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highlights

Amendments to the Act on Accounting – What changes will the approximation to EU directives produce?

IFRS in Hungary – an option for anyone soon?

Amendments to the Act on Accounting – What changes will the approximation to EU directives produce?

Based on Act CI of 2015, the amendments to the Act on Accounting 2016 were approved which took effect from 4 July 2015. Below is an overview of the amendments that have the greatest impact on the current accounting and reporting practices of Hungarian enterprises.

The Act on Accounting must be amended in order to approximate accounting regulations to EU directives. International Financial Reporting Standards (i.e. IFRS) are now more universally used in the EU as well, and the Hungarian accounting environment will move another step closer to IFRS by introducing the expected amendments.

Extraordinary items

The new accounting rules **do not permit the accounting of extraordinary items**. Of course, this does not mean that the company cannot account for such items in the future, it only means that this category will no longer exist according to the directives. Items previously defined as extraordinary income or expenses shall be recognised under other expenses or income from financial transactions in accordance with their content and type.

In practical terms this is rather a technical change, but it nevertheless requires some sort of change in approach from the profession.

Significant errors

Significant errors identified must be accounted for directly against the profit reserve as disallowed or deductible items, contrary to previous practice when the error and the impact thereof had to be recognised on the appropriate line of the income statement.

Simplified annual report

This might have the most beneficial impact on the vast majority of Hungarian enterprises. According to previous regulations, the following limits applied to those preparing simplified annual reports:

Undertakings keeping double-entry books may prepare a simplified annual report if, on the balance sheet date in two consecutive financial years, two of the following three size indicators do not exceed the following thresholds:

a) total assets do not exceed HUF 500 million,
b) annual net sales revenues do not exceed HUF 1,000 million,
c) the average headcount in the financial year does not exceed 50 persons.

These indicators will change significantly, generally rising more than two-fold, as follows:

a) total assets do not exceed **HUF 1,200 million**,
b) annual net sales revenues do not exceed **HUF 2,400 million**,
c) the average headcount in the financial year does not exceed **50 persons**.

Although 50 employees can be regarded as a relatively low value – companies are usually classified into a higher category during SME classification because of this – a new method of calculation must be employed. Even if the headcount exceeds the set limit, the company can still prepare a simplified annual report provided that its total assets and sales revenues are below the thresholds.

This is definitely a positive change because far fewer obligatory items are prescribed by the Act on Accounting for simplified annual reports, which means that accountants need considerably less time to prepare them than they need for annual reports. This reduces the **administrative burdens for companies**. The Ministry of National Economy expects the higher thresholds will enable 97-98% of Hungarian enterprises to prepare simplified annual reports in the future.

Although it affects fewer entities, the limits on preparing **consolidated annual reports** will also change as follows from the previous regulations:

Parent companies do not have to prepare a consolidated annual report on the financial year if, on the balance sheet date in two consecutive years preceding the financial year, two of the three indicators below do not exceed the following limits:

a) total assets do not exceed HUF 5,400 million,
b) annual net sales revenues do not exceed HUF 8,000 million,
c) the average headcount in the financial year does not exceed 250 persons.

These indicators will also change significantly, as follows:

a) total assets do not exceed **HUF 6,000 million**,
b) annual net sales revenues do not exceed **HUF 12,000 million**,
c) the average headcount in the financial year does not exceed **250 persons**

Dividends

Although the prevailing IFRS and the provisions of the Hungarian Act on Accounting differ in several regulatory issues, the rules on dividend payment probably require most explanations when a company wants to make a foreign owner understand why, for example, a dividend approved in 2015 is presented in the 2014 report.

Following the amendment, the former **category of retained earnings will cease**, the income statement will contain the breakdown of **profit after tax, the amount of dividends will be entered into the books as of the date of the decision** and not into the report of the given year (income statement) in relation to which it was approved.

Pursuant to the Civil Code, however, decisions on dividend payments can only be made at the time of the approval of annual financial statements.

In short

Unfortunately, the changes can **first be applied for annual reports and consolidated annual reports prepared for financial years beginning in 2016**, not for reports prepared for the financial year beginning in the calendar year of 2015.

Of course, there are further minor changes, clarifications and refinements in addition to the above amendments. The law amendment clearly brings the Hungarian Act on Accounting, and thus accounting practice, closer to the International Financial Reporting Standards; yet, Hungarian accounting regulations are still far from being fully compliant with IFRS. To ensure harmonisation it would make more sense to recodify the entire Act on Accounting instead of minor and major amendments.

IFRS in Hungary – an option for anyone soon?

On 12 June 2015, Government Resolution No. 1387/2015 on the use in Hungary of International Financial Reporting Standards for individual reporting purposes was published. As is clear from the resolution's name, the Hungarian government is essentially permitting the domestic use of International Financial Reporting Standards (hereinafter referred to as: IFRS) for individual reporting purposes.

When can the IFRS be applied?

The government resolution gradually expands the scope of those who may compile their individual reports according to IFRS instead of the Hungarian Act on Accounting.

Optional from 1 January 2016 for
- Listed companies
- Companies whose supreme parent company prepares its consolidated reports according to IFRS and instructs them to do the same
- Not an option for companies subject to the supervision of the National Bank of Hungary

Compulsory from 1 January 2017 for
- Listed companies
- Credit institutions and certain financial enterprises

Optional from 1 January 2017 for
- Insurance companies
- Companies subject to an audit obligation

Compulsory from 1 January 2018 for
- All financial enterprises

The implementation procedure is logical and carefully planned, since the companies that will probably use IFRS anyway can implement it earlier than others, even when this is only an option. Listed companies already prepare their consolidated reports according to IFRS, so they have the appropriate apparatus and expertise to use the same standards for individual reports as well. For them it may actually save costs and resources if they only have to apply one reporting framework when preparing their consolidated and individual reports.

There is a similar situation with the Hungarian subsidiaries of foreign enterprises, although at present they usually just compile an information package for consolidation purposes instead of complete IFRS stand-alone financial statements, so this new task may hold surprises for them.

Why is this good? What is the drawback?

What is considered as one of the greatest advantages of using IFRS is that it is a unified cross-border system of rules that makes the comparison of different companies really easy in today's globalised world (e.g. a Hungarian company versus a company based in New Zealand or Singapore). If we don't go that far but remain in the region, for example, then such comparability can even bring about a great competitive advantage over other competitors.

Nevertheless, it must be noted that since use of IFRS is only optional for many businesses, and a large number of Hungarian enterprises – not subject to an audit – are even excluded from the implementation, it could happen that comparability is hindered in the end.

In the long run it is not ideal if two reporting schemes coexist; yet there are currently plenty of examples of this at global level. It will certainly cause varying degrees of trouble if a business has to keep preparing its report according to both schemes (be it for data provision or tax return purposes), of which IFRS is considered the primary one. In such cases there will be no reduction in the costs and administrative burden as expected. Consequently, it would come as no surprise if having shared initial experiences over a transitional period, the scope of affected parties broadened further either on a voluntary or obligatory basis.

What changes will this imply in related regulations?

As IFRS are based on valuation principles that differ significantly from Hungarian accounting rules, the legislator cannot overlook the assessment of tax bases for those preparing their reports according to IFRS. The regulator will face yet another serious challenge, namely that corporate tax and business tax calculated on the basis of tax bases determined in line with international principles should incur taxation similar to that applicable to competitors paying tax according to Hungarian accounting rules. This is because bearing in mind the principle of equal treatment, there can be no advantage given either to those preparing reports under IFRS or under the Hungarian accounting standards in this regard.

Those who opt for IFRS will nevertheless have to carefully think about future taxation with regard to the change. This inevitably requires thorough tax planning because switching could bring considerable tax advantages or disadvantages.

It is not yet known how related legislation will eventually be amended. The resolution nominates the Minister of Economy to prepare the relevant legislative changes with the involvement of ministers affected in their areas of activity by 30 September 2015. Based on the resolution the Minister of Economy is further required to ensure that IFRS and their supplements are all translated into Hungarian, the existing translations are checked and corrected, the specialist literature issued by the IFRS Foundation is translated into Hungarian and made available to anyone in Hungary, and that any incurred costs are covered.

How should accountants prepare?

If a report is prepared according to IFRS, the tasks related to accounting services must be managed and controlled along with the preparation of the annual report by someone who

» is IFRS-registered in the register of accounting service providers, or
» is an auditor with chamber membership holding IFRS certification.

In addition, the legally prescribed audit duties for a company preparing IFRS reports can only be assigned to an auditor holding IFRS certification.

IFRS registration is subject to a professional qualification, i.e. the registration of IFRS certification can be requested based on the professional qualification of qualified accountant obtained on an IFRS course.

How should companies prepare with regard to IT?

The preparation of reports as per the IFRS framework requires a large amount of data provided from companies and content that is very different from that required so far. To comply with the IFRS valuation, classification and publication requirements, a duly customised corporate information system is indispensable. This may further require significant IT developments and generate additional costs, but a well-established system can indeed lead to a reduction in administrative burdens in the middle and long term.

The transition should be planned in good time because IFRS requires that at the first time adoption of IFRS two years of comparative prior period financial information be presented.

The newsletter accurately reflects the statutory provisions as they stand at the time of its issue.
The authors of the news articles have endeavoured to provide general information that both reads well and is professional. Given the general nature of the content and possible changes to legal regulations, please contact us if you require this information tailored to your personal circumstances.

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