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Cash Pooling and Its Accounting Treatment

In today's article we will focus on cash pooling as an expanded instrument to optimise corporate accounts and its accounting treatment. We will also remind you of the related obligations to various governmental bodies.

What is Cash pooling?

Cash-pooling is an instrument used to optimise corporate accounts. Companies typically use a number of current accounts and cash-pooling gives them the opportunity to consolidate these bank accounts into a 'master account' and accrue interest on a daily basis as a whole. The overriding benefit is that companies have the ability to avoid interest being charged on current accounts where the negative balance of an overdraft account is offset by a positive balance on another bank account. Obviously, cash-pooling does not necessarily serve only companies that have multiple bank accounts but also group companies to manage funding within the whole group.

Banks typically offer their corporate clients physical cash-pooling where the balances of all accounts physically transfer to one account that has been designated as the 'master account', or notional cash-pooling that makes it possible to achieve the same effect of interest optimisation as with physical cash-pooling, without the need to physically transfer account balances.

Accounting implications of using cash-pooling

Notional cash-pooling does not result in physical transfers of cash balances and, for this reason, this cash-pooling form has no accounting implications.

By contrast, physical cash-pooling poses a question as to whether the company does or does not have, at any point of time, the ability to "touch" its money that was transferred to the master account. In the vast majority of cases, the group conditions will be set such that physical cash-pooling will *de facto* represent an intercompany loan and hence the cash-pooling account balance will not be reported as part of "Cash at bank" or "Payables to credit institutions" but as a component of intercompany receivables or payables, ie in balance sheet lines C.II.2.2 "Receivables - controlled or controlling entity" or C.II.6 "Payables - controlled or controlling entity".

Similarly, in the cash flow statement, if the company does not have the ability to handle the funding on the cash-pooling account, the cash-pooling account will not be included in cash and cash equivalents but rather as part of the "Cash flow from financial activities" section.

Legislative requirements for cash-pooling reporting

Cash-pooling transactions are not defined by law. However, they are subject to standard rules as any other transactions with the same substance. If foreign transactions are performed under physical cash pooling we recommend taking into consideration the obligations with respect to the Czech National Bank or the Tax Authorities.

Reporting to the Czech National Bank

Certain cash-pooling transactions can be subject to reporting to the Czech National Bank (the "CNB") based on Regulation 235/2013 Coll., on Reporting to the CNB by Statistically Significant Reporting Entities for the Purpose of Preparing Cross-Border Payment Balance, Investment Position and Debt Service. This Regulation defines the number of reporting entities that are required to provide the CNB with the reports defined in the appendices to the Regulation. Under the Regulation, reporting entities include entities with the total annual amount of financial loans provided or received in respect of a foreign entity of at least CZK 100 million at the end of the calendar year.

According to the CNB's statement, information on cross-border financial transactions is only reported by entities that have been notified by the CNB that they have been included in the group of statistically significant entities under the criteria specified in Regulation 235/2013 Coll. The obligation to prepare and submit a monthly statement on the balance of payments (ČNB) 41-12 "Financial Loans and Accounts Abroad" thus does not apply to any company exceeding the annual limit of financial loans provided or received in respect of a foreign entity in the amount of CZK 100 million.

Tax impacts of cash-pooling transactions

The Tax Authorities will naturally focus on tax impacts of cash-pooling transactions. When providing loans under cash-pooling, group entities are obliged to set up the arm's length loan conditions or at least calculate the difference between the arm's length and the set-up conditions and reflect the difference in preparing their tax returns. Any incorrect set-up of cash-pooling may result in additional tax assessment and the payment of resulting sanctions.

Please note that the rules of thin capitalisation should be followed, ie that the limit for the application of loan interest (or the related fees, etc) as the tax deductible item applies to cash-pooling as well. For non-financial companies, tax-deductible items only include financial expenses of the amount of up to the quadruple of the company's equity.

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Revised Conceptual Framework for IFRS – Part I.

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 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.

Background

The IASB's Framework was published initially in 1989. In 2005 the IASB started working with the US FASB to develop a common Framework. The boards published chapters setting out the objective of general purpose financial reporting and the qualitative characteristics of useful financial information in 2010, and these were incorporated into the IASB's Framework.

The IASB then decided to continue its work alone. In May 2015 it published an exposure draft proposing six new chapters, and some changes to the chapters it had completed with the FASB. The IASB finalised this work and issued a revised Framework on 29 March 2018. It came into effect as soon as it was published, although the practical consequences are unlikely to be significant in the short term.

Structure of the Conceptual Framework

The 2018 Conceptual Framework is structured into an introductory explanation on the status and purpose of the Conceptual Framework, eight chapters, and a glossary:

Chapter	Topic
	Status and purpose of the Conceptual Framework
1	The objective of general purpose financial reporting
2	Qualitative characteristics of useful financial information
3	**Financial statements and the reporting entity**
4	**The elements of financial statements**
5	**Recognition and derecognition**
6	**Measurement**
7	Presentation and disclosure
8	Concepts of capital and capital maintenance
Appendix A	Glossary

Five of the chapters (marked bold in the table above) are new, or have been revised substantially. The revised Framework is about three times the length of the version it replaces.

Status and purpose of the Conceptual Framework

The first section notes that the Conceptual Framework's purpose is to assist the IASB in developing and revising IFRSs that are based on consistent concepts, to help preparers to develop consistent accounting policies for areas that are not covered by a standard or where there is choice of accounting policy, and to assist all parties in understanding and interpreting IFRS.

It maintains that the framework does not override any specific IFRS. If there is a conflict, or inconsistency, between the Framework and a Standard, the requirements in the Standard take precedence. The IASB has decided not to automatically change existing Standards as a result of the changes it has made to the Framework. The IASB will expose any proposed amendments to an existing Standard just as it would do with any other proposed amendment.

Chapter 1 - the objective of general purpose financial reporting

This is the first of the two chapters that were finalised as part of the joint project with the FASB in 2010, so there are only limited changes. The chapter notes that the objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity. This is identified as information about the entity's economic resources and the claims against the reporting entity as well as information about the effects of transactions and other events that change a reporting entity's economic resources and claims. The chapter newly stresses that information can also help users to assess management's stewardship of the entity's economic resources.

Chapter 2 - Qualitative characteristics of useful financial information

This is the second of the two chapters that were finalised as part of the joint project with the FASB in 2010 (published as Chapter 3 in the 2010 Conceptual Framework). Again, changes are limited. The chapter explains the fundamental qualitative characteristics (relevance and faithful representation) and the enhancing qualitative characteristics (comparability, verifiability, timeliness, and understandability) of useful financial information and notes the cost constraint. Materiality is noted as an entity-specific aspect of relevance. The chapter reintroduces an explicit reference to the notion of prudence and states that the exercise of prudence supports neutrality. Prudence is defined as the exercise of caution when making judgements under conditions of uncertainty. New is also a clarification that faithful representation means representation of the substance of an economic phenomenon instead of representation of its legal form only.

Chapter 3 - Financial Statements and the reporting entity

The material in this chapter is new to the Framework.

The chapter states the **objective of financial statements**: to provide information about an entity's assets, liabilities, equity, income and expenses that is useful to financial statements users in assessing the prospects for future net cash inflows to the entity and in assessing management's stewardship of the entity's resources. It only mentions two statements explicitly: the statement of financial position and the statement(s) of financial performance (the latter being the former statement of comprehensive income); the rest are "other statements and notes".

The new Framework states that financial statements are prepared **from the perspective of the entity as a whole**, rather than from the perspective of any particular group of investors, lenders or other creditors (the entity-perspective). It is important for matters such as non-controlling interests (NCI) in a group.

This chapter also includes the statement (brought forward from the 2010 Framework) that the financial statements are prepared on the assumption that the reporting entity is a **going concern** and will continue in operation for the foreseeable future.

New to the framework is the definition of a **reporting entity:** an entity that chooses, or is required, to prepare financial statements. The new Framework describes the financial statements of a parent entity as **unconsolidated financial statements**, which is a new term. IAS 27 *Separate Financial Statements and* other Standards use the term separate financial statements. The financial statements of a group are defined as **consolidated financial statements**. The IASB is convicted that, generally, consolidated financial statements are more likely to provide useful information to users of financial statements than unconsolidated financial statements.

Chapter 4 - the elements of financial statements

This chapter discusses the definitions of the elements of financial statements, i.e. assets, liabilities, equity, income and expenses. The IASB has changed the definitions of an asset and a liability. The definitions of the other elements remain largely unchanged.

	2010 Framework definition	New Framework definition
Asset	A resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.	A present economic resource controlled by the entity as a result of past events. (An economic resource is a right that has the potential to produce economic benefits.)
Liability	A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.	A present obligation of the entity to transfer an economic resource as a result of past events.

The most significant change to the asset and liability definitions is the removal of the reference to the expected flow of economic benefits.

The focus of the definitions is now on the existence of a right (or an obligation) that has the *potential to* produce (or require an entity to transfer) economic benefits. For that potential to exist it does not need to be certain, or even likely, that the right will produce (or require an entity to transfer) economic benefits.

The expression "economic resource" " instead of simply "resource" stresses that the IASB no longer thinks of assets as physical objects but as sets of rights.

Distinguishing between liabilities and equity is not part of the new framework but has been transferred to the IASB's research project on financial instruments with the characteristics of equity.

Chapters 5, 6, 7 and 8 of the new Conceptual Framework will be covered in the next issue of our Accounting news.

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 24 April 2018.

As of 25 May 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]

Potential Areas of Difference between U.S. GAAP and IFRS in Accounting for Uncertainty in Income Taxes

Nowadays there are an increasing number of companies for which the accounting for Uncertainty in Income taxes is relevant and applied, but there are still gaps in knowledge and experience in these accounting treatments.

We have prepared a practical comparison between U.S.GAAP and IFRS in the accounting, measurement and recognition in the area of Uncertainty in Income Taxes.

U.S. GAAP Accounting

ASC 740 requires a two-step approach for determining the amount, if any, of a tax benefit that should be recognized in an enterprise's financial statements.

The first step is **recognition**: the enterprise determines whether it is more likely than not (more than 50%) that a tax position will be sustained upon examination. This includes resolution of any related appeals or litigation processes, based on the technical merits of the position. In evaluating whether a tax position has met the more-likely-than-not recognition threshold, the enterprise should presume that the position will be examined by the appropriate taxing authority that has full knowledge of all relevant information.

The second step is **measurement**: a tax position that meets the more-likely-than-not recognition threshold is measured to determine the amount of benefit to recognize in the financial statements. The tax position is measured at the largest amount of benefit that is greater than 50 percent likely to be realized upon ultimate settlement.

IFRS Accounting

IAS 37, Provisions, Contingent Liabilities and Contingent Assets, is a one-step approach requiring the recognition of a provision when "(a) an entity has a present obligation . . . As a result of a past event; (b) it is probable . . . that an outflow of resources embodying economic benefits will be required to settle the obligation; and (c) a reliable estimate can be made of the amount of the obligation."

The term "probable" is defined in IAS 37 as "more-likely-than-not." If these conditions are not met, no provision is recognized. According to par. 39 of IAS 37, "...Uncertainties surrounding the amount to be recognized as a provision are dealt with by various means according to the circumstances. Where the provision being measured involves a large population of items, the obligation is estimated by weighting all possible outcomes by their associated probabilities. The name for this statistical method of estimation is 'expected value...'" IAS 37 goes on to explain that where "... there is a continuous range of possible outcomes, and each point in that range is as likely as any other, the mid-point of the range is used." Furthermore, IAS 37 states that where "... a single obligation is being measured, the individual most likely outcome may be the best estimate of the liability. However, even in such a case, the entity considers other possible outcomes. Where other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount...”

Difference Between U.S. GAAP and IFRSs — Recognition

Under ASC 740, a tax position must meet the more-likely-than-not (more than 50%) recognition threshold in order for the associated tax benefit to be recognized in an enterprise's financial statements. If a tax position does not meet the recognition threshold, a liability or other adjustment would be recognized for the full amount of the tax benefit.

IAS 37 does not include a separate recognition threshold; rather, it provides a single threshold for the recognition and measurement of the provision. Therefore, the liability recognized under IAS 37 may or may not be the same amount as that recognized under ASC 740.

<u>Example</u>: assume an enterprise takes a deduction of $100 on its tax return (resulting in a $40 tax benefit) and concludes that it is not more likely than not that the deduction would be sustained upon examination by the taxing authority. Under ASC 740, the enterprise would recognize a liability or other adjustment for an unrecognized tax benefit for the full amount of the tax benefit ($40) in its financial statements. Under IAS 37, the enterprise would recognize the most reliable estimate that can be made of the amount of the obligation. This amount likely would be less than the full amount.

Difference Between U.S. GAAP and IFRSs — Measurement

Under ASC 740, a tax position that meets the more-likely-than-not recognition threshold is measured at the largest amount of benefit that is greater than 50 percent likely to be realized upon ultimate settlement (cumulative-probability approach). The enterprise would recognize a liability for an unrecognized tax benefit for the difference between the full amount of the benefit and the largest amount of the benefit that is greater than 50 percent likely to be realized.

IAS 37 does not include a separate measurement threshold; rather, it provides a threshold for the recognition and measurement of the provision. Under IAS 37, the enterprise would recognize the most reliable estimate that can be made of the amount of the obligation.

For example, assume an enterprise takes a deduction of $100 on its tax return (resulting in a $40 tax benefit) and concludes that it is more likely than not that the deduction would be sustained upon examination by the taxing authority. Under ASC 740, the enterprise would measure the associated tax benefit at the largest amount of benefit that is greater than 50 percent likely to be realized upon ultimate settlement. The enterprise concludes that the following table of values accounts for all possible outcomes and probabilities:

Possible Estimated Outcome	Individual Probability of Occurring (Percent)	Cumulative Probability of Occurring (Percent)
$40	31	31
$30	20	51
$20	20	71
$10	20	91
$0	9	100

Under ASC 740, the enterprise should recognize a tax benefit of $30 because this is the largest benefit with a cumulative probability of greater than 50 percent. Accordingly, the enterprise should record a $10 income tax liability based on ASC 740 (assuming that the tax position does not affect deferred taxes).

IAS 37 does not provide explicit guidance on which method to use in determining the best estimate of the liability to recognize. There are many acceptable methods. Applying any of these methods may or may not result in a difference in the amount of recognized liability as compared with ASC 740. One acceptable method would be a weighted-average method that results in a $16 liability in accordance with the example above, since the weighted average of all possible outcomes is $24.

Other Differences

ASC 740 also provides guidance on subsequent recognition, derecognition, measurement, recognition of interest and penalties, classification, and disclosure. This guidance will probably create additional differences between U.S. GAAP and IFRSs.

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