Ildikó ORBÁN,
Ágota KISS
Institute of Accounting and Finance, Faculty of Economy and Business,
University of Debrecen, Debrecen, Hungary

PRACTICAL ISSUES IN THE ADOPTION OF IFRS FOR INDIVIDUAL REPORTING PURPOSES IN HUNGARY

Case Study

Keywords
IFRS,
International accounting,
Adoption,
IFRS 1

JEL Classification
M41

Abstract

International Financial Reporting Standards (hereinafter referred to as IFRS) are the collection of accounting standards published by the International Accounting Standards Board (IASB) which enables the legislators to establish a framework for the individual financial reporting. Out of standards by IASB, the application of standards adopted by the EU is mandatory for Member States. The EU introduces its supported standards in its legal system through regulations. As a result of the harmonization of law, Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19th July 2002 on the application of international accounting standards has been in force since 14th September 2002. The Regulation required all companies listed on the European Union's stock exchange to prepare their consolidated financial statements as of 1st January 2005 in accordance with the International Financial Reporting Standards. According to the EU's standpoint, this requirement increases transparency and comparability of corporate financial statements and, as a result, increases market efficiency in the EU, reduces capital cost to companies, thereby improves competitiveness and increases growth (1606/2002 /EC). Under the Regulation, in addition to binding rules, Member States may allow or require the application of IFRSs adopted by the European Union in the compilation of individual or consolidated financial statements of unlisted companies in the EU or in the compilation of individual accounts of EU listed companies. Thus, in recent years, more and more Member States have permitted or have made compulsory the preparation and publication of individual financial statements based on IFRS principles. Hungary tries to enlarge the business scope the obligation and possibility of the IFRS adoption for individual reporting purposes. In this article we would like to represent the process of this adoption under Hungarian conditions.

MILESTONES IN THE INTRODUCTION OF IFRS IN HUNGARY

By complying with the EU regulation, Hungary required the consolidated financial statements of the companies listed on the Budapest Stock Exchange to be prepared since 2005, but did not authorize the application of standards at the level of other companies or individual statements. However, on June 12th 2015, Decision No. 1387/2015 of the Hungarian Government was made after a lengthy preparatory work on the national application of International Financial Reporting Standards for individual reporting purposes (Hungarian Official Gazette, 2015/80). The Parliament adopted the Act CLXXVIII of 2015 on Amendments to the Introduction of International Financial Reporting Standards for Individual Reporting Purposes and the Amendment of Certain Financial Matters "(CLXXVIII of 2015) on November 29th 2015. In the document, amendments to related legislation, in particular Legislative Decree No. 2000, were recorded. The Act on Accounting governs the introduction of IFRSs in individual financial statements in three stages. The deadlines related to the conversion and the scope of the companies affected by the conversion is shown in Figure 1.

According to the original plan of the Hungarian Government, credit institutions and financial businesses that comply with prudential regulation equivalent to credit institutions would have made the conversion from 1st January 2017, but these businesses were granted a moratorium until 1st January 2018. The law emphasizes that from 1st January 2017 the application of standards for companies subject to audit is optional. This provision excludes companies for whom, pursuant to § 155 (3) of Act C of 2000, auditing is not mandatory. By the amendment in the Act on Accounting in 2016, the legislator narrowed the scope of companies subject to audit. Based on the above mentioned, audit is not mandatory if it is jointly met that in the average of the two business years preceding the business year the contractor's annual turnover (converted to annual turnover) does not exceed 300 million HUF and, on average, and the number of employees does not exceed 50 (Article 155 (3) of the CC of 2000) in two business years preceding the business year.

At the same time, the law expressly forbids the adoption for entrepreneurs under supervision of the National Bank of Hungary (MNB) dealing with the supervision of financial intermediary system, entrepreneurs dealing with state or local government asset management and non-profit enterprises (Article 9 / A (2000) 2)).

The question arises: which companies should complete the adoption of accounting and reporting based on IFRS in addition to the mandatory group. According to legislators, affiliates receive benefits by the adoption where consolidation and reporting under IFRS are carried out at company level. Data provided to the parent company can be obtained directly from the accounting system in the prescribed form and content, so the information transfer becomes significantly smoother.

Being aware of the schedule of the adoption and the company circles involved, it can be concluded that:

- At present, there are 65 issuers on the Budapest Stock Exchange, of which 46 issuers prepare consolidated financial statements based on IFRSs.
- The scope of IFRS will affect a larger number of companies that are currently preparing IFRS based statements for their parent company, but their financial statements are also carried out in accordance with the Hungarian accounting and taxation regulations.
- Credit institutions, savings co-operatives, insurers and institutions supervised by the Hungarian National Bank (MNB) have an IFRS obligation or choice over an organization of over 1000.
- The number of companies involved in auditing is currently about 30,000 "(Madarasiné, 2016).

At the beginning of 2018, with regard to the above mentioned companies, all the 58 issuers are obliged to prepare a consolidated or individual IFRS report – in the absence of affiliates - for the business year of 2017. From the business year of 2018, credit institutions and financial institutions under prudential regulation are also subject to IFRS reporting. Mandatory IFRS adoption for individual reporting has therefore already taken place, but there is still a wide range of companies for whom the IFRS adoption is an opportunity.

PRACTICAL ISSUES IN THE ADOPTION

If an enterprise is obliged or selects the adoption from 1st January 2018 to its individual report, Figure 2 illustrates the deadlines for adoption.

It is advisable to pay attention that although under IFRS 1, the starting date of the adoption is the first day of the comparative year (i.e. our example January 1st, 2017), Hungarian laws (such as Law on Corporate Tax.) consider the starting date of carrying out IFRS report as the date of the adoption (1st January 2018). According to Act C of 2000 No. 114 / C. § ‘The first day of the business year of the annual financial statements prepared in accordance with the first IFRSs is the first day of adoption of annual financial statements based on IFRS’, i.e. 1st January 2018. The intention of the adoption is to be submitted by the business entities on a paper or electronically to the National Tax and Customs Office (NAV), the submission will be forwarded by the NAV to the Hungarian Central Statistical Office. Under the supervision of the National Bank of Hungary acting under the supervision of the

Hungarian Financial Supervisory Authority, enterprises have reporting obligations to the Hungarian National Bank (MNB) (Article 114 / C (5) of the CC of 2000).

Whether we are talking about a compulsory adoption, or just as an option, enterprises should definitely clarify some basic questions:

- optimal date for adoption,
- identification of differences between Hungarian and international standards (possibly including differences between the group reports already prepared and the individual IFRS reporting)
- an overview of IFRS 1 exemptions,
- identification of relevant accounting policy decisions,
- paying attention to tax effects at the time of adoption and afterwards,
- effects on the indexes,
- monitoring of the necessary IT support and its possible development
- scheduling of the adoption process.

As a condition of the adoption, the business entity shall have the auditing report certifying the preparedness of the adoption at the deadline of reporting the adoption that may be issued by an auditor with IFRS certification as a member of the chamber or by an auditor company.

The auditor verifies during the audit of the preparedness - and thus the report issued by the auditor certifies- that the enterprise is prepared and entitled to the adoption and the accounting under IFRS, and has:

- IFRS certified registered accountant or external expert,
- Accounting policies compiled and approved in accordance with IFRSs,
- Balance sheet of the IFRS for the first day of the financial year preceding the adoption date (Article 114 / C (6) of the Act C of 2000).

Data of the opening balance sheet (January 1st 2017) prior to the date of adoption (1st January 2018) correspond to the record date of the balance sheet in the previous business year (31st December 2016). In practice, this means that data of 2016 of the entrepreneur choosing the adoption should be turned in accordance with IFRS. During adoption, comparative data were provided.

Supposing after the clarification of the basic issues, a decision has been made on the adoption and the date has been also fixed, the enterprise shall prepare its accounting policy in connection with IFRS accounting and reporting and its opening balance sheet for the date of adoption based on IFRS. Relevant definitions, applied measurement principles and procedures based on standards shall be laid down in the accounting policy. For many affiliates choosing adoption that currently provide IFRS data to the parent company for the purpose of consolidation, adoption of the consolidated IFRS accounting policy at individual report is facilitation.

The same accounting policies apply to the period covered by the financial statements for the first IFRSs (those IFRSs that are in effect at the balance sheet date of the first IFRS financial statement with retrospective application for the opening IFRS balance sheet and for each period presented but for accounting policies there may be optional exceptions and optional exemptions, as listed in the Standard Annex, but it shall be indicated by the company).

The most crucial step in the adoption is to carry out an IFRS opening balance sheet. First, a balance sheet format that complies with the company's activities, in line with the requirements of IFRSs, shall be determined. Unlike Hungarian regulations, standards do not require a compulsory balance sheet format, but IAS 1 Presentation of Financial Statements sets out which items are mandatory. During the inversion of the balance sheet carried out in line with the Hungarian rules, the following steps shall be taken:

- Any asset and liability shall be included in the IFRS account that are required to be IFRSs but not included in the Hungarian financial statement: For example, the inclusion of provisions in accordance with standard IAS 37 Provisions, contingent liabilities and contingent assets standard or the implementation of tax instruments or liabilities in the balance sheet according to IAS 12 Income taxes standard.
- All assets and liabilities shall be excluded which IFRSs do not allow. Capitalised values for establishment-reorganisation and experimental development under the Hungarian regulation do not comply with the criteria for the inclusion of assets therefore they shall not be included in the balance sheet.
- Other assets, liabilities and equity under the Hungarian regulations shall be reclassified into assets, liabilities and equity complying with IFRSs. For example, own shares in IFRS shall be included as item reducing capital, not as an asset.
- Evaluation principles and methods complying with IFRSs shall be applied that to all assets and liabilities. The standards take changes due to time value into account, thus discounted present value method is applied and measurement at real value is accepted in many areas (IFRS 1).

In addition to carrying out the balance sheet, the equity reconciliation table must be prepared during the adoption. The effects of the discrepancies between the two accounting rules are generally reflected in the opening balance sheet in retained earnings.

According to the IFRS 1 standard, the adoption shall be implemented and assets and liabilities shall be defined as if accounting has always been in line with IFRSs. The application of IFRS evaluation principles is a requirement unless an exemption or an exception otherwise allows or requires.

Exemptions are merely options, from which the enterprise freely chooses, but exceptions are mandatory for all enterprises. Previously, retrospective application has been already mentioned in the accounting policy with the exception of the following (retrospective application ban):

- Estimations
- Termination of financial assets and liabilities
- Hedge accounting
- Non-controlling interest
- Embedded derivatives
- State grant (discounted loans)
- Classification and measurement of financial assets (IFRS 9)

Regarding exceptions, it is a general rule that if new information arises, there is no need to go back, this new information is not included in the opening balance sheet, it will have to be taken into account during the year (except for an accounting change or an error) (Halmosi, 2016).

While the application of exceptions is mandatory, exemptions may be freely chosen by the enterprise, taking its business activities and business features into consideration. The role of exemptions is to ease some of the most difficult tasks for business entities adopting IFRS. Exemptions apply to the following areas and their evaluation:

- Business combinations
- Fixed asset, property with investment purpose and intangible assets
- Borrowing costs
- Accumulated conversion differences
- Complex financial instruments
- Date of adoption for subsidiaries, associates and joint ventures
- Indication of financial assets and financial liabilities
- Share-based payment transactions
- Transfer of assets from customers
- Severe hyperinflation
- Insurance contracts
- Depreciation obligations
- Leases
- Initial valuation of financial assets and liabilities that are not active
- Service Concession Contract
- Stripping costs of removing surface mine
- Joint arrangements
- Investments in subsidiaries, jointly controlled entities, associates and joint ventures
- Termination of financial obligations
- Regulatory Tariff Accruals (IFRS 1)

For those companies that retrospective application of the above listed areas is difficult or impossible requirements, it is worth setting up an optimal package of exemptions to facilitate work.

According to IFRS 1 standard, financial statement for 2018 will be considered as an IFRS-based statement supposing the adoption of 1st January 2017 by an explicit and unreserved statement in those financial statements of compliance with IFRSs. This financial statement must be systematically and regarding the valuation principles as if the enterprise has always prepared the financial statement by IFRSs. Thus, in the first IFRS report, 3 balance sheets (balance sheet for January 1st 2017, 31st December 2017 and 31st December 2018) and 3 statements of changes in equity (January 1st 2017, 31st December 2017 and 31st December 2018), 2 comprehensive income statements (2017 and 2018) and 2 cash flow statements (2017 and 2018 respectively) are included (Droppa & Becsky-Nagy, 2015). The application of IFRSs and the consequence of their introduction should be taken into account when compiling a business report to be prepared simultaneously with financial statements (Böcskei et al., 2015). Since the statement of the comparative year of 2017 is carried out according to the Act on Accounting and IFRS, the enterprise to adopt leaves the application of Hungarian accounting rules on January 1st 2018 except for rules applicable to IFRS adoption, such as certificates, etc.).

TAX LIABILITY OF THE ADOPTION

Adoption of IFRSs is a major challenge for those who adopt in accounting and reporting. At the same time, as the tax liability of those who adopt is also based on the IFRS accounting process, the changes have a significant effect on both the legal environment and the operation of the companies from a tax point of view.

In the future, companies applying IFRSs comply with their tax liabilities (corporate tax, local business tax, income tax on energy suppliers, etc.), according to IFRS (Halmosi, 2016). If an enterprise chooses 1st January 2018 as the date of adoption for accounting purposes, i.e. the first IFRS reporting period for the 2018 business year, this year will be the year which is subject to taxation based on its IFRS rules.

During the amendments legislators have strived not to make difference between those who apply IFRS and those who don't regarding taxation. To do so, in the II Chapter in Act LXXXI of 1996 on Corporate and Dividend Tax special provisions have been made for taxpayers compiling their annual financial statements and accounting closure according to IFRSs. Regarding corporate tax, legislators are trying to re-adjust the tax base in a form as if adoption would not take place. Professionals emphasize that there is no significant difference between the tax bases based on Hungarian accounting rules and the tax base calculated on the basis of the IFRSs, time differences may take place (Tuboly, 2016).

Of course, the adoption does not only affect the corporate tax liability. It should be emphasized that the calculation of the local business tax is based on the financial statement –pre-defined and fixed-structure - and in the Hungarian system under the Act on Accounting, the base is net revenue. With the enactment of Act C of 1990 on Local Taxes 40 / B-40 / M. § adoption and its subsequent application for enterprises with IFRS system special provisions are included.

REFERENCES

[1] Act C of 2000 on Accounting
[2] Act LXXXI of 1996 on Corporate and Dividend Tax
[3] Act C of 1990 on Local Taxes
[4] Act CLXCXVIII of 2015 on Amendments to the Introduction of International Financial Reporting Standards for Individual Reporting Purposes and the Amendment of Certain Financial Matters
[5] Bill of T/12741 on the amendment of certain tax laws and other related laws (http://www.parlament.hu/irom40/12741/12741.pdf) Date of download: 2016-12-08.
[6] Hungarian Bulletin, Hungarian Official Gazette, 2015/80.
[7] REGULATION (EC) No 1606/2002 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 19 July 2002 on the application of international accounting standards (http://eur-lex.europa.eu/legal-content/HU/TXT/?uri=celex:32002R1606)
[8] IFRS 1 - First-time Adoption of International Financial Reporting Standards (http://www.iasplus.com/en/standards/ifrs/ifrs1)
[9] Böcskei E. - Fenyves V. - Zsidó K. - Bács Z. (2015): Expected Risk Assessment - Annual Report versus Social Responsibility. SUSTAINABILITY (ISSN: 2071-1050) 7: (8) pp. 9960-9972. (2015)
[10] Droppa D. – Becsky-Nagy P. (2015): A cash flow-kimutatások hazai és nemzetközi szabályozása. Szakma 2015/3. sz., pp. 124–126.
[11] Halmosi G. (2016). PwC training material
[12] Tuboly Z. (2016): „A magyar IFRS-szabályozás megfelel a nemzetközi standardoknak" Interjú Tuboly Zoltánnal. Szakma 2016/3.
[13] Madarasiné Szirmai K. (2016): Egyre bővül az IFRS-ek alkalmazásának köre. (https://mkvkok.hu/az-ifrs-alkalmazasanak-hatasai-az-eredmenyre-es-a-tarsasagi-adoalapra), Date of download: 2016-12-08.

ANNEXES

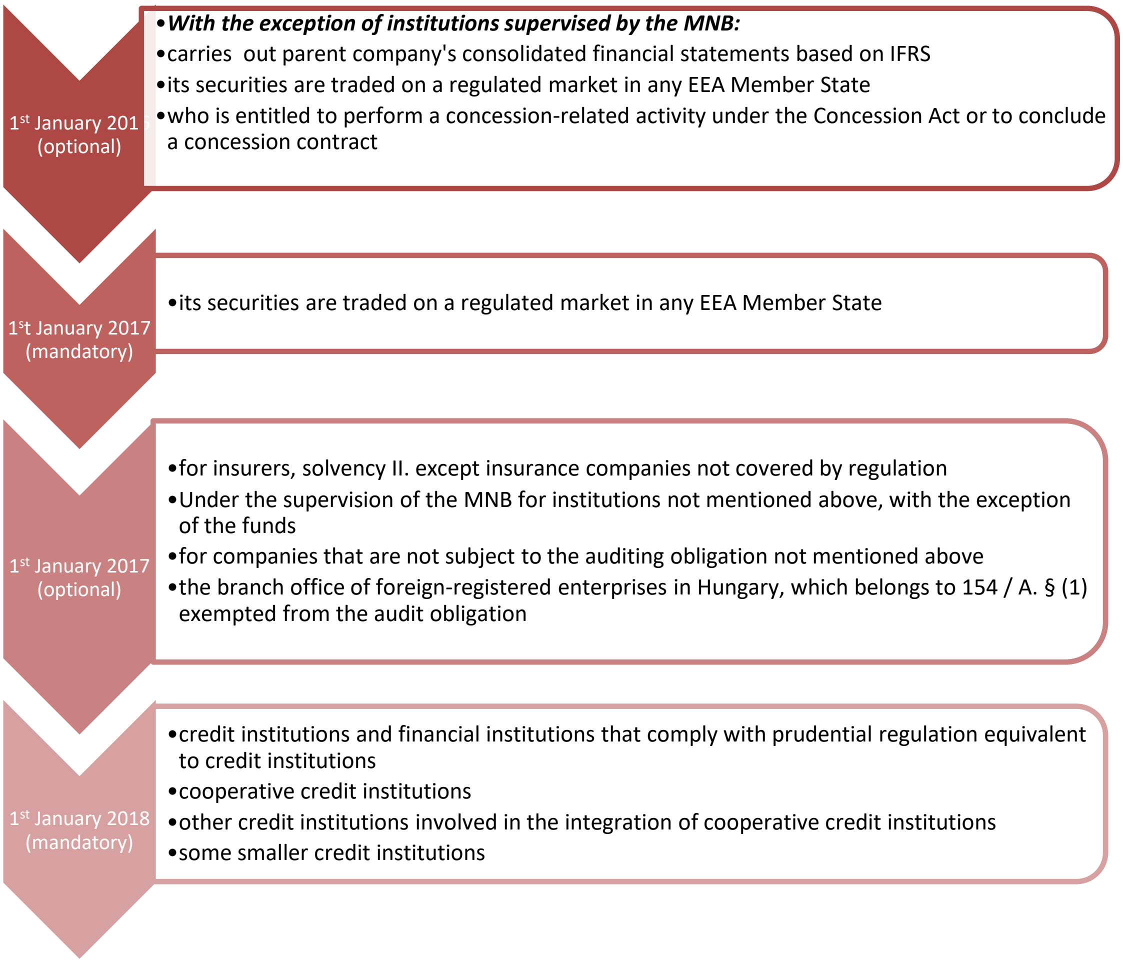

Figure 1: Deadlines and stakeholders involved in the adoption of IFRSs in Hungary
Source: Own edition

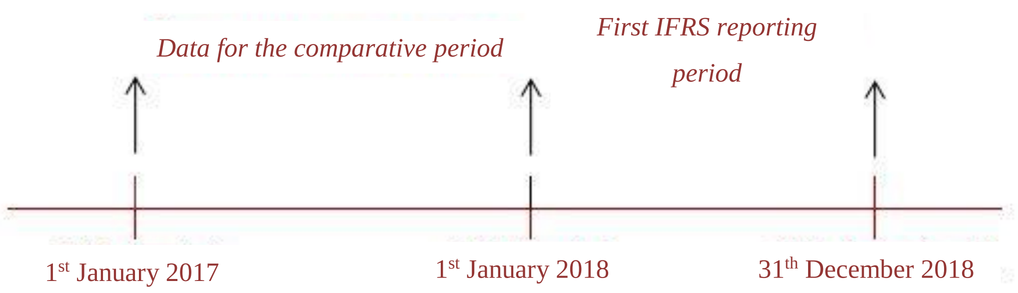

Figure 2: Deadlines for the adoption of IFRS
Source: Own edition