



Emerging Markets Queries in Finance and Business

A Few Fields of the Harmonization of Accounting Statements on the Basis of IFRS

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Abstract

The objective of the study is to introduce the major accounting systems (US GAAP, EU directives, IFRS) in a conception way with a special regard on compiling financial statements on the basis of IFRS. The accounts should include not only validity but the preciseness expected by both the owners and the creditors focusing on consistency, the usefulness, transparency and unambiguousness of the contained pieces of information. All these are especially important when a given enterprise or an enterprise-group represents itself in several countries or continents. The actuality of the topic is strengthened by the fact that more and more entities being interested even in abroad require to use a system based on internationally accepted standards as a basis when compiling annual accounts and consolidation for the sake of comparability. The study introduces the features of fixed asset valuation, the effect of valuation on income and property through a concrete case study regarding the realization of accounting principles.

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Selection and peer-review under responsibility of Asociatia Grupul Roman de Cercetari in Finante Corporatiste

Keywords: US GAAP, IFRS, EU directives, asset valuation, cost

1. Introduction

Nowadays regarding the globalization the need for comparing statements has become increasingly urgent, which requires the harmonization of the regulations at different levels. Systems of accounting striving for

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commonality and being outstanding from the aspects of their relevance and utilizations are the followings:

1. United States Generally Accepted Accounting Principles (US GAAP)
2. EU directives accepted by the member states of the European Union
3. Standards published by the International Accounting Standards Board (IASB), the so-called International Financial Reporting Standards (IFRS)

The system of the international regulation of accounting is summarized in Table 1.

Table 1. The System of the International Accounting Regulation

EU Directives	IASB	US GAAP
Directive 4	IAS	
On annual accounts of companies	International Accounting Standards	Generally accepted in the USA
Directive 7		
On consolidated accounts	IFRS	
	International Financial Reporting Standards	
Directive 8		
On audits		

1.1. United States Generally Accepted Accounting Principles (US GAAP)

The US GAAP system though it is still of a great significance in the world shows a decreasing role regarding the tendency of the past years, but its system may be considered as the first prevailing, global sized accounting system used mainly in the USA. Independent experts worked it out for capital investors and owners without any state intervention. Its use is only compulsory for listed companies of New York Stock Exchange. It is an extremely regulated and strict system, which is taken as a precedent just like the legal system of the USA, which means that court decisions and judgments are deterrent (Boros, 2013).

Almost 10 years ago the systems of IFRS and the US GAAP fought spectacularly regarding the fact that the American Securities and Exchange Commission (SEC) did not accept IFRS as the replacing system of the US GAAP. They would have liked to think of it as a possible alternative. Their argument was legitimate from the aspect that the total capitalization of the two biggest European stock exchanges such as the Financial Times and Stock Exchange (FTSE) in London and the Deutscher Aktien IndeX (DAX) in Frankfurt do not exceed even the half of the capitalization of the New York Stock Exchange, on which basis the adaptation to the extremely significant volume even all over world was expected. The European counter-argument was naturally the fact that the reliability of the European accounting system is higher than that of the USA, on which basis an Enron-case would have never happened (Rozsa, 2014).

1.2. EU directives accepted by the member states of the European Union

The accounting systems of the certain EU member states developed due to the EU law harmonization processes started in the 1970-ies. The following directives affected their national accounting acts:

- Directive 4th on Annual accounts of companies
- Directive 7th on Consolidated accounts
- Directive 8th on Qualifications of persons responsible for carrying out the statutory audits of the accounting documents

The Fourth Directive was accepted in 1978 with the aim of improving the comparability; furthermore, it was the first directive where the “real image” conception appeared. The objective of the Seventh Directive was the harmonization of making accounts in case of companies, as well as the fact that the company should reflect the financial and profit condition by the given calculation methods and exemption criteria as if it was a single enterprise. With its acceptance in 1983 it brought a relevant change to the certain member states as it made the construction of consolidated accounts compulsory everywhere. The Eighth Directive gave guidelines for the position, person, conflicts of interest, independency and qualification of the auditor by its acceptance in 1984 (Rozsa, 2007).

Act C of 2000 on Accounting in harmony with the directives of the European Union was one of the most important steps of Hungary in the past in its pathway towards the international accounting standards.

This act was born four years before Hungary’s EU accession, which was modified for several times, but at the time of the accession, it did not change significantly, though it was expected.

The Act determines accounting rules which are in harmony with the directives of the European Union regarding this legal field, and take the international accounting principles into consideration, as well as it refers to the official issue of the European Union and the 1606/2002/EC regulation (Act C of 2000).

The aim of the Regulation of the European Parliament and the Council of July 19 in 2002 is to accept and utilize the International Accounting Standards in the European Union, to unify the financial information of companies in order that the accounts should become transparent and comparable (1616/2002 EC Regulation). Though since 2005 it has been compulsory for every listed company to compile its account according to the IFRS, the certain member states may allow the use of the system. (Lado et al, 2013)

1.3. Standard by the IASB, the System of IFRS

The International Accounting Standard Committee (IASC) was formed in 1973 and turned to International Accounting Standard Board (IASB) in 2001. Their aim was to compile the International Accounting Standards (IAS). It is interesting that contrary the fact that the great rival, the US GAAP registered as an accounting standard had been formed since the beginning of the 20th century, there were countries from the American continent among the IFRS founders such as the USA, Canada and Mexico altogether with 101 other countries of the world. The basic standards were developed and supervised by 1998, which were called IAS then IFRS since 2001. The EU accepted these standards and made a proposal for their utilization since 2005. As a result every listed company has to compile its aggregate annual account in harmony with the IAS. Mainly capital markets strived for the unification. The foundation of the IFRS has information on 173 countries where their standards are used in case of listed and over-the-counter companies.

The following aspects were focused on when the IFRS were compiled:

- Developing a standard package which is acknowledged and used all over the world, easy to understand, based on clear frame principles and shows high standard

- Taking needs of ambitious companies as well as small and medium-sized enterprises into consideration
- Advertizing IFRS as the standards and the interpretations of IASB and establishing the opportunity to take them over
- Taking more economic logic and different firm sizes into consideration

The Framework of IFRS is similar to the accounting principles set in the Hungarian Accounting Act; however, this Framework does not reflect such a strict regulation than the Hungarian regulation.

The Framework contains guidelines of conceptual type just like the certain recommendations, reports and institutional guidelines of the EU in the law harmonization processes. The aim in every case is that it should help in the work of legislative bodies of member states and in interpreting for the users of the standards.

The main difference between the two systems is the fact that while IFRS prefers the interests of creditor; the US GAAP concentrates on the interests of owners and capital investors. IFRS uses theoretical approaches and lets experts decide and make judges, the US GAAP concentrates on cases and focuses on details. The common point of the systems is the fact that according to the founders of the standards their own system is better (Boros et al 2003).

2. Standards by the IASB, the System of IFRS

Fixed assets serve the activity of the entity for a longer period of time; they produce economic benefit during a longer run.

Relating to the benefit production for the long run the question arises: how is the principle of comparison ensured in the case when an investment of higher value recovers only during a longer period of time? How do these costs have to be handled and how to distribute them during the useful life?

If an asset is used for a longer period of time, costs arise later being in connection with this asset. In what cases should these costs be accounted for the income immediately as well as in what cases and how to distribute these costs during the useful life?

It may occur that the cost and the real, actual value of the asset differ significantly during a longer period, for example in case of a real estate which was purchased 50 years ago. It may be relevant to know that what the present value of the asset is, whether the value changes may be shown in the financial statements. If yes, in what way?

If a cost was already charged to the income, later this decision may not be changed and carried at an asset. In every case the valuation of costs and the examination of their capitalization should be carried out when the cost arises. Costs incurred relating to the generation and the purchase of the asset as well as to the supplementation, to exchanges of it's any part and to its improvement belong to here. (Lakatos, 2013)

On the basis of IFRS the cost of fixed assets basically consists of three parts:

- the purchase price of the asset,
- directly related costs incurred,
- expected decommissioning cost of the asset.

The purchase price is not necessarily means the consideration expressed in money but it may be the value of an asset gained free of charge within a swap contract, which should be corrected with certain items such as duties, taxes etc. Subsidies should be handled as negative taxes. The interest calculated in case of deferred payments is a special element of the purchase price, when the time value of the money has already significance.

The directly related costs may be any costs which incurred relating to the commissioning of the asset. The capitalization of the costs lasts for the time, when the asset is able to operate and serve the production by taking it to its place and being in a proper condition. The fixed assets cease at the end of their useful time in an

economic meaning (they are written off), but physically they exist further. The costs of their decommissioning, transport and disposal belong to the cost. Handling this regarding accounting is a complex task. The expected cost of decommissioning has to be calculated to the present value being valid at the time of the capitalization by discounting with the prevailing interest rate, and the cost has to be increased with the discounted present value. The capitalized decommissioning cost reduces the income as a part of the depreciation of the asset.

2.1. The fixed asset valuation

Case study: purchasing machinery

November 1, 2012.:

- contracting, deadline of payment: February 1, 2014.
- the sum of payables of the supplier is 252 000 thousand HUF

February 1, 2013:

- the manufacturing line has arrived
- commissioning cost is 400 thousand HUF

April 1, 2013:

- being able to operate

October 1, 2013

- start of production (occupancy)

October, 2023:

- decommissioning after 10 years, the expected cost of deposition is 4 000 thousand HUF

The prevailing interest rate is 5% for discounting.

Let us examine:

- how much will be the cost (capitalized) of the asset,
- how much will be the net book value on the 31st of December in 2013 and the sum of accounted depreciation,
- according to the Hungarian accounting act and
- on the basis of the IFRS.

Figure 1 illustrates the sequence of the economic events.

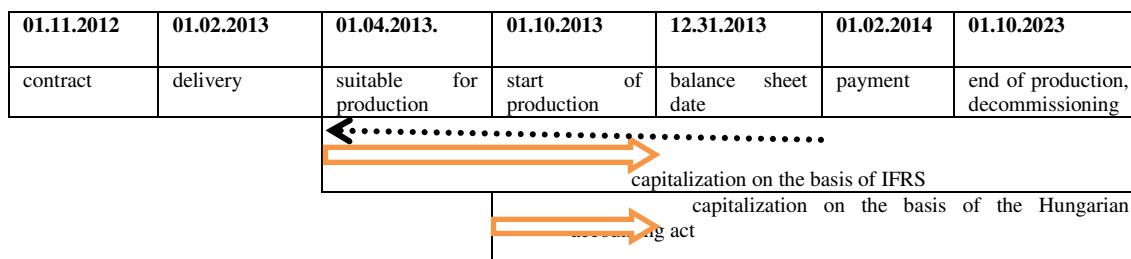


Fig. 1. The flow diagram of the economic events

Hungarian accounting act:

IFRS financial statement:

Cost of machinery:

$$252\,000 + 400 = \mathbf{250\,400} \qquad \frac{252\,000}{1.05} + \frac{4\,000}{1,05^{10}} + 400 = \mathbf{243\,235}$$

Depreciation:

$$252\,400 \times \frac{3\,months}{120\,months} = \mathbf{6\,310} \qquad 243\,235 \times \frac{9\,months}{126\,months} = \mathbf{17\,374}$$

Net book value on the 31st of December:

$$242\,400 - 6\,310 = \mathbf{246\,090} \qquad 243\,235 - 17\,374 = \mathbf{225\,861}$$

The calculation proves the fact that the cost on the basis of IFRS is lower because of the discounting, however, the sum of depreciation is significantly higher thus the net book value at the end of the year is much lower than the amount calculated according to the accounting act. Naturally, the income decreases by 17 374 HUF which is the depreciation cost calculated on the basis of IFRS. It is worth mentioning that the accounting act does not make the capitalization of decommissioning cost possible, as well as does not take the implicit interest related to the postponed payment into consideration. The assessment of decommissioning costs has to be regularly reviewed. Such estimate changes have to be carried out in harmony with IAS 8, the prevailing interest rate has to be determined on the basis of IAS 37. Another difference is the fact that the accounting act makes the capitalization of costs till commissioning possible, which may be different from the date of the ready-to-operate condition of the asset.

3. Summary

In harmonizing with the accounting regulation Hungary has walked a long way in order that it should meet the requirements and regulations of both the national and international stakeholders. The technical development has brought the opportunity of the acceleration of accounting and making it more precise. The continuous calculation of time value of money and other assets, evaluating it to valid values, making estimates were unimaginable earlier in enterprises without computer techniques and other achievements of the modern age. (Molnár, 2013)

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