from the company and sold;
- are a nonmonetary item (because they do not include rights to obtain fixed units of currency); and
- have no physical substance.

Under IAS 38, cryptocurrencies would be recognised at cost on initial recognition, with subsequent measurement using either the cost or the revaluation model.

If a company applies the cost model, it measures intangible assets at cost less any accumulated amortisation and impairment losses.

Which IFRS applies to holdings of cryptocurrencies?

The IFRIC Committee concluded that a holding of cryptocurrency is not a financial asset. This is because a cryptocurrency is not cash (because an insignificant number of businesses currently use them for transactions). Nor is it an equity instrument of another entity. It does not give rise to a contractual right for the holder and it is not a contract that will or may be settled in the holder's own equity instruments.

The IFRIC Committee concluded that in cases where a company holds cryptocurrencies **for sale in the ordinary course of business** (ie dealer of cryptocurrencies), such holdings could be within the scope of **IAS 2 *Inventories***. If the company is a broker-dealer (eg a trading platform or exchange) in cryptocurrencies, it may be able to measure inventory at fair value less cost to sell. If the company is not a broker-trader, its holdings will be measured at the lower of cost or net realisable value.

If IAS 2 *Inventories* is not applicable, an entity applies **IAS 38 *Intangible Assets*** to holdings of cryptocurrencies.

Disclosure of holding of cryptocurrencies

According to the IFRIC Committee a company should apply the presentation and disclosures requirements of the Standard it applies (ie IAS 38 or IAS 2) to recognise and measure the holding of cryptocurrencies. In addition, a company may have to disclose information related to material non-adjusting events (events that may arise after the reporting date that indicate conditions after the reporting period). For example, a company holding cryptocurrencies may have to consider whether changes in the fair value

of those holdings after the reporting period are of such significance that non-disclosure could influence the economic decisions that investors make based on the financial statements.

Accounting for other crypto-assets

Neither the IASB nor the IFRIC Committee have discussed the accounting for other types of crypto-assets, such as those issued via initial coin offerings (ICOs).

Companies that raise capital via ICOs often provide holders (coin holders) with promises. Generally, the accounting treatment for holders of these coins will depend on the obligations arising for the company issuing the crypto assets. The nature of the obligations could result in these being recognised as equity, liabilities or revenues.

The full version of the IFRIC Committee tentative agenda decision is available here.

'Mining' of Cryptocurrencies

Neither IASB nor the IFRIC Committee have discussed how a cryptocurrency miner should account for these activities. The following text is based on Deloitte's recommendation included in the iGAAP 2018 publication.

In the blockchain technology upon which cryptocurrency is based, 'miners' create new blocks that are added to the blockchain by using a 'proof-of-work' approach. Miners use 'brute force' computing power (a huge number of iterative trial-and-error calculations) to find a solution to a designated algorithm in the form of a unique identifier meeting defined parameters specified in the protocol underpinning the cryptocurrency.

When a solution is found, this new 'block' is added to the blockchain and can then be used by the miner to record the next set of cryptocurrency transactions waiting to be processed. In return, that miner receives:

- a reward of a number of newly 'minted' units of cryptocurrencies for identification of a new block; and
- any transaction fees (also in the form of cryptocurrencies) that the parties to cryptocurrency transactions have paid to have their transactions processed and confirmed.

No party is obliged to participate in and/or complete mining activity (a miner can cease their activities at any time) and no specified single party is responsible for providing the new units of cryptocurrency to a successful miner. The entitlement to an award is established through a protocol.

The transaction fee is agreed upon by the transacting parties, often by means of a bidding process based on the demand for space in a block.

Income

Revenue should be recognised at the fair value of cryptocurrencies received at the time it is earned both for identification of a new block and in respect of transaction fees.

In respect of the 'reward' for identification of a new block, the miner does not have a contract with a specified party in respect of its search for the successful generation of a valid identifier (rather, all parties to the blockchain are subject to the same protocol). As such, the definition of a customer in IFRS 15:Appendix a ('a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration') is not met. Accordingly, IFRS 15 *Revenue from Contracts with Customers* is not applicable to this aspect of the activities of a cryptocurrency miner.

Nevertheless, the miner is receiving an asset (in the form of cryptocurrencies) upon generating a new block. Hence, income (defined in part under IFRSs as an increase in economic benefits in the form of an inflow of asset) will be recognised if it can be measured reliably. This should be presented as revenue (albeit not revenue from contracts with customers).

In contrast, the transaction fee is received from the parties to the recorded transaction that have a common and binding understanding that the miner who solves the next block first will be unconditionally entitled to the transaction fee for that transaction. Those parties are the miner's customers and recognition of revenue with respect to the transaction fee is, therefore, subject to the requirements of IFRS 15.

In both cases, the consideration received is in the form of cryptocurrencies, not cash, and therefore, as required by IFRS 15:66 (or by analogy to those requirements, in the case of the 'reward' for identification), the revenue should be measured at the fair value of the cryptocurrencies received.

As discussed above, the cryptocurrencies received should then be classified as an intangible asset in the scope of IAS 38 or, if held for sale in the ordinary course of business, as inventory in the scope of IAS 2.

Costs

The costs the miners incur, which can be substantial, cannot be related to a particular transaction for which the miner will receive consideration (i.e. they do not meet the asset recognition criteria and so will be expensed as incurred).

Property, plant and equipment used in the mining activities would be depreciated over its useful life in accordance with IAS 16.

Payment for goods or services

An entity could pay for goods or services using a cryptocurrency. Some companies offer to pay their employees in cryptocurrency.

Generally, these non-monetary transactions will need to be recognised at fair value. For example, IAS 16 *Property, Plant and Equipment* states that when plant and equipment is acquired in exchange for a non-monetary asset the cost of the item of property, plant and equipment is measured at fair value. A Standard might indicate that an entity should look

to the fair value of the thing being acquired, such as in the plant and equipment example, or to the fair value of the consideration paid (which would be the cryptocurrency) such as for employee remuneration.

You can find more information about accounting for cryptocurrencies under IFRSs in the Deloitte publication Thinking Allowed — Cryptocurrency: Financial reporting implications.

Accounting for cryptocurrencies pursuant to Czech accounting legislation

For the sake of completeness, we add that communication on the accounting for and presentation of digital currencies was issued by the Ministry of Finance regarding the issues of cryptocurrencies in May 2018.

According to this opinion, the Ministry of Finance recommends that all users, regardless of the different motives for holding and using digital currencies, account for and present them as inventory "of its kind".

More information about accounting for cryptocurrencies in line with Czech accounting legislation can be found in our Accounting News from July 2018.

Sources: www.iasplus.com
IFRIC Update March 2019
Investor Update April 2019
iGAAP 2018

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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 28 March 2019.

As of 29 May 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

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US GAAP

FASB improves Accounting for Episodic Television Series

In March 2019, the Financial Accounting Standards Board (FASB) published an Accounting Standards Update (ASU) that amends and clarifies the accounting for production costs for films and episodic content produced for television and streaming services.

In past several years, the production and distribution models used in the entertainment industry have changed significantly, one of the main changes was the adoption of subscription-based revenue models for online streaming services.

Based on the reactions of industry and key stakeholders of the organizations that use subscription-based revenue models, the current accounting capitalization guidance doesn't properly reflect the results and does not give the right information.

Based on FASB Chairman Russell G. Golden "the new standard converges the guidance for films and episodic content. This better reflects the economics of an episodic television series and improves the information provided to investors about the various types of produced and licensed content".

The current accounting guidance has differing capitalization requirements for content production:

- For films, production costs are capitalized.
- For episodic content (for example, a TV series), production costs are capitalized subject to a constraint based on contracted revenues in the initial and secondary markets.

The amendments in this Update improve GAAP by aligning the accounting for production costs of episodic television series with the accounting for production costs of films.

In addition, the amendments require that an entity test a film or license agreement within the scope of Subtopic 920-350 for impairment at the film group level, when the film or license agreement is predominantly monetized with other films and/or license agreements. This improvement addresses application issues with existing guidance as a result of changes in the industry and better reflects the economics of how certain entities monetize their content.

The amendments in the standard also:

- amend presentation requirements;
- require that an organization provide new disclosures about content that is either produced or licensed; and
- address cash flow classification for license agreements.

For public companies, the standard is effective for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. For all other organizations, the standard is effective for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. Early adoption is permitted.

For the full ASU text see www.FASB.org.

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