

WEST HUNGARIAN UNIVERSITY
FACULTY OF ECONOMICS

**THE REALISATION OF TRUTHFULNESS
CONVENTION IN THE HUNGARIAN SYSTEM OF
ACCOUNTANCY**

Thesis of Doctoral Disertation (PhD)

Made by: Imre Varga

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Doctoral School: István Széchenyi Economic and Organization Management Sciences

Its leader: Prof. Dr. Csaba Székely

Programme: Financial Subroutine

Its leader: Prof. Dr. Gusztáv Báger CSc.

Consultant:Dr. habil Béla Lett CSc.

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Consultant's supporting signature

Preliminaries of researching work, the aims set

The author of this dissertation as a person having been teaching in the accounting higher education for almost a decade. He has also been dealing with accounting issues, accounting teaching material development and partly their practical application. This dissertation is a result of this activity.

Since Act on Accounting of 2001. year there have been several changes showing emerging of truthfulness convention against the principle of prudence. The appreciation according to the book value is stopped by the balance sheet date valueing. Some pieces of information until preparing the balance sheet are to be considered for the sake of the real market valueing. *The determined dethronement of the prudence can be seen through the truthfulness convention's pushing forward in changes of the Accounting Act in the past years.*

Up-to-dateness:

This theme is current because Accounting has gradually been developing partly because of EU accession. At the same time several critics happen concerning the fact that the accounting report does not give a real picture of the enterprises property, their financial situation and their results. According to truthfulness convention I want to examine, analyse and prove the opposite side of it.

This topic is emphasized by the Decree 1606/2002 of July 19, 2002 year issued by European Parliament and European Union. Therefore the companies quoted in stock exchange should make their annual report on basis of the international accounting standards. The aim of regulating is to adapt the international accounting levels to harmonize accounting.

Besides all these, the world financial crisis in 2008 and the reasons for it throw light on the demand for the accounting reports to be able to reflect reality as soon as possible and in other words the truthfulness convention is to be realized.

The aims set:

The researching work is focusing on the changes in Hungarian accounting system on basis of the realisation of truthfulness convention since coming into force of the new Accounting Act after social system change. On the other hand how the existing selecting possibilities, valuating procedures promote the realisation of truthfulness convention and how these things appear in reports.

The purposes of the accounting valuating procedures:

- Presentation of the accounting valuating procedures proving increasing of the truthfulness convention
- Changes of the valuating procedures in time, their analysis
- To discover the influence of the accounting valuating procedures concerning the truthfulness convention on property and profitability of the enterprises.
- To examine the practical use of these methods

Hypotheses:

H1: The international-European-Hungarian accounting system has been undergoing a continuous change and so the constant alteration of regulatory system is not easy to follow.

H2: The theoretical basis of accounting is the balance theory, the substantial difference of the various balance theories shows the different aims and tasks. The values differ from one another numerically, substantially, systematically. The accounting and the business values also differ from each other.

H3: The divergence of the accounting and the business value can be decreased by the accounting valuating possibilities in connection with the truthfulness convention.

H4: The truthfulness convention plays a greater and role in Hungarian accounting system mainly because the prudence is being forced back.

H5: The gradual strengthening of truthfulness convention can be noticed in case of valuating methods which make the accounting reports more accurate, more transparent, fairer.

H6: The practical use of the accounting changes is imperfect apart from the obligatory elements it is very small.

Researching methodology and contents

The dissertation is chiefly of a scientific dissertation character based on the Accounting Act as well as on processing the special literature in connection with this topic. (**secondary research** 1-4 chapter)

Furthermore I am examining the accounting evaluating system of the greater enterprises (**primary research** 5. chapter) the researching work comprises the enterprises of Budapest Stock Exchange 'A' and 'B' categories (years 2000-2007) but those firms are also examined having come out of the stock exchange as well as some representative, not quoted, Hungarian firms are watched as well.

The limits of researching field:

- in its centre the Hungarian accounting practice is
- home enterprises, we concentrate on Hungarian economic units under accounting law
- focusing on individual, annual report on basis of book-keeping by double entries
- firsts of all we should pay attention to the valuating procedures as a value-teacher of the accounting system

In this dissertation the author is focusing on valuating changes of the accounting property (balance sheet footing) from the point of the realisation of truthfulness convention and the truthfulness means determining the current market value. Nevertheless the influence of these valuating procedures on results is tested.

As far as the truthfulness convention is concerned, the author, beyond the traditional interpretation, uses ***an extended explanation*** which brings all the valuating methods into the realisation of truthfulness convention promoting the accounting report's reality.

The main theses, statements, proposals of the dissertation

T1: In accounting system there is an organic development in both Hungarian and international level. At the same time the answer to the world economy changes is rather difficult, first of all the Hungarian accounting responds late, there is no steady value and procedure order.

It was stated that the Accounting Act of 1991 year after the change of social system and then, following several modifications, the Act of 2000 year brought significant changes, which has made a necessary harmony with EU as well.

The international accounting standards (IAS) and the international financial reports standards (IFRS) provided a unified, international regulating which has become more widespread. In this process a milestone can be considered that the IAS, which has been transformed and accepted by EU, has turned to be *compulsory since 2005 year and also the IFRS standards by reorganizing the standard committee* has also become obligatory in case of consolidated reports. The European standard Board (IASB) and also the American one (FASB) are trying to answer to the new economic challenges, especially to the problems of the international financial crisis in 2008.

According to the international practice (e.g. IAS) a more detailed accounting regulation than the Accounting Act, has also become necessary *in Hungary*, in form of *standards*. This does not come into existence instead of law but together with it plays a detailed, interpreting role, there and in such an order that the players of economy and the experts think in necessary, where the Accounting Act does not give details about given question the range of subjects properly. The creation of standards greatly contribute to the accuracy of accounting regulation and contains a more detailed description concerning the given range of subjects.

The standard formation started by the Hungarian Standard Board but the publication of standards has not been yet so far and *in 2006 this process has been stopped*.

It is proved to be by the facts: *there is no stable value and procedure order which can be represented inside and outside by the professional of accounting experts* (no theory but practice similarly, to the continuously modifying tax-laws). The standard means a stable, long-lasting solution being worth recognizing, applying, exercising.

Because of the constant and late modifications the accounting badly react on the financial-economic crisis.

T2: The different balance theories as the streamlines accounting, the value study e.g. reflect the differences between the aims and the tasks. The property stated in balance sheet is based on the realization principle but the time value principle can also be applied. Therefore the accounting and the market (business) value deviate from each other.

Majority of the balance theories belongs to *the material (classic)* group which starts from one-one concrete balance purpose, the other one does to the so called *realscientific* and there the starting points are the aims of interest-holders and their demand for information. Our present accounting system is a system based on further development of *the classic dynamic balance theory*. In these system *the concept of value is based on the net property*.

The business value and the book value differs from each other. The necessity of the fair valuating is supported by the fact that during the past decades the companies market valuating very much separates from the accounting estimation. (Particularly some surveys have been made in international level). A part of divergences originates from the difference of two attitudes. The third factor-group are to be investigated outside the company: the macroeconomic and the industrial branch effects are of value-influencing but their presentation is not the task of accounting. The reasons for divergences can be as follow:

- No every creature has a market value.
- Several prices can be determined for the same product.
- All the assets have a greater value than the sum of individual values (synergy)

We can differentiate the following values for valuating a company's assets in addition to the book value (value received, replacement value, net realization value, liquidating value). For these values it is necessary to have a thorough preparation, lastingness for the practical spreading.

T3: The difference between the accounting and the business value can be reduced by the accounting valuating possibilities in connection with truthfulness convention.

The financial reports rather emphasize the fair (real) valuating then the book value. Thus there is a step from the steady property and result increasing appearance to a volatile, unstable, profit and loss statement. Thus the role of explaining, supplemental appendix has increased.

The accounting basic principles fundamentally determines Hungarian accounting system. Their composition has not been changed a lot, but a shift of a centre of gravity can be seen especially for the benefit of truthfulness convention against pushing back of prudence. The author, concerning the truthfulness convention, applies an extended interpretation in order to utilize all the valuating methods to especially the accounting reports reflect reality, as soon as possible. I understand reality a the current market value determination.

T4: The accounting act changes of the past decade prove that the truthfulness convention in Hungarian accounting system plays a greater and greater role, its ever-increasing realization can be seen because the prudence is forced back.

The accounting system approved by EU is similar to the Hungarian accounting basis principles (IASB) with similar framework principles. Among them there is the principle of truthfulness convention. In addition to it, *IAS 1 emphasizes the truthfulness convention* and the principle corresponding with IFRS in connection with the financial reports.

The accounting politics fundamentally determines the *valuating procedures* can be used by an enterprise. The Hungarian Accounting Act regarding the accounting policy is not so detailed as IFRS. Generally they do not give help for the concrete realization of accounting policy.

Valuating on basis of the book value in the past is forced back by the balance-sheet date valuation.

It can be proved that the determined entronement of the prudence can be noticed with pushing forward of truthfulness convention during the past years in the changes of Accounting Act.

T5: The gradual strengthening of truthfulness convention appears in application of the valuating procedures which make accounting reports more accurate fairer. There can be found in assessing the value of nearly each property element.

I stated that the valuating methods proving strengthening of the truthfulness convention, assessing the value of the balance items, have been increasing during the past decades of Accounting Act's changes. E.g. in the following cases.

1. The expansion of assets especially of tangible assets *in book value promotes all the items of book* in connection with their purchase should appear. It should be stressed in case of purchase without payment only the market value of assets can be used since 2006 year, so there has been *a trend for a more accurate, more realistic determination.*
2. In the *amortization control of invested assets* the main target is the balance value of physical assets and immaterial goods to show the reality as soon as possible. The most substantial such factors from 2001 year are:
 - Residual value determination
 - Useful lifetime
 - Possibility of the over-plan amortization's writing back
3. *One of the most significant elements of the realization of truthfulness convention is the accounting of value adjustment* which means an upgrading for market-value in case of the invested assets. It has the greatest importance at the real properties because there have been a high upgrading of the real properties during the past two decades.

As to the results of primary research about a quarter of the examined companies made a value adjustment. *Its correct application modifies in a great extent the report of the given firm.* (The size of property item and of the total property by 10 per cent on average.) There were some striking cases when the given company possesses a very large real property, the value adjustment would change the property value in spite of this the firm has not used it either. The reason for it because this activity would mean a big plus administration burden and the annual value adjustment would mean a huge plus charges. *A critics of regulating* if a company chose the way of value adjustment then it should do it every year, no stepping back.

4. *The evaluation on basis of the real (fair) value is the second most important step in Hungarian accounting system towards the valuation on market value.* Its introduction

caused by the EU joining in 2004. This method *pushed the principle of prudence back and also made it possible to revalue assets and sources, strengthening the truthfulness convention*. Above all in case of securities it is possible to evaluate in good results and simply to use because we can have a stock-exchange rate (occasionally from outside the stock) making a real value easier and more correct. I would like to stress *the importance of (real /fair) market value determination*. The independent standard formulating committee of IFAC (IAASB) called attention of the auditors for the risk of estimation in the changes uncertain market situation in Autumn of 2008 year. On basis of the *empiric analysis* of the fair value valuation, I stated that the revaluation like this of the financial instruments are not sufficiently widespread (approximately 8.5 per cent of the examined companies). But relatively small proportion is represented by the companies introduced this method. In spite of it this helped the real presentation of financial instruments.

5. In case of particularly the invested financial instruments, securities, inventories, receivables, writing back of the value loss. *The accounting of value loss rather strengthens the prudence, but its writing back does the truthfulness convention.*

With the help of empiric analysis I can say that the great majority of firms accounts value loss (73 per cent) and their 64 per cent also applies writing back of the value loss.

6. In balance sheet the *receivables* (generally customer's claim) is going to be presented at the expectable payment. A value loss is accounted when the given enterprise (debtor) is under bankruptcy proceedings or liquidation but it has not been finished yet. However I have to tell you *that the criteria of debtor rating are not properly clarified, they might seem to be subjective.*
7. From 2001 year in evaluating of the *foreign currencies items* there have been radical changes which brought simplifications and made us possible to account the *non-realized exchange gain* as well, if the total price difference of foreign currencies items at bank accounting date is significant. All this strengthens the truthfulness convention. But these activities mean a lot more work.
8. The *prepaid and accrued expenses* appeared in more detailed way in balance sheet since 2001 year. The postponed cost and the postponed input are with new elements. In the *primary research* the postponed costs and the postponed inputs were going to be

examined. It has been proved that these items do not represent great amounts similarly to the total property.

9. The *elements of equity* are exactly regulated in law and so there is a smaller role for the entrepreneur's decisions.

From the point of the realization of truthfulness convention the most significant item is the *revaluation reserve*. The aim is to reach the market fair value.

The *fixed reserve* an exactly regulated element of own capital, the enterprise decisions have an influence on it only indirectly but i think its creation significantly contribute to a real presentation in the report. *In the primary research* of fixed assets we can tell that it is an important factor of the payable dividend determination, it occurs in more than half of the companies (51 per cent) but it does not represent a great value in most firms. At the same time in case of *enterprises making great experimental development or of an on occasion own huge share repurchase, the proportion is very big as compared to both own capital or the balance sheet footing.*

10. *The formation of provisions can modify* the results in a great extent in some cases. *It was said the formation of provisions is in connection with the principle of prudence first of all but it also strengthens the truthfulness convention by its influence of making the report more precious. Critical notice is concerning the other provisions creation is not thought over so they are not calculable enough. It is proved in the primary research that the obligatory provisions can happen twice as many as in case of optional provisions.*
11. *The presentation of hindered liabilities* in a separate balance group can be reasonable. During time of tax-determination for instance the group of liabilities may be separated which endanger the liquidity of the company not in the least.

In case of *the long-term liabilities* there is no substitution transformation. One-one element ceased and a new one has been created according to capital market development tendencies. (e.g. convertible laws). Among the long-term liabilities leasing which is essential from the point of topical. At the operating leasing the paid leasing fee is accounted in the operation costs while *there is no sign of this transaction*. This regulation makes the firms possible to keep some debts outside the balance. *In the author's view these do not all this does not correspond to the truthfulness convention.*

12. *Among the short-term liabilities the prepayment received from the customers as a bookvalue contains VAT to be paid as well. VAT is a separate item. Thus the prudence is realized extremely.*

The liability on bills of exchange in the Accounting Act is to be registered as name value, increasing the expiring value with interest. The prudence principle can be seen.

The unfunded and future liabilities as they are outside the balance-sheet items by assessing the value more punctual.

T6: The accounting changes strengthening the truthfulness convention in practice are incomplete with exception of value adjustment being significant, apart from the obligatory items. The firms do not utilize the accounting opportunities in full extent. This can be explained by a greater administrative and assessing the value charges as well as difficulties of the fair value determination and contradictions of the accounting and the tax rules.

As a result of the financial-economic crisis a little restoration can be noticed towards the realization of prudence.

In the primary research, on basis of the empiric analysis that the factors and the evaluating methods prescribed by Accounting Act as obligatory rules are going to be applied in for greater rate than the optional opportunities. Therefore, we can say that the firms do not utilize the opportunities given by accounting. Among the optimal evaluating methods the value adjustment is used in a proper frequencies of accounting and of sums.

The world financial crisis starting from the autumn of 2008 year (after closing up of the primary research) put the accounting experts and the regulation systems to a test in both international and home relationship. It can be stated that owing to the crisis a small restoration might be seen towards the principle of prudence which appears in accounting of the valuating practice. Because of the contradictions of the accounting and the tax-rules, the enterprises feel disadvantageous to discover their weaker achievements and at the same time it can't be taken into consideration in taxation, so the least value is shown from this.

Proposals:

1. The creation of standards greatly contribute to the accuracy of accounting control, however **the standard forming process** seems to be difficult, so far only three standards have been prepared, but they were not going to be published. The process **needs acceleration**. If it does not realize because of any reasons then it would make possible to choose IFRS on an individual reporting level.
2. In order to decrease the difference between market and book value **far reaching application of such valuating methods** should be aimed which reflect the real, **market value**, namely the **truthfulness convention is realized**.
3. **The residual value of** tangible and intangible assets are to be determined by enterprises on basis of information during time of activating. Because the market conditions undergo some rapid changes therefore at the invested assets amortized where the useful life-time is longer than 5 years, **the residual value is to be revised in every fifth year**.
4. I suggest **the value adjustment application should be obligatory** for enterprises operating for 5 years at least and they have to prepare an annual report if the **fixed assets reach 40 per cent** of the balance sheet footing. The market value of fixed assets should be refreshed in every **5th year**, if the value adjustment without upgrading and also value adjustment does not surpass 20 per cent of the fixed assets without upgrading.
5. In case of financial instruments **valuating in a fair value with consideration to the financial crisis starting in 2008, the fair market value is to be paid attention to**. In case of the assets where the market is frozen, **some other valuating models are needed** and also the accounting decision-makers's proposals are important.
6. In case of demands the frames connecting with value loss of **the debtor classification** and the conditions **are necessary to regulate** (with special consideration to increase of the go-round debits). The standard, forming in connection with this can repair this situation.
7. While one of the most substantial things for the sake of market economy operation is **the reliability** in statutory regulation therefore the Accounting Act should follow this. The Act ceased the **A-C difference accounting possibility** in case of same other

provisions in 2005, then in 2006 **it was again introduced**. All this refers to an unconsidered solution which ought to be avoided.

8. **The operative leasing**, in my view, is also an obligation but it does not appear in balance sheet, it is only cost having an influence on profitability. If we want to approach the values of accounting report to the market value, there would be a step **if it appeared as an obligation**. It can be solved **by as a long-term credit as a discounted current value of future fee payments**. And then we should pay attention that leasing-fee's covering maintenance is to be left out and it is accounted as charge. In the meantime we indicate the purchased tangible assets and continuously amortize.
9. **The prepayment received from the customers** in book value contains VAT to be paid as well, at the same time VAT is accounted as a separate item against other claim. As a matter of fact the given prepayments in book value does not contain the previously estimated VAT either, so it is not justified either. The VAT to be paid means a short-term obligation this the received prepayment can be counted according to reality.

Proposol: T 384 Accounting deposit - K 453 Prepayments from customers

T 384 Accounting deposit - K 467 VAT to be paid

The enterprises reports (within this balance sheet footing) are not influenced probably by this factor but it **would be a simplification instead of exaggerated prudence**.

10. In case of other short-term liabilities, **the continuous tax-paying obligation**, similarly to IFRS, ought to be put as a separate balance item. This rather strengthens the principle of clearness but it can be reaction to the extended interpretation of truthfulness convention.
11. I propose **the discounted current value of future (certain) liabilities should appear in the balance sheet** in the long-term or short-term liabilities. These liabilities surely emerge (irrevocable just fulfilment is missing) thus there is no reason for getting out of the balance sheet.
12. It would be necessary **to reduce many tax-base-correcting items** (tax-simplification) because it deforms the net income a bit and through this fakes the balance sheet. It is advisable to bring closer the tax and the accounting law while **the**

value losses in connection with crisis **spoil the firms judgement, at the same time it can't appear as a tax-base reduction as well.**

The modernness of the dissertation:

The modernness of the dissertation can be explained as follow:

- It gives a comprehensive survey of the Hungarian accounting development after the social system change adding some necessary critical remarks.
- It shows the tendencies towards the ever-increasing realisation of truthfulness convention.
- Through empiric analysis, we can give an answer to a question whether the elements, evaluating procedures in connection with truthfulness convention can be applied in an extent and what kind of influences on the accounting reports
- on basis of these some information, proposals can be used for the accounting, regulating decisions.

The dissertation based on the following publications

2008: ***Vagyommérleg: tükrözi-e a cég tényleges vagyonát?***

HVG.hu, Vállalkozás rovat

http://hvg.hu/kkv/20080131_merleg_szamviteli_rendszer.aspx

The role of the revaluation of fixed assets in the Hungarian Accounting System

NYME, SEK - III. Természet-, Műszaki- és Gazdasági Tudományok
Alkalmazása Nemzetközi Konferencia (CD)

2007: ***Számvitel II. Példatár (bővített, újraserkesztett kiadás)***

Számvitel I. Példatár (felújított kiadás)

Balogh és Társa Nyomdaipari Kft., Szombathely

2006: ***Adóelkerülés Magyarországon és ennek a számviteli háttere***

Tudományos Közlemények XV., Természettudományok 10.;
Prof. Dr. Veress Márton Dsc., BDF TTK dékánja

2005: ***The realisation of Truthfulness Convention in the Hungarian system of accountancy***

A Berzsényi Dániel Főiskolán - III. Természet-, Műszaki- és Gazdasági
Tudományok Alkalmazása Nemzetközi Konferencia (CD)

2004: ***Számvitel II. Példatár***

Balogh és Társa Nyomdaipari Kft.; Szombathely

2003: ***A számvitel fejlődési irányai***

A Berzsényi Dániel Főiskolán - II. Természet-, Műszaki- és Gazdasági
Tudományok Alkalmazása Nemzetközi Konferencia (CD)

Számvitel I. Példatár

Balogh és Társa Nyomdaipari Kft.; Szombathely