

# Accounting Advisory

## Amendment of accounting legislation for entrepreneurs as of 1 January 2008

This newsletter provides an overview of the key changes brought by the amendment of Decree No. 500/2002 Coll., amending some of the provisions of Act No. 563/1991 Coll., on Accounting, as amended, on reporting entities – entrepreneurs using double entry accounting (the “Decree”), and by the amendment of Czech Accounting Standards (“CAS”) for reporting entities doing accounting under the Decree.

The amendment of the Decree was published in Section 109 of the Collection of Laws dated 21 December 2007 under item No. 349/2007. The CAS changes were published under item No. 31 in the *Financial Reporter (Finanční zpravodaj)* No. 10/2007, dated 31 December 2007.

The amendments are valid for fiscal periods commencing in 2008. However, some of the provisions will be used when compiling financial statements and consolidated financial statements with the balance sheet date on or after 29 June 2008 (specified below in the relevant paragraphs).

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Key changes may be grouped into several areas:

- Changes in the area of financial statements
- Changes relevant to fixed assets
- Changes relevant to inventory
- Changes in other areas

### 1. Changes in the area of financial statements

#### Possibility of presentation in millions of CZK

Reporting entities with the aggregate value of assets (net of depreciation and provisions) of CZK 10 billion or more may present individual items in whole CZK millions. So far, only banks and other financial institutions have been allowed to do this. However, reporting entities will have to apply this new possibility in all parts of their financial statements, i.e. the balance sheet, the income statement, the cash flow statement, the statements of changes in equity, and the explanatory notes. This change is stipulated in Section 4(11) of the Decree. It allows large corporations to provide relevant and transparent information while saving costs in the process of preparing the financial statements.

#### New requirements for disclosing information in the notes to the financial statements and consolidated financial statements

- Information not presented in the balance sheet  
As a new requirement, the reporting entity has an obligation to disclose in the notes the nature and commercial purpose of transactions that are material, with respect to the risks and benefits, for the assessment of the financial position of the company. The reporting entity also has to disclose information about the financial impact of those transactions on the company, provided that it is obliged to use the full scope accounting system. This requirement is stipulated in Section 39(9) of the Decree. The requirement for disclosing the information in the notes to the consolidated financial statements is stipulated in Section 67(k) of the Decree. The change is effective for financial statements with the balance sheet date on or after 29 June 2008.

- **Information on related-party transactions**

The reporting entity must disclose in the notes information about related-party transactions, provided that these transactions are material and have not been entered into under an arm's-length basis. Provided that a transaction has been entered into only by the reporting entity and its sole owner, there is no obligation to disclose this information. The IFRS definition stipulated by the EU law has to be used in order to define "related parties". Information about the transactions may be grouped according to their nature; however, if an individual transaction is material, it has to be shown separately. There may be a problem to assess whether these transactions are material and whether they have been entered into on an arm's-length basis. This may be addressed by disclosing all these transactions regardless of the conditions under which they have been realised. This requirement is stipulated in Section 39(10) of the Decree. The requirement to publish the information in the notes to the consolidated financial statements is stipulated in Section 67(l) of the Decree. The change is effective for financial statements with the balance sheet date on or after 29 June 2008.

- **Disclosing auditors' services**

The reporting entity must disclose separately in the notes to the financial statements information about the total fees paid to the auditor for the fiscal period for the statutory audit, other assurance services, tax advisory, and other non-assurance services. In the event that this information is already disclosed in the notes to the consolidated financial statements, it does not need to be stated again in the notes to the financial statements. This requirement is stipulated in Section 39(11) of the Decree. The requirement to publish the information in the notes to the consolidated financial statements is stipulated in Section 67(m) of the Decree. The change is effective for financial statements with the balance sheet date on or after 29 June 2008.

### **Abolition of the obligation to file a certified translation of the consolidated financial statements**

The amendment has abolished the requirement of publishing a certified translation of the consolidated annual report, including the consolidated financial statements of a foreign company that consolidates the Czech reporting entity using the exemption under Section 62(5) and, thus, does not prepare its own consolidated financial statements. The obligation to submit consolidated annual report (uncertified) of the foreign company in Czech remains, however. This change is stipulated in Section 62(6c) of the Decree. The change is effective for financial statements with the balance sheet date on or after 29 June 2008.

## **2. Changes relevant to fixed assets**

### **Negative definition of intangible fixed assets**

The amended Decree now specifies what an intangible fixed asset is not. Intangible assets do not include expert reports, market research, development plans, proposals for promotion and advertising campaigns, quality system certifications, and control software for technology or devices that may not function without such software. The reporting entity may decide that the technical and energy audits, forestry economic plans, and river basin plans do not represent intangible fixed assets. This change is stipulated in Section 6(9) of the Decree.

## Valuation of fixed assets

Initial measurement of fixed assets and technical enhancements newly comprise also taxes related to acquisition of these assets, including the real estate transfer tax. This change is stipulated in Section 47(2) of the Decree.

## Fixed assets depreciations

CAS 013 has been amended to enable depreciation of plants developed by a lessee on a third party's land and not booked and depreciated by the owner of the land.

## 3. Changes relevant to inventory

### Change in the definition of inventory

- **Inclusion of small tangible assets into the definition of 'Raw Material'**  
Small tangible assets (i.e. separate tangible things and sets of movables with useful lives longer than one year and with their purchase price under the limit specified for classification as tangible fixed assets) were included into the definition of 'Raw Material'. Prior to the amendment, the small tangible assets were stipulated in Section 7 (Tangible Fixed Assets), but this amendment may not represent a factual change. This amendment is stipulated in Section 9(1g) of the Decree.

### Changes related to valuation of inventory

- **Items not included in the initial measurement of inventory**  
The amendment expands the list of items that are not included in the initial measurement of inventory. In addition to interest from loans used for the purchase of inventory, it is not possible under the amendment to include exchange rate differences, contractual penalties, penalty interest, and other fines in the initial measurement of inventory. We believe that this provision will not result in factual change for most reporting entities. This change is stipulated in Section 49(1) of the Decree.
- **Extension of items measured at replacement cost**  
Replacement cost will be applied to the measurement of overhauled spare parts, refurbished tools, waste, by-products returned from production or other activities, and animals, provided own costs to produce such items are indeterminable. Thus, the change brings a practical guidance for dealing with such issues. This change is stipulated in Sections 3.5 and 3.7 of CAS.

## 4. Changes in other areas

### Receivables and payables

CAS 017 (Receivables and payables) was amended to require recognition of an irrevocable right to receive a subsidy. The following entries should be posted when the right arises: Credit of account group 37 (Other receivables and liabilities); Debit of account group 34 (Taxes and subsidies). Prior to the amendment, it was not clear whether it is possible to account for the right to a subsidy as a receivable. The reporting entity has to assess at which moment the right to the subsidy is irrevocable.

## Short-term financial assets

The duty labels for the marking of spirits are also deemed to be cash equivalents (amended in CAS 016).

## Derivatives

The amendment to the Decree enables the reporting entity to choose whether it will book separately the embedded derivative which is part of a financial instrument or whether it will not account for it at all. This measure is a simplification of the Czech accounting regulation for entrepreneurs outside of the financial institutions category, as the accounting for embedded derivatives remains without change for the regulated financial institutions. This change is stipulated in Section 52(7) and Section 53(2) of the Decree.

## Abolition of CAS 010 – Special receivables operations

CAS 010 stipulating the procedure for booking receivables with maturity on or before the end of 1994 has been abolished. The reason for the abolition of this standard is the fact that such receivables should have been fully written off as tax-deductible items in previous years. As a result, CAS 010 became redundant in practice.

## Accounting procedures for company conversions

There is a change in Section 2.8 of CAS 011 with respect to measurement of ownership interests and shares being eliminated in conversions. The standard valid until 31 December 2007 required elimination of respective ownership interests and shares based on the purchase price, which may not have corresponded with the actual carrying amounts of these ownership interests and shares. The former standard did not address the treatment of the difference. According to the new wording of the regulation, it is necessary to eliminate ownership interests and shares based on the carrying amounts booked in the accounting records of the participating reporting entity as of the date of the conversion.

## Limitations in using accounting procedures for composition, forced composition and bankruptcy

Provisions for accounting procedures in CAS 021 will apply only to composition, forced composition, and bankruptcies commenced prior to the effective date of Act No. 182/2006 Coll., on Insolvency, as amended.

Changes related to accounting for animals are not the subject of this newsletter. Nor are the changes related primarily to shifting of paragraphs between the Decree and CAS or other minor amendments, given the low significance of those changes for practical application. You may find these changes in the relevant provisions of the Decree and CAS.

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