

Name of candidate: **Imre Polyák**

Title of study: **The current questions of the result-oriented approach and its possible applications in Hungary**

Doctorial school: **Theory and Practice of Economic Procedures**

Supervisor: **Dr. habil Erzsébet Gidai DSc**

Programme: **Financial programme**

Programme supervisor: **Dr. habil Gusztáv Báger CSc**

Discipline: **Economics**

Theme supervisor: **Dr. László Nyikos CSc**



## **1. THE RELEVANCE OF THE TOPIC**

The paradigm of Hungary's national accountancy is under revision. With the theses brought up in the dissertation, the author undertakes to map this procedure that is nowadays being under preparation and which will be launched in the near future. The conclusions of the thesis were made relying on the latest national and international professional literature. It shows the relevance of the issue, since, as it can be observed that even among international professionals there have still been serious debates in connection with the adaptability of the accruals method in national accountancy system.

During the course of the research the author elaborated on the experiences of the countries that have already adopted the accruals method, and he presented the innovative results of accountancy that appeared. The aim was to develop a possible way of reform for Hungary, and also to present the risk factors and the potential wrong directions which could jeopardise the success of the reform. It is necessary to take into consideration that in each country the reform of accountancy is realised as a part of a wider process, and accordingly, its realisation, reception and its subsequent assessment are also unique, thus it is not sure that it is possible to make one single "recipe" that could be applied in changing the paradigm of Hungary. However, it is necessary and during the preliminary investigations it is inevitable to create the script,

since it is the token of the efficient and circumspect realisation of the reform.

There are various supporting studies available for this. It is possible to take advantage of the help of international professional organisations, and previous experiences can also be used.

During the preparation the largest challenge is careful timing, as the introduction of the new system must happen – especially in case of certain institutions – in a way that there is no gap in accountancy, that is, it is necessary to assure persistent accountability.

## **2. THE AIM OF THE RESEARCH**

The primary aim of the author in the course of the research is to study the possibility of introducing the accruals method in Hungary. Nevertheless, it also must be shown and confirmed that there are problems with the present accounting system. Based on the study, it can be laid down that there are no efficiency indicators in the present system.

When we examine the issue it is worth reviewing what kind of new reasons appeared because of which the change has become inevitable. What at first sight have seemed to be changing recently are the modern management-thinking and the appearance of need of information deriving from this in management of state institutions.

When preparing the conversion it is also necessary to take into consideration the traditional differences as well, since they led to the different practical realisation earlier. However, the traditional differences may have an effect both on the legitimacy of the new system and on the procession of the conversion. Consequently, first of all it is expedient to examine the roots of accountancy and clearing, with special emphasis on controlling institutions from the 19th century.

Within the framework of international accountancy convergence, the regulations concerning different economic entities have been coming nearer. The reasons of this approximation must be taken into consideration as well, since – although in a peculiar way – there are similar forces affecting state institutions.

The central issue of the thesis is the adaptation and integration of the accruals method in budgetary accountancy. Within this framework, of course the peculiarities of different state structures must also be considered. The efforts for the reform appear in a different way in case of different political structures.

The paradigmatic change always goes with conflicts in case of a larger economic entity, and this conflict must be dealt with during the procedure. However, it is also important to consider that smaller or bigger restorations of the previous system are frequent, so appropriate timing is essential. There are well-known techniques by which the procedure can be kept under control. Those methods by which the dynamics of the reform can be influenced appear in the dissertation. The strategic mistakes that appeared in the present reform of health care in Hungary must be avoided. The reform must be clear and firm, and it must have expansive social compliance. The best way to protect ourselves from restoration is to define the changes as final for the organisations. However, for this it is necessary that the procedures are free of political scandals.

As the most important feature of public accountancy it must be taken into consideration that in budgetary clearing continuous control is much more significant. As a result, in the course of conducting the reform, continuous maintenance of transparency is an important viewpoint.

### **3. THESES**

#### ***1. The present Hungarian public accounting system is not efficient***

There is a universally accepted criterion system which can be defined to measure the efficiency of the accountancy system. The generally accepted function of the accounting clearing is to provide information, which function has to be fulfilled with proper efficiency: with the least expenditure, it has to provide information with adequate standard, accuracy and structure. The general expectation regarding reports is that it should give a true picture about the economic subject's assets, financial situation and earnings.

The dissertation implies the major regulations about the present public accounting system, on the basis of which it can be concluded that the efficiency criteria are not fulfilled, since:

- the presented static data (assets and financial position) appear only with limited reliability (there is no closed system);
- the system cannot present the income position since it only provides results about cash flow;
- regarding the presented information the administrative burden is too high, so the operation of the accounting system demands too high expenditure.

## **2. The introduction of the partial accrual approach is proposed**

In the dissertation the author presents the possible directions of the accountancy paradigm, the method which is purely based on cash flow, the modified result-oriented approach in cash flow accountancy, partial result-orientation and the full result-orientation.

Naturally, the presented modified result-oriented cash flow accountancy approach has also got its advantages, since

- for the less competent ones it is easier to understand cash flow, the political decision-makers better understand the structure;
- the budget was also made according to the cash flow approach, thus it can be argued that the accounting system need to be consistent with the budget;
- the financial problems must be dealt with separately from the result-oriented approach which can be more easily realised with the cash flow method;
- theoretically, the clearing method also provides data about assets, and it is also possible to follow how the budget is realised by keeping a record of the estimate and estimate-fulfillment.

In the dissertation the author's opinion of the present cash flow clearing system is clearly drawn up:



- there is no possibility to make a comparison between economic subjects, so there is no possibility to encourage them for higher efficiency;
- it can be easily manipulated by postponing the payments;
- there is no closed system for staff register;
- the financial positions, liquidity cannot be manifested in a reliable form;
- the modern management functions cannot be integrated into the system, while we cannot evaluate economic subjects' performance using general analytic methods;
- there is no possibility for accurate measurement – in cash flow clearing – of the production costs of the public utility services. However, it also affects the efficiency of state budget.

It must be added that theoretically it can be imagined to introduce production costs in the cash flow method as an extra informational level, there are relevant experiments in this direction as well. The problem with this is that the register will not be a closed system, which means an additional administrative burden. The law allows continuous staff book-keeping because of advanced record-keeping systems (these systems cannot „not book-keep”), however, it cannot be made obligatory.

### *3. Efficiency indicators can be and must be developed*

It is necessary to use appropriate indicators for economic subjects' operation. It is the interest of the society to be able to display the necessary needs of resources of single public utility services. With this, its functioning would also become more efficient, and the efficiency of the national and private sector could be evaluated.

In order to evaluate performance it is the simplest way to build up the system according to the notion of the private sector (the IPSAS standards were also born according to this theory!). In the framework of this, first of all it is worth defining the basic unit of measurement, that is, the product or public utility service produced by the economic subject. Afterwards, we can define the amount of resource used for the given unit, namely, the production cost of the measurement unit must be displayed.

The definability of the above mentioned production cost depends on the fact that there must be a given comparable base, in other words, the system can only be built in accruals method (otherwise we may not talk about "production cost").

However, when forming the efficiency index, it is necessary to pay attention to the danger of index opportunism, namely that the economic subjects may learn how to elude the indexes. For instance, if we measure the performance of a school on the basis of the lessons that were really held, it is easy to produce extra lessons, since a lot of lessons can be accomplished if the education happens in smaller groups,

etc. Consequently, in this case, the basic unit can be the lesson for a single student.

But if the production cost is specified for a measuring unit, it will be an objective measurement for effective production, since we got data about performance for different institutions and this way they can be compared.

#### ***4. In Hungary the introduction of the IPSAS standards is not possible in the short run***

We could eye-witness the international process of standardisation of accountancy. The international standards conquered the whole world in short time. (Although their development started in 1973, their real expansion began only after the millennium, when the mainly dispositive notion of regulation was given up, and the characteristics of the system of standards was developed.)

The development of the IPSAS standards was carried out by correcting the international standards. It is so true, that wherever possible, they stucked to the original norm texts of the IAS/IFRS, and the differences were elaborated on at the end of each standard. Still, it is unambiguous that the IPSAS standards are completely different. While in case of international standards there are harsh interests concerning their spread, as for budgetary accounting standards, the need for changing the paradigm of regulation only appears transmissionly, through the change of the viewpoint.

In the dissertation the main obstructive factors for the IPSAS standards are presented in detail, consequently the regulation of state accountancy is a much more delicate issue regarding the establishment of state sovereignty.

In Hungary this is exactly where the problem arises in the short run, and similarly, in accountancy measurement the conservative, historical-based principle is still general.

### ***5. The only aim can be the regulation by law***

The constancy of the regulation paradigm, however, goes beyond the difficulties related to the introduction of the IPSAS standards. The problem is not only that we do not dare to place the regulation of accountancy apart from the country, but also it is even more problematic that we cannot loosen the legal framework in a way that we could delegate law-making to a level where most of the information is.

Seemingly, modernisation of the regulation cannot be considered to be successful in Hungary. The need already appeared back at the end of the 90s, that we should make the legal regulation even more framework-like, and that the actual accountancy regulations should be developed on a lower level by experts. This way the principle of subsidiarity would be enforced, and the lawmaking for accountancy would be much more efficient.

Unfortunately, it can be observed that this notion did not suit the decision-makers in the Ministry of Finance. The law (statutory order)

about the formation of the Hungarian standards and the impoundment of the duties came into existence.

They established the standard-bodies, the aim of which was the development of the new Hungarian accounting standards. Three standards were developed: about the accountancy politics, about the supply-clearing and the leasing. However, the Ministry of Finance cut the right of the bodies over and over again, at first by shrinking the scope of standards to a governing principle, later to a recommendation.

The author bases his opinion on this, namely that in Hungary this type of regulation is not accepted, thus – that would provide a solution to the previously highlighted problems – there is no chance in the short run to develop the Hungarian budgetary accountancy standards.

***6. The economic and political risk of Hungary's accountancy reform can be significantly reduced by making use of international experiences***

When changing the state budget paradigm it is worth reviewing the experiences of other countries. The transformation of the register system significantly improved the transparency of the system everywhere.

However, there is no safe recipe for the accruals procedure. The process of the transition, the time needed for it, the necessary steps, and the questions of social agreement depend on the form of the given country, its traditions, the stability of the existing institutions. Still, it is worth studying from other countries' mistakes. The preparatory phase

can be simplified if we take other countries' preparatory procedures and their outcome as a base. We are aware of the possible directions, either if we think of the range of reforms or the different phases. It is necessary to reveal whether it is possible to carry out the reform in case of Hungary – I mean the social resistance that must be overcome – and whether the necessary resources are available.

It can also serve as a solution to lengthen the phase of introduction, as a result, the risk can be further reduced, but it cannot be accepted that we want to "take a small step" right at the beginning. (This is when they say that two small steps are not enough to cross over the abyss.)

In the part about informatics it is presented what kind of ideas can come true if we dare to make the right expectations towards the system to be developed.

It is also worth taking into consideration that social resistance does not only constitute a problem only in case of Hungary, other countries also had to fight the retracting powers. However, in most places the society was successfully involved, and for this, unity is necessary in decision-making positions.

## ***7. During the informatics reform the island-systems must be replaced by a centralised structure***

The author openly expresses his opinion in the informatics part, namely that in the system of public accountancy it is the change of the atomised clearing that must be sought.

Currently the aggregated data of the budget are based on the institutions' single reports. The reports that are made are processed again later on and this way are the consolidated reports made, for instance on municipal level, and then the aggregated reports onto state budget level. This procedure represents considerable extra costs, and at the same time the reliability of the aggregated data is also decreased.

It is not efficient and hides a lot of sources of errors when the information reaches the central decision-makers in many-many steps, and there is no direct connection between the levels of aggregation.

According to the author's point of view, it is possible and it must be solved that the operation of single institutions, the local government and respectively the municipal institutions could be traced down on a central level. Local governments also manage on public funds, nevertheless, we can see that they fall out of the structure, their financial management is not centralised either, as it is in case of the central level. Anyway, it is a delicate issue in municipal management, but that is exactly why this state budget unit should be included in budget cycle to be able to trace down the way of public funds.

The next phase could be the centralisation of the accountancy data organisation. This way it should be achieved that the single book-keeping data would be organised according to a harmonised structure, and it would be possible to arrange it in a specified state budget database.

With centralised data organisation the transparency of the use of public funds would be realised on a higher level, and it could be traced down well. However, with it we also achieve that it is enough for all data to be recorded in the system only once. As there would be no redundancy, clearing would become more efficient, since the system would provide information of a significantly higher standard, and the expenditures would be much lower.

### ***8. The most efficient data organisation is the one centralised in batch processing***

International experiences of centralised clearing systems are available and these are the other extremities compared to the clearing system of Hungary.

According to the author's explicit opinion, it is much easier introduced and it will involve a much lower operation risk if we do not establish a completely closed system, but the basic data would appear in the centralised database through periodically refined data transfer.

Otherwise, we must face a lot of considerable sources of risk, which are heavier to cope with:



- the system is much more vulnerable, a central error of database can paralyse the whole state budget clearing system;
- the structure is much more exposed to either physical or logical assault, and this way it is easier to get hold of data through a diverse on-line connection;
- the probability of a virus infection is also higher in this case;
- probably in case of data damage we must face definitive data loss, here only the lost set of data can be reduced at best by periodical data saving;
- in case of the centralised structure, periodically there is too much pressure on the hardware resources, which together with the defensive routines – practically no matter how high the nominal network speed is – can cause the slowing down or stopping of the whole system.

The solution to these problems is the periodical data transfer, namely batch processing, the essence of which is that the single client-machines periodically transfer the newly registered data to the central system. It is also the advantage of this solution that data manipulation either in the central data base or in the decentralised panels can be detected to some extent.

The disadvantages of the solution:

- there is redundant data storage, which demands multiple capacity
- because of redundancy, database administration is much more difficult, in case of data panel refreshing, the decentralised panels must be refreshed individually.

## **4. CONCLUSIONS**

In Hungary there is an urgent need to change the system of accountancy. It is necessary to recognise the advantages of the accurate and reliable record-keeping and accountability. In today's political life accountability is present only as an empty phrase, the professional issues are neglected. Nevertheless, the system of accountancy must be transformed, and by this, it could be realised that citizens would get a true picture about how public money that they paid in was used. On the other hand, the system must also be developed to be able to measure the efficiency of public utilities. To achieve this, the standard of the internal controlling system should also be improved.

Our experts –led by the researchers of the Audit Office– keep trying to have an effect on the decision-makers in order to change the approach. Unfortunately, they do not have a lot of means to do so, they only have initiation and preparation of the law. Hopefully, professional issues would also come to the front besides the political skirmish.



## 5. PUBLICATIONS

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