cutting through complexity™

Accounting Advisory Services

Amendments to accounting legislation in 2010 and from 1 January 2011

The accounting legislation has been amended several times during the course of 2010.

1 Amendment to the Act on Accounting, effective from 1 January 2010

Act No. 431/2002 Coll. on Accounting as amended (hereafter referred to as the „Act on Accounting") has been amended by Act No. 504/2009 Coll., which entered into force on 1 January 2010.

The amendment to the Act on Accounting was not extensive, but it concerned several key provisions, for example, the instances of merger, amalgamation into a separate accounting entity and demerger, audit of financial statements by an auditor, publication of financial statements, valuation of PPP projects, and so forth. This amendment was discussed in the December 2009 Newsflash.

2 Amendment to the Act on Accounting, effective from 31 December 2010

An amendment to the Act on Accounting, concerning the obligation to prepare consolidated financial statements and a consolidated annual report, entered into force on 31 December 2010 (Act No. 486/2010 Coll.).

This amendment follows up on Directive 83/349/EEC of the European Parliament and of the Council (the so-called Seventh Directive).

According to the amendment, a parent accounting entity is not required to prepare consolidated financial statements and a consolidated annual report if the preparation of individual financial statements pertaining solely to the parent accounting entity does not materially influence the judgment about the financial situation, expenses, income, and profit/loss of the consolidated group (Article 22 (12)).

The amendment will be used for the first time to assess the obligation to prepare consolidated financial statements and a consolidated annual report as of 31 December 2010 or later.

3 Amendment to the Accounting Procedures for Entrepreneurs, effective from 1 January 2010

An extensive change was represented by an amendment to Decree of the Finance Ministry of the Slovak Republic No. 23054/2002-92 of 16 December 2002

Content

laying down details of the accounting procedures and the framework for the chart of accounts for entrepreneurs maintaining accounts under the system of double entry bookkeeping (hereafter referred to as the „Accounting Procedures" or the „Accounting Procedures for Entrepreneurs"), which entered into force on 1 January 2010 (certain provisions entered into force on 31 December 2009).

It primarily concerned the instances of merger, amalgamation into a separate accounting entity, demerger, purchase of a business or part thereof, and contribution of a business or part thereof. This amendment was discussed in the January 2010 Newsflash.

4 Amendment to the Accounting Procedures for Entrepreneurs, effective from 1 July 2010

An amendment to the Accounting Procedures for Entrepreneurs, which entered into force on 1 July 2010, concerned the following:

- accounting for a concession by a concessionaire (Article 30c); it regulates PPP (Public Private Partnership) projects;
- the introduction of the option to capitalize interest on loans as a part of the acquisition cost of non-current intangible assets (Article 34 (1)). Prior to the amendment, capitalization of interest on loans was optional only with respect to property, plant and equipment, whereas it was required to capitalize interest on loans with respect to non-current intangible assets (based on the general provisions of Article 25 (6) of the Act on Accounting, according to which costs related to the acquisition should also be included in the acquisition cost).

5 Amendment to the Accounting Procedures for Entrepreneurs, effective from 31 December 2010 and from 1 January 2011

The amendment to Accounting Procedures for Entrepreneurs, based on a Decree of the Finance Ministry of the Slovak Republic No. MF/25822/2010-74 of 13 December 2010, contains several important changes. Some of these changes entered into force on 31 December 2010, whereas others entered into force only on 1 January 2011.

Changes that entered into force on 31 December 2010 include:

- deferred taxes.

Changes that entered into force on 1 January 2011 include:

- construction contracts
- construction of real estate for sale (continuous transfer)
- construction of real estate for sale – other than continuous transfer

- acquisition of real estate for the purpose of resale
- concessions of a concessionaire
- insurance of assets intended for operating activities.

5.1 Deferred taxes – most important changes

Deferred taxes also apply to goodwill and negative goodwill

The amendment to the Accounting Procedures follows up on the amendment to the Act on Income Taxes effective from 1 January 2010, according to which the amortization of goodwill is tax-deductible in some cases and the release of negative goodwill against income is taxed (for example, in the event of purchase of a business or part thereof and contribution of a business or part thereof).

If a temporary difference arises upon initial recognition of goodwill/negative goodwill, deferred tax should not be applied to this difference, and also not in subsequent accounting periods (Article 10 (11) of the Accounting Procedures).

If no temporary difference arises upon initial recognition of goodwill/negative goodwill, but a temporary difference arises in the future, for example, owing to a difference between amortization for accounting and tax purposes, the carrying value for accounting purposes will be different from the carrying value for tax purposes and deferred tax should be applied to this difference (Article 10 (11) of the Accounting Procedures).

Deferred taxes – exemption related to initial recognition of an asset and liability

According to Article 10 (20) of the Accounting Procedures, deferred tax should not be accounted for:

- in the event of initial recognition of an asset and liability and, at the same time,
- if the accounting transaction representing initial recognition has no impact on either profit/loss or the tax base, and, at the same time,
- it is not an accounting transaction established in the event of so-called business combinations (with respect to the receiver of a contribution in the event of a contribution in kind represented by a business or part thereof; with respect to the buyer in the event of purchase of a business or part thereof; with respect to the successor accounting entity in the event of a merger, amalgamation into a separate accounting entity, and demerger).

Deferred tax in respect of these temporary differences should also not be calculated in the subsequent accounting periods.

Transitional provisions

According to the transitional provisions referred to in Article 86i (5) of the Accounting Procedures, these provisions, in the wording effective from 31 December 2010, shall be used for the first time with respect to financial statements prepared as of 31 December 2010.

5.2 Construction contracts – most important changes

Extension of the definition of a construction contract

The definition of a construction contract has been extended; from 1 January 2011, it applies not only to the construction of tangible assets, but instead assets in general (Article 30 (1) of the Accounting Procedures). This means that it will also apply to the development of intangible assets (for example, software).

Construction contract costs, general administration costs, development costs

Following the amendment to the Accounting Procedures (Article 30 (1) (h) et seq.), contract costs include:

- direct costs of the construction contract,
- indirect costs that are generally attributable to the construction contract,
- such other costs as are specifically chargeable to the customer under the terms of the contract; these include, for example, certain general administration costs and development costs.

A change has been made in the category „other costs." Prior to the amendment to the Accounting Procedures, these costs were always included in contract costs, except for cases where the contract provided otherwise.

Zero profit method

The term „zero profit method" has been introduced (Article 30 (10) of the Accounting Procedures). Under the zero profit method, contract revenue should not be presented according to the percentage of completion method, but only up to the amount of costs incurred. This is possible in cases where the outcome of the construction contract cannot be reliably estimated.

Changes in accounting for construction contracts

Following the amendment to the Accounting Procedures, the following new accounts have been introduced:

- account 316 – *Net value of contract*
- account 606 – *Contract revenue.*

If a construction contract is expected to generate a loss, it should be recognized as an expense, as has been the case up until now. However, it should not be recorded as a value adjustment or provision, but only as a provision:

- in account 548 – *Other operating expenses* with a corresponding entry
- in account 316 – *Net value of contract.*

This represents a change in accounting with no impact on profit/loss.

5.3 Construction of real estate for sale – continuous transfer

This change primarily concerns developers – construction of office premises, apartments, residences, suites, etc. for the purpose of sale.

If the criteria for so-called continuous transfer are met, revenue from construction must be recognized under the percentage of completion method.

Continuous transfer (Article 30d (1) (a) of the Accounting Procedures) means:

- transfer of effective control of the real estate under construction from the developer to the customer and, at the same time,
- the developer does not retain managerial involvement in the real estate under construction, and
- all this is based on a contract between the developer and the customer.

The Accounting Procedures also refer to certain indicators of continuous transfer.

5.4 Construction of real estate for sale – other than continuous transfer

Construction of real estate for sale shall be recorded as own work capitalized (Article 30d (6) of the Accounting Procedures) in:

- account 121 – *Work in progress,*
- account 123 – *Finished goods,*
- account 611 – *Change in work in progress,*
- account 613 – *Change in finished goods,*
- account 601 – *Revenue from own products.*

However, the acquisition of land on which such a construction project is carried out should be recorded in account 133 – *Real estate for sale* (Article 30d (7) of the Accounting Procedures).

This represents a change in accounting and presentation with no impact on profit/loss.

5.5 Acquisition of real estate for the purpose of resale

Acquisition of such real estate should be recorded in account 133 – *Real estate for sale.* This account should also be used to account for repair, technical improvement and related expenses associated with the real estate, which arise as a result of putting the real estate into a state in which it can be sold (Article 30d (7) of the Accounting Procedures).

The removal of this real estate from the accounting books upon its sale should be recorded:

- in account 507 – *Real estate sold* with a corresponding entry,
- in account 133 – *Real estate for sale*.

Income from the sale should be recorded:

- in account 607 – *Revenue from the sale of real estate* with a corresponding entry,
- in account 311 – *Customers receivables*.

This represents a change in accounting and presentation with no impact on profit/loss.

5.6 Accounting for a concession by a concessionaire

A concessionaire should account for a construction contract if the public procurer or procurer acquires the ownership title to the work project at the beginning of its performance or prior to the expiration of the concession term (rather than putting the work project into use).

The change consists of an extension of the time limit within which the public procurer or procurer acquires the ownership title. Instead of the criterion related to putting the work project into use, as previously applicable, now it is the expiration of the concession term.

The amendment also specifies that account 316 - *Net value of contract* should be used to account for construction contracts.

5.7 Presentation of insurance premium

Part of insurance premium continues to be presented in account 568 – *Other financial expenses* (Article 70 (7) of the Accounting Procedures), but insurance of assets intended for operating activities and other insurance premium related to operating activities should be presented in account 548 – *Other operating expenses* (Article 68 (7) of the Accounting Procedures).

This represents a change in recording and presentation with no impact on profit/loss.

Transitional provisions

Changes referred to in sections 5.2 to 5.7 entered into force on 1 January 2011 and should not be reflected in financial statements prepared as of 31 December 2010. They are effective prospectively, i.e., applicable to transactions that were carried out on 1 January 2011 or later. They should not be applied to transactions carried out until 31 December 2010 (inclusive), which will continue to be presented according to legislation applicable as of 31 December 2010.

6 Amendment to Decree of the Finance Ministry of the Slovak Republic No. 4455/2003-92 on financial statements, effective from 31 December 2010 and from 1 January 2011

Changes effective from 31 December 2010

If a parent accounting entity is relieved of the obligation to prepare consolidated financial statements and a consolidated annual report according to Article 22 (8) and Article 22 (12) of the Act on Accounting, it must state this fact in the notes to the financial statements.

Changes effective from 1 January 2011

- If interim financial statements are prepared for the purpose of determining the tax base of an accounting entity subject to bankruptcy proceedings or liquidation, information related to the preceding accounting period should not be presented.
- Account 316 – *Net value of contract* should either be presented on the asset side or the liability side of the balance sheet, depending on the nature of its balance.
- Information on a construction of real estate for sale (continuous transfer) should be presented, including an assessment of continuous transfer indicators.
- In the case of income, it is required to present the amount of net turnover according to Article 19 (1) (a) (2) of the Act on Accounting.
- The structure of information on expenses related to an audit of financial statements by an auditor and other services provided to the accounting entity by the same auditor has been specified.
- New examples of the balance sheet and income statement have been introduced.

Contacts:

Richard Farkaš
Accouting Advisory
Partner
T: 02 / 59 98 41 11
E: rfarkas@kpmg.sk

Andrea Šikulová
Accouting Advisory
Manager
T: 02 / 59 98 44 12
E: asikulova@kpmg.sk

More at www.kpmg.sk