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Digital Currency Accounting and Presentation

Regardless of the purpose for which digital currencies are used, it is necessary to maintain the appropriate records on those currencies. The Ministry of Finance has issued a long-awaited opinion on digital currency accounting and presentation.

Digital and Crypto Currencies

A **digital currency** is a currency which, unlike a physical currency (ie banknotes and coins) is created and stored in an electronic form. Just like traditional money, digital currencies may be used for purchasing physical goods and services but may also be limited to a specific community, such as online games and social networks.

A **crypto currency** is a digital currency based on a complex, encrypted mathematic algorithm. At present, there are more than 1,300 individual crypto currencies with a different practical utilisation. The most popular and commonly used crypto currency includes Bitcoin which was already established in 2009. Other widely used crypto currencies include, for example, Ethereum, Bitcoin cash and Litecoin.

The main objective of the first crypto currencies was to replace "traditional" money transfers in online shopping which were slow, expensive and non-transparent. Crypto currencies allow one to transfer money anonymously across the globe within several tens of seconds at a relatively low cost. Unlike traditional currencies (issued by central banks), crypto currencies are decentralised and cannot be influenced (destroyed, forged, devaluated) from one centre. They function without intermediaries, whereby users communicate with each other via peer-to-peer networks. Crypto currencies are fully transparent thanks to a public database entitled blockchain which demonstrates all transactions executed in the network. The aggregate volume of a crypto currency is final and pre-determined.

At present, crypto currencies are also used as "classic" investment instruments or as a means for obtaining input investment funds. They may be purchased at online exchange offices, in specialised stock markets or via "ATMs" (such as bitcoinmats).

Digital Currency Accounting and Presentation in the Czech Republic

No specific provisions for digital currency accounting and presentation have been incorporated into Czech accounting legislation currently or International Financial Reporting Standards (IFRS).

With regard to the trading with bitcoins (a specific type of digital currency), the Czech National Bank (the "CNB") issued an opinion on 10 February 2014 stating that bitcoins are neither money nor investment instruments (as they do not meet the definition of securities or derivatives).

Tax authorities consider bitcoin to be an intangible movable property under Section 496 of the New Civil Code (another property without a tangible substance). In this context, a debate was held in practice as to whether bitcoin should be accounted for based on the purpose for which it was acquired or for which it is used. Bitcoin used as payment means would be reported as part of current financial assets (although it is not payment means). Bitcoins acquired for investment purposes would be reported as non-current financial assets (and measured at fair value if acquired for trading) and only the bitcoins which are mined by the entity would be reported as inventory.

New Opinion of the Ministry of Finance

On 15 May 2018, the long-awaited opinion of the Ministry of Finance on digital currency accounting and presentation (hereinafter the "MoF's opinion") was published.

The MoF's opinion stipulates that digital currencies:

- Are an intangible asset which is created and stored in an electronic form;
- Are not issued or regulated by the central bank or a public interest authority and do not have a legal status; and
- Are accepted by selected individuals and legal persons as assets that may be transferred, stored or traded.

The MoF's opinion states several intents for purchasing or holding digital currencies – they are used for making payments for goods and services, investments on speculative grounds, exchanging for other currencies or are "mined" which ensures their delivery into circulation.

Regardless of different motives for the holding and use of digital currencies, the Ministry of Finance currently recommends **unified accounting and presentation of digital currencies by all users as a type of inventory**.

Below is our opinion on the possible accounting for bitcoins in various accounting operations in line with the MoF's opinion.

a. An entity purchases bitcoins

Bitcoins purchased by an entity are measured at cost, just like inventories. Inventories purchased in foreign currencies are translated to and subsequently recorded in the accounting records in CZK pursuant to the entity's accounting policy.

A question remains which exchange rate shall be used since, according to the CNB's opinion, a digital currency is not considered payment means, i.e. The CNB's exchange rate table does not include the BTC/CZK exchange rate. It is possible to consider the application of Section 24 (9) of Act No. 563/1991 Coll., on Accounting, stipulating that



foreign currencies the exchange rate of which is not promulgated on a daily basis shall be translated by the entity using the interbank exchange rate for the respective foreign currency in relation to USD or EUR and the foreign exchange rate promulgated by the CNB for USD or EUR as of the same day.

As of the balance sheet date, the entity will analyse whether the inventory value of bitcoins corresponds to their market value. If the market value is lower, the company shall, in line with the prudence concept, reduce the value of inventory by the amount of this difference in the form of a provision.

b. The entity sells bitcoins

Bitcoins sold by an entity shall be measured upon sale in the same manner as other inventory items, i.e. either for the average warehousing cost or using the FIFO method, i.e. “first in, first out”. The selected method should be specified in the entity’s internal policy.

c. The entity receives a payment for receivables in bitcoins

If an agreement between a trader and a customer exists, the value of received bitcoins is equal to the value of purchased goods or services. Otherwise, the entity shall recognise this payment as an addition to inventory in measurement as we have specified above. The receivable will be settled by means of crediting.

d. The entity settles its payables in bitcoins

An entity which has settled its payables by means of bitcoins shall recognise this payment as a disposal of inventory in measurement as we have specified above. The payable will be settled by means of crediting.

e. The entity mines bitcoins

Bitcoins mined by an entity shall be measured in line with the MoF’s opinion at internal costs. Internally developed inventory is measured at actual value or based on the production calculation specified by the entity. Internal costs include direct costs and may also involve a proportionate part of variable and fixed indirect costs which are causally attributable to the respective performance, relating to the period of activity. With respect to the “mining of bitcoins”, direct costs may include the depreciation of hardware, software, wages of “mining” employees etc.

Conclusion

We are just at the beginning of finding a solution to the optimal accounting for digital currencies in the accounting records. The MoF’s opinion is welcomed as the first step on this journey.

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Revised Conceptual Framework for IFRS – Part II.

On 29 March 2018, the International Accounting Standards Board (IASB) published its revised 'Conceptual Framework for Financial Reporting', which became effective immediately. In this article, we continue to outline the main changes and the key concepts in the revised Framework.

The main purpose of the Framework is to guide the IASB when it develops International Financial Reporting Standards. It helps to ensure that the Standards are conceptually consistent and that similar transactions are treated the same way, providing useful information for investors and others. The Framework can also be helpful for preparers and auditors when there are no specific or similar standards addressing a particular issue.

In the previous issue of our Accounting news we dealt with the introductory explanation on the status and purpose of the Conceptual Framework and the first four chapters of the new Conceptual Framework:

Chapter 1 - the objective of general purpose financial reporting

Chapter 2 - Qualitative characteristics of useful financial information

Chapter 3 - Financial Statements and the reporting entity

Chapter 4 - the elements of financial statements

In this article we cover the next four chapters of the new Conceptual Framework.

Chapter 5 - Recognition and derecognition

The revised recognition criteria require an entity to recognise an asset or a liability (and any related income, expenses or changes in equity) if such recognition provides users of financial statements with:

- relevant information; and
- a faithful representation of the underlying transaction.

The recognition criteria no longer include a probability or a reliable measurement threshold. Instead, uncertainty about the existence of an asset or liability or a low probability of a flow of economic benefits are noted as circumstances when recognition of a particular asset or liability might not provide relevant information.

For an asset or liability to be recognised it must also be measured. Most measures must be estimated, which means that they will be measured with some uncertainty. The Framework discusses the trade-off between providing a more relevant measure that has a high level of estimation

uncertainty and a measure that might be less relevant but has lower estimation uncertainty. In limited circumstances all relevant measures may be subject to high measurement uncertainty, such that the asset or liability should not be recognised.

The chapter provides a high-level overview of how different types of uncertainty (e.g. existence, outcome and measurement) could affect the recognition decision. There is no detailed guidance, because it is a matter of assessing several factors that will depend on the facts and circumstances of each case. The IASB will consider these factors when developing Standards. It might be that some uncertainties should result in more supplementary information being provided by reporting entities.

The new Framework states that **derecognition** should aim to represent faithfully both:

- any assets and liabilities retained after the transaction that led to the derecognition; and
- the change in the entity's assets and liabilities as a result of that transaction.

The focus of this section is on cases when these two aims conflict. This is sometimes the case when an entity disposes of only part of an asset or a liability or retains some exposure.

The chapter also includes a discussion on how derecognition works in the case of contract modifications.

Chapter 6 - Measurement

The material in this chapter is new to the Framework.

Chapter 6 discusses:

- the different measurement bases and the information they provide; and
- the factors to consider when selecting a measurement basis.

The new Framework describes two **measurement bases**: historical cost and current value. The Framework asserts that both bases can provide predictive and confirmatory value to users but one basis might provide more useful information than the other under different circumstances. As such, the Framework does not favour one measurement basis over the other.

Historical cost

Historical cost reflects the price of the transaction or other event that gave rise to the related asset, liability, income or expense.



Current value

A current value measurement reflects conditions at the measurement date. Current value includes:

- fair value,
- value in use (for assets) and fulfilment value (for liabilities), and
- current cost.

Current cost is newly introduced into the Conceptual Framework as it is widely advocated in academic literature. A table offers an overview of the information provided by various measurement bases.

The Framework also sets out factors to consider when **selecting a measurement basis** (relevance, faithful representation and enhancing qualitative characteristics). The objective in selecting a measurement basis is consistent with that of financial statements: i.e. To provide relevant information that faithfully represents the underlying substance of a transaction.

The Framework does not provide detailed guidance on when a particular measurement basis would be suitable because the suitability of particular measurement bases will vary depending on facts and circumstances. On equity, the Framework offers some limited discussion, although total equity is not measured directly. Still, the Framework maintains, it may be appropriate to measure directly individual classes of equity or components of equity to provide useful information.

Chapter 7 – Presentation and disclosure

The material in this chapter is new to the Framework.

In this chapter, the Framework discusses concepts that determine what information is included in the financial statements and how that information should be presented and disclosed.

The statement of comprehensive income is newly described as a “statement of financial performance”; however, the Framework does not specify whether this statement should consist of a single statement or two statements, it only requires that a total or subtotal for profit or loss must be provided. It also notes that the statement of profit or loss is the primary source of information about an entity’s financial performance for the reporting period and that only in “exceptional circumstances” the Board may decide that income or expenses are to be included in other comprehensive income. Notably, the Framework does not define profit or loss, thus the question of what goes into profit or loss or into other comprehensive income is still unanswered.

Chapter 8 – Concepts of capital and capital maintenance

The content in this chapter was taken over from the existing Conceptual Framework and discusses concepts of capital (financial and physical), concepts of capital maintenance (again financial and physical) and the determination of profit as well as capital maintenance adjustments.

Effective date

The new Framework became effective as soon as it was published on **29 March 2018**.

Updating References in Standards to the revised Conceptual Framework

Some Standards include references to the 1989 and 2010 versions of the Framework. The IASB has published a separate document *Updating References to the Conceptual Framework* which contains consequential amendments to affected Standards so that they refer to the new Framework. These amendments are effective for annual periods beginning on or after **1 January 2020**, with earlier application permitted.

There is one exception. IFRS 3 *Business Combinations* states that, in a business combination, identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in the Framework. IFRS 3 refers to both the 1989 and 2010 Frameworks. The definitions of asset and liability in those Frameworks are also in IFRS Standards. IAS 38 *Intangible Assets* includes the 1989 and 2010 Framework definition of an asset and IAS 37 has the 1989 and 2010 Framework definition of a liability.

The IASB decided not to amend IFRS 3 at this stage, because they are concerned that an item that meets the definition of an asset or liability when the new Framework is applied might need to be derecognised immediately because it does not meet the asset or liability definition in IFRS Standards. The IASB will explore this issue in a separate narrow-scope project.

Sources: www.iasplus.com
www.ifrs.org

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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 May 2018.

As of 25 June 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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Consignment inventory

Do you have inventory that may be considered as a consignment inventory? How would you treat it in your US GAAP reporting?

Consignment inventory transactions can take different forms. In many cases, consignment inventory represents inventory that is received by a dealer (consignee) from a manufacturer (consignor) for the purpose of selling the inventory to customers. The dealer returns any unsold inventory to the manufacturer. The manufacturer maintains title to and risk of ownership of the inventory until the inventory is sold to the end customer.

In other cases, the consignee is a manufacturer that receives inventory from a supplier (consignor). The manufacturer can return the inventory to the supplier before the inventory is consumed in the manufacturer's production; however, once the inventory is consumed, the title and risk of ownership transfer to the manufacturer. Therefore, the consignee does not record inventory in its balance sheet for the amount of consignment inventory held until the inventory has been consumed in the consignee's production.

Example

A retailer enters into an agreement with a supplier to purchase inventory to sell to customers. Under the agreement, the retailer receives the inventory and has

the right to return the inventory at any time during the contract period, but must either return or purchase any unsold inventory at the end of the contract period. Is this agreement a consignment inventory arrangement?

How to treat this inventory?

If the retailer takes title to and assumes risk of ownership of the inventory upon receipt, the agreement would generally not be considered a consignment arrangement. Therefore, the retailer would record the inventory as of the date of inventory receipt.

If the supplier retains title to and maintains risk of ownership of the inventory, the agreement generally would be considered a consignment arrangement and the supplier would continue to record the inventory until both title and risk of ownership transfer to the retailer (e.g., when the retailer sells the inventory to a customer).

Primary Reference for this area under US GAAP is the FASB codification, reference 330-10-05-3.

There was also a Q&A issued in the *SEC Staff Accounting Bulletin, Topic 13.A.2., „Persuasive Evidence of an Arrangement“*, for further reference in this area.

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