



dReport: September 2019

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Ground-breaking ruling: usability of financial statements in deciding on profit distribution

In its ruling of March 2019, the Supreme Court allowed the use of ordinary or extraordinary financial statements as a basis for the payment of profit shares until the end of the following reporting period. This broke the previously required six-month limit for the usability of financial statements as a basis for the payment of profit shares.

The earlier legal regulation contained in the Commercial Code set a six-month period starting with the end of the fiscal year when the general meeting had to approve the company's financial statements. The Commercial Code did not specifically determine a period within which the general meeting had to decide on the distribution of profit. The case law of the Supreme Court, contained e.g. in ruling no. 29 Cdo 4284/2007 of 30 September 2009, inferred that particularly in order to protect creditors, "the ordinary financial statements prepared for the previous reporting period could not be used as a basis for profit distribution after the end of the period set for calling the general meeting for the purposes of discussing the ordinary financial statements." the arguments were based on the fact that an older set of financial statements no longer had sufficient informative value to provide a realistic view of the company's financial situation based on which shareholders could make a qualified decision about profit distribution.

This ruling was criticised by many experts; however, it continued to be respected in practice even after 1 January 2014, when the Business Corporations Act came into force. Companies therefore often chose to make profit share prepayments after the end of the six-month period.

A turn in this interpretation came only with ruling no. 27 Cdo 3885/2017 of 27 March 2019. In this ruling, the Supreme Court explained the changes in the legal regulation of the distribution of profit of a joint stock company brought by the Business Corporations Act compared to the regulation contained in the Commercial Code.

The Supreme Court addressed in particular the following three matters:

1. Decisions of the general meeting on the distribution of profit and relation to the usability of the financial statements;
2. Interpretation of the required elements of the invitation to a general meeting; and
3. Compliance of the general meeting's decision with good morals.

The next part of this article will deal only with the first item.

Usability of the financial statements for the previous reporting period

First of all, the Supreme Court stated that the legal regulation of profit distribution of a joint stock company had undergone several changes with effect from 1 January 2014, and it was therefore impossible to automatically apply the judiciary conclusions adopted in the interpretation of the Commercial Code.

Although the Business Corporations Act ("BCA") stipulates that a profit share shall be determined based on ordinary or extraordinary financial statements approved by the highest body of the business corporation (Section 34 (1) of the BCA) and simultaneously regulates the period for discussing the ordinary financial statements of a joint stock company (Section 403 (1) of the BCA), the previous case law related to the Commercial Code can no longer be applied. This is the case because the Business Corporations Act – unlike the Commercial Code – explicitly regulates the "insolvency test" (Section 40 (1) of the BCA), which should be sufficient for achieving the goal of preventing the payment of profit shares "to the detriment" of the Company's creditors.

In addition, it is also necessary to take into consideration the fact that based on the Business Corporations Act, the rule of the "limited usability" of the ordinary financial statements for the distribution profit based on the case law can be easily circumvented if the company issues shares with fixed profit shares. The right to a fixed profit share for the preceding reporting period arises as of the first date of the following reporting period as long as profit was generated in the preceding period. Shareholders holding shares with fixed profit shares will therefore receive a fixed profit share regardless of whether and when the general meeting makes a decision about profit distribution.

According to the Supreme Court, "with effect from 1 January 2014 the ordinary financial statements prepared for the previous reporting period can therefore serve as a basis for profit distribution until the end of the next reporting period."

In this respect it is a breakthrough ruling which will make it possible for the **general meeting to make a decision about profit distribution at any time during the entire subsequent reporting period, provided that the company meets the insolvency test and would not bankrupt itself by paying out profit.**



Payment of director's fees without profit distribution to shareholders

The Supreme Court additionally addressed the matter of impossibility to pay out director's fees unless profit is paid out to shareholders. At the time of validity of the Commercial Code, a rule applied that the general meeting could not determine the profit share of members of the Board of Directors and Supervisory Board (director's fees) without approving profit for distribution and the shares of shareholders in the profit determined in this way (dividends). According to the Supreme Court, "with effect from 1 January 2014 the general meeting may also decide on the distribution of profit by distributing its part in the form of director's fees to the members of elected bodies (provided that this is allowed by the company's articles of association), or allocating it to a fund established by the articles of association and created from profit, and keeping the rest in retained earnings; however, the non-distribution of the remaining portion of profit has to be duly justified." a valid reason for not distributing (a portion of) profit among shareholders can be (for example) a provision contained in the articles of association, regulating the handling of the company's profits.

Amendment to the Business Corporations Act

The anticipated draft amendment to the Business Corporations Act that should come into force on 1 2020 explicitly states, in reaction to the new case law of the Supreme Court of the Czech Republic, that profit determined based on ordinary or extraordinary financial statements can be paid out until the end of the reporting period following the reporting period for which the financial statements are prepared.

It also limits the level of profit share prepayments to the half of the average profits achieved in the last three reporting periods.

The full text of the Supreme Court's ruling is available [here](#).

Source: www.nsoud.cz

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Invitation to a Seminar

News in Czech Accounting

Prague, Brno, Ostrava, Pilsen and Hradec Kralove

We would like to invite you to Deloitte's traditional autumn seminar focusing on financial statements and accounting in the Czech Republic. 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 introduce to you the concept of new accounting legislation for the period 2020 -2030, which is in the process of preparation. We will also discuss the planned changes to the Czech accounting legislation related to the forthcoming amendment of the Act on Business Corporations. 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.

Seminars will be held in Czech and will be delivered by our professionals.

The seminar is not intended for consultants or employees of companies engaged in providing advisory services.

Dates

Prague:	12 November 2019 and 10 December 2019
Ostrava:	21 November 2019
Pilsen:	5 December 2019
Hradec Kralove:	11 December 2019
Brno:	12 December 2019

More information and registration on: akce.deloitte.cz



The Biggest Pitfalls of Adopting IFRS 16, which Addresses the Reporting of Leased Assets

Since 1 January 2019, IFRS 16 has been in effect. This standard substantially revised the accounting treatment applied by lessees to leased assets. For companies, this means more demanding work with data; the need to define which of their contracts fall under the scope of IFRS 16; and also, for instance, employee training. What are the pitfalls lessees face in connection with the new standard? And is there a way the whole accounting process can be simplified?

While earlier, payments under operating leases were directly expensed, and any extraordinary payments and rental-free periods were reported on an accrual basis, now lessees are required to report on the face of the balance sheet both the right-of-use asset and the liability arising from future lease payments, which is similar to the treatment formerly applied to finance leases. The way leases are reflected in expenses is through the amortisation of the right-of-use asset and interest on the lease liability.

What does the term “lease” under IFRS 16 incorporate? Some readers may think this only includes leases of cars or other movable assets. However, in fact, leases also include leases of buildings, office premises, land and IT infrastructure.

Three key challenges companies have to address in accounting for leases:

1. **The data in place are not homogenous.** To determine correctly the values of the right-of-use asset and the lease liability, companies have to, first of all, identify contracts that fall under the scope of the standard. Subsequently, the relevant data need to be extracted from the contracts. However, these primary data are unstructured. This is because frequently the contracts do not have a unified form. For instance, the lease payments are not always specified as a unique amount - conversely, primarily in respect of leases of buildings, lease amounts comprise multiple components. In such cases, a decision needs to be made on whether a particular component shall be reflected in the calculation or not. Moreover, some of the components increase on a regular basis, depending on inflation.
2. **Judgements regarding the lease term.** Frequently, lease contracts incorporate options for lease term extension or reduction. Here, companies have to assess whether they are reasonably certain about exercising the relevant option. Moreover, contracts for an indefinite period of time are a special issue, especially in relation to property leases. This is because IFRS 16 does not explicitly specify how the lease term should be determined in respect of such contracts, based on which subsequently the value of the right-of-use asset and the value of the lease liability are calculated. Therefore, company management is required to apply judgement, which may have a material impact on the statement of financial position. Also, most probably, the judgement will be subject to due scrutiny by auditors.

3. **Frequently, Excel is not enough.** After creating the register of contracts including all necessary data, the values of the right-of-use asset and the lease liability are calculated. For the primary calculation, work experience with Excel and knowledge of essential functions of financial mathematics will suffice. Many firms have decided to go this way, that is, to calculate the relevant amounts on their own using Excel spreadsheets. However, life brings about changes, and thus, new contracts are concluded, while others expire, are prolonged, extended or shortened. IFRS 16 does reflect events like this and provides guidance on their accounting treatment. However, this is the stumbling block of using the simple models in Excel – if they are to at least partially address such issues in an automated way, they may not be merely a simple Excel spreadsheet. For instance, as soon as the number of contracts increases, contracts paid in EUR are added, the Excel spreadsheet will soon reach its limits in terms of reliability and transparency of the data contained in it.

Forget about Excel – let us introduce dLease, a smart assistant in accounting for leased assets

At Deloitte, we decided to hit another way by creating an SQL database tool. We offer this instrument to our clients under the title **dLease**. Among other things, tens to thousands of contracts can be managed in the tool, without any impact on the system's stability. Embedded formulas also address the changes specified above, including foreign currency translation and automated lease payment indexation (ie based on the development of inflation). With one click, dLease generates a report including all details that are necessary for the reporting of leases in line with IFRS 16 and all data required by the standard for disclosure in the notes to financial statements. This is because like every new standard, IFRS 16 not only places increased requirements on the accounting treatment, but also on the disclosure of complementary information. **Would you like to know more about dLease? Go to [our webpage](#).**

The application of IFRS 16 is mandatory for reporting periods starting 1 January 2019. Even though companies were required to disclose the assessed impact of this standard already in the financial statements for 2018, many of them have postponed ongoing accounting for these items until the preparation of financial statements for 2019. If you do not have in place a tool for reporting lease contracts yet, we recommend paying attention to the selection of an appropriate instrument now so as to avoid unpleasant last-minute surprises.

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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 13 September 2019.

As of 23 September 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* (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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Invitation to Autumn Seminars

IFRS News 2019

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

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

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

This on-line seminar will not cover in detail the new IFRS 16 *Leases*. This standard will be the topic of specialised seminars organised in the autumn.

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

Date:

- 16 October 2019, 10 a.m. – 11 a.m.

For more information and to register, please go to: akce.deloitte.cz

The Pitfalls of Financial Statements under IFRS for 2019

We are pleased to invite you to Deloitte's autumn seminar on International Financial Reporting Standards (IFRS).

You will be provided with an overview of standards and interpretations, which have been mandatorily effective since 1 January 2019 or later. We will draw your attention to the major changes and their impact on financial statements prepared for the year 2019.

We will have a closer look at the new IFRS 16 *Leases*, which has been in effect since 1 January 2019. The standard brings along changes that are primarily critical from the lessee's perspective, as according to the amended rules, operating leases are now reported on the face of the balance sheet. We will primarily focus on how the adoption of this new standard should be reflected in the 2019 financial statements and what practical expedients may be used in the transition. We would like to note that we will focus on IFRS 16 in greater detail during a special seminar entitled "[IFRS 16 Leases in Practice](#)".

We will also draw your attention to the most common errors our auditors came across during audits of financial statements prepared in accordance with IFRS for 2018. Given



that most frequently, the errors were related to the implementation of the new standards IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers*, we will address these standards with appropriate care during the seminar.

We will also pay attention to missing disclosures in the notes to the financial statements.

And finally, we will also have a look at an overview of IFRS changes that are expected to come into effect in the near and later future.

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

The whole day's seminar will be held in Czech in Prague, Brno and Ostrava and will be hosted by Deloitte experts.

Date:

Prague	6 November 2019, 9 a.m. – 3 p.m.
Ostrava	12 November 2019, 9 a.m. – 3 p.m.
Brno	19 November 2019, 9 a.m. – 3 p.m.

For more information and to register, please go to:
akce.deloitte.cz

IFRS 16 – *Leases in Practice*

We are pleased to invite you to the autumn seminar on International Financial Reporting Standards (IFRS), which will be held in our new office premises in Prague Vinohrady. We will scrutinise the new IFRS 16 *Leases*, which has replaced IAS 17 *Leases* and which has been effective for reporting periods starting on 1 January 2019. Also, we will address in detail the relating interpretations. The new standard brings along significant changes, primarily those from the lessee's perspective. This is because operating leases are newly reported on the face of the balance sheet.

At the seminar, we will focus on challenging areas that require applying greater judgement in implementing the new standard. We will provide practical examples on how individual requirements placed by the standard shall be implemented. We will also pay detailed attention to various practical expedients that may be used in the transition to the new standard. You will also find out about new disclosures to be provided in the notes.

Certainly there will be time to answer your questions during the seminar.

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

The whole day's seminar will be held in Czech in Prague and it will be hosted by our professionals.

Date:

- Prague: 26 November 2019, 9 a.m. – 4 p.m.

For more information and to register, please go to:
akce.deloitte.cz

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