European traditions in accounting

Accounting in Hungary

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From the Past – before the second word war

In Hungary, the oldest rule related to business bookkeeping can be found in the 53rd section of the 1723 commercial decree of Charles III, king of Hungary. According to it, every tradesman had an obligation to maintain his books fairly and regularly, and record correctly his receivables and liabilities.

The laws of 1840 are especially important. Laws 15 and 16 of 1840 contain rules and regulations related to business bookkeeping, compliance with regulations and the conclusive evidence of records. Based on these rules each transaction – including all types of commercial and industrial transactions be it purchase or sale or other trading or draft transaction – should be registered in a chronological order and according to the types of assets. So, even at that time, the law required records to be kept in a journal and general ledger.

The Act on Commerce XXXVII of 1875 is significant from the point of accounting. It regulates bookkeeping in the following way: Every tradesman had the obligation to register business transactions in a book which had serially numbered pages. These books presented each business transaction and the full value of the assets of the tradesman, but the method and the language of bookkeeping was optional, up to the trader. Records had to be made one after the other, i.e. without gaps. The trader was allowed to modify his records, but the original content of the records had to remain readable, deleting or scraping off data was not allowed.

Act V of 1930 introduced the qualification of 'auditor' and regulated the tasks and duties of auditors. As bookkeeping progressed with time, bound books used by accountants started to give way to single pages. In the end, a Ministerial Decree allowed the use of single pages in 1948. The bookkeeping regulations of the above mentioned commercial laws remained operative till 1968, but it remains a fact that after 1945 a new chapter began in the fields of bookkeeping and accounting.

Past – after the second word war

Between December 1945 and the end of 1949 the most important institutions of the private sector were nationalized. The result was that 91% of mining, 80% of industry, and 95% of the banks were nationalized.

On 1 January 1947 the first mandatory chart of accounts was launched. Before 1945, in Hungarian accounting practice charts of accounts were not generally used, only some companies decided to use a chart of their own. Based on the mandatory chart of accounts a chart of account was produced for each sector of the economy i.e. commerce, agriculture, industry. In 1948 the Finance Ministry became the authority responsible for accounting in Hungary. In the following years some modifications were made to the 1947 mandatory chart of accounts, but these were not essential changes.

In 1949, in response to the establishment of the Organization for European Economic Co-operation, the Council for Mutual Economic Assistance was set up. The same year Hungary became The People's Republic of Hungary and, until 1990, it was a centrally planned economy. From 1950, during the planned economic system, accounting was given new tasks. The main aim of accounting was to provide data for measuring the completion of plans. Legislation focussed on the bookkeeping of business transactions and there was a detailed rule system for recording each transaction. Rules were based on soviet accounting literature and mainly tried to satisfy the needs of the nationalized industry. According to the regulations, the main aim of accounting was to meet the information needs of central governmental institutions.

1954 is an important date: it was in this year that a Decree of the Financial Ministry prescribed the mandatory content of the financial statements of companies.

The reforms of 1968 changed the requirements for accounting. As the economic control system changed, there was a new requirement that accounting could be used to provide information to compare and measure the effects of business transactions. For that purpose the charts of accounts for the various sectors of the economy became standardized. Along with the standardization of structure, the standardization of the content matter was also essential.

Decree XXXIII of 1968 stated that it was the task of the Finance Minister to establish and control the integrated accounting system of the people's republic. In essence, from 1875 this was the first law related to accounting. To execute Decree XXXIII, the Finance Minister issued a decree which stipulated the details of bookkeeping.

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According to this decree accounting contains:

- bookkeeping,
- (prime)cost calculation,
- the balance sheet,
- the profit and loss statement.

With this regulation the Chart of Account of The People's Republic came into force. It described the main rules of the bookkeeping system. Based on it, the charts of accounts for the various sectors were worked out. The Integrated Chart of Accounts of the people's republic was unified and ensured a unified information service for the institutions controlling the economy. As a consequence, government regulation was very detailed, and, basically, the requirement was to comply with the written regulations.

The regulation of accounting was the task of the Finance Minister. This entailed the regulation of:

- the bookkeeping system of companies and government agencies,
- inventory taking, evaluation and the compilation of the balance sheet and income statement,
- the documentation system of accounting,
- cost and prime cost calculation.

Decrees XIV and XV 1977 – along with the modification of the Civil Code which ensured the independence of companies – contained rules for private tradesmen and craftsmen, thus opening the doors to entrepreneurs and private companies. In 1981 the opportunity arose to run smaller shops and restaurants based on lease contracts. To establish small and medium sized enterprises, and to make our economy more flexible, it was allowed to form subsidiaries, and corporate business communities.

From 1983 a new decree prescribed the development of corporate governance, and the tasks and powers of Supervisory Boards, Boards of Directors and Chief Executive Officers.

Since 1987 there has been a two-tier banking system in Hungary, so the functions of commercial banks and those of the central bank have been separated. In the middle of same year the Tax and Financial Control Administration was established – earlier it was one of the departments of the Ministry of Finance.

Act VI of 1988 created a new framework for the establishment of private companies. Since that year we have had a new taxation system based on personal income tax, company tax and value added tax. The Finance Minister modified the regulation of accounting to suit the requirements of company taxation. At the time unified governmental control was prevalent in the regulation of accounting. These principles and methods were applied in data processing.

Present – market economy

The transformation of the ownership system, large-scale privatization and the liberalization of the economy in general all made it necessary to remove the obstacles to free competition. This entailed the modernization of the whole system of accounting. There was a need for an accounting law to create the framework for a system of accounting which would meet the needs and requirements of a market economy. The Act on Accounting came into force in 1991. The basic requirement of the Act was already expressed in its Preamble: "For the operation of the market economy it is essential that objective information based on past data be available on the financial and earnings position of undertakings, non-profit organizations and other types of economic organizations, as well as on the development thereof, in order for the participants on the market to be able to make well-founded decisions based on the information made accessible."

The second Act on Accounting came into force in 2001. It is based on the first one, but was updated, developed, and modified to fit international rules. The law may have been modified but the underlying philosophy has not changed: the idea is to provide a fair and true view about the assets, liabilities and profits of companies in financial statements.

Since 1992 Hungary has had a two-level accounting regulation system. On the highest level, the Act defines the requirements for the preparation of financial statements and recording business transactions, the principles and the rules based on those principles to be used in bookkeeping, and the requirements related to disclosure and audit. The Act on Accounting delegates power to the government to regulate the accounting of certain business entities, governmental and other institutions; also, it is the government that may set the special rules of liquidation and dissolution. That is the second level of the system.

The regulation of Hungarian accounting is controlled by the Hungarian Parliament and the Hungarian government, so it can be rightfully called "state regulation". (The Ministry of Finance, of course, has an important role in the preparation and implementation of the laws.) The National Accounting Committee also played an important role, first from 1946 to 1952, then from 1992 to 2012. The Committee was established to develop the theory and methods of accounting and to facilitate the implementation of accounting principles in practice.

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The Hungarian act-based regulations are much more detailed than the directives. They contain more detailed conditions, structures and evaluation rules. The Act contains a lot of instructions which, in other EU member states, are not incorporated in an Act but rather in decrees. The reason we need more detailed regulations is that the Hungarian legal, taxation and control experts cannot accept standards as mandatory rules, it is only legal regulations that may be enforced.

According to the Hungarian Accounting Act, the detailed rules and methods supplementing the stipulations of the Act, which are necessary for the presentation of a true and fair view, have to be written in national accounting standards. In spite of this rule and the activity of the members of the Standards Board, there are still no standards in force in Hungary today.

Present - nowadays

Hungarian accounting system is based on EU directives and its central element is Act "C" on Accounting of 2000. This is where the various conditions relating to company size and information needs, which may affect financial reporting, are laid down. From business year 2013 – if the conditions specified in the Act permit – businesses may choose to prepare on of the following reports:

- Annual financial statement
- Simplified annual financial statement
  - General
  - Simplified annual statement for micro businesses
- Consolidated annual financial statement
- IFRS

The Act on Accounting stipulates that entrepreneurs subject to the Act have to prepare **annual financial statements**. They can choose to prepare simplified annual financial statements if they meet the requirements laid down in the Act.

Company may prepare a simplified annual financial statement if it meets two of the following three criteria on the balance sheet day in two consecutive business years:

- Total Assets may not exceed HUF500m (€1,666,667);
- Net Sales may not exceed HUF1,000m (€3,333,333);
- The average number of employees in the business year may not exceed 50.

Simplified annual financial statements may not be prepared by public limited companies, parent companies and entrepreneurs whose securities can be traded on the stock exchange or a request for the authorization of such activity has been submitted to the authorities.

The gradual increase of the above limits granted by the EU directive on accounting and gradually adopted by the Hungarian accounting system ensures that the majority of entrepreneurs can use the simplified form. This simplification, according to the Hungarian rules, means that cash-flow statements do not need to be prepared, separate detail lines can be combined, the Notes may include fewer data and the simpler evaluation methods may be used. The parts of the simplified annual financial statement are the Balance Sheet, the Income Statement and the Notes. The Balance Sheet gives fewer details on assets and liabilities; and the Income Statement gives fewer details on incomes and expenses.

A consolidated annual financial statement must be prepared by a business which is considered to be a parent company in relation to one or more companies. A consolidated annual financial statement presents the financial standing of a group of companies – after the elimination of cumulative effects – as if it operated as a single corporation. The Act provides exemptions from the obligation to prepare consolidated statements and one important criterion is the size of the group of companies. The parent company does not need to prepare a consolidated financial statement for the business year if it meets two of the following three criteria on the balance sheet day in the two preceding – and consecutive – years:

- Total Assets may not exceed HUF2,700m (€9,000,000);
- Net Sales may not exceed HUF4,000m (€13,333,000);
- The average number of employees in the business year may not exceed 250.

To calculate the necessary figures, the aggregated figures of the parent company and those of its subsidiaries and jointly managed businesses need to be taken into account before consolidation.

The reporting format allowed by the Act from 2009 to 2013, known as 'special simplified annual financial statement', can be regarded as a temporary solution. It included only a Balance Sheet and an Income Statement and released the entrepreneur from the obligation to perform most of the evaluation tasks at the end of the business year. The problem was that the Act made this an option only for limited and general partnerships and sole proprietorships which are not obliged to undergo external audits. The reason for this was that EU law at the time stipulated the content and use of simplified annual financial statements along stricter rules for Hungarian limited liability companies and private limited companies.

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In fact, one of the obstacles of a more wide-spread use of special simplified annual financial statements was the high number of limited liability companies among Hungarian macro and small enterprises. These companies, because they met the relevant criteria, could have opted for the special simplified annual financial statement but EU law did not allow for that. On Hungary's initiative, certain changes were made in the EU's 4th company law directive and the modified version (EU/6/2012) took effect in April 2012. The new regulation allowed companies with total assets of less than €350,000, sales of less than €700,000 and fewer than 11 employees, to prepare statements similar to the Hungarian special simplified annual financial statements. These statements incorporate some more rules on evaluation than their Hungarian counterparts. The modified directive refers to the member states the competence of transposing this regulation in their legal system. Hungary decided to transpose the regulation in 2013.

As a result of this, the so-called **simplified annual statement for micro businesses**[1] was created, the detailed rules of which are set forth in Government regulation 398/2012 (20/12).

The statement for micro businesses can be an option if the business meets two of the following three criteria on the balance sheet day in two consecutive business years:

- Total Assets may not exceed HUF100m (€333,333)
- Annual Net Sales may not exceed HUF200m (€666,667)
- The average number of employees in the business year may not exceed 10.

Another important criterion is that the entrepreneur should not be obliged to undergo an external audit. According to the Act on Accounting (being in force in business years 2012 and 2013) external audits need not be carried out if the following two criteria are met:

a) In the two business years preceding the current year the average annual net sales did not exceed HUF200m (€666,667) and

b) In the two business years preceding the current year the average number of employees did not exceed 50.

The following entities may not opt for the above exemption from external audit, i.e. they are obliged to undergo external audits in all cases, which means they may not choose to prepare the simplified annual statement for micro businesses:

a) Entrepreneurs who maintain a double entry system and are obliged by law to undergo external audits
b) Savings co-operatives
c) Companies undergoing a bail-out
d) The Hungarian branch of a foreign based company
e) Entrepreneurs who – under the Act on Accounting – in exceptional cases deviate from the letter of the law in the interest of fair and reliable reporting.

Whether an entity is allowed to use the statement for micro businesses depends on the form of business. The statement for micro businesses can be used by entrepreneurs as defined by the Act, such as business organizations, sole proprietorships, co-operatives and the Hungarian branches of foreign based companies, but not by some other organizations as defined by the Act, for example non-government organizations, housing associations, law firms.

A business involved into consolidation financial statement may not use the statement for micro businesses because, despite the fact that it is considered an entrepreneur and irrespective of its financial data, it is obliged to undergo an external audit. The Hungarian branch of an EU-based foreign company, however, is exempt from the obligation of being audited so it can choose to make a statement for micro businesses.

According to the Act, an entrepreneur whose business year is different from the calendar year may not use the statement for micro businesses. It is worth noting, however, that entrepreneurs maintaining their books and preparing their statements in foreign exchange are allowed to report using the statement for micro businesses.

Considering the above restrictions for entrepreneurs and audits, it seems that the potential users of the statement for micro businesses will be smaller business organizations and sole proprietorships: approximately half of the companies may opt for the statement for micro businesses.

The Act on Accounting, in line with 19 July 2002 decree of the EU Parliament and Council (EU 1606/2002) on the use of international accounting standards, stipulates the application requirements of the **International Financial Reporting Standards (IFRS)**. Under the Act, companies which are listed on the stock exchanges of the EU and prepare consolidated accounts are obliged to make their financial reports in line with IFRS.

In Hungary, the use of IFRS is not as deeply rooted as in larger economies built on stock exchanges. We can say that Hungarian companies are not yet fully aware of the great responsibility that financial statements represent or of the need to provide high quality information in them. IFRS require companies to make a lot of disclosures and that, in turn, requires a lot of effort, which costs a lot of money and so harms profits.[2]

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When creating the standards, the main aim of the standard setters was to enable outside parties – the users of the financial information in the statements – to get reliable and fair information; the creation of regulations which were favourable for businesses seems to have been rather less important for them. Companies need to spend a lot of energy and effort to prepare their financial statements according to IFRS. An advantage of IASB policy may be that it does not force the management of a company to meet extra requirements which they would be unable to do anyway. This is the realization of the cost-benefit principle. Also, when management prepare their IFRS report, they can use already existing or accessible information.

In 2009 the International Accounting Standards Board (IASB) introduced its standards for small and medium-sized enterprises (IFRS for SMEs) but they have not been too enthusiastically welcomed by players in the economy. A research in 2011 initiated by ACCA (Association of Chartered of Certified Accountants) and IAAER (International Association for Accounting Education and Research) aimed to find out how open the SME environment is towards IFRS. The findings show that current market conditions (tax regulations, not quite realistic SME categories, the audit requirement, other outside parties) are not yet fully suitable for accommodating such changes and, what is more, the enterprises themselves cannot see themselves benefiting from the changeover. All of the micro, small and medium-sized businesses are privately owned; also, they cannot stand up to comparison on an international level so, for them, the introduction of IFRS is not a burning issue.

In Hungary, too, IFRS have failed to attract SMEs. Preparing statements according to IFRS is viable for companies involved in global markets or if the publication of individual and/or consolidated IFRS statements is allowed. Companies obliged to report according to IFRS in Hungary today will use the full IFRS as they are listed companies. For other companies, such reports would not give any added value. The international practicability of SME standard raises serious questions since, for the time being, it is quite impossible to set the same quantity stipulations for different countries. The aims set by and the regulation of the standards are good, unfortunately, however, the world is not quite ready to embrace them.

Footnotes:

1) The implementation of the medium-term government program [1405/2011 (25/11) Annex 12] called Simple State to reduce the administrative burdens of entrepreneurs

2) In Hungary 52 companies publish their consolidated financial statements according to the IFRS, these are the companies registered in the Hungarian stock exchange and trade A and B shares.

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