ACCOUNTING BASICS

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BEFEKTETÉS A JÖVŐBE

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1. INTRODUCTION

1.1 OBJECTIVES, COMPETENCES AND CONDITIONS OF THE VALIDATION OF THE SUBJECT

1.1.1 Objective

When I meet unknown people and they inquire me about my job, they always feel pity for me when I tell them that I teach accounting. They also ask me in disbelief: “Is there anybody who is able to learn it and who likes it?”

My dear student, yes, there is, believe me. And the next one can be you.

If you traverse the curriculum step by step with me, if you comprehend the correlations, if you practice what you have learnt with the help of the tests and the exercises, you will certainly understand the role of accounting and you will manage its content, and what is the most important for you: you will know how to collaborate seamlessly with the economic experts whose main work area revolves around accounting tasks.

However, I must call your attention to one important thing. This curriculum will provide you a complete and comprehensive basic knowledge of accounting, but you will be able to comprehend the logic and the correlations of the curriculum only if you follow the learning order chapter by chapter.

Within the frameworks of the course, my aim is to present the place and the role of accountancy in the international and the domestic economy, since this is the basis for the validation of the subject. You have to see the purpose and the philosophy of the Accountancy Act, the fundamental accounting principles and you are supposed to understand the need for having an accounting policy and to interpret its contents.

For learning, it is necessary to review the concepts of book-keeping and accounting, since vocational reputation is not to be gained without expertise. The condition of this is the correct usage of the concepts. You must be familiar with the entrepreneurial property structure, with the balance sheet and the inventory pertaining to it, as well as the correlations and the dissimilarities between them.

When speaking of accounting, almost everyone talks about the use of "gallows trees", i.e. the T-shape ledger accounts, but based on the curriculum you will understand that they are in fact only economic events, which are recorded in a very simple and logical way, and the "gallows tree" is only a tool, which can be even simple paper-based records.

When stating the income, I want you to comprehend the content and the correlations of the sales turnover, revenue, cost, and expense. In particular, it is important to see the difference between revenue and income.

For the tasks ahead of you, it is assumed that you are sure to apply the possibilities and the application of the evaluation procedures laid down by law.

You have to acquire knowledge progressing step by step. Whenever you feel that something is not clear, you had better go back. And do not forget: doing the given exercises serves dual purpose. On the one hand, they help you understand the concepts and the correlations more accurately; on the other hand, they intensify your knowledge and allow to amplify the conservation of your knowledge.

1.1.2 Competences

Some of the professional competences will help your work significantly. I think the following are the really important ones:

- Ability to interpret the parts and the content of reports. Doing this, you will be able to assess at basic level your own business, enterprise, and what may be of the same importance, the partner companies. This latter may help in preventing future problems, because you will not choose a partner which ab ovo may put you in a difficult situation.
- Being familiar with and able to apply the rules that in everyday life are necessary to comply with the requirements of the Accountancy Act, and to ensure the smooth transaction of accounting processes. If you understand why it is important to do something, it is more probable that you will do it well.
- Based on what you learn during this course, you can see a little further as well, because you will understand the practical principles of the operation of integrated ERP systems, you will be able to support the processes more efficiently, and you can be involved more effectively in supporting the electronic data processing.

I would also like to highlight some determining elements of attitude:

If you go through and observe the rules for learning you will understand the need to comply with the rules in order to be able to work with the economic experts who are responsible for the cash-clearing operations and the reports, and this is an essential requirement for all economic operators.

As a income of learning, you will be open, within a workplace environment and outside, to the development and the transfer of the economic approach and methods related to your qualifications and charges, and to the organisation your work is connected to.

What you learn here will assist you to accept and abide the work and organisational culture, the ethical principles, the policies and the rules and regulations of the workplace, and will **make you committed** to the support of the accountancy processes matching your job to achieve quality work. This may also help the integrated teamwork within the enterprise.

You will be able to judge ***critically with the intention of enhancement*** your own work and the professional activity going on in your environment.

And finally, I hope you will understand why it is important and why one should strive to achieve life-long learning, both individually and in a workplace environment, in order to ensure that one's knowledge and work be updated and current.

1.1.3 Conditions of the validation of the subject

The student can obtain the final assessment mark for this course based on two tests, in which the theory practice ratio is 30-70 %, and the lowest performance which is accepted is 51 %.

We check your knowledge of the theoretical material related to the subject in the form of a test. 30 minutes are available for 60 test questions. The response given to the questions cannot be altered during the exam. These test questions can be found at the end of each chapter, and may be exercised up to the expected level.

If the income of the theoretical part does not reach 50 %, i.e. 30 points, this part of the test is to be repeated.

The practical exercise can also be exercised or made in an interactive way.

A balance sheet, a profit-and-loss statement shall be drawn up, accounting items should be designated, and evaluation exercises should be resolved in accordance with the practical examples.

The sample exercises will greatly facilitate the writing of the test, but in compliance with the algorithm, the exercise must always be done with different components.

This partial income should also reach 51 %, i.e. 35 points. If the income is below this level, the examination is to be repeated.

With the help of the evaluation solutions, you will be able to state cost values and values to be reported in the balance sheet, to interpret the value changes, and to interpret the content of the balance sheet, that of the profit-and-loss statement.

You will not become a veritable posting accountant, but you will understand the fundamental correlations of accounting, the essence of the four-statement-line accounting theory, which serves as the base of accounting, but what is more important, you may become a committed colleague to the accounting professionals.

Please, remember that you are not allowed to repeat the partial performances within 7 days, because so much time is needed at least to fill the gaps in your knowledge.

1.2 COURSE CONTENT (1-15) (CORE MATERIAL 2-13)

The core curriculum consists of five modules, but each of them contains more than one lesson. In the traditional approach, a complete curriculum related to a subject consists of 12 lessons. For the subject of Accounting basics your learning plan should be drawn up on the basis of the following.

Module 1: Introduction to domestic and international accountancy

Number of the lesson	The key concept of the lesson:	
Lesson 2	**1)**	The management, the essential management processes of organisations
	2)	The concept of accounting, its basics and functions
	3)	An overview of the international accounting rules
Lesson 3	**1)**	The scope and the structure of the Accountancy Act
	2)	The named and the non-named accounting principles

Module 2: The role of the Accountancy Act and its function in the Regulations, and the subdivisions of accountancy

Number of the lesson	The key concept of the lesson:
Lesson 4	**1)** The role and the content of the accounting policy
	2) The divisions of accounting. The subdivisions and the components of financial and management accounting.

Module 3: The legal standards of book-keeping and reporting

Number of the lesson	The key concept of the lesson:
Lesson 5	**1)** Book-keeping and reporting
	2) Book-keeping
	3) Audit, deposit and disclosure
Lesson 6	**1)** Book-keeping and reporting obligation
	2) Forms of the report
Lesson 7	**1)** Accounting documents
	2) Periods and dates set by the Accountancy Act

Module 4: Company assets, assets evaluation

Number of the lesson	The key concept of the lesson:
Lesson 8	**1)** Company assets (fixed assets, current assets, own and foreign ressources).
	2) Assets inventory
	3) The concept of the inventory and that of the balance

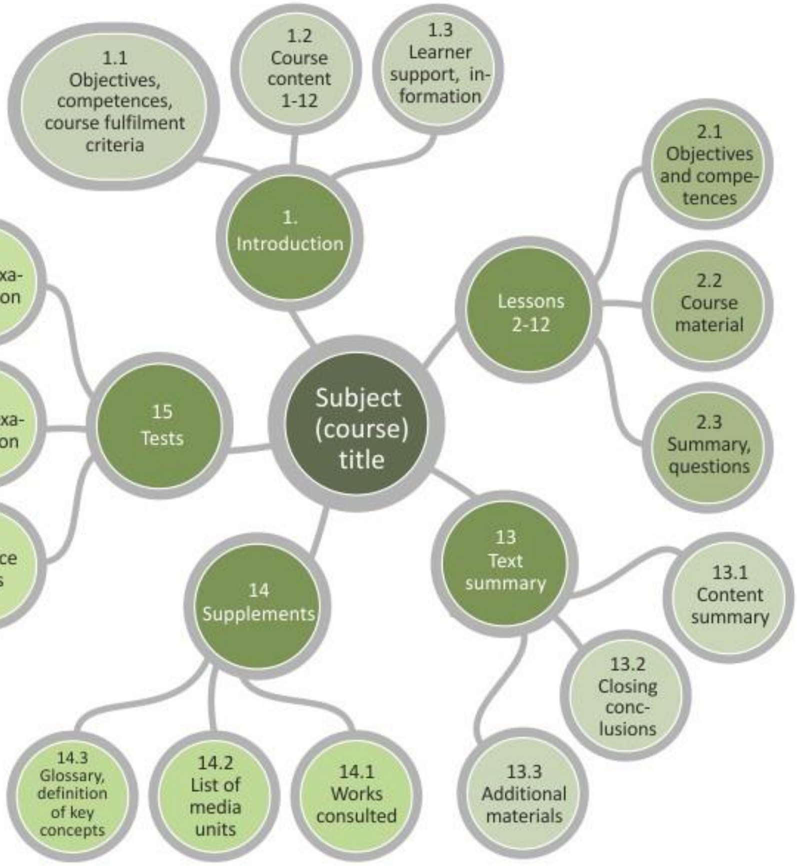
	sheet, their main features, types and structure
Lesson 9	**1)** Balance sheet item evaluation
	2) Value modifying items

Module 5: The uniform account chart and the account system
Cost-systematising and cost-booking
Role, content and draw-up of the profit-and-loss statement

Number of the lesson	The key concept of the lesson:
Lesson 10	**1)** The costs
	2) The revenue
	3) Income statement

Module 6: Accounting basics, the four-statement-line accounting theory.
Basic and complex economic events

Number of the lesson	The key concept of the lesson:
Lesson 11	**1)** Book-keeping accounts.
	2) Double-entry accounting
	3) Accounting the book-keeping accounts
	4) Accounting close
	5) The uniform account chart and account system
Lesson 12	**1)** Economic events
	2) Basic economic events
	3) Complex economic events



1. Figure: Mind map

1.3 LEARNING TIPS, INFORMATION

Everyone has a specific learning method. There are some people who swear that if they put the book under their pillow in the evening, they will know everything the next day...

This method will not work for us, so I must draw your attention to other clever things. First of all, I would like to ask you the most essential thing: please, give a chance to a quick and successful learning!

I admit that the beginning was very difficult for me too, as I started to learn the accounting with lots of prejudice (and not little disgust).

It will not work!

You must be able to accept and learn the basics which are necessary for your work.

Believe in yourself – and a little bit in me, too – that you will be able to make it. Otherwise, the chances are minimal.

If all this is done, you must accept that the terminology consists of terms that cannot be used at random. You need to learn them in order to use them in the right place.

In accountancy the most evil is that we must be very precise to say what we want to say, so that others can understand it as it serves our goals.

A typical example is that we confuse the concepts *cost* and *expenditure*.

Let us look a little bit ahead, but I hope you can follow me. I get the income by extracting the costs and expenses from the revenue. So, all costs will reduce the income of the enterprise, but if I give some money from the cash to the purchaser, it is not cost, but only expense, so it will not affect the income. What it will be at the end, will be determined later depending on what happens to it. It may be nothing if it is returned because he could not buy what he drew it for, or it may become cost, indeed, because he bought, for example, sugar, tea and lemon for the workers working at –10 C˚. This, indeed, clearly means that my income will be less.

My aim with this simple example was to make you understand that the concepts used tin accounting can never be "approximate" wordings!

You will need your patience and your accuracy. First, read the course material, several times if you have to. Try to remember the concepts. Do not leave any blurry spots, do not go on without understanding the real meaning of all the words. If you are not sure to understand an expression, look it up in the curriculum, or on the Internet, but browse only reliable sites.

With the tests, check if you really know what you have learnt. Do not go any further until you have a question that you just guessed and you are not sure of your job. Luck is needed in Life but in a decisive situation it does not come usually.

In the chapters which contain practical exercises, I shall first do and explain the examples, highlighting the problems, cases, which are emphasised, specific, or the general rules do not apply to them.

After that you are supposed to be able to do the exercises alone. Should you not manage, go back to the solution of the sample exercise, and let us start it at the beginning… if you go back several times, finally, you will be able to do it alone.

The time demand of the course is about 150 hours (!!!) by individual learning (which must seem daunting). This is, of course, variable, depending on individuals, whether they have knowledge from pilot studies, depending on the work area he/she is working in, or previously worked in, and this, of course, also affected by the individual interest. If you consider that it is difficult to master the course content by individual learning, it is essential to take advantage of the consultation opportunity, as well as to ask other students for assistance.

Joint learning is a very effective method! If you can, come together, and the learning and testing each other may become a pleasant activity.

Lesson 15 contains all the tests of the entire material and the exercises to be solved.

I shill use the following icons to help us in our work.


This will indicate my personal explanations.


According to my experience, for a specific problem almost always the same questions were asked by my students. If you asked the same question, you will find the answer to it, if you click on the icon.


When you see this icon, you will find there an exercise there, and I hope we can continue on together.

 After this whiz kid, you will always find an extremely important note.

So, let us hop to it!

Have enough self-confidence, perseverance and patience.

The income will not delay!

2. INTRODUCTION TO DOMESTIC AND INTERNATIONAL ACCOUNTANCY

2.1 OBJECTIVES AND COMPETENCES

The aim of this lesson is that:

- you understand the basic processes of the economic systems, interpreted in a system approach
- you find and accept where the place of accountancy is,
- you understand which are the essential processes of the economic organisations,
- you see that management of economic processes is inconceivable without the support of the accounting processes.

It is also important to me, that in addition to all these:

- you understand the principles governing accounting processes
- who are concerned in them
- the subdivisions of accounting
- you see the development of the international accounting rules
- you can place each trend,
- you can accept state today's efforts for harmonisation.

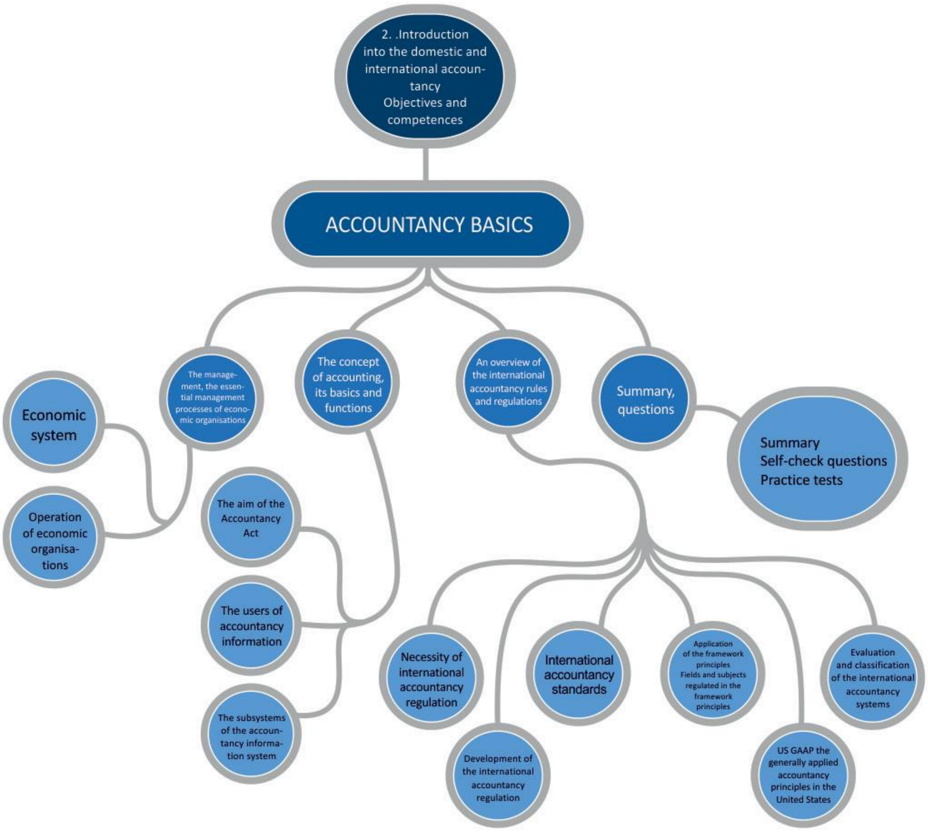
Time demand in this case, I think 8 hours…. minimum! ☹ Not because of the memorisation, but so that you understand the correlations thoroughly.

Key expressions (maybe, which are to be revised on the basis of your previous studies!):

- production, manufacture, service,
- human resource management,
- marketing and sales,
- finance and accounting
- real flows
- information processes
- management processes
- "external" users
- "internal" users
- management accounting

- IAS
- IFRS
- US GAAP
- accounting harmonisation
- international accounting systems

Here is the idea map of Lesson 2:



2. Figure

2.2 MANAGEMENT, THE ESSENTIAL PROCESSES OF ECONOMIC ORGANISATIONS

Before we start proper work, I would like you to understand what the role and place of accounting are in general, you will be able to feel closer to the discipline thereby.

The creation of economic organisations are determined by a number of factors. Let us have a look at from where and how a business can start! Look at a sketch for starting – if not about the foundation of the Microsoft but about a current theoretical practice.

Future millionaires in fact have been created a business, which is also an economic organisation or system.

2.2.1 Economic system

An economic system is a system, the activity of which is carried out in the sphere of material production; the available material and personal assets are limited, but they constitute an organised unit in a specific environment; the system is capable of setting objectives and of the implementation of actions I favour of the objectives.

The young people in the video sketch have undertaken to offer bicycles for rent and to repair them, i.e. to provide services. When doing this, someone need to be there to give out the bicycles, someone is to advertise the service on the internet, someone is to do the “paperwork” and to watch that the accounts be all right, so the specific job shall be divided between them.

Based on this, we can accept that the operation of economic organisations are determined by four main functions:

- production, manufacture, service,
- human resource management,
- marketing and sales,
- <u>*finance and accounting.*</u>

The basic objective of economic systems complies with the main functions:

- **Production,** supply and distribution **of products, produce and services** that they can realise profit thereby.
- In order to realise profit the product, produce and service must be provided. The **task of marketing** is to find and exploit sales and market channels.
- Economic systems carry out their activity managing their resources and assets, which are to be accounted for and presented in the framework **of financial, Accountancy Activities** in compliance with law.

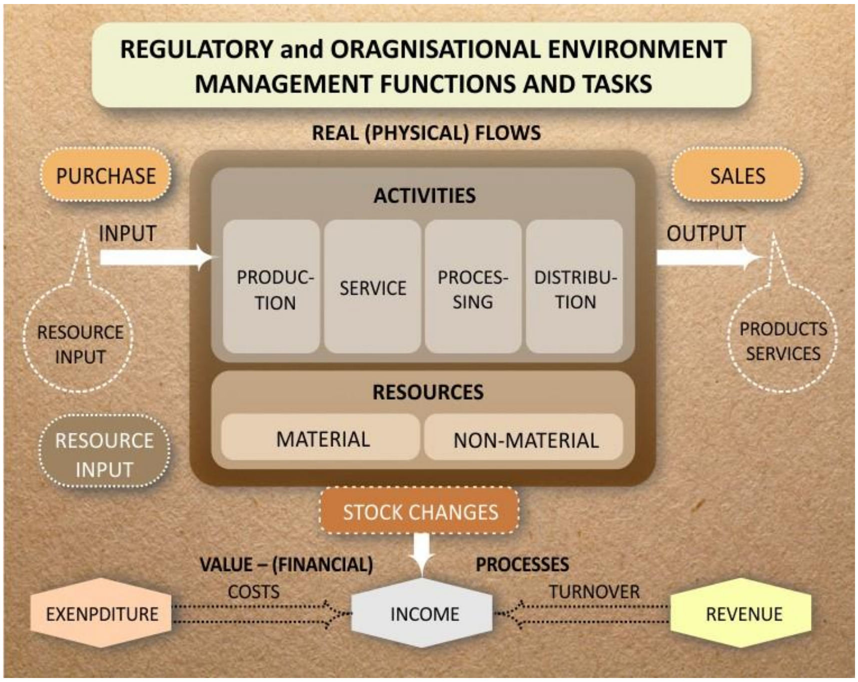
– Nowadays, an essential condition of the competitiveness is the well-structured employment, the motivation of the employees, their professional development, in other terms, the **human resource management**.

Within an economic system, real flows, i.e. physical or economic processes and management processes take place. Both are accompanied by and also bound together with the information process.

Going further, a general model of operation can be set up.

2.2.2 The operation of economic organisations

You can see the general model of the operation of an economic organisation engaged in a production activity.



*3. Figure: The general model of the operation of an economic organisation engaged in **a production activity***

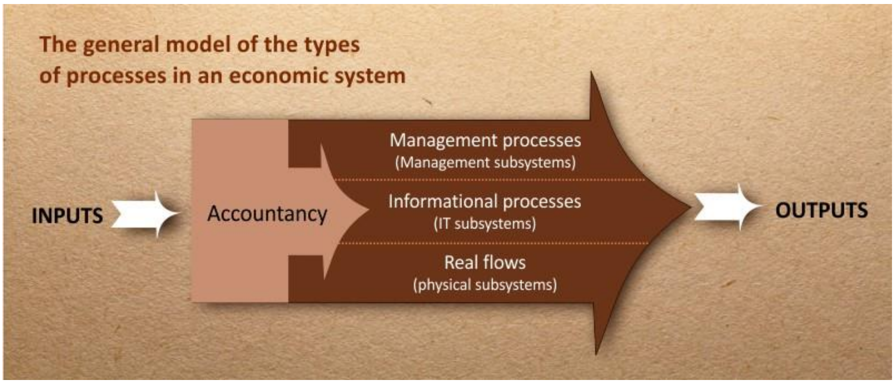
☸ Please, note in the figure that the real flows are accompanied by financial and value processes.

The tasks may be carried out by a wide range of organisational units. A large company, for example, is divided into divisions or departments, while in a one-person enterprise the owner performs these tasks.

In conclusion, it can be concluded of the economic systems:

- An economic system is the organised group of persons and assets.
- An economic system carries out an activity, which determines its position in the social work division. When setting their goals and operating, they are to take heed of their environment as well.
- An economic system is also capable of setting objectives and of the implementation thereof. This implies that the activities of economic systems can be classified in two groups.
  - Their *objective-setting* activity includes the definition of tasks and performance conditions, as well as analyses related to them.
  - By their *executive* activity, we mean providing the conditions of carrying out the tasks, the organisation of their implementation, and the concrete execution of the tasks, i.e. the implementation.

The enterprise-organisation model can be simplified and be applied generally. In the simplified model, the position of the information system within the economic system may be made clearer.



4. Figure

It is evident that the three basic system lines cannot spare the registration and Accountancy Activity, that is, the accounting processes that affect the basic processes in a complex way. **Accounting is essentially an accounting and information system,** which registers the changes of assets as a income of real flows, the information technology system carries out the data processing and meets the decision-support need of the management processes.

In the video, the enthusiasm of the young people, the question of "how to go on?" suggests many tasks; and the foundation of an enterprise entails certain legal, taxation and other registration tasks. From the list of the tasks only one area will be important for us:
<u>the accounting</u>.

2.3 THE CONCEPT OF ACCOUNTING, ITS ESSENCE AND FUNCTIONS

Accounting is not a simple task. Each party in the economy must follow the same principles in order to ensure that the accounting, the control and the information service be comprehensible and easy to follow to everyone. This function is ensured by the Accountancy Act, so it achieves the use of a uniformed vocabulary.

2.3.1 Purpose of the Accountancy Act

Basically, it regulates the accounting of processes and the data disclosure associated with it. The purpose of the Accountancy Act is to provide accounting rules, which allow having a reliable and real view of the property, the financial position, the profits, the income-generating capacity and the incomes of the activities of all those covered by law, for the benefit of the owners, managers, creditors, investors, tax authorities and government authorities.

- **The Accountancy Act, in accordance with international practice, includes the reporting, book-keeping principles and rules to be applied, the publication or disclosure rules, as well as the audit rules and requirements.**

In the application of the accounting principles and requirements of the Accountancy Act, the computerised accounting systems got a significant role via the operation of the ERP systems. The expanding memory capacity, the new processors – which mainly incomeed in an increase of speed – allowed a significant quality increase in the accounting and management jobs.

The decentralisation of the management system and the expansion of the market economy incomeed in the transfer of the planning emphasis onto the economic systems.

The computing support provided the up-dating of the information, their comprehensiveness, and thereby the leaders' need for "foreseeing the future" has become more and more high.

This demand has brought into existence the management information systems, for the establishment of which the most important aspect is to create a database, which reflects real events, and that this database should be available on a single set of principles at each level of the management.

The development, however, has also brought additional requirements with itself.

2.3.2 The users of the accounting information

From 1992, in accordance with the international practice and the needs of the market economy, the content and form of meeting the information demand of the "external" and the "internal" users have been separated in the economic systems.

The "external" users may have the needed information from the obligatory content reports regulated by law. These reports are associated with book-keeping also under legislation.

The "external" circle of users includes investors, potential investors, customers, suppliers, creditors, the tax authorities, the government authorities, etc.

The need for information of managers is much more complex, and more extensive than the needs of the external claimants.

The "internal" users may create their demand of information and the book-keeping related to it in accordance with their own needs. The "internal" circle consists of owners, executive managers, the members of the Supervisory Committee, the leaders on various levels of each organisational unit, the representatives of the employees, etc.

Concerning the details of the information various requirements arise.

2.3.3 The subsystems of the accounting information system

In accordance with the general international practice, the **accounting information system**, or rather its provision of information, has been divided into **financial accounting and management accounting,** but the progress has not stopped there **environmental accounting** is spreading**.**

The primary responsibility **the financial accounting** is to record assets changes and the prepare reports.

The primary responsibility of **the management accounting** is to ensure the necessary information for managers and the management, which are

absolutely essential in order to

- to keep record of the expenditure of the economic system,
- to control and to manage the processes and the activities,
- to support the planning.

In the next stage of the development of the accounting processes, environmental protection has also come into view. In the companies' accounting system, a substantial part of the expenses are posted among the general costs related to the enterprise's operation, which cannot be subdivided and allocated to products or services, but they are stated without any break-down. A major part of the environmental costs are usually posted among these non-allocated costs. Because of the lack of an appropriate accounting system this is often not realised, or may not be properly allocated to the products or processes, the income of which is that the decisions related to the products, services or whole businesses will not be correct.

Environmental accounting is intended to provide a precise picture of the financial aspects of the company's activity related to the environmental protection. This may include the identification of items of the expenditure and income, the exploration of the environmental aspects of investment decisions, and the analysis of other financial data related to the environmental performance of the companies in the course of decision-making.

2.4 AN OVERVIEW OF THE INTERNATIONAL ACCOUNTING RULES

I would also like you to understand why the current content of the domestic rules is important. For this, the development, the content and the role of the international rules must be reviewed.

2.4.1 The need for an international accounting regulation

As a income of the fast capital flow which characterises our economic life today and the expansion of corporate relations, national frontiers are losing their importance. The multinational companies are present all over the world, and through stock exchanges of the world, more and more capital is waiting for more and more complex investment opportunities.

The process itself is the globalisation, among the effects of which we must highlight the following:

- Quick capital flows,
- Corporate relations widened,
- National borders may be crossed at any time,
- The companies' need for capital keep growing,
- Multiple investment opportunities.

Under different regulations, the development of the accounting processes incomeed in a different practice in each country. The applied methods and models developed and changed according to what the essential preferences were, how developed the economy was, what growth stage the countries were in, and what law was applied.

Enterprises have to present reports based on different principles and with different content about their units operating in different countries, so it is difficult to compare their performance for the owners, the investors, the authorities, and other decision-makers.

These synergetic effects have asserted and have been asserting the need for a uniform system, which enables those who are planning to start a business or to invest in a business in various countries to compare their performances. **The most effective performance meter communication tool** – despite its shortcomings – is **accounting**, the harmonisation of which has become a global endeavour for these obvious reasons.

Currently, the effect of three main accounting systems shall prevail in the accounting regulation.

In addition to the specific national accounting rules, mainly the United States of America have determined the rules in accordance with the US GAAP, and the EU, the financial rules in accordance with the legislation of the European Union, the IAS, the international accounting standards and their interpretations, the IFRS and the SIC.

In a spirit of the unification fight, the national accounting rules are being push in the background and losing of their importance, since the IFRS replaces the national rules. An example of this:

- In Canada, the Canadian National accounting rules have been abolished in 2011, and they were replaced by the IFRS.
- From 2007, the listed companies in China have been applying compulsorily the IFRS.
- In Japan, all nonconformity between the Japanese national accounting rules and the IFRS has been eliminated.

The accounting regulatory systems interpret the accounting and reporting tasks more or less in a different manner.

2.4.2 The development of the international accounting rules

The International Accounting Standards Committee (IASC) was established in 1973 to create the rules of the IAS.

The IASC has been transformed in 2001; in March 2001, a non-profit organisation, the IASC foundation was created. Its main task was the supervision of the International Accounting Standards Board (IASB). The IASB is to make the standards drawn up from the accounting practices each of the country accepted and to promote the application thereof. The IASB endeavoured to make its own standards accepted as the official accountancy regulation in the developing countries, where no accounting regulating had been done. The primary task of the Commission was to create consistency between the IAS and the national, for example, the US-GAAP standards.

In 2001 the Council of the Economic and Finance ministers agreed with the proposal that from the year of 2005 listing companies within the EU – banks, and insurers included – prepare their consolidated reports in compliance with the IAS. Companies using the US GAAP were granted a respite until 2007. In addition, the Member States shall be entitled to extend this system to other organisations and also to the individual accounts.

2.4.3 International Accounting Standards

The names of the standards changed as well, so that the standards issued by the IASB and those issued by the IASC could be distinguished.

The Standards of IASC are called International Accounting Standards (IAS), while the IASB standards are known as the International Financial Reporting Standards (IFRS). The application of the standards was assisted by the interpretations issued by the Standing Interpretation Committee (SIC).

The creation of the IFRS is the income of a professional self-organisation; they were created by the International Accounting Standard Board (IASB).

- In addition to the IAS (International Accounting Standards), the denomination IFRS (International Financial Reporting Standard) has been introduced, but the standards issued until then remained the IAS, the new ones are called the IFRS.

– Standards will be set for such economic documents such as the environmental and sustainability reporting, for which the name "accounting" does not fit.

The economic development requires from experts the continuous expansion and supervision of these solutions.

2.4.4 Application of the Framework Principles

The Framework Principles shall apply to the financial statements of all commercial, industrial and service providers, regardless of whether they belong to the public sector or the private one. Therefore, the reporting entity is an enterprise, where the users of the financial statement trust this statement, and this is their major information source regarded to the situation of the enterprise.

By creating the Framework Principles *the IASB was intended to provide assistance in a number of areas. It assists the overview and the development of current standards, the harmonisation of accounting standards. The Framework Principles support the creation of national standards, the work of standard creator bodies, and the work of those who prepare the financial statements. The Framework Principles do not mean, however, the International Accounting Standards, therefore, they deal neither with evaluation issues nor with disclosure rules. It mustn't be disregarded that none of the points of the Framework Principles overwrite the rules set by the IAS.*

Areas and topics regulated in the Framework Principles

– The general definitions of theoretical character in the Framework Principles are grouped around five large topics. These are the following:
– Purpose of the financial statements,
– Elements of the financial statements,
– Principles, quality characteristics and limits determining the usefulness of the information content of the financial reports,
– Definition, accounting and measurement of the basic concepts of financial statements,
– Evaluation of the capital, the possibility of the measurement of the capital increase.

The US GAAP, the generally accepted accounting principles in the United States

US GAAP is a specific accounting regulatory system, in which in addition to the standards designed by the professional organisations authorised for this purpose, essentially treated as acts, edited by topics, high court decisions have a major role as well, following the precedents, the case-law traditions accepted in the USA. The rules have been developed by the civil sector (accounting professionals, auditors, professors), without any state influence. The instructions are very detailed, with many loopholes and exceptions (“creative accounting").

Previously, accounting professionals considered the US rules and regulations, the USA-GAAP (United States Generally Accepted Accounting Principles) to be the highest quality standard system; that this gives the most reliable accounts, and that the transition to any other system would decrease the reliability of the reports.

The USA-GAAP is a very detailed control, however, there are very many loopholes and exceptions in there, thus they provide an opportunity to practice “creative accounting”, i.e. for the creation of deceptive, misleading reports for the investors.

The big accounting and audit scandals at the millennium (ENRON, Worldcom, Parmalat) have made the US professional public to realise this, and now they are open to accept a new, less detailed accounting system, which is rather based on principles than practical solutions.

In the the decision-making process of the US GAAP as well, are included the obligation of convergence and of the cooperation with other accounting systems, such as the IFRS.

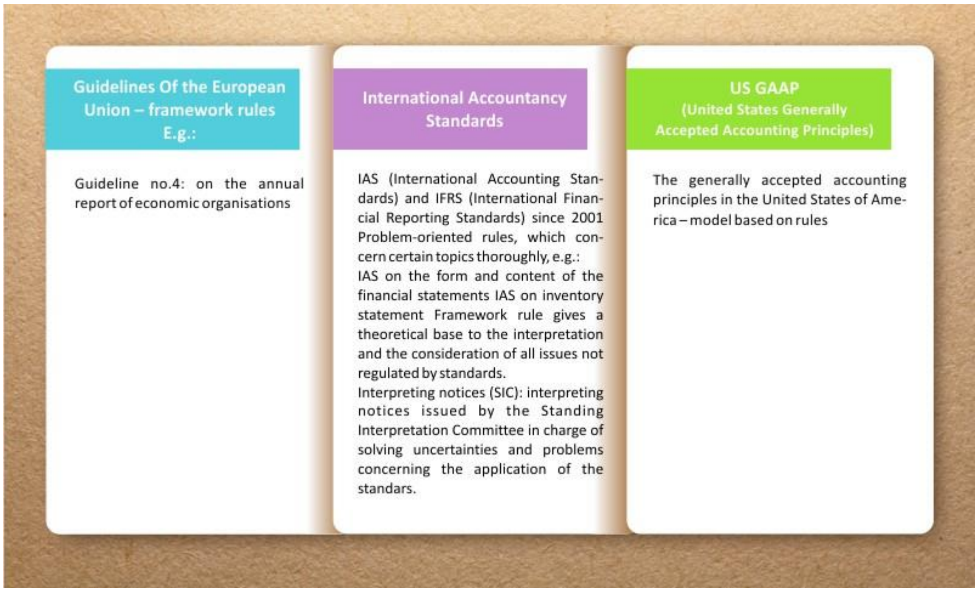
Based on this, approaching the IAS, the IFRS and the American regulation to each other has begun.

2.4.5 Evaluation and classification of the international accounting systems

The international accounting systems mean the operation under the same principles of groups interested in the accomplishment of accounting tasks.

Some nations have developed their own accounting rules appropriate to their specificities. These, however, have become the obstacles of the economic development, and the harmonisation of accountancy activities has become absolutely essential.

Essentially, three international accounting systems have been created, which are as follows:



5. Figure: International accounting systems

Source: [6]

As a consequence of the international capital flows and the international expansion, there is a growing need for a single “accounting language”, which would allow for both the investors’ and the companies cost savings due to easier accounting, reporting and evaluation.

The need for a uniform accounting language is essentially important because of the unification of the financial reports prepared on the basis of different principles, since the comparison of the different reports incurs additional costs for big companies and their related entities.

The measurement of the performance of divisions operating in different countries is necessary, but reporting in accordance with uniform reporting principles in different countries is **also important from the point of view of investors**.

The solution of the problem is the harmonisation of accounting, which is a process in order to increase the comparability of the accounting practices.

In 2002 the so-called Norwalk convention was signed by the IASB (International Accounting Standards Committee) and the FASB (Financial

Accounting Standard Board of the US) by which the convergence project has begun, which aims to eliminate the differences between the two dominant accounting principles systems, the IAS/IFRS and US GAAP.

2.5 SUMMARY, QUESTIONS

2.5.1 Summary

This is the end of this lesson. It is not necessary to remember the contents of this lesson “word by word”, but, however, it is required that at this point you see the exact place of accounting, and that you understand that it is present both on micro- and macro-level. Its development was not smooth, but the endeavour and the intention are clear: identical measurement and assessment systems are required in the economy. Accounting with its legislation is one of its tokens.

2.5.2 Self-test questions

1. The concept of economic system.
2. The main functions of economic organisations
3. Characteristics of economic systems
4. Activities of economic systems
5. Types of processes of an economic system
6. Purpose of the Accountancy Act
7. Task of the financial accounting
8. Task of the management accounting
9. Purpose of environmental accounting
10. International accounting systems
11. Contents and importance of International Accounting Standards
12. The importance of the IAS
13. The importance of the IFRS
14. The importance of the US GAAP
15. Accounting harmonisation

2.5.3 Practice tests

		Correct answer	Wrong answer	Wrong answer	Wrong answer
1	The essential activities of an economic system include the following:	management of finance and accounting processes	teambuilding	social care	scientific research
2	The purpose of the Accountancy Act	To give information about the real situation of an enterprise to the operators of the market	to set precise rules for businesses	to determine the exceptions among those covered by it	Excluding the exceptions from those covered by it
3	International accounting systems	- Guidelines of the European Union - International Accounting Standards - US GAAP	- Guidelines of the European Union - IAS - US GAAP	- Guidelines of the European Union - IFRS - US GAAP	-The National accounting rules
4	Subsystems of the accounting information system	- financial accounting - management accounting - environmental accounting	- controlling, - control - decision support.	- real flows - management processes - control processes	- external users - internal users
5	The “external” users may be:	- investors - customers, - suppliers, - creditors, - authorities, etc.	- foreign owners - investors - customers, - suppliers etc.	- creditors, - tax authorities, - workers - subordinates - foundations etc.	- TV programmes - radio programmes - animal right activists - the controller - the internal controller etc.

3. THE REGULATION OF ACCOUNTING

3.1 OBJECTIVES AND COMPETENCES

The purpose of this chapter is to bring a little bit closer to you and to teach you

- the basic concepts of the Accountancy Act affecting business entities,
- to make you familiar with the law and to see its structure.
- to make you familiar with the accounting principles, and to help you understand their content using examples,
- as well as their expediency and use.

Time required: in this case, you will need at least 10 hours to acquire a permanent knowledge. In particular, the revisions require more time.

One advice:

Take a sheet of paper and a pen, and take notes of what you want to remember.

Organise what you have learned in your own logic!

Not everyone has an "accounting" thinking. I had a student, who memorised the accounting principles making acronyms from their initials. Maybe, it would be easier for you, too, to remember them in that way. It is worth a little game!

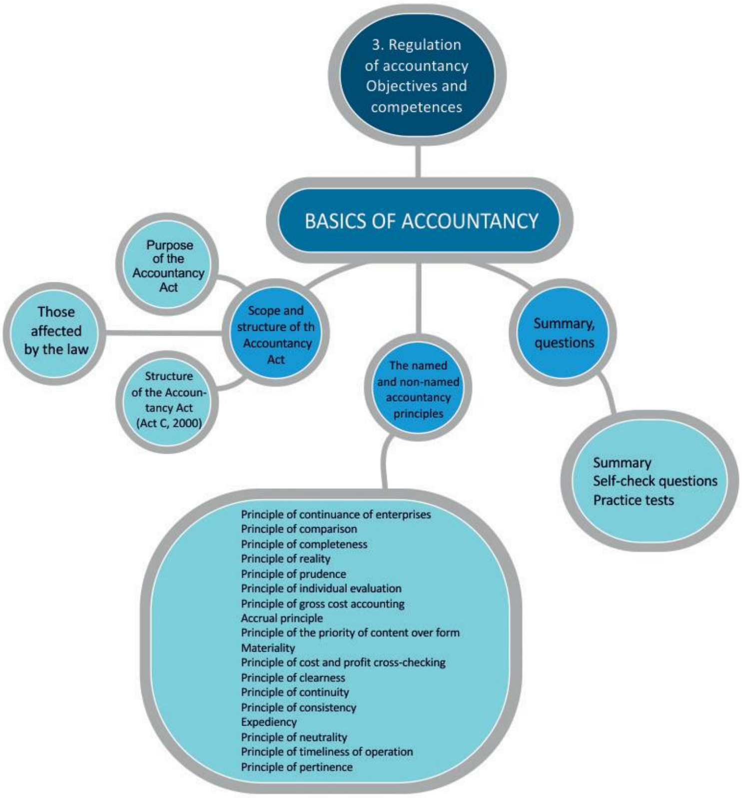
Key expressions: *These will now appear intimidating, but do not give up!*

- Purpose of the Accountancy Act
- Business entity
- Contractor
- Organisations of the national finances
- Other organisation
- Principle of continuance of enterprises
- Principle of comparison
- Principle of completeness
- Principle of reality
- Principle of prudence

- Principle of individual evaluation
- Principle of gross cost accounting
- Accrual principle
- Principle of the priority of content over form
- Materiality
- Principle of cost and profit cross-checking
- Principle of clearness
- Principle of continuity
- Principle of consistency
- Expediency
- Principle of neutrality
- Principle of timeliness of operation
- Principle of pertinence

3.2 THE SCOPE AND THE STRUCTURE OF THE ACCOUNTANCY ACT

Learning chart of Lesson 3:



6. Figure

You will often meet in the curriculum applications, which are not necessarily quickly acceptable. Yet, we must accept them, and carry them out as it is in the curriculum. For this, the Accountancy Act is to be "blamed".

3.2.1 Purpose of the Accountancy Act

For the operation of the market economy, it is essential for the decision-making that objective information should be available for the operators of the market about both of the enterprises and the non-profit-oriented organisations, as well as about other economic entities – concerning their assets and liabilities, financial situation and the development thereof.

The Accountancy Act prescribes accounting rules, which are in accordance with the European Community directives to be applied for this field; they take heed of the international accounting principles, and on the basis of which true and fair information can be provided on the income-generating capacity, assets, development of assets, financial situation and the plans for the future of those covered by the law.

The triple purpose of the Accountancy Act:

- to determine the **reporting and book-keeping obligation** of those covered by the law,
- to determine the **principles** and the ***rules*** for reporting and book-keeping.
- to determine the requirements of **publication, disclosure *and audit***.

3.2.2 Entities covered by the Act

The Act applies to all the participants of the economy, about the activities of whom other participants of the national economy require information.

*The Act covers **the enterprise**. This concept includes*

- entrepreneurs,
- public finance bodies,
- other organisations,
- the National Bank of Hungary,
- in addition, social and educational institutions founded by them or by a natural person.

The Accountancy Act does not apply to:

- sole traders,
- civil societies,
- building communities,
- trade companies in Hungary representing enterprises based in a foreign country
- companies without legal personality (general and limited partnerships) and sole proprietorships, which record their accounts of the financial year according to the specifications of the act on the simplified entrepreneurial taxation, the itemised taxation of small-tax-paying enterprises and on the small business taxation.

Sole proprietorship: any business entity, which carries out a production or service activity (business activity) in its own name and at its own risk in order to make profit and to obtain property, with compensation:

- credit institutions,
- financial enterprises,
- investment enterprises,
- insurance enterprises,
- non-profit economic entities,
- associations,
- social cooperatives,
- school cooperatives,
- European Economic associations,
- European limited-liability companies,
- European cooperatives,
- water companies,
- forest proprietorships,
- a foreign-based enterprise’s branch in Hungary, if it does not listed among other organisations, or public finance organisations.

Public finance organisations: organisations, which is classified such as by the legislative provision on the operation of public finance on the basis of the act on public finance. (The organisations of public finance are organisations in the public finances subsystems.)

Other organisations:

- housing cooperatives,
- condominiums,
- social organisations, public bodies,
- ecclesiastical legal persons,
- foundations, including public foundations,
- lawyers, patent executive offices,
- non-profit organisations,
- the Broadcasting Fund,
- organisations created within the frameworks of the Employee Shareholder Program,
- the public water company,

- the investment fund, other funds,
- the stock market, the clearing house,
- the private pension funds,
- the voluntary pension funds,
- the voluntary mutual health and self-administered funds,
- the public inventory,
- other statutory organisations having the status of a legal person.

3.2.3 The structure of the Accountancy Act (Act C, 2000)

The Accountancy Act consists of chapters. The content of each chapter can be found in the following tablet. For their detailed content, please, consult the Internet.

Chapter I.	General provisions (Art.1 – 3)
Chapter II	Reporting and accounting (Art.4 – 16)
Chapter III.	The annual report (Art.17 – 95)
Chapter IV	Simplified annual report (Art.96 – 98)
Chapter V.	Simplified accounts (Art.99 – 114)
Chapter VI.	Consolidated annual report (Art.115 – 134)
Chapter VII	Specific reporting obligations (Art.135 – 149)
Chapter VIII.	Accounting services (Art.150 – 152)
Chapter IX.	Publication and disclosure (Art.153 – 154)
Chapter X.	Audit (Art.155 – 158)
Chapter XI.	Accounting, certification (Art.159 – 169)
Chapter XII.	Sanctions (Art.170)
Chapter XIII	The National Accounting Committee (Art.171 – 173)
Chapter XIV	Final provisions (Art.174 – 178)
	Attachments (1 – 7)

7. Figure: The structure of the Accountancy Act (Act C, 2000)

You may accept easier that definitions and concepts cannot be "something about" solutions, because they have other content immediately. Look for the Accountancy Act on the Internet.

http://net.jogtar.hu/jr/gen/hjegy_doc.cgi?docid=A0000100.TV

3.3 THE NAMED AND NON-NAMED ACCOUNTING PRINCIPLES

When preparing the accounts and during the accounting, our work must be carried out in accordance with the accounting principles. Pursuant to the principles and the requirements set out by the law, the most appropriate accounting policy for the circumstances of the enterprise – defining methods of implementation and means of the law – should be established and formulated in writing.

Accounting does not mean the system of fully determined procedures, but the adaptation of legal solutions, which serve the most the interests of the enterprise. In many cases, there is no such thing as a model, which you can follow, therefore, practical solutions should be developed by us. In this activity the accounting principles are the direction indicators, work should be carried out in the spirit thereof.

Non-conformity with the Accountancy Act is only permitted in cases provided in the Act and in the way defined by the Act.

Let us see first the named principles.

3.3.1 The principle of the continuance of enterprises

It is a general accounting principle, which in fact cannot be considered to be an essentially accounting principle but the conditions of the implementation of the other principles; it means the compliance with the rules of the honest and fair economic activity.

When preparing the accounts and doing the accounting, it must be assumed that the economic entity can maintain its operation and resume its activities in the unforeseeable future as well; any cessation or decrease of the operation for any reason is not expected.

3.3.2 The principle of completeness

The economic entity shall keep accounts of all the economic events, the effect of which on the assets, accounting assets, resources and the annual income must be accounted for.

Economic events should also be reported,

- which concern the financial year,
- which became known after the balance sheet date but prior to the designated date of the preparation of the balance sheet,
- which arise from the economic events of the financial year closed by the balance sheet date, have not occurred yet before the balance sheet date but became known prior to the preparation date of the balance sheet.

When applying the principle of completeness, attention must be paid to the requirement that the documents, which the accounting of the economic events is based on, which are related to the current period, are to be processed without omission and snug.

3.3.3 Principle of reality

It states that the items recorded in the books and the reports and fixed are to be existing, proved and clear also to outsiders. The evaluation of each item must meet the statutory assessment principles and the related assessment procedures.

The application of the principle ensures the authenticity of documents, inventories reflecting the reality, the enforcement of the statutory assessment principles and the related assessment procedures in book-keeping and in reports.

3.3.4 Principle of clearness

According to the principle of clearness, books and reports shall be transparent, understandable, prepared in a clear form in accordance with the law.

You can see the law content in the attachments of the Accountancy Act, which may be reduced in the report if too excessive, or expanded in accordance with the principle of materiality – if necessary.

The application of the principle of clearness in the book-keeping – with regard of the provisions of the principle of a uniform accounting plan – is essentially the responsibility of the enterprise. The accounting policy, the registration of the accounts, the analytical records, the dispatches' system, the accounting of the economic events shall be designed in such a way that it will be clear and easy to understand to the management and the control authorities. The principle of clearness applies to the accounting system as a whole, but it is of special importance in respect of internal information in the management accounting.

3.3.5 Principle of consistency

This principle sets that consistency and comparability shall be ensured in the content and the form of the report, as well as in the book-keeping supporting it.

This principle also makes our own job easier from the point of view of the stability; it assumes the development of a thoughtful, well-organised accounting system, which must be recorded in the account linkage of the enterprise. The evaluation processes in the accounting policy are relatively stable, but if modification is needed, these changes should be justified and traceable.

3.3.6 Principle of continuity

The opening figures of a new business year shall match the closing figures of the previous business year. This is the basic and evident requirement to be met in respect of the assets.

In the following years, the evaluation of the assets, resources and the income may only change in accordance with the Accountancy Act.

This does not mean that we work with solutions engraved in stone. If the economic conditions change, our rules must be adapted to them, but this can be done only with respect to the regulatory requirements, and by presenting the effects on the income.

3.3.7 Principle of comparison

When determining the income of a certain period, the recognised revenue of the settlements of the activities in a specific period and the corresponding cost (expenditure) must be taken into account, regardless of the financial fulfilment. The revenues and the costs shall be attached to the period when they occurred economically.

The financial year and the current year are not the same concept; revenues and costs are also completed in a different way in this context.

An economic event may very often affect more than one year, for example, we can get a three-year rental fee as income I advance, which is to affect the revenue for three financial years.

3.3.8 Principle of prudence

Earnings cannot be stated, if the financial realisation of the turnover or of the revenue is uncertain. When determining the current year's income, the foreseeable risks and potential losses shall be taken into account along with the accounting of loss in value and the creation of provisions, even if they became known between the balance sheet date of the financial year and date of the preparation of the balance sheet. Losses in value or provisions must be accounted for, regardless of the fact that the income of the current year is profit or loss.

This principle helps the economic entity in calculating a truly realistic income. All items of loss in respect of the economic activity in a business year must be recognised in the books as well, but an item, which would be an income, may only be entered in the books, when there is no uncertainty factor.

3.3.9 Principle of gross cost accounting

The revenue and the costs (expenditures), the claims and the liabilities cannot be accounted for one another – except in the cases set by the Accountancy Act.

This is perhaps the most difficult basic principle to interpret, but the most important one in respect of the accounts.

If I sell something for 100 HUF and I buy, for example, material as well for 100 HUF from the same a partner, it does not mean that there is no such thing happening as an economic event, since we settled the thing fifty-fifty. The material will increase my assets, should be recorded, not to mention that the cost price of my product will not be real, if I leave it out form the calculation.

3.3.10 Principle of individual evaluation

The assets and the liabilities must be recorded and evaluated individually during the preparation of the books and the report.

It means the individual accounting of the assets and liabilities, the evaluation of the inventory (analytical accounts) broken down into items and, simultaneously, the application of the principle of reality in the preparation of the report. The principle of individual evaluation – harmonised with the principle of materiality and the principle of cost and profit comparison – may be applied in a specific way in cases under the law.

For the item-by-item evaluation of certain accounting assets, the Accountancy Act identifies the average purchase price and the FIFO method, which can also be used as evaluation processes. The First In First Out (FIFO) method is an evaluation method at purchase price, when assets are evaluated on the basis of the last purchase prices of the financial year, so if used or sold, the assets purchased first must always be derecognised first in the books.

It is useful to apply this method in accounting assets with the same parameters, usually purchased in groups, but at different times, such as shares, securities, reserves, currency and foreign-exchange holdings.

3.3.11 Accrual principle

The effects of economic events, which concern two or more business years, shall be recognised among revenues and costs of a specific period in the ratio of the accounting period and the entire period of the event taken as a base.

The accrual principle in the report and the accounts means the recognition of the active and passive accruals, the provision of the documentation and the calculations, the recognition of the items of costs, expenditures, turnovers, revenues concerning more than one year *pro rata temporis* in the actual business year. (This principle shall not apply to enterprises subject to simplified accounts and micro-economic.

3.3.12 Principle of the priority of content over form

In the report and the supporting books thereof, the economic events and transactions, shall be recognised and accounted in accordance with their actual economic contents.

Based on this, business transactions shall be included in the annual report and the simplified annual report according to their economic content and not to their legal formula. This principle shall be applied, if:

the legal basis of the transaction is not totally clear;

the transaction under the provisions of the contract may be disputed in accounting terms;

- the transaction is a leasing, a forward transaction etc. based on specific contracts, not regulated by the Civil Code, the accounting recognition of which should also be “specific”.

The Accountancy Act provides a general framework how to do the accounting and compile the report. Everyone knew, for example, that bills are securities. In accounting terms, however, what counts is whether the inscription on it is “I shall pay”, that is a liability, or “you shall pay”, that is a claim. So, the actual content is important.

3.3.13 Materiality

From the point of view of the report shall be deemed substantial all of the information, the omission or false presentation of which – within the limits of rationality – affect the decisions of the users of the report data.

The principle of materiality is applied, for example, when we post the amounts of long-term credits and loans to be repaid the following year among the short-term liabilities, or when on the basis of the statement of the check, a major mistake, which is not qualified significant by the law but is indeed significant from the point of view of the enterprise, is also determined numerically.

The application of the principle of materiality depends on the amount of the item or mistake; omission or false presentation shall be considered and treated on the basis of this. This is the principle, which assists the application of the principle of clearness as well, because in the attachment of the report the data of the balance sheet or the profit and loss statement – if the information are relevant – can be detailed, or any data may be posted, which are not included in there at all.

3.3.14 Principle of cross-checking cost and profit

In the report (in the balance sheet, the income statement, the attached notes) the expediency (usefulness) of the published information shall be in proportion to the cost of providing the information.

Application of the principle is necessary in all cases, when the accounting or other costs of an economic event or a business transaction exceed the revenue amounts. We should think of that sometimes is the paper and postage costs are the multiple of the invoiced items. What is the efficient and effective solution in this case?

The non-named principles mean that the law does not mention them, but the professional requirements demand their application.

3.3.15 Expediency

The report shall be available to the interested parties with the content and in a form, which give help in assessing the business events and the economic entity. In this spirit the book-keeping accounts system or the chart of accounts is set, or the profit and loss statement version is chosen.

3.3.16 Principle of neutrality

According to the principle of Neutrality (objectivity) *the annual report information must be free of preconception and partiality, but this principle shall be followed in the book-keeping, for example, in the cost accounting.*

3.3.17 Principle of the timeliness

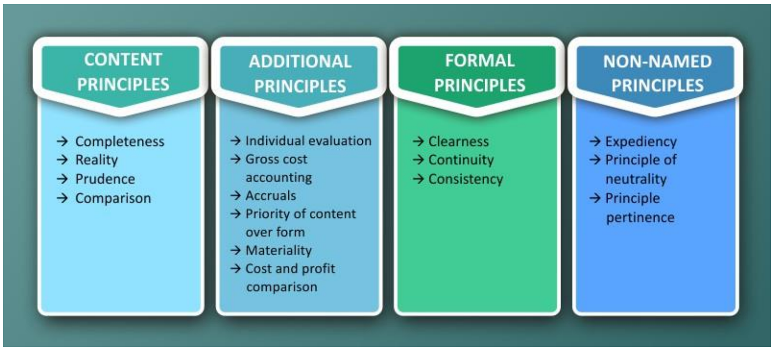
The accounting and the information in the report do not be available unjustifiably late.

3.3.18 Principle of pertinence

The information shall be free of mistakes and preconception, and they shall not be misleading when supporting the decision-making and providing information.

Classification of the accounting principles

The accounting principles can be classified by their function as well. Maybe, it is easier to have an overview of them and to see them in a system:



8. Figure: Classification of the accounting principles

3.4 SUMMARY, QUESTIONS

3.4.1 Summary

Economic organisations shall comply with the law. The accounting rules for economic activity are provided by the Accountancy Act.

Very important: the law describes its purpose and those covered by its scope in very fair conceptual definitions. It is evident who are to comply with the provisions of the Accountancy Act. The Accountancy Act (which *I hope you have already found and viewed on the internet*) does not provide literally “word of the law” compliance, but a reasonable practice, economic activity and **assertion of interests**.

Within the framework of the law, each economic entity shall determine its own rules, which will be binding to itself and which are to be called to account. These rules prescribe the observation of the basic principles in any respect.

3.4.2 Self-test questions

1. What is the purpose of the Accountancy Act?
2. Who are covered by it?
3. Enumerate the economic entities named in the Act.
4. Who is an entrepreneur?
5. Tell five entrepreneurs named in the Act.
6. What are the public organisations?
7. Tell five other organisations named in the Act.

The summary questions are a bit different now. You have to tell what we mean by the following concepts:

1. The principle of the continuance of an enterprise
2. Principle of comparison
3. Principle of completeness
4. Principle of reality
5. Principle of prudence
6. Principle of individual evaluation
7. Principle of gross cost accounting
8. Accrual principle
9. Principle of the priority of content over form
10. Materiality
11. Principle of cost and profit comparison
12. Principle of clearness
13. Principle of continuity
14. Principle of consistency

As well as

15. Expediency
16. Principle of neutrality
17. Principle of timeliness of operation
18. Principle of pertinence

3.4.3 Practice tests

		Correct answer	Wrong answer	Wrong answer	Wrong answer
1	*Purpose of the Accountancy Act*	• determines the *reporting and accounting* obligations of those covered by its scope determines the *principles and rules of* report preparation and book-keeping determines	• determines the scope and scale of economic organisations • determines the *reporting and accounting* obligations of economic entities determines the *principles and rules of* report	• determines the *reporting and accounting* obligations of those covered by its scope • specifies the rules for personal income taxation determines the requirements of publication, disclosure *and audit* .	• determines the *accounting* obligations of those covered by its scope determines the *principles and rules of* report preparation and book-keeping determines the requirements of publication, disclosure *and the taxation* .

		the requirements of publication, disclosure *and audit* .	preparation and book-keeping		
2	Content principles	Completenes s Reality Prudence Comparison	Principle of pertinence Reality Prudence Comparison	Expediency Principle of neutrality Principle of timeliness of operation Principle of pertinence	Materiality Principle of cost and profit comparison Principle of clearness Principle of continuity
3	Buisiness entity	entrepreneur, organisations of public finances, other organisation, National Bank of Hungary	entrepreneur sole trader civil legal society housing communities	entrepreneur sole trader organisations of public finances, other organisation, National Bank of Hungary,	• housing cooperatives • condominium, • social organisation, • a public body, • ecclesiastical legal person, • foundation, • lawyers, • patent executive office

4. THE ACCOUNTING POLICY, THE ACCOUNTING SUBSYSTEMS

4.1 OBJECTIVES AND COMPETENCES

The aim of this lesson is that you become familiar with and be able to apply:

- the concept, role, of the accounting policy, and the rules defined in it,
- you understand the principles to be applied in establishing the accounting policy,
- learn and use in your work the regulations set within the framework of the accounting policy.

Find related regulations on the Internet and study them.

Also:

- to understand the basic accounting functions in another approach as well,
- to understand that certain areas of the accounting meet specific requirements,
- the content and the tool system of the subsystems are adapted to these requirements.

Thus, you will understand why the accountant colleagues appear to be so stringent and resolute.

Time required: in this case, rather 300 minutes will be needed to cover the material properly.

This is only five hours, isn't it?

Key expressions:

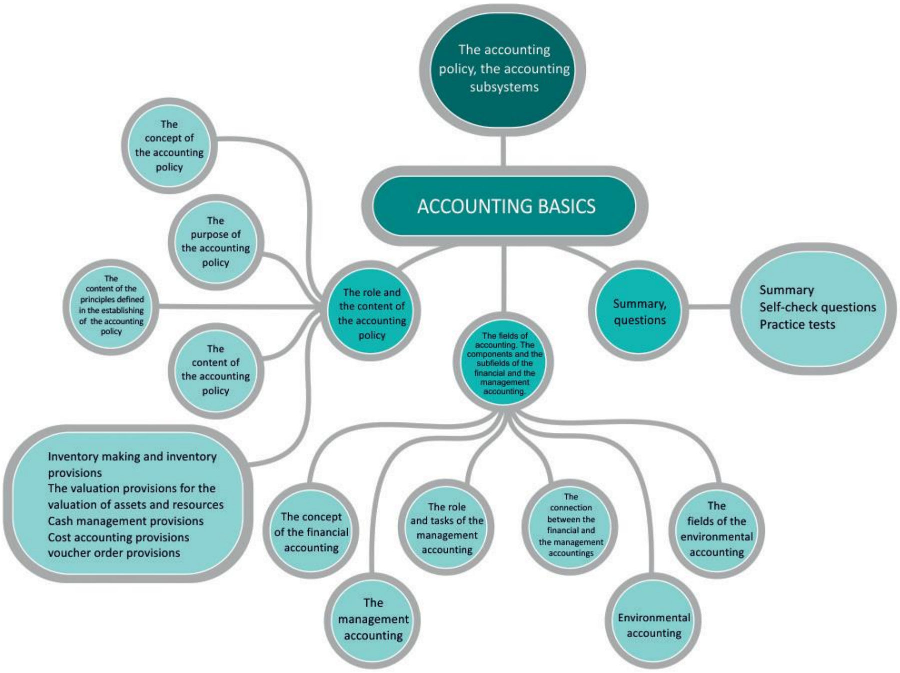
accounting policy

- valuation provisions
- inventory provisions
- cost accounting provisions
- cash management provisions
- voucher order
- financial accounting
- content of the financial accounting
- management accounting

- the tasks of the management accounting
- environmental accounting
- the two main areas of environmental accounting
- ordinary cost
- hidden cost
- conditional cost
- intangible cost
- external cost

4.2 THE ROLE AND THE CONTENT OF THE ACCOUNTING POLICY

The learning chart of Lesson 4:



9. Figure

In the Accountancy Act we can find the rules and principles that the economic entity may use during its operation. But these are not to be changed capriciously as it wishes, as this would impair in addition to the daily work the control tasks as well. The alternatives are only options. It is necessary that each economic entity shall edit these possibilities in a system in accordance with its own interests and that all shall be put in writing. This lesson is designed to organise what and how the accounting policy should include, what other rules are to be applied. This is also important in your daily work!

4.2.1 The concept of accounting policy

The accounting policy is nothing else than a series of well-founded decisions, which are adopted by the management of the economic entity in order to ensure that all of the units of the economic organisation be able to work according to uniform principles.

In each case, the accounting policy includes the methods, tools, specific rules and provisions, which are necessary to ensure the implementation of the Accountancy Act, but which either individually or all together have an impact on the assets, financial or income situation of the economic entity.

For the appropriate accounting policy the comprehensive knowledge of the entire business, of the activities, market positions, business plans, the strategy, the technical equipment etc. is indispensable. With the implementation of the rules as defined in the activities the **information system** of the economic entity can be created, and on that are based:

- the accounting system,
- the data processing method,
- the content of certain parts of the report,
- the supply of information,
- the control system,
- the carrying-out of the audit.

4.2.2 The purpose of accounting policy

Each economic entity shall establish its own accounting system, on the basis of which a report including true and fair information can be compiled. This is the purpose of the accounting policy.

The decisions under the accounting policy shall be binding to the economic entity; deviation from that is only possible by modifying the accounting policy, or rather after the adoption of the amended regulations, and only in accordance with them.

The accounting policy shall be drawn up within 90 days from the creation of the organisation, or within 90 days after the date of entry of the statutory amendment into force.

The person authorised to represent the economic entity is *responsible* for its creation and modification.

Under the accounting policy shall be recorded in writing, among other things, the rules, provisions, methods specific to the economic entity, with which the organisation determines what it considers in the accounting and the evaluation of the economic organisation,

- significant, which *means a specific amount, or eventually a certain percentage of the assets or of the turnover,*
- from the options or qualification options granted by law, which one and under what conditions will be applied (for example, *which is the exchange rate, which is favourable: if, for example, it receives its income typically in EUR but the costs are to be paid in HUF, a more realistic pictures can be given, if it applies the bank rate for foreign currency purchase…)*
- *Or* for what reasons the applied practices are to be changed.

4.2.3 The content of the principles set out in the creation of the accounting policy

We shall operate according to the Accountancy Act and the relevant principles, which are as follows:

- according to the principle of customisation the accounting policy is to be adapted to the characteristics of the organisation,
- the principle of comprehensiveness requires that all the decisions are to be included, which are needed to the implementation of the Accountancy Act,
- the principle of straightforwardness means that on the basis of the law in force the accounting rules must be accurate and they are to assist the accounting tasks,
- the principle of expediency states that the accounting policy is to allow the production of all the information, which are necessary for the claimants of internal and external information,
- **in virtue of the principle of consistency** the accounting policy for financial years following each other is only to be changed, if important reasons occur for this. The decisions under the accounting policy have an effect on the income, so these decisions are always to be supported by calculations.
- **the principle of the timeliness of operation** requires that the accounting policy should be current and up-to-date.

4.2.4 The content of the accounting policy

When setting up the accounting policy the management of an organisation shall decide, inter alia:

- What will be the form of reporting and accounting,
- What will be the form of the balance sheet,
- What will be the form of the profit and loss statement,
- What will be the date of preparation of the report (balance sheet),
- the further division of the balance sheet and the profit and loss statement, if needed,
- What method is used to classify the accounting assets
- What are the components of cost (purchase, production) values, what are the conditions of their recognition
- What are the rules of specific reserves,
- What are the rules of audit,
- The manner in which the disclosure of the report will be carried out.

The Accountancy Act as part of accounting policy is obliged to name the regulations, which will help the management, the protection of property and the audit. So, in accordance with the standards the accounting policy must include:

4.2.5 Inventory-making and inventory provisions

The purpose of the inventory regulation is that, with regard of its special features, the economic entity set the rules related to the making of inventories supporting the items in the balance sheet as part of the report, and to the inventory of equipment, resources, as well as to their valuation.

For the end-of-the-year close, for the preparation of a report such inventory must be drawn up which certifies the items in the balance sheet, that is it presents individually and in a controllable way the existing assets and resources of the economic entity on the balance sheet date, both in quantities and cash values, allowing thereby that the report show a real image of the organisation’s assets, financial and income situation under the current circumstances.

4.2.6 The provisions for the valuation of the assets and resources

This document allows the accounting of the cost and the value changes, and shall be recorded, inter alia:

- For fixed assets
  - the criteria on the basis of which the company qualifies its assets fixed or current.
  - the value limit of the lump-sum depreciation of small value assets,
  - the methods of planned depreciation for certain assets, and the set of tangible assets of which depreciation cannot be recognised
  - in which case special depreciation must be recognised, when it can be recorded back,
  - the accounting method of the depreciation and posting back of financial fixed assets; the set of the supporting calculations and documents thereof.
- For current assets
  - Stocks: the method of determining the cost, the market value, the depreciation and the posting back.
  - Asset side: the base on which the asset is considered irrecoverable, and what are the criteria for classifying debtors.
  - Funds: in which method (average rate, FIFO) the monetary movements of the currency or foreign currency accounts are recorded.
- Resources: conditions for the recognition of liabilities, the valuation method of liabilities denominated in foreign currency.

4.2.7 Cash management provisions

This regulation under the Act gives provisions concerning the movements of funds, their accounting, the specific management of the money. Essentially must regulate at least:

- the execution of the cash flow (in cash, or on bank account),
- the personal and objective conditions and the rules of responsibility of cash management,
- the traffic between the funds in cash and the funds held on a bank account,

- the titles and the rules of procedure of the monetary movements affecting the cash at hand,
- the maximum closing amount of the daily cash at hand,
- the procedure to be followed when checking the cash at hand,
- the frequency of check, the conditions for money transfer,
- the order of documents relating to the cash management
- the registration rules related to the cash flow

4.2.8 Costing provisions

The objective of the regulation is the reconciliation and the definition of the cost of products and services. The costing rules shall be drawn up by all the enterprises, in which the net annual turnover reduced by the purchase value of the goods sold and the subcontractors performance value exceeds 1,000,000 HUF, or the expanses by nature exceed 500,000 HUF.

Shall be exempt from the obligation of making a costing regulation:

- the entrepreneur preparing simplified reporting,
- the entrepreneur preparing microeconomic reporting,
- the entrepreneur preparing a simplified annual report,
- the entrepreneur, who in accordance with the provisions of the Accountancy Act, shall not be obliged to state the cost of self-provided stocks or services by recalculation.

If the indices exceed the value limits here above, the direct cost of the internally produced products and provided services shall be established in the following year by the method of recalculation. The recalculation-making procedure shall be recorded in the costing regulations. The enterprises, which are to do the simplified annual reporting and to keep books by single entry, shall be exempt from the obligation of making the costing regulation. In the costing regulation, in addition to regulating the recalculation, it is also advisable to deal with other areas of cost management.

4.2.9 Provisions concerning the system of vouchers

This is the regulation supporting the daily work to ensure the order of the issue, control, transmission, use and treatments of vouchers related to accounting settlements in the enterprise.

4.3 THE AREAS OF ACCOUNTING. THE COMPONENTS AND THE SUBDIVISIONS OF FINANCIAL AND MANAGEMENT ACCOUNTING

As it could be noticed in the foregoing, the task of accounting is complex. For the effective decisions of the business organisations appropriate information is required. Accounting is one of the means to meet this need of information.

The accounting systems' structure and subdivisions are adjusted to this set of tasks.

4.3.1 The concepts and interpretation of financial accounting

Accountancy is an accounting and information system. It is a practical activity, in which information is provided.

Pursuant to specific interests and rules, it shall include the completed economic events, and the monitoring, measurement, evaluation, record, process of economic statuses incomeing from them, and the comparison of the obtained data with the past, so that decision makers could make decisions of their interests based on past occurrences.

Accounting is simultaneously responsible for the settlement and the supply of information.

So, the essential responsibility of accounting is to prepare the report in accordance with legal principles and requirements, which may be realised based on the specific book-keeping. This branch of the accountancy is called financial accounting.

The financial accounting essentially designed to meet the needs of users outside the business; its primary purpose is to prepare the report. And the purpose of drawing up the report is to give a reliable and true image of the assets and liabilities, financial and profitability position of the enterprise to the participants of the market, who may be

- (potential) investors,
- creditors,
- existing and future partners,
- the environment,
- the management, staff, etc. of the neterprise
- ***and maybe even you, who wants to study the operation of a certain business organisation.***

The content of the financial accounting is governed by the Accountancy Act. But why is it needed?

Obviously, the market operators require different information, but the owners' and the company managers' interests may also be different in terms of information needs. The **resolution of the clashes inherent in the various information needs is ensured by the legislation.**

So, accounting shall publish the information in the report, which – under certain compromises – will meet the needs of all those concerned. The regulation also ensures that **the content of the information is uniform and can be interpreted in the same manner by all the interested parties.**

So, in accordance with the rules the financial accounting content is clearly definable, and includes:

- the book-keeping,
- the voucher order,
- the reporting system,
- the valuation, the income calculation,
- the creation of the inventory,
- the check of the information, the auditing,
- the disclosure and the publication of the report.

4.3.2 The management accounting

The management accounting is the area of accountancy, which provides information to the managers, by which the quality of the work can be improved, the performances can be increased, the costs (expenses) can be reduced, and the income can be maximised.

While the financial accounting provides information basically for the market operators, i.e. for outsiders, the management accounting is part of the information system of the management; it assists the managers of the enterprise to found their decisions.

The available information may only be used effectively, if the manager has all the essential information for the decision-making. Although the financial accounting provides information which can be used by the managers as well, but these are often not sufficient for the managers because, for example, it is outdated, or its content is incomplete. This is why, it was necessary to create a management information system, which ensures the correct information at the relevant decision-making points, and these were the reasons for bringing the managerial accounting into life. The creation and the regulation of the management accounting is the entrepreneur's interest and responsibility, but it should always be adapted to the characteristics of the enterprise.

The preparation of the decisions often require a wide range of economic calculations, therefore, the management accounting applies different methods, the most objective analysis methods.

During your college studies, you can learn the specific methods, which can be used for the preparation of decisions, in various financial, analytic, control and IT subjects; the presentation of these is not our task now.

4.3.3 The role and the tasks of management accounting

The management accounting supports the management functions in various areas, let us look at the most important functions:

- *planning*, since the leaders must make plans for the future when making essential decisions related to the production and the sales. The past data or maybe the data built on the past data and calculated on the basis of the past data help in seeing the trends and in determining the future values. The terms of time horizon, this planning can be short-term and long-term. Obviously, the two types of plans show great difference in their elabouration, as short-term plans are significantly more detailed and elabourated.
- *decision-making,* because the leaders of profit-making enterprises often have to decide in what manner they can reach their goals, how the available resources to be shared between the activities in order to maximize the profit. For those companies where the ownership is not composed of the same persons as the management, it is particularly important to found the decisions, because the owner's and the leader's interests are often in conflict. Today the issue of the management's liability also arises more and more strongly.
- *check,* since this task has an outstanding role among the leadership functions. The leader is to verify that the operation, the activity, in particular the profit-making production, meets the plans. To do this, leaders need up-to-date, correct, accurate and timely information.

The management accounting has the essential role to direct the attention to the problems in time and in proper amount, to allow recording the incomes, and to assist in problem solving.

The management accounting – as you have read it several times – provides information to the leader, but of course, the scope of these is to be defined, and in any case such indicators[1] are needed, which characterise the process well. Relatively few information can also draw the attention of the leader to the critical points and processes, whether they are in the right or wrong track.

4.3.4 The connection between management accounting and financial accounting

Let us summarise and include in a table the characteristics of financial and management accounting, so the tasks of and the need for the two subsystems become more transparent.

Let us set out the properties of the two subsystems.

[1] Indices, models, reports.

10. Figure: The connection between management accounting and financial accounting

4.3.5 The environmental accounting

This subchapter shall look a little further in the general classification of the accounting tasks.

*In our environment we encounter more and more frequently the notion of environmentally conscious management. I wish to make you familiar with this concept in connection of accounting as well, because I think that it is an important issue in shaping our future, and I hope that in shaping your approach too. Therefore, in addition to the two basic accounting subsystems, I would like to present the new subsystem of accountancy, which is getting more and more important, having an increasing role nowadays: the **environmental accounting, as a means of the environmentally conscious management.***

The literature of accounting describes the environmental accounting as a subsystem, which aims to explore and resolve the environmental problems of a particular economic system, and includes in itself the methods and procedures to organise and treat the economic impacts of the environmental protection.

By assessing the environmental charges and benefits, the **environmental accounting** system provides a precise picture to the environmental leaders about the environmental performance of the company, and the impact thereof on the financial situation of the company.

One of its positive incomes is that by identifying the environmental costs the company may make significant savings, because the complete assessment of the environmental costs often have the income of finding out certain measures will be recovered in short-term, about which an unfavourable decision was made previously, because the savings account was not complete, some of the items were not taken into consideration.

The environmental accounting in this regard is closely linked to the preventive environmental protection, with **the principle of clearer production**, according to which the harmful emissions reduction is best implemented by the rationalisation of the use of resources.

With the full assessment of savings, the environmental accounting may promote the cleaner production and the application of preventive measures in the companies.

It draws the attention of the company's management to identify savings opportunities, , to the economic opportunities inherent in the environmental protection, thus, it makes the decision-makers more open and receptive of environmental investments.

Its most important advantage is that the environmental management systems, which require the company's environmental performance data, are well supplemented by the environmental accounting system. To operate the environmental management systems, it is necessary to use environmental indicators, a substantial part of which can be extracted from a well-structured environmental accounting system.

The purpose of environmental accounting is to provide a precise picture of the company financial aspects related to the environment. This may include the exploration of the environmental aspects of investment decisions, the identification of the environmental-related items of expenditure and income, and the financial analysis and use of other data related to the companies' environmental performance in the decision-making.

4.3.6 The areas of environmental accounting

One of the most important area of the environmental accounting is the exploration, the quantification of the environmental costs, and the **analysis** of their effects on the economic activity.

Beginner professionals should know what we mean by environmental costs.

With an example taken from the literature [7] I would like to illustrate what the different types of environmental costs are.

Basic situation: *a car spare parts manufacturing company sells its products after finishing.*

Fact: *during the surface treatment process, solvent paints are spread on the metal surfaces in the painting chambers; air pollution is generated during the process.*

Reaction: *in order to meet the health and environmental standards, extractors and filters are installed in the painting chambers, which clean the air issued.*

Notice: *To ensure compliance with the environmental standards, the company purchases extraction and filtering equipment, which* ***represent a significant cost item.*** *In addition, the occasional cleaning and replacing of the filters, also represents costs to the company, which will be recorded among the operating costs****. The items that we can follow up in the traditional accounting system are called ordinary costs.***

But: *the operation of the equipment for cleaning the air issued will, however, represent* ***other costs*** *as well to the parts manufacturing company. Such as the costs related to the handling, transport, administration of the hazardous substances and waste, or the costs, which may be in connection with the health damage of the workers. The former costs are usually recorded among the service or corporate general costs, the latter costs may appear as the compensation for the eliminated working time due to frequent illnesses of the employees. S****uch expenses are called hidden costs.***

And there is more: *in the areas where it is possible that accidents befall and as a income, an injury will occur in the environment or the personnel, it is necessary to take into account the so-called* ***conditional costs*** *as well. These will include* ***costs incurred in the future****, which are* ***not sure to occur****. Such conditional costs may be present in the case of most producing companies, depending on the hazard in the production processes. They include the costs of the clean-up of the environment, the amends and fines paid by the company, but the conditional costs would* *also include the incremental costs due to the higher and higher standards.*

To go on with the example, it may happen that the company is located in a residential area; it may be encircled by dwelling houses. In this case, such environmental decisions must be made, which take into consideration the good relations to be maintained with the population, like in the case of connections established with customers, suppliers and public authorities. The fourth type of environmental costs is related to the image of the company and these are called ***intangible costs***.

We also distinguish the so-called ***external costs,*** that is the costs, which do not arise within the company, but in other groups of the society. External costs are all of the unintentional damage caused by the company in the environment or health, for which the company shall not be liable to make amends for. A typical example of the external costs in Hungary is the emissions of carbon dioxide as a income of burning processes, the quantity of which is not limited by legislation and which are not taxed or penalised, however, it is proven to contribute to the climate change, which causes considerable costs today for certain members of the society.

A serious issue of the environmental accounting is the problem of the identification and quantification of the environmental costs. The data related to the **ordinary costs** can usually be extracted from the financial accounting system, but the **hidden costs** are more difficult to be identified, and the means of the environmental accounting should be applied in carrying out the task.

The quantification of the **conditional costs** is an even more difficult task, since they will occur only in the future will be, if at all. As a income, in addition to the estimation of the magnitude of the effect, it is also necessary to consider the probability of the occurrence.

The **intangible costs** are similarly difficult to identify and calculate, since factors have to be quantified such as the costs of the favourable image of the company or restoration costs of a negative image.

The quantification of the **external costs** is not primarily the company's responsibility, but that of the regulatory authorities, since they have to treat the problems originating from the externalities. However, here as well, the biggest problem in the creation of the appropriate regulation is often the difficulty of the quantification.

Beside the identification and the quantification of the environmental costs, **another important area of the environmental accounting is the analysis of the corporate projects**, they are either explicitly to protect the environment, or of a kind which has an impact on the company's environmental performance.

As the income of certain projects, with the accounting items debiting the income side, the revenue side may change as well, and revenues may appear, which were not available to the company so far.

Going on with the example, it may occur, for example, that the company buys the finishing substances placed in a new packaging, which can be sold on the market after cleaning. Similarly, should be interpreted as income the cost reductions as a income of the projects. If, for example, the company changes the solvent paints to water-based paints, the quantity of hazardous waste will be reduced, and with that, the handling, transport and administrative costs will decrease as well.

Sooner or later the environmental accounting must be one of the most important means for evaluating projects, therefore, that all financial factors due to the measure must be identified – let them be ordinary, hidden, or intangible costs, or or revenues, profits as a income of the project.

4.4 SUMMARY, QUESTIONS

4.4.1 Summary

All business entity shall put in writing within 90 days the rules from the Accountancy Act it considers itself as bound by. From that time on, these rules are to be observed strictly, and will also be controlled by the surveillance and monitoring bodies. The accounting policy, therefore, is a basic document of the enterprise, which shall be drawn up very carefully, taking into consideration the characteristics of the enterprise.

Accountancy is both a settlement and information system; however, the users of the information provided by the system are different. Users can be internal or external. Depending on their situation they need different information.

Accountancy had to adapt to this situation, so **the financial accounting** was separated, which focuses on data capturing, accounting, and reporting based on book-keeping.

In parallel with this, strictly built on one another, functions the **management accounting** assisting decision-making, with the help of which the quality of the work can be improved, performance can be increased, the costs (expenses) can be reduced, and the income can be maximised.

The "drudgery", the precise, regular recording of data is the responsibility of the financial accounting, while "soaring", the

brilliant case analysis, decision support is the task of the management accounting.

The development and the thinking green have brought about the creation of the third subsystem of accountancy, the **environmental accounting**, which is supposed to serve the exploration and the solution of the environmental problems of the specific economic system, and it includes the methods and procedures, which organise and deal with the economic impact of the environmental protection.

The accounting policy defines the company's accounting subsystems, too.

4.4.2 Self-test questions

1. What is the purpose of the accounting policy?
2. What is to be put in writing within the framework of the accounting policy?
3. How much time is available for the compilation ad the amendment of the accounting policy?
4. Who is responsible for compiling it?
5. Define five conditions in which decisions are to be made during the compilation of the accounting policy?
6. What are the regulations which are compulsory to be prepared?
7. What is the purpose of the assets and resources valuation regulation?
8. What is the purpose of the inventory regulation?
9. What do you know about the costing regulation?
10. What is the purpose of the cash management regulations?
11. Why is the voucher order regulation important?
12. Tell what it means for you:
    - financial accounting
    - management accounting
    - environmental accounting
13. What are the two main areas of the environmental accounting?
14. Present the content of the financial accounting.
15. What are the tasks of the management accounting?
16. What do the following concepts mean?
    - ordinary cost
    - hidden cost

- conditional cost
- intangible cost
- external cost

4.4.3 Practice tests

		Correct answer	Wrong answer	Wrong answer	Wrong answer
1	Who is responsible for preparing the accounting policy?	*The* person entitled to represent the business entity.	The economic leader.	The owner.	The manager-council.
2	What may be included in the accounting policy?	what will be the reporting and accounting form, what will be the chosen form of the balance sheet	- who the leaders are - what activity to carry out - where to carry out the activity	what will be the content of the profit and loss statement what will be the date of the general assembly,	what will be the reporting and accounting discipline what will the balance sheet be consist of
3	The content of the costing regulation:	Calculation of the actual manufacturin g cost of products	The rules of cash management applied in the company	The rules applied for the cost of assets and resources, and their change in value	The inventory-making and inventor rules incomeing from the individual evaluation of assets and resources
4	The content of the cash management regulation:	The rules of cash management applied in the company	The reconciliation of the actual manufacturin g cost of products	The rules applied for the cost of assets and resources, and their change in value	The inventory-making and inventor rules incomeing from the individual evaluation of assets and resources
5	The content of the inventory regulation	The reconciliation of the actual manufacturin g cost of products	The rules of cash management applied in the company	The rules applied for the cost of assets and resources, and their change in value	The inventory-making and inventor rules incomeing from the individual evaluation of assets and resources

5. REPORTING, ACCOUNTING, PUBLICITY

5.1 OBJECTIVES AND COMPETENCES

Now I would like to teach you what reporting and accounting mean, and what the provisions of the Accountancy Act (UAA)[2] prescribes to us to observe.

These are the basic rules, which each business entity has to apply and customise to itself in the most favourable way in compliance with legislation. You will be able to assist your accountant colleague in this task.

But let us look at the options that a business entity has.

Time required: in this case, about 360 minutes.

Key expressions:

- Report
- Accounting
- Single-entry accounting
- Double-entry accounting
- Balance sheet
- Profit and loss statement
- Notes to accounts
- Annual report
- Related business
- Other share ratio relation
- Audit
- Deposit
- Disclosure

5.2 ACCOUNTING AND REPORTING

The learning chart of the material to be learnt is the following:

2 Please, note that here the abbreviation UAA (Uniform Accountancy Act) stands for the Accountancy Act in force in Hungary.

11. Figure

5.2.1 The report

Before starting the business, the young entrepreneurs in the video had looked at the situation in the bicycle market. Gábor has already asked information about similar entrepreneurs. It is true in general as well, but it can be concluded from this, too, that the market environment requires information about the activity of businesses. Owners would like to know how much it is worth risking, whether it was a good idea to invest, if there are chances to maintain operating the lucrative enterprise.

If the business starts, the little team, that is the corporate management will be primary interested in how the business could be more profitable, but the environment will need information about them. They want to know how they work, how much they are rivals, maybe also, whether to invest in this enterprise, or to grant them loan and credit.

As we had discussed above, this information can be extracted from the report, which is public, uniform and available for operators of the market without restriction.

All this is ensured by the UAA, by its provisions related to the ***obligation of reporting***, that is to say:

"The business entity shall prepare – in Hungarian – a report, supported by books under legislation, on the operation, assets, financial and income situation of the enterprise after having closed the books of the business year."

It is evident how close the connection is between accounting and reporting, isn't it?

Please, notice that the accounting is allowed to be made only in Hungarian, and that the report must give a reliable and true picture about the enterprise's assets, financial situation and the incomes of its activities.

The form of the report depends on:

- the magnitude of the net annual turnover,
- the total assets of the balance sheet,
- the number of employees
- and on the limit values thereof.

The parts of the report are named by the law, but let us look at what the individual concepts mean.

A **balance sheet** is an accounting documentation, which shows the assets and liabilities, that is the assets and resources in money value, on a scale of a thousand or million HUF for a given time.

I will show you the major balance sheet form, which can be used by entrepreneurs; please, find the simplified balance between them, but we will learn about its content later in detail.

BALANCE SHEET (Version „A”)

Data in 1000 HUF

Denomination	Previous year	Significant amount corrections	Current year
A. FIXED ASSETS			
I. **Intangible assets**			
1. Activated value of foundation-reorganisation			
2. Activated value of experimental development			
3. Property rights			
4. Intellectual property			
5. Business value or goodwill			
6. Advances for intangible assets			
7. Value adjustment of intangible assets			
II. **Tangible assets**			
1. Properties and related property rights			
2. Technical equipment, machines, vehicles			
3. Other equipment, devices, vehicles			
4. Animals for breeding			
5. Investments, renovations			
6. Advances for Investments			
7. Value adjustment of tangible assets			
III. **Fixed financial assets**			
1. Permanent participation in affiliated company			
2. Permanent loan granted to affiliated company			
3. Other permanent participation			
4. Permanent loan granted to company in other participation relation			
5. Other permanent loan granted			
6. Permanent debt securities			
7. Value adjustment of fixed financial assets			
8. Evaluation difference of fixed financial assets			
B. CURRENT ASSETS			
I. **Stocks**			
1. Material			
2. Production-in-process and semi-finished products			
3. Young, store cattle and other animals			
4. Finished products			
5. Goods			
6. Advances for stocks			
II. **Receivables**			
1. Receivables from delivery and service (customers)			
2. Receivables from affiliated company			
3. Receivables from company in other participation relation			
4. Bill receivables			
5. Other receivables			
6. Evaluation difference of receivables			
7. Positive evaluation difference of derivative operations			
III. **Securities**			
1. Participation in affiliated company			
2. Other permanent participation			
3. Own shares and business participations			
4. Debt securities for dealing			
5. Evaluation difference of securities			
IV. **Cash**			
1. Cash at hand, cheques			
2. Bank deposits			
C. ACTIVE ACCRUALS			
1. Active accruals of revenues			
2. Active accruals of costs and expenditures			
3. Deferred expenditures			
TOTAL ASSETS:			

Denomination	Previous year	Significant amount corrections	Current year
D. EQUITY CAPITAL			
I. **Subscribed capital**			
of this: repurchased shareholders's equity at nominal value			
II. **Subscribed but not paid capital (-)**			
III. **Capital reserve**			
IV. **Retained profit**			
V. **Fixed reserve**			
VI. **Evaluation reserve**			
1. Evaluation reserve of value adjustment			
2. Evaluation reserve of actual evaluation			
VII. **Balance sheet earnings**			
E. PROVISIONS			
1. Provisions for planned liabilities			
2. Provisions for future costs			
3. Other provisions			
F. LIABILITIES			
I. **Subordinate liabilities**			
1. Subordinate liabilities to affiliated company			
2. Subordinate liabilities to company in other participation relation			
3. Subordinate liabilities to other business entity			
II. **Long-term liabilities**			
1. Long-term loan			
2. Commutable bonds			
3. Debts from bonds issue			
4. Investment and development loans			
5. Other long-term loans			
6. Long-term liabilities to affiliated company			
7. Long-term liabilities to company in other participation relation			
8. Other long-term liabilities			
III. **Short-term liabilities**			
1. Short-term loans			
- of this: commutable bonds			
2. Short-term credits			
3. Advances form customers			
4. Liabilities from delivery and service (suppliers)			
5. Bill debts			
6. Short-term liabilities to affiliated company			
7. Short-term liabilities to company in other participation relation			
8. Other short-term liabilities			
9. Evaluation difference of liabilities			
10 Negative evaluation difference of derivative operations			
G. PASSIVE ACCRUALS			
1. Passive accruals of revenues			
2. Passive accruals of costs and expenditures			
3. Deferred revenues			
TOTAL LIABILITIES:			

BALANCE SHEET
version „A"

Data in 1000 HUF

Denomination				Previous year	*	Current year
A.	**FIXED ASSETS**					
	I.	**Intangible assets**				
		1.	Activated value of foundation-reorganisation			
		2.	Activated value of experimental development			
		3.	Property rights			
		4.	Intellectual property			
		5.	Business value or goodwill			
		6.	Advances for intangible assets			
		7.	Value adjustment of intangible assets			
	II.	**Tangible assets**				
		1.	Properties and related property rights			
		2.	Technical equipment, machines, vehicles			
		3.	Other equipment, devices, vehicles			
		4.	Animals for breeding			
		5.	Investments, renovations			
		6.	Advances for Investments			
		7.	Value adjustment of tangible assets			
	III.	**Fixed financial assets**				
		1.	Permanent participation in affiliated company			
		2.	Permanent loan granted to affiliated company			
		3.	Other permanent participation			
		4.	Permanent loan granted to company in other participation relation			
		5.	Other permanent loan granted			
		6.	Permanent debt securities			
		7.	Value adjustment of fixed financial assets			
		8.	Evaluation difference of fixed financial assets			
B.	**CURRENT ASSETS**					
	I.	**Stocks**				
		1.	Material			
		2.	Production-in-process and semi-finished products			
		3.	Young, store cattle and other animals			
		4.	Finished products			
		5.	Goods			
		6.	Advances for stocks			
	II.	**Receivables**				
		1.	Receivables from delivery and service (customers)			
		2.	Receivables from affiliated company			
		3.	Receivables from company in other participation relation			
		4.	Bill receivables			
		5.	Other receivables			
		6.	Evaluation difference of receivables			
		7.	Positive evaluation difference of derivative operations			
	III.	**Securities**				
		1.	Participation in affiliated company			
		2.	Other permanent participation			
		3.	Own shares and business participations			

		4.	Debt securities for dealing			
		5.	Evaluation difference of securities			
	IV.	**Cash**				
		1.	Cash at hand, cheques			
		2.	Bank deposits			
C.	**ACTIVE ACCRUALS**					
		1.	Active accruals of revenues			
		2.	Active accruals of costs and expenditures			
		3.	Deferred expenditures			
TOTAL ASSETS:						

*** Significant amount corrections**

Denomination				**Previous year**	*****	**Current year**
D.	**EQUITY CAPITAL**					
	I.	**Subscribed capital**				
		of this: repurchased shareholders' equity at nominal value				
	II.	**Subscribed but not paid capital (-)**				
	III.	**Capital reserve**				
	IV.	**Retained profit**				
	V.	**Fixed reserve**				
	VI.	**Evaluation reserve**				
	1.	Evaluation reserve of value adjustment				
	2.	Evaluation reserve of actual evaluation				
	VII.	**Balance sheet earnings**				
E.	**PROVISIONS**					
		1.	Provisions for planned liabilities			
		2.	Provisions for future costs			
		3.	Other provisions			
F.	**LIABILITIES**					
	I.	**Subordinate liabilities**				
		1.	Subordinate liabilities to affiliated company			
		2.	Subordinate liabilities to company in other participation relation			
		3.	Subordinate liabilities to other business entity			
	II.	**Long-term liabilities**				
		1.	Long-term loan			
		2.	Commutable bonds			

		3.	Debts from bonds issue			
		4.	Investment and development loans			
		5.	Other long-term loans			
		6.	Long-term liabilities to affiliated company			
		7.	Long-term liabilities to company in other participation relation			
		8.	Other long-term liabilities			
	III.	**Short-term liabilities**				
		1.	Short-term loans			
			- of this: commutable bonds			
		2.	Short-term credits			
		3.	Advances form customers			
		4.	Liabilities from delivery and service (suppliers)			
		5.	Bill debts			
		6.	Short-term liabilities to affiliated company			
		7.	Short-term liabilities to company in other participation relation			
		8.	Other short-term liabilities			
		9.	Evaluation difference of short-term liabilities			
		10	Negative evaluation difference od derivative operations			
G.	**PASSZÍV IDŐBELI ELHATÁROLÁSOK**					
		1.	Passive accruals of revenues			
		2.	Passive accruals of costs and expenditures			
		3.	Deferred revenues			
TOTAL LIABILITIES:						

*** Significant amount corrections**

BALANCE SHEET
version „B”

Data in 1000 HUF

Denomination				Previous year	*	Current year
A.	**FIXED ASSETS**					
	I.	**Intangible assets**				
		1.	Activated value of foundation-reorganisation			
		2.	Activated value of experimental development			
		3.	Property rights			
		4.	Intellectual property			
		5.	Business value or goodwill			
		6.	Advances for intangible assets			
		7.	Value adjustment of intangible assets			
	II.	**Tangible assets**				
		1.	Properties and related property rights			
		2.	Technical equipment, machines, vehicles			
		3.	Other equipment, devices, vehicles			
		4.	Animals for breeding			
		5.	Investments, renovations			
		6.	Advances for Investments			
		7.	Value adjustment of tangible assets			
	III	**Fixed financial assets**				
		1.	Permanent participation in affiliated company			
		2.	Permanent loan granted to affiliated company			
		3.	Other permanent participation			
		4.	Permanent loan granted to company in other participation relation			
		5.	Other permanent loan granted			
		6.	Permanent debt securities			
		7.	Value adjustment of fixed financial assets			
		8.	Evaluation difference of fixed financial assets			
B.	**CURRENT ASSETS**					
	I.	**Stocks**				
		1.	Material			
		2.	Production-in-process and semi-finished products			
		3.	Young, store cattle and other animals			
		4.	Finished products			
		5.	Goods			
		6.	Advances for stocks			
	II.	**Receivables**				
		1.	Receivables from delivery and service (customers)			
		2.	Receivables from affiliated company			
		3.	Receivables from company in other participation relation			
		4.	Bill receivables			
		5.	Other receivables			
		6.	Evaluation difference of receivables			
		7.	Positive evaluation difference of derivative operations			
	III	**Securities**				
		1.	Participation in affiliated company			
		2.	Other permanent participation			
		3.	Own shares and business participations			
		4.	Debt securities for dealing			
		5.	Evaluation difference of securities			

	IV	**Cash**				
		1.	Cash at hand, cheques			
		2.	Bank deposits			
C.	**ACTIVE ACCRUALS**					
		1.	Active accruals of revenues			
		2.	Active accruals of costs and expenditures			
		3.	Deferred expenditures			

*** Significant amount corrections**

Denomination				**Previous year**	*****	**Current year**
D.	**LIABILITIES DUE WITHIN A YEAR**					
		1.	Short-term loans			
			- of this: commutable bonds			
		2.	Short-term credits			
		3.	Advances form customers			
		4.	Liabilities from delivery and service (suppliers)			
		5.	Bill debts			
		6.	Short-term liabilities to affiliated company			
		7.	Short-term liabilities to company in other participation relation			
		8.	Other short-term liabilities			
		9.	Evaluation difference of short-term liabilities			
		1 0	Negative evaluation difference od derivative operations			
E.	**PASSIVE ACCRUALS**					
		1.	Passive accruals of revenues			
		2.	Passive accruals of costs and expenditures			
		3.	Deferred revenues			
F.	**DIFFERENCE BETWEEN CURRENT ASSETS – SHORT-TERM LIABILITIES (B + C – D –E)**					
G.	**TOTAL ASSETS REDUCED WITH LIABILITIES DUE WITHIN A YEAR (A ± F)**					
H.	**LIABILITIES DUE OVER A YEAR**					
	I.	**Long-term liabilities**				
		1-	Long-term loan			
		2.	Commutable bonds			
		3.	Debts from bonds issue			
		4.	Investment and development loans			
		5.	Other long-term loans			
		6.	Long-term liabilities to affiliated company			
		7.	Long-term liabilities to company in other participation relation			
		8.	Other long-term liabilities			
	II.	**Subordiante liabilities**				
		1.	Subordinate liabilities to affiliated company			
		2.	Subordinate liabilities to company in other participation relation			
		3.	Subordinate liabilities to other business entity			
I.	**PROVISONS**					
		1.	Provisions for planned liabilities			
		2.	Provisions for future costs			

		3. Other provisions			
J.	**EQUITY CAPITAL**				
	I.	**Subscribed capital**			
		of this: repurchased shareholders' equity at nominal value			
	II.	**Subscribed but not paid capital (-)**			
	III.	**Capital reserve**			
	IV.	**Retained profit**			
	V.	**Fixed reserve**			
	VI.	**Evaluation reserve**			
	1.	Evaluation reserve of value adjustment			
	2.	Evaluation reserve of actual evaluation			
	VII.	**Balance sheet earnings**			

*** Significant amount corrections**

12. Figure

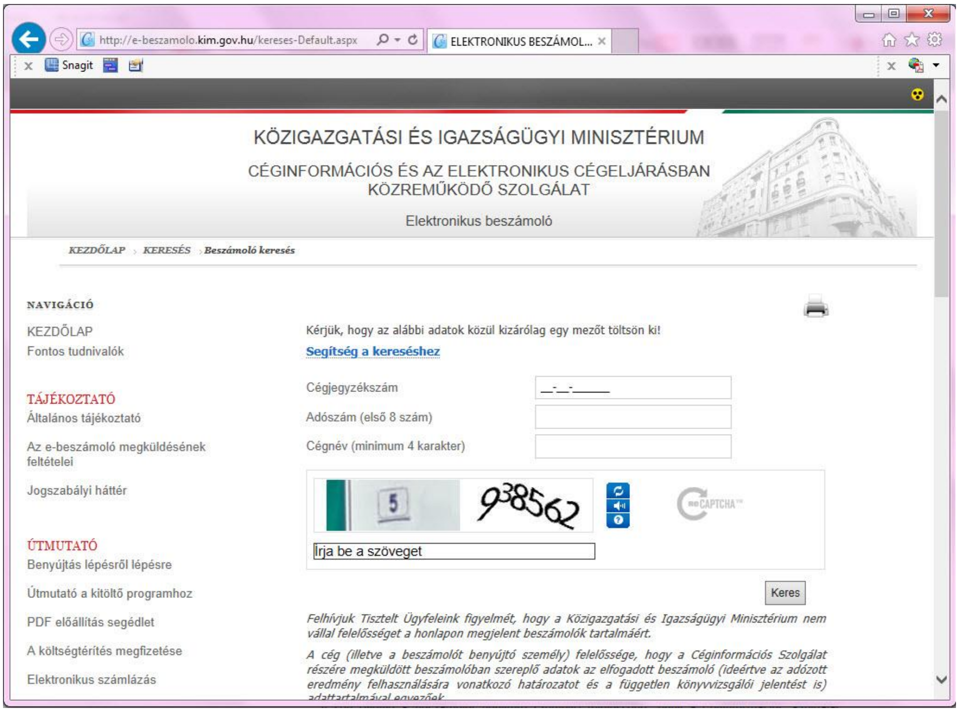
The other part of the report is the **profit and loss statement,** which is an accounting document, which gives the balance sheet earnings of the financial year in a pre-defined structure, and components of the earnings broken down into various classifications. It contains income and expenditure for the calendar year and the previous business year, as well as the main factors affecting the earnings.

The **notes to the accounts** are essentially the text comments, which under the principle of materiality may be important to the operators of the market, but cannot be derived from the data of the balance sheet or the profit and loss statement.

The **annual report** is not really public; it is not part of the report, but the preparation of which is obligatory under the conditions defined by the law. The annual report shall include an overall analysis of the development of the course of business, the performance and the situation of the enterprise, in accordance with its size and complexity. By the evaluation of the annual report data, it is to present the entrepreneur's assets and liabilities, financial and income situation, the course of business, the main risks and uncertainties occurring in the activity, in accordance with the actual conditions, giving a reliable and real picture – based on facts of the past and the expected future data.

The balance sheet, the profit and loss statement and the notes to the accounts, as parts of the annual report, ***shall be deposited,*** and ***shall be disclosed*** *at the same time*. The entrepreneur complies with the obligation of disclosure, if he/she sends the Company Information Service an original or a certified copy of the report and, if necessary, an independent audit report containing an audit clause, together with the electronic form defined by the Act on Public Company Information, Company Registration and Winding-up Proceedings, via the government portal. The Company Information Service shall forward the electronic form to the state tax authorities.

The purpose of this is that information accessible to the public be available, as the report deposited is public, anyone may have information from it or make copy of it.



13. Figure: If you have a little spare time, find here

You will understand more easily what balance sheet, profit and loss statement and notes to accounts mean.

If you are lucky, you can find a business, the annual reporting of which is also available, even if not fully.

5.2.2 The relations of businesses

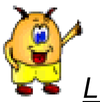
Were I to present you a car in the field of machinery, I would opt for an Audi for the presentation. (Or rather a Mercedes???) This make may be manufactured in Győr, the manufacturer, Audi Hungary, however, is only a subsidiary. (The same goes for Mercedes, as the site in Kecskemét is also a subsidiary.)

The knowledge of these relationships, due to the principle of materiality, may have an important role, which is properly emphasised in the UAA.

If we look at the balance sheet, and within that, for example, the financial fixed assets, we can see this:

Fixed financial assets

1. Permanent share in affiliated business
2. Loan granted on a permanent basis in affiliated business
3. Other permanent holdings
4. A loan granted on a permanent basis by virtue of participation in an enterprise
5. Other loans granted on a permanent basis
6. Long-term debt securities
7. Value adjustments of financial fixed assets
8. Evaluation difference of financial fixed assets



<u>Look at the other items of the balance sheet and find similar classifications for assets and resources as well.</u>

So, to understand the content, it is necessary to know what kind of relationships can be interpreted between enterprises.

If you can, rely on what you have learnt in the course of economic law. Or you can look at the Accountancy Act directly to see the interpretation of the terms at the beginning!

Let us see who can be behind these relations.

Parent company: the enterprise, which is able to pursue a dominant influence over another enterprise (subsidiary) either directly or indirectly through its subsidiary, because it meets at least one of the following conditions:

- on the basis of its proportion of ownership, holds alone the majority of the votes (exceeding 50 percent) of the owners (shareholders), or
- based on the agreement with other owners (shareholders), it holds alone the majority of the votes, or
- being the company’s owner (shareholder), it is entitled to elect or to call back the majority of the senior officials and of the members of the Supervisory Board, or
- on the basis of an agreement with the owners (shareholders), or of the provision of the incorporation articles) exercises decisive direction and control – regardless of the proportion of ownership, the voting ratio, or the right to elect and call back.

Subsidiary: the company, which the parent company exercises a decisive influence on.

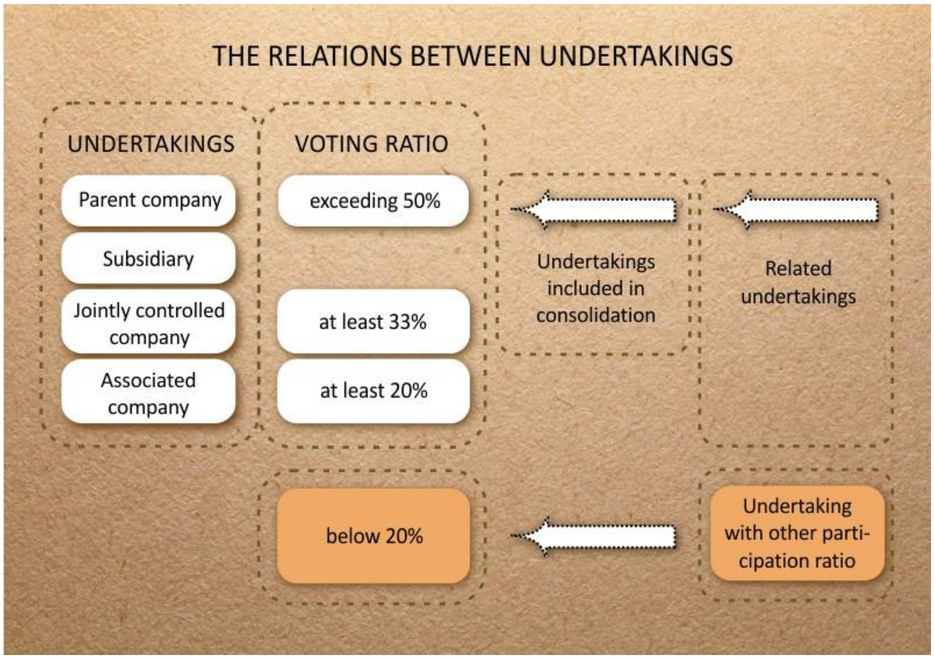
Jointly controlled company: the company, where, the parent company (a subsidiary of the parent company included in consolidation) on the one hand and another (or more) enterprise on the other hand share parent company privileges on a basis of parity, at least 33 percent ratio. A jointly controlled entity is jointly managed by the partners.

Associated company: the company not fully included in consolidation, where the parent company or its subsidiary included in consolidation has a major share, exercises a prevailing influence on the business and financial policy of the company. A company with prevailing influence shall be deemed the company, which has directly or indirectly at least 20% of votes at another company.

Related company: a parent company and its subsidiary, the jointly controlled company, an associated company.

In the figure the relations between different undertakings and the criteria of classification can be seen.

The relations between undertakings



14. Figure

5.3 BOOK-KEEPING

Book-keeping is the activity of keeping continuously records of the economic events occurring in the course of the activity of the business entity, which affect its assets and liabilities, its financial and income situation and which is closed at the end of the financial year.

Book-keeping forms:

- single-entry accounting
- double-entry accounting

Language: only Hungarian

Double-entry accounting: records of assets, their liabilities and the changes thereof, which shows the changes occurred in the assets and liabilities in accordance with the facts, continuously, fully, in a closed circuit and clear form.

One of its features is that the accounting or the recording of the economic events takes place at settlement (in chronological order and on the basis of their economic content), regardless of the financial account day.

Double-entry accounting is obligatory to:

- each entrepreneur,
- the National Bank of Hungary,
- the government organisations and other organisations, if a government regulation requires so.

Single-entry accounting

The single-entry accounting (cash-flow accounting) means the records of the funds, their resources, and the changes thereof.

The business entity doing single-entry accounting shall keep accounting records (cash-flow accounting) of the funds owned and used by the undertaking and of the resources thereof, as well as of cash-flow accounting operations, of the definitive change in assets, which are related indirectly to the cash-flow operations but do not entail actual cash movements, of non-balanced revenues, expenditures, which show the changes in the assets and liabilities in accordance with reality, continuously and in a clear form.

Associated with this accounting recording, in order to compile the simplified report, it is necessary that the detailing records related to the assets and liabilities be kept in accordance with reality and continuously.

Under the UAA, single-entry accounts shall not be kept by entrepreneurs, only a few civil organisations (such as foundations) may apply it. Although it may help sole traders, we do not deal with single-entry book-keeping either..

5.4 AUDIT, DEPOSIT AND DISCLOSURE

5.4.1 The audit

The purpose of the audit is to determine whether the report presented by the entrepreneur about the financial year is in accordance with the requirements of the Accountancy Act, and, accordingly, if it gives a reliable and true picture of the property and financial situation, and the incomes of the operation of the business(cash-flow accounting).

The audit is obligatory for all undertakers doing double-entry accounting, if the annual (converted to annual) average net sales over the two financial years prior to the business year did not exceed the 300 million HUF, and the average number of employees was less than 50 persons. In all other cases, when the audit is not obligatory under the Accountancy Act or other regulations, the entrepreneur may decide to have the report reviewed by an appointed auditor.

Please, pay close attention when you start to work and you are concerned that the entrepreneur, who has – under the act on

taxation – more than 10 million HUF of public debt expired more 60 days before on the balance sheet date of the current business year, shall apply a mandatory auditor.

For auditing, a member of the Hungarian Audit Chamber or an auditing company registered at the Hungarian Audit Chamber can be selected.

About the audit the auditor shall prepare and hand over to his/her client a written **audit report** including the ***audit clause*** or the rejection of giving such clause.

5.4.2 Publication and disclosure

Deposit

The entrepreneur shall be obliged to deposit the report along with the audit report and the decision on the use the income after taxation within 150 days from the balance sheet date of the financial year in the form and with the content (wording), on the basis of which the auditor has reviewed the annual report or the simplified annual report.

In the case of a statutory audit, the report data deposited along with the audit report shall be public, anyone can get information about them, and can make copies of them.

5.4.3 Disclosure

Simultaneously with the deposit, each entrepreneur is to **disclose** the report, in the case of a statutory audit together with the independent audit report including the audit clause or the rejection of granting the clause.

The business entity shall ensure that its clerks, employees and members could review the report at the headquarters of the business (parent company) and that they could make full or partial copies of them.

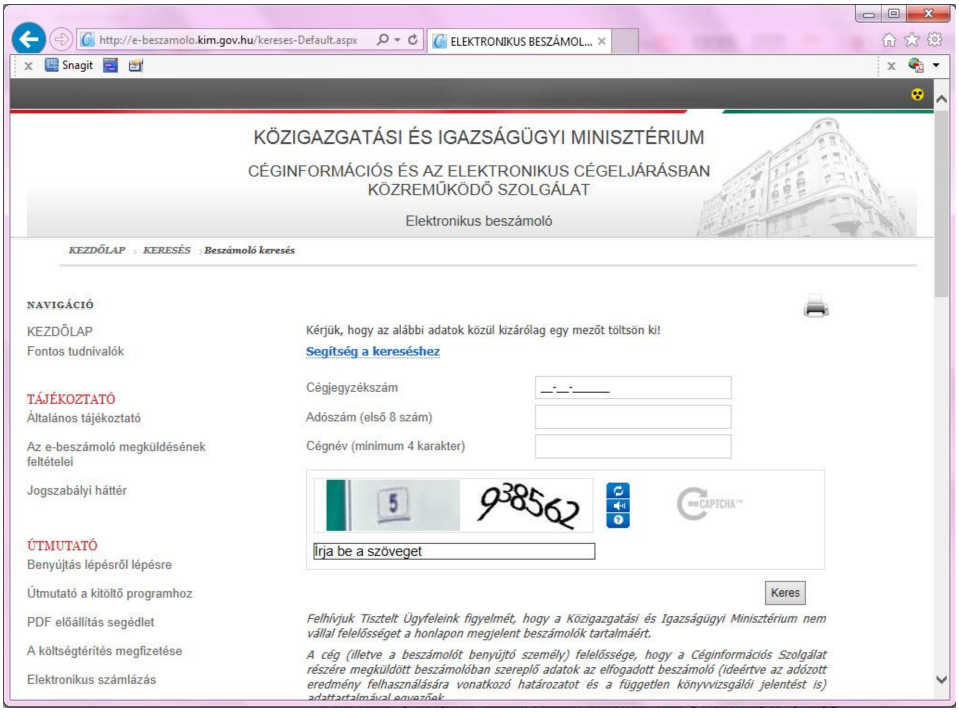
The entrepreneur complies with the depository and publication, if the report is **sent to** the company information and electronica administration service, **company information service**, in short.

The business entity obliged to prepare a ***report in accordance with the international accounting standards*** is also obliged to publish the report and the annual on its website, and to ensure the continuous viewing of the data published at least until the disclosure of the data related to the second following business year. On the basis of an own decision or under other legislation, other business entity may also publish its report on its website.

The viewing of the business report which is not part of the annual report is to be ensured to all interested parties on the headquarters of the business, and it shall be made possible to make full or partial copies of it.

I would like you to see as well how it works in practice. Go to the following internet address again, and search for the report of a company that you know.

You will find it! Look into it!



15. Figure

5.5 SUMMARY, QUESTIONS

5.5.1 Summary

In this lesson you became familiar with the features related to business reporting. The essential thing is that all business entity shall make an annual report, but this can be overwritten by scale of the indicators of the company. Again, each business entity is to choose a report in accordance with the interests of its own, and is to apply the cost-and-profit principle, i.e. the compilation should not cost more than its benefit.

Reporting is an integral part of book-keeping. Now, only the concepts have been shown, since this topic will be dealt with in more detail later in the future.

The report shall be made available to others, this can be carried out by the publication and disclosure. *(This is in fact an IT job in practice.)*

And how good we were shall be evaluated by the auditor, whose responsibility is to ensure legality.

5.5.2 Self-test questions

1. What does the reporting obligation mean?
2. What do you mean by the concept of book-keeping?
3. What does single-entry accounting mean?
4. What does double-entry accounting mean?
5. Could you tell what they mean?
   – the balance sheet
   – the profit and loss statement
6. What is the role of the notes to accounts?
7. And that of the annual report?
8. What does related company mean?
9. What does the relation of other share ratio mean?
10. What is the purpose of audit?
11. How the deposit is carried out?
12. And the disclosure?

5.5.3 Practice tests

		Correct answer	Wrong answer	Wrong answer	Wrong answer
1	***The form of the report depends on***	the amount of the net annual turnover the total assets of the balance sheet how many persons are employed the limit values of the	the amount of the annual revenue, the amount of the assets who the employees are — what activity is carried out	the amount of sales, the amount of assets, the employment rate — the method of book-keeping	the amount of the net annual turnover the total assets of the balance sheet, how many persons are employed — the form

		previous indicators			of the statement
2	The single-entry accounting	records only actual cash-flow	Records everything	Records all assets changes	No need to do accounting.
3	The double-entry accounting	Records all assets changes	Everything is recorded in two books	records only actual cash-flow	Records everything twice
4	The balance sheet shows the company's assets	• in total • in thousands of HUF • for a given date	• fully separately • for a given date	• in total, • in thousands of HUF • or a given year	• in total, • in quantity and in value • for a given date
5	The related undertaking	means a proportion of ownership more than 20%	means a proportion of ownership more than 50%	means a proportion of ownership more than 25%	means a proportion of ownership more than 70%

6. REPORTS

6.1 OBJECTIVES AND COMPETENCIES

It is rather difficult to introduce regulations concerning reports in a simple and clear way, as there are quite a few different approaches to be found in the relevant acts.

This chapter has a double duty function. On one hand you will learn these regulations and you will also have to know one by one what these regulations refer to.

My objective is that:

- you get acquainted with regulations concerning accounting obligations,
- you learn to whom, under what conditions and what type of reports can be or have to be prepared,
- you also learn about the forms of these reports.

Chapter 5.3. is going to be a little different than the previous ones. I can *only* help you in your studies if you are active enough. I will present you the balance sheet as well as the income statement but *you* will have to search. Behind each letter highlighted you will find an explanation if you click on it.

Let's learn a little bit together!!!

Reviewing and learning the material will only take you 5 hours but I also count on your interest regarding the content of the account which will take at least another hour. This will be six hours altogether.

Basic definitions:

- annual report,
- simplified annual report,
- consolidated annual report,
- simplified report,
- *simplified annual report of micro enterprises.*

6.2 ACCOUNTING AND REPORTING OBLIGATIONS

Before starting let's have a look at the learning chart:

16. Figure

After the closure of accounts of the given financial year, a report on the operation as well as on the property and financial situation of the enterprise is to be prepared – in Hungarian – supported by the accounting specified in this present act.

This report is to provide a reliable and realistic overall picture of the assets, their composition, the financial situation and the income of the activity of the enterprise.

In this report the balance sheet will present the assets as well as the composition of the assets while the income statement will deduce the incomes of the activities. The supplementary appendix will contain those narrative explanations that can not be deduced from the balance sheet or from the income statement but are necessary for the enforcement of basic accounting principles.

In addition to the regulations of the act, further information is to be provided in the supplementary appendix in case applying the requirements of this act and the enforcement of basic accounting principles are not enough to present a reliable and realistic overall picture in the balance sheet and in the income statement.

As we have already seen in the previous chapter the form of the report will depend on the amount of the annual net revenue, the total assets of the balance, the number of employees and also on the limit values of all the above.

The report can be a(n):

- annual report,
- simplified annual report,
- consolidated annual report,
- *simplified annual report of micro enterprises*
- simplified report.

The enterprise has to support the report by proper accounting.

General rule: Entrepreneurs having double-entry book-keeping are to prepare an annual report and a business report.

BUT there is an exception!

Entrepreneurs may prepare a simplified report supported by single-entry book-keeping in case the Sztv. [Accountancy Act] or other governmental decree allows it.

Entrepreneurs having double-entry book-keeping may prepare a simplified annual report if, during two successive years, two of the following three values would not exceed the limit at the time of the balance sheet date:

a) total assets of the balance – 500 million HUF,
b) annual net revenue – 1000 million HUF,
c) the average number of employees – 50.

Simplified annual reports, called ***simplified annual report of micro-entities*** can be made by the entrepreneur not subject to auditing – by his own choice who, during two previous successive years has not exceeded the following limits in respect of two out of three indexes indicating the size at the time of the balance sheet date:

a) total assets of the balance – 100 million HUF,
b) annual net revenue – 200 million HUF,
c) the average number of employees – 10.

In case the entrepreneur preparing a simplified annual report of micro enterprises does not meet the specified conditions during two successive financial years, he is to prepare an annual report or a simplified annual report as from the following year after the second financial year.

The entrepreneur preparing a simplified annual report of micro enterprises may only change his choice at the earliest after closing three financial years by a simplified annual report of micro enterprises.

The entrepreneur considered to be a parent company related to one or more entrepreneurs is to prepare a consolidated annual report and a consolidated financial report as well.

Form of Report	Annual report	Simplified annual report	Consolidated annual report	Simplified report
Parts	Balance sheet Income statement Supplementary appendix + Business report[1]	Balance sheet of simplified annual report Income statement of simplified annual report Supplementary appendix of simplified annual report	Consolidated balance sheet Consolidated income statement Consolidated supplementary appendix + Consolidated business report[1]	Simplified balance sheet Income analysis
Conditions to their preparation:				
Accounting	Double-entry book-keeping			Single-entry book-keeping
Size	*To be prepared by:* enterprises having double-entry book-keeping except if allowed to prepare a simplified annual report To be prepared if during two successive years at the time of the balance sheet date, two of the three values representing the size exceed the following limits: - total assets of the balance – 500 million HUF - annual net revenue – 1.000 million HUF - Average number of employees of the current year – 50.	*Allowed to be prepared by:* enterprises having double-entry book-keeping if during two successive years at the time of the balance sheet date two of the three values representing the size DO NOT exceed the following limits: - total assets of the balance – 500 million HUF - annual net revenue – 1000 million HUF - Average number of employees of the current year - 50. Important! Not allowed to prepare: - public companies limited by shares - parent companies - entrepreneurs whose debt or property securities issued are permitted to be traded on the stock exchange or the permission has already been applied for	*To be prepared by:* enterprises considered to be parent companies based on the relation to one or two entrepreneurs, except for: - parent company - exemptible if during two successive years at the time of the balance sheet date two of the three values DO NOT exceed the limits: • total assets of the balance – 5400 million HUF • annual net revenue – 8.000 million HUF • average number of employees of the current year – 250.	Simplified report supported by single-entry accounting can be prepared by enterprises permitted by the Accountancy Act or governmental decrees referred to therein

[1] Business reports (consolidated business reports) are not part of this report but their preparation is obligatory.

17. Figure: Forms and parts of reports, and the terms of their preparation

6.3 FORMS OF REPORTS

Let me begin again with legal regulations: on the last day of the financial year as being the balance sheet date, entrepreneurs having double-entry book-keeping may or under certain conditions must prepare a simplified annual report about their financial year.

6.3.1 Annual report

Annual reports *must present a reliable and realistic overview on the property, financial and income situation of the entrepreneur.* To make one step further: *they also have to contain all assets, equities, provisions and liabilities considering accrued and deferred payments as well, furthermore the items of income and expense of the current period, the after-tax and balance sheet earnings as well as items and narrative explanations necessary for the presentation of the entrepreneur's fair asset and financial situation and that of the income of the activities.*

The annual report consists of a balance sheet, an income statement and supplementary appendices. Together with the annual report a business report is also to be made.

Comparability of the annual reports on successive financial years is to be guaranteed by the consistency of the structure, the division and the content of the income statement and also by the evaluation principals and the procedures of the items of the balance sheet.

In the balance sheet as well as in the income statement, corresponding data from the previous financial year must be indicated beside each item. In case data are not comparable, this must be indicated and explained in the supplementary appendix. If auditing or self- auditing has detected a mistake/mistakes of any considerable amount in the annual report of the previous year/years, then modifications – concerning statements of the previous year(s) found, not disputed not appealed and having become final until the preparation of the balance sheet – are to be presented at each item in the balance sheet and in the income statement beside the data of the previous year and they will not be part of the data of the income statement of the current year. In this case data of the previous financial year, modifications concerning financial year(s) closed and data of the current year are shown in separate columns (*This is the middle data row in the figure!)* in the balance sheet as well as in the income statement.

It might happen that an asset or liability can be placed in several items of the balance sheet and also if the qualification of the asset or of the liability changes, the solution used is to be given numerically in the supplementary appendix along with the item references of inherence and comparability.

Annual reports are to be made in Hungarian in a simple and clear form following the structure defined in the Accountancy Act and also the division and the given order specified and detailed therein, while respecting the rules relating to the subdivision and aggregation of items, based on the duly accounted data of the double entry book-keeping supported by accounting documents.

The balance sheet, the income statement and the supplementary appendix being part of the annual report are to be signed by the person entitled to represent the entrepreneur indicating also the date and place.

As for the indexes of the size, if the index remains below the given sises in relation to two previous years, the entrepreneur then may make a simplified annual report. A simplified annual report consists of a balance sheet, an income statement and a supplementary appendix. No financial reports – relating to simplified reports – are to be made. Rules concerning the preparation of the annual report are to be applied to the preparation of simplified annual reports with respect to derogations specified in this present chapter.

In case the entrepreneur making the simplified annual report exceeds the limit of any two of the three indexes during two successive years, he is to make an annual report as from the year following the preparation of the annual report of the second year.

In case – at the entrepreneur making an annual report – any two of the three indexes falls under the limit during two successive years, as from the year following the preparation of the annual report of the second year the entrepreneur may make a simplified annual report.

6.3.2 Simplified report

Using 31, December as record date, entrepreneurs having single-entry book-keeping **are to make a simplified report** of the financial year. The financial year of entrepreneurs having single-entry book-keeping corresponds with the calendar year.

The simplified report consists of a simplified balance sheet and a income analysis. The items of the simplified balance sheet and the income analysis can be subdivided even further. Items also here can be found in three columns i.e. data of the previous year, data of the current year and data in connection with mistakes of considerable amount.

The simplified balance sheet and the income analysis are to be prepared in a clear and transparent form with respect to the order of items specified in this present Act and based on the data of the properly kept single-entry book-keeping supported by documents (cash book-keeping, detailed records of assets and liabilities, inventories).

The simplified balance sheet as well as the income analysis to be made in Hungarian and data must be given in terms of thousand forints (HUF).

The simplified balance sheet and the income analysis must be signed by the authorised representative of the enterprise. .

Book-keeping is determined by the characteristics of the cash flow.

The simplified balance sheet will contain all assets and relating liabilities of the entrepreneur existing on 31, December confirming the items of the balance sheet and entered in the inventory with values; while the income analysis will contain all final (non-repayable) income and all final (non-reclaimable) expenses of the activities of the current year and the gross value adjustments deriving from the evaluation of assets and liabilities at the record date of the balance sheet – irrespectively of whether at the execution of transactions there had been any actual cash outflow or income or not.

6.3.3 Consolidated annual report making obligation

In case of joint companies the consolidated report affects the parent, the subsidiary and the jointly controlled companies. When considering dominant influence, the rights of any of the subsidiaries to be taken into account at the parent company.

When considering the consolidated annual report making obligation entitlements (rights) under paragraph (1) though not exercised directly by the parent or the subsidiary company but are exercised to the benefit of the parent or subsidiary company by third parties – in their own names – are to be taken into account at the parent company.

The parent company is not obliged to make a consolidated annual report of the financial year if during the two previous – successive – years at the balance sheet date any two of the following three values do not exceed the limits hereunder:

a) total assets of the balance – 5400 million HUF,

b) annual net revenue – 8000 million HUF,

c) the average number of employees – 250.

It is not compulsory to make a consolidated annual report and consolidated business report for

- the exemptible parent company
- the overarching parent company having a 100% ownership in the exemptible parent company and the minority of the owners has accepted the exemption or has not asked the exemptible company to prepare the consolidated annual report.

Have a look again at the balance sheets!

Try to systematise a bit the characteristics of the balance sheet!

And this is an income statement:
Types of income statement

Statistical number

INCOME STATEMENT BY TOTAL COST PROCEDURE
„A" VERSION

No.	Description of item	Previous year	Modification of previous year(s)	Current year
a	b	c	d	e
01.	Net domestic sales revenue			
02.	Net export sales revenue			
I.	**Net sales revenue (01+02)**			
03.	Changes in inventory of own production			
04.	Capitalised value of own produced assets			
II.	**Value of capitalised own performance (±03+04)**			
III.	**Other revenues**			
	Reversed impairment loss			
05.	Material cost			
06.	Value of services acquired			
07.	Value of other services			
08.	Value of goods sold			
09.	Value of services sold (mediated)			
IV.	**Material expenses (05+06+07+08+09)**			
10.	Salary expenses			
11.	Other personnel expenses			
12.	Salary costs			
V.	**Personnel expenses (10+11+12)**			
VI.	**Depreciation charges**			
VII.	**Other expenses**			
	Depreciation			
A.	**OPERATING (BUSINESS) PROFIT** (I±II+III-V-VI-VII)			
13.	Dividend and share received (due)			
	Received form joint enterprise			
14.	Exchange gain on sales of shares			
	Received from joint enterprise			
15.	Exchange gain and interest on fixed financial assets			
	Received from joint enterprise			
16.	Other interest and similar income received (due)			
	Received from joint enterprise			
17.	Other income on financial operations			
VIII.	**Income on financial operations (13+14+15+16+17)**			
18.	Exchange loss on fixed financial assets			
	Given to joint enterprise			
19.	Interests to be paid and similar payments			
	Given to joint enterprise			
20.	Impairment loss on shares, securities and bank deposits			
21.	Other expenses of financial operations			
IX.	**Expenses of financial operations(18+19±20+21)**			
B.	**INCOME OF FINANCIAL OPRATIONS(VIII-IX)**			
C.	**CURRENT PROFIT/LOSS (±A±B)**			
X.	**Extraordinary income**			

XI.	**Extraordinary expenses**			
D.	**Extraordinary income (X-XI)**			
E.	**PRE-TAX INCOME(±C±D)**			
XII.	**Tax chargeable**			
F.	**AFTER TAX INCOME (±E-XII)**			
22.	Usage of retained profit for dividend and share			
23.	Dividend, share approved			
G.	**BALANCE SHEET INCOME (±F+22-23)**			

Statistical number

INCOME STATEMENT BY CLASSIFICATION OF EXPENSES BY FUNCTION

„A" VERSION

data in 1000 HUF

No.	Description of item	Previous year	Modification of previous year(s)	Current year
a	b	c	d	e
01.	Net domestic sales revenue			
02.	Net export sales revenue			
I.	**Net sales revenue (01+02)**			
03.	Direct first-costs of sales charged			
04.	Cost of goods sold			
05.	Cost of services sold (mediated)			
II.	**Direct costs of sales (+03+04+05)**			
III.	**Gross value of sales (I-II)**			
06.	Expenses of sales and distribution			
07.	Expenses of administration			
08.	Other general expenses			
IV.	**Indirect costs of sales (06+07+08)**			
V.	**Other income**			
	Reversed impairment loss			
VI.	**Other expenses**			
	Impairment loss			
A.	OPERATING (BUSINESS) PROFIT (±III-IV+V-VI)			
09.	Dividend and share received (due)			
	Received form joint enterprise			
10.	Exchange gain on sales of shares			
	Received from joint enterprise			
11.	Exchange gain and interest on fixed financial assets			
	Received from joint enterprise			
12.	Other interest and similar income received (due)			
	Received from joint enterprise			
16.	Other income on financial operations			
VII.	**Income on financial operations (09+10+11+12+13)**			
14.	Exchange loss on fixed financial assets			
	Given to joint enterprise			
15.	Interests to be paid and similar payments			
	Given to joint enterprise			
16.	Impairment loss on shares, securities and bank deposits			
17.	Other expenses of financial operations			
VIII.	**Expenses of financial operations(14+15±16+17)**			
B.	**INCOME OF FINANCIAL OPRATIONS(VII-VIII)**			
C.	**CURRENT PROFIT/LOSS (±A±B)**			
IX.	**Extraordinary income**			
X.	**Extraordinary expenses**			
D.	**Extraordinary income (IX-X)**			
E.	**PRE-TAX INCOME(±C±D)**			
XI.	**Tax chargeable**			
F.	**AFTER TAX INCOME (±E-XII)**			
18.	Usage of retained profit for dividend and share			
19.	Dividend, share approved			
G.	BALANCE SHEET INCOME (±F+18-19)			

INCOME STATEMENT BY TOTAL COST PROCEDURE
(„B" VERSION DEDUCED FROM THE OPERATING (BUSINESS) PROFIT)

EXPENSES | REVENUE | DATA GIVEN IN 1000 HUF

SSerial number	Denomination of item	Previous year	Modification of previous year(s)	Current year	SSerial number	Description of item	Previous year	Modification of previous year(s)	Current year
a	b	c	d	e	a	b	c	d	e
I	**Reduction of stock of own performance**				13	Net revenue on domestic sales			
01	Material cost				14	Net revenue on export			
02	Value of services acquired								
03	Value of other services				**XI**	**Net revenue on sales** (13+14)			
04	Cost of goods sold								
05	Value of services sold (mediated)				15	Increase of stock of own performance			
II	**Material expenses** (01+02+03+04+05)				16	Capitalised value of own assets			
06	Salary expenses								
07	Other personnel expenses				**XII**	**Capitalised value of own performance** (15+16)			
08	Salary costs								
IIII	**Personnel expenses** (06+07+08)				**XIII**	**Other income**			
IV	**Depreciation charge**					From it: reversed impairment loss			
V	**Other expenses**								
	From it: impairment loss								
VI	**Operating (business) expenses** (I+II+III+IV+V)				**XIV**	**Operating (business costs** (XI+XII+XIII)			
A	**OPERATING (BUSINESS) PROFIT (VI<XIV)**				**H**	**OPERATING (BUSINESS) LOSS (VI>XIV)**			

INCOME STATEMENT BY CIRCULATION EXPENSES PROCEDURE

(VERSION „B" DEDUCED UNTIL THE OPERATING (BUSINESS) PROFIT)

EXPENSES REVENUE Data in 1000 HUF

SSerial number	Denomination of item	Previous year	Modification of previous year(s)	Current year	SSerial number	Description of item	Previous year	Modification of previous year(s)	Current year
a	b	c	d	e	a	b	c	d	e
01	Direct first-costs of sales charged				11	Net revenue on domestic sales			
02	Costs of goods sold				12	Net revenue on export			
03	Value of services sold (mediated)								
I	**Direct costs of sales** (01+02+03)				**IX**	**Net revenue on sales** (11+12)			
04	Expenses of sales and distribution								
05	Expenses of administration				**X**	**Other income**			
06	Other general expenses					From it: reversed impairment loss			
II	**Indirect costs of sales** (04+05+06)								
III	**Other expenses**								
	From it: impairment loss				**XI**	**Operating (business costs** (IX+X)			
IV	**Operating (business) expenses** (I+II+III+IV+V)								
A	**OPERATING (BUSINESS) PROFIT (VI<XIV)**				**H**	**OPERATING (BUSINESS) LOSS (IV>XI)**			

6.4 SUMMARY, QUESTIONS

6.4.1 Summary

So, we have got acquainted with reports. In the future during your work you can meet any of them but at this point it is only important for us to understand the content of the simplified report relating to the fundamentals. Later on, these will be further used.

6.4.2 Self-test questions

1. What type of reports do you know?
2. What does the form of the report to be made depend on?
3. What parts does the report have?
4. What does a joint enterprise mean?
5. What does other participation mean?
6. Who can make a simplified annual report?
7. Who can make a simplified report?
8. Who is to make a consolidated annual report?

6.4.3 Practice test

		correct answer	wrong answer	wrong answer	wrong answer
1	Parts of the annual report	balance sheet income statement supplementary appendix	balance sheet income statement supplementary appendix financial report	balance sheet income statement supplementary appendix business report	balance sheet income statement supplementary appendix audit report
2	Indexes demonstrating the size	balance sheet total annual net revenue number of employees	subscribed capital balance sheet total annual net revenue	balance sheet total Shareholder's equity number of employees	balance sheet total annual income number of employees
3	Parts of the consolidated report	consolidated balance sheet consolidated income statement consolidated supplementary appendix	consolidated balance sheet consolidated income statement consolidated supplementary appendix financial report	consolidated balance sheet consolidated income statement consolidated supplementary appendix consolidated business report	consolidated balance sheet consolidated income statement consolidated supplementary appendix consolidated audit report
4	It is true for the business report that:	to be made but it is not part of the report	to be made because it is part of the report	to be made and deposited	to be made, it is part of the report but only with the approval of an auditor
5	Parts of the simplified report	simplified balance sheet income analysis	balance sheet income analysis	simplified balance sheet income statement	simplified balance sheet income analysis supplementary appendix

7. ROLE OF DOCUMENTS IN BOOK-KEEPING

7.1 OBJECTIVES AND COMPETENCES

The Accountancy Act specifies the rules and contents concerning reporting and accounting obligations. The realisation of accounting duties are impossible without the accounting method deriving from the **principle of documentary evidences** meaning: each economic event must be supported by an original document.

Our task here is to get acquainted with the role and the characteristics of accounting documents and for the actual settlement of accounting processes you will also have to know the basic time aspects of the Accountancy Act.

With the help of this chapter you can come to understand and respect the rules concerning the handling of documents and you will not be surprised when accountants give you a dirty look if you do not comply with regulations.

Timeframe:

In case you are really present and not just sitting here staring at the material, this part can be quickly and very efficiently acquired! Here I expect you to cooperate during 480 minutes i.e. 8 hours!

Key expressions closely relating to practical work:

Accounting document

Principal of documentary evidences and adherence to rules on documenting

- Financial year
- Balance sheet date
- Date of depositing and disclosure
- Date of preparation of the balance sheet

7.2 ACCOUNTING DOCUMENTS

First, have a look at the learning chart!

18. Figure

The notion of accounting document is determined by the Accountancy Act (Sztv.) According to this, any document made or issued by the entrepreneur or made and issued by a natural person having a financial or other relation with the entrepreneur or by other entrepreneur are considered to be accounting documents meaning an invoice, a contract, an agreement, a statement, a certificate of a credit institution, a bank statement, a legal regulation or other document to be considered as such – irrespectively of the means of the preparation – which would **support the accounting clearance of the economic transaction** (registration).

Data of the accounting documents must be authentic, reliable and correct both formally and in terms of content. When drawing up the format of the document clarity should be always borne in mind.

Documents are to be drawn up in case the asset of the enterprise changes in some way and that's **the point!**

Accounting documents are to be drawn up in Hungarian at the date or during the period of the change in the asset i.e. at the time of the event, the economic transaction or the execution.

Data on documents drawn up in Hungarian can also be given in other languages.

If appropriate, accounting documents can also be drawn up in foreign languages. Data and descriptions of documents issued in a foreign language and those of foreign documents accepted which are necessary for authenticity and for the reliable and realistic data recording and accounting are to be **given also in Hungarian in compliance with internal rules** – prior to recording them in the accounting records.

Future proofness of data in the accounting documents must be granted for a **minimum retention period of 8 years.**

AND IT'S NOT FIVE, NOT SIX, NOT TEN!!!! This is repeatedly mistaken by colleagues. It is important to watch out for the adjective: these are accounting documents meaning they are governed by the Accountancy Act. There are documents related to employment that can never be discarded and must be archived after the expiration of the record management deadline.

During these 8 years *competent control authorities may ask for these account documents but as for documents supporting the individual income tax (SZJA) declaration, they must „only" be kept for five years as they are not ACCOUNTING DOCUMENTS!*

Respecting the **principal of documentary evidences and adherence to rules on documenting** is a basic requirement in accounting according to which***:***

- A document is to be made about each economic transaction or event where there is a change in the stock or in the composition of the asset or of the source of the asset.
- All data of documents reflecting the course of economic events are to be recorded in the accounting records.
- Data may only be recorded in the accounting records if based on documents properly issued. Documents are considered as properly issued if they contain data – to be recorded in accounting and specified in other acts – relating to a given economic event completely and realistically and they are also in accordance with the requirements of the document concerning the format and the content and duly corrected in case of any possible mistake.

Respecting this principle might relieve you from criminal liability!

Never make any correction to any document! Send it back to its issuer as he is the only one entitled to make any modification. In accounting, there is no such thing as „good intention", only strictly respected adherence to rules on documentation!

Processing of documents is developed by each enterprise according to its own internal rules but he following regulations of the Accountancy Act (Sztv.) are also to be respected:

- data of documents on economic transactions and events related to cash flow must be recorded without delay meaning in case of cash transactions: at the time of actual cash movement and in case of bank account operations: at the time of arrival of the credit institution's notice and items concerning other cash types should be recorded in the books until 15th of the following month at the latest,
- data of documents relating to other economic transactions and events are to be recorded at least quarterly after the realisation of these economic transactions and events until the date determined by the accounting policy and not later than until the end of the month following the quarter concerned.

Double-entry accounting is a self-checking closed system where the well structured coordination between the data of the general ledger accounting, the analytical records and the documents grants the possibility of control as well as the elimination of data entry mistakes and other mistakes in consistency.

But!!! Within the limits of the law we can „play" with the dates. If it is needed, referring to this principle we can also ameliorate the liquidity situation of our enterprise. In case e.g. a number of order is not indicated on the invoice (which may not have been required until now!) we can legally return it asking for remedy. This way we may gain an extension in time for payment and we do not have to take out a loan for the current financial completion.

But always remember that regarding the collection of flat rates the Art. 177.(33)-(38) of Act C of 2000. have changed based on the regulations of the Civil Code (Ptk.):

The instrument of the **collection of flat rate** *was introduced on 1, July 2013.*

- This flat rate can be construed in connection with the relationship between enterprises in case the debtor is in delay.
- Flat rates can not be lawfully disregarded and the minimum amount is specified by law which is currently 40 Euros.
- In substance it corresponds to the **interest on late payment**.

Still, the Accountancy Act provides a minimum standardisation of data content and prescribes the general accessories in format and substance of the documents directly supporting accounting, which are the following:

- number and designation or other identifier of the document;
- designation of the enterprise (a business unit of the enterprise) issuing the document;
- designation of the person or organisation ordering the economic transaction, the payment allocator and the person verifying the execution of the order plus the signature of the controller depending on the organisation; the signature of the recipient on cash handling and stock movement documents and that of the person making the payment on counter receipts;
- date of issuance of the document and exceptionally, the period which the data of the document should be referred to – depending on the nature or the temporal application of the economic transaction;
- description or designation of the content of the economic transaction (executed), the quantity, quality and – depending on the nature and the rules of accounting of the economic transaction – the value data changes caused by the economic transaction;
- in case of an external document, among other data the document must contain the name and address of the issuing entrepreneur;
- in case of aggregation of document data, the document must contain the designation of the documents grounding the aggregation and the period of time which the aggregation refers to;

- reference to the method of accounting and to the book-keeping invoices concerned;
- date and confirmation of data recording into the accounting records,
- and all other data specified by law.

You should not be frightened by this list. It is very likely that you will simply have to fill in blank fields. ***What you have to see is that participants of an event and the economic transaction must fully be identified in compliance with law.***

Documents nowadays are mostly completed by computers. Though it is the responsibility of the person who has completed the document to respect and update legal regulations, software suppliers are extremely demanding concerning the usage of updated good solutions which is essential to maintain a good reputation.

During your work in the future you will mostly encounter invoices, simplified invoices of reduced content, further requirements concerning them may be determined by other legal regulations.

It also might happen that the authenticity of the document in terms of format and content can not be ensured by the document itself but in this case the authenticity can be verified with the signature of a person entitled to represent the enterprise.

Technical development largely supports data processing, today documents are typically issued and processed by computing assets.

Electronic documents, writings can be used as accounting documents if they comply with the regulations of the Accountancy Act. Conditions of the usage of electronic documents, writings as original documents and also the requirements of their authenticity and reliability are to be ensured by other legal regulations.

In case the accounting document is a product of a technical or an optical procedure the followings are to be ensured:

- immediate display in order to visually view data – if necessary,
- code list for unambiguous identification.

The entrepreneur may also meet the document handling obligation by physically or logically assigning given data, information and certificates to the original – both electronic and paper based – document excluding the possibility of post modification. Logical assignment may also be made by means of electronic records.

Original documents can be grouped in different ways.

- According to their role in accounting procedures, according to the date of their issuance:
  - ***base or primary documents:*** original record about the economic event;

DELIVERY NOTE

№ 325354

designation of enterprise

designation of business unit

designation of cost bearer or cost centre

designation of work team management

designation of stock location

20….. year month day

Product	Description		Type	Quality	Humidity content %
Delivery	from				
	to				
Estimated weight					kg
Gross measured weight					kg
Designation of package	piece	weight			kg
Net weight accepted, delivered					kg
Conversion factor	loss of weight				kg
Net weight converted					kg
Number of received note					

………………………… signature of deliverer

…………………………….. signature of recipient

……………………… signature of controller

19. Figure

Invoice		
Supplier details: **X-Ker Ltd.** **Address: 1116 Budapest, Sós u. 6.** **Email: xker@ker.hu** **Tel.: 06 89 987-811** **Fax: 06 89 987-812** **Bank account number: 12586547-19541636** **Tax number: 21598734-1-54**		**Client details:** **Pihenő Panzió** **Jó Béla** **Executive Vice President** **8000 GYŐR, RÁBASOR 37.** **Tel.: 06 37 555-999** **Fax: 06 37 555-998** **Bank account number: 11784009-15610021** **Tax number: 10614726-2-01**

Order No.	Payment method	Performanc e date	Invoice date	Payment term	Invoice number
66/2014	Bank transfer	14.03.20	14.03.21	14.04.12	05100016

Other data

Article reference	Descriptio n	Qty pcs	Price	Discount %	VAT%	Net amount
Tw 100/60	towel	100	270		27,0	270.000
Tw 150/90	towel	100	1300		27,0	1.300.000
St 100/200	sheet	50	480		27,0	24.000
				Total w/o VAT		1.590.000
				Invoice discount		0
				27% VAT base		1.590.000
				VAT		429.300
				VAT total		429.300
				TOTAL		2019.300

20. Figure: Invoice

- – ***aggregate or secondary documents,*** made during the course of processing original documents e.g. technical data carriers, or are suitable for the aggregation of original documents (e.g. overall delivery note).

- According to the type of handling they can be:
  - documents subject to strict accounting:

        - documents relating to cash handling or to certain economic events specified under other legal regulations (including invoices, simplified invoices and receipts) and all forms for which a sum exceeding the value of the form or the nominal value indicated on the form is to be paid or the unauthorised use of which might lead to abuse, must be subject to strict accounting.
        - Strict accounting is the obligation of the issuer of the document, form. The person entrusted to handle or authorised to issue these documents and forms must make records granting their accountability.
    - ***documents not subject to strict accounting:*** no separate records to be made of them (e.g.. book entry from payroll).
- According to their formation they can be:
    - ***internal documents:*** issued inside the enterprise (e.g. pay-list, cash document),
    - ***external documents:*** arrive to the enterprise from the economic environment (e.g. bank notice).
- ***According to their content they can be:*** documents of parts of the assets (e.g. documents of fixed assets, cash handling, stock management) and mixed documents (e.g. sales documents).
- ***According to their generation:*** written, processed, electronic documents.
- ***According to the language:*** Hungarian or foreign language documents.

According to the rules concerning retention **– as we have already clarified – records, complying with the requirements of the Accountancy Act *must be* retained for at least *8 years in a readable form and* also being retraceable by the references of accounting records, but while preparing internal rules the followings are also to be considered:**

- The entrepreneur must classify here the annual report on the financial year and the inventory, the evaluation, the ledger statement supporting it, the general ledger and all other documents directly or indirectly supporting the accounting. Retention obligation is valid also for the spoiled copies of documents subject to strict accounting!
- Documents issued in electronic form are to be retained in electronic form – in compliance with the requirements of the legal

regulations on digital archiving – in such a way that the method used would grant the immediate presentation and the continuous readability of the data of the document and would also exclude the possibility of post modification.

- Retention obligation specified in the Accountancy Act can also be met by making an electronic copy of the document primarily issued in a non electronic form – respecting at the same time all requirements of the legal regulations on making electronic copies of paper based documents – if the method of copying used grants the immediate presentation and the continuous readability of all data of the original document, and also excludes the possibility of post modification.

7.3 PERIODS, DATES IN THE ACCOUNTANCY ACT

So, documents are indispensable for the preparation of the report. After we have processed them there are some dates that must be kept in mind. Let's see them.

As simple as this subchapter may seem it can create quite a problem at the exam.

I would like you to always use **the word „year"** in „accounting language" together with an adjective. There is a **calendar and a financial year**. *The calendar year lasts form 1, January until 31, December.* ***Financial year:*** the period on which the report is to be made. The period of the financial year generally corresponds with the calendar year, but not necessarily.

Why is this good for us? Let's see an example. I suppose both of us like melon. (Even if you do not, I would like you to consider this example!) If we were melon growers and we were only involved in nothing but melon growing, then we would certainly begin works with autumn ploughing in November, then we would grow seedlings, would cultivate the land, would bed out the plants and would also employ complicated techniques such as engrafting melon into pumpkin. And at the very end we would finish the procedure by the sales of the late melon in October. Then we can account for what we have gained or what we have lost. In this case our financial year would last from 1, November until 31, October, of which we would like to see the incomes.

We carry out a whole production procedure and we do not have to make any evaluation, estimation by using means of different methods, *only because we are supposed to show specified data to other participants of the market. Thus on the basis of real data, we get and we can also provide a more accurate picture.*

Along these aspects any **entrepreneur is allowed to chose a financial year differing from the calendar year** in case it is justified by the characteristics of the activity (specially the cyclicality of the business and the need for information of the parent company in case of an enterprise drawn into consolidation).

*(**There are certainly exceptions, where the Act does not allow the discrepancy between the financial and the calendar year, such as:***

- the credit institution,
- the financial enterprise,
- the insurance institution,
- enterprises preparing specific simplified annual reports and
- enterprises subject to EVA (simplified corporation tax) if recording in compliance with the Accountancy Act.

The duration of the financial year is generally 12 calendar months but in special cases the period of the financial year may differ from the 12 calendar months:

- enterprises founded without predecessor (pre enterprise),[1]
- **at the time of transition to a financial year different from the calendar year**,
- at the time of transition from a financial year to a **new financial yea**r,
- enterprises **ceasing** by conversion,
- enterprises **incomeing** from conversion,
- at the time of transition from HUF to foreign currency, from foreign currency to HUF, from foreign currency **to another foreign currency,**
- in case of **liquidation, winding up** of the enterprise.

According to the principle of comparability, the **balance sheet date** is important for unified evaluation which is generally 31, December of the current year. But you should note that it is **always the last day of the financial year** and should not forget that in case the duration of the financial year is not 12 calendar months or it does not correspond with the calendar year, the balance sheet date then can differ from 31, December.

The day of depositing and disclosure is primarily intended to satisfy the need for information of the market participants, meaning:

- in case of registered entrepreneurs having double-entry book-keeping, the last day of the 5th month following the balance sheet day of the financial year,
- in case of registered entrepreneurs having double-entry book-keeping, the last day of the 6th month following the balance sheet date of the consolidated report
- in case of reports made on the pre enterprise, the last day of the 3rd month following the balance sheet date.

Day of preparation of the balance sheet: a date – after the balance sheet date of the financial year but before the date of depositing – until which the evaluation work necessary for the reliable and realistic presentation of the financial situation can or must be carried out.

The Accountancy Act does not give the obligatory day – as a certain date – to be used for the preparation of the balance sheet, it will be determined and recorded in the accounting policy by the entrepreneur. The expectation is that the day of the preparation of the balance sheet fall in between the record day and the day of depositing. Depending on the characteristics – size, composition of assets etc. – of the enterprises, the evaluation procedures necessary for the determination of the real value of the assets may be carried out during different periods of time meaning, the date for the day of the preparation of the balance sheet is quite diverse.

7.4 SUMMARY, QUESTIONS

7.4.1 Summary

As you could see, the most important objective of this chapter is that you understand and accept that accounting work is impossible without accounting documents and the principle of documentary evidences should always be respected. Beside document handling, relating dates and periods are also regulated so that the principles of comparability and essentiality could also prevail.

Knowing all this will support your professional reputation.

7.4.2 Self-test questions

Tell in your own words what the following expressions are:

- Accounting document
- Principle of documentary evidences and adherence to rules on documenting
- Financial year
- Balance sheet date
- Day of depositing and disclosure
- Day of preparation of balance sheet
- When are accounting documents to be accounted by the date?
- Until when accounting documents are to be retained?

7.4.3 Practice tests:

		correct answer	wrong answer	wrong answer	wrong answer
1	Financial year:	the period about which the report is prepared	any period chosen by the entrepreneur	the calendar year	minimum 12 months long period
2	Balance sheet date:	last day of the financial year	date of the preparation of the balance sheet	31, December	any day chosen by the enterprise
3	Accounting date of documents of economic events concerning cash movements	at the time of cash movement	any time during the working hours of the cashier	at the end of each month	the 20th of the following month
4	Adherence to rules on documenting	➢ a document is to be made on each economic event ➢ all data of documents of the economic event are to be recorded in the records, ➢ documents duly issued can only be recorded in the records	➢ a document is to be made on each economic event ➢ documents of economic events of the given period only are to be recorded in the records ➢ documents duly transferred can only be recorded in the	➢ a document is to be made on each economic event ➢ data of documents of controlled economic events are to be recorded in the records, ➢ docu ments duly assigned can	➢ a document is to be made on each economic event already executed ➢ data of documents of controlled economic events are to be recorded in the records ➢ docu ments duly

			records	only be recorded in the records	assigned can only be recorded in the records
5	Retention period of accounting documents	8 years	3 years	5 years	10 years

8. THE COMPANY'S ASSETS

8.1 OBJECTIVES AND COMPETENCIES

We have arrived at the most sensitive section of accounting. In effect this chapter is a base concept for "ACCOUNTING ITSELF", which we'll be exploring from all aspects: the **ASSETS**!

What we have seen so far were the regulations governing the broader and narrower expectations, regulations. Now, we are going to learn about the reason these were formed: about the assets of a company.

You won't be enjoying this chapter until you can confidently handle the conceptions, so your task with the help of this chapter is to:

- familiarise yourself and at the same time learn the basic categories and concepts of ***assets***
- familiarise yourself using a different approach with basic accounting features,
- understand that certain fields of accounting comply with specific requirements,
- and the subject and tools of the sub-systems are geared towards these requirements.

Time required: for me at Your age this was the most time consuming part of accounting, more than a hundred (!) hours had to be devoted.

But not all at the same time. I invoked systems theory, divided the assets based on the part-whole relationship, prepared tiny "cribs" about these and whenever I had time – for instance when commuting – I ran the subjects to memorise them.

Eventually, it was this way that I managed relatively quickly and logically to learn the concept and subject matter of assets.

(May I help you prepare a Crib?)

I think you will also need at least 60 hours! And it would be of help if you could print out the balance sheet! Possibly the balance sheet of an annual report, any annual report.

Key expressions:

This will be a good many:

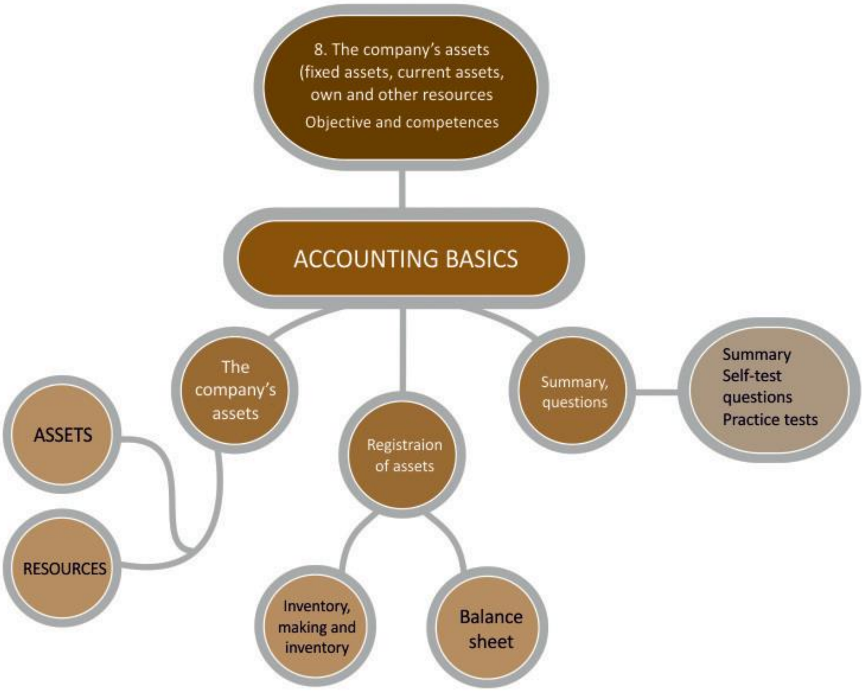
- assets
- balance sheet
- assets

- fixed assets
- intangible assets
- tangible assets
- investments (financial assets)
- current assets
- stocks
- receivables
- securities
- liquid assets
- sources
- shareholder’s equity
- subscribed capital
- subscribed but not paid-up capital
- capital reserves
- accumulated profit reserve
- locked up reserve
- rrevaluation reserve
- retained profit (earnings)
- provisions
- liabilities
- subordinated liabilities
- long-term liabilities
- short-term liabilities
- accruals and deferrals
- inventory

These are merely basic subject-matter concepts and balance sheet main groups and groups.

8.2 THE COMPANY’S ASSETS

The learning chart:



21. Figure

And here is the income: the accountancy act regulates the enterprise's reporting, as well as the matching book-keeping system, which we are able to interpret too.

Let's look at certain categories, concepts.

Concrete manifestations for the entrepreneur's holdings are assets (actual assets). As you could see the assets are all of the resources in possession of the entrepreneur, classified by law as the total of fixed assets, current assets and accrued and deferred assets.

The resources (liabilities) show the origin, background of entrepreneur's assets.

Main groups of resources: the shareholder's equity, provisions, liabilities and accrued expenses.

Every asset derives from some sort of a resource, that is every asset has its source its origin, hence the total assets and total liabilities are identical.

At foundation the assets, the **monetary**, i.e. cash and **non-monetary contributions**, as in our case the bicycles, the garage, and the laptop are provided to the enterprise by the founders. At this point, this relationship is still valid: ***value of assets = value of shareholder's equity*. *It can exactly be followed which asset comes from which source (from whom).***

However, during operation the enterprise's assets are constantly changing, a new bicycle may be bought with the money, Internet, or telephone charges may be settled, but our fledgling entrepreneurs may also buy a new phone that needs only be paid off within 60 days, and until it is settled their payment obligation will exist. This is a commercial credit from outsiders, that is not from their own, but a **foreign source**.

Such a foreign source may for example be a credit, loan, or any such liability where the consideration is settled later.

These items can again be classified according to whether they are short-term or long-term items, i.e. ***short-term***, or ***long-term liabilities***.

While the bicycle business is going ... there are some whose bicycle needs repair, and there are others, who need a new bicycle, ... but in the meanwhile the enterprise also receives bills, such ***liabilities*** that must be settled, such as phone bills, electricity bills, bills of spare parts ordered for the repair of bicycles.

Evidently, the assets are constantly changing!

As time goes by the specific relationship between the assets and liabilities is hardly demonstrable, the precise form, composition and stock of the assets is constantly changing, the permanent source of assets is the assets contributed by the owners, the **equity capital** is relatively stable, undergoing less change, but the foreign sources are constantly on the move.

However, the basic relationship remains constant: the total assets must correspond to total liabilities. The difference is a income of the activity. If the assets are the larger we are profitable, if the liabilities, then we have certainly lost from our assets, thuswise our activity is loss-making.

This is always the retained profit (earnings).

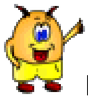
8.3 THE ASSETS

Considering the appearance form, objective character of the enterprise we can talk about assets (honouring the accounting traditions about actual assets).

On the basis of the ***Acc. Act.*** the ***non-current assets, current assets and accrued and deferred assets*** made available to and used by the entrepreneur, serving the activity of the entrepreneur must be shown as assets.

On the basis of designation and usage the assets must be classified as non-current or current assets.

This task – knowing the purpose, foreseeable use of the assets – is to be performed by the entrepreneur. Should the use, function under the original classification change, the entrepreneur is required to reclassify the asset into its correct place.



Print out the balance sheet chart, or spread it out if you already have it, and view it with the syllabus. Immediately the first balance sheet-like type “A” is already good for us!

LET’S GO AHEAD SLIGHTLY, however the marking is important now, for legal requirements:

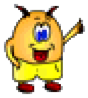
Large print: balance sheet main group
Roman numerals: balance sheet group
Arabic numerals: balance sheet item

Now, we are going to upset the table of contents logic, and follow the markings given on the balance sheet further in this chapter. All this is done to facilitate the learning of balance sheet main groups and groups, so that it is easier to classify the balance sheet items!

Find the mark ”A”! Have you got it? This is the Fixed assets main group.

A) Fixed assets

The ***Fixed assets*** are such assets, which are designed to aid the activity, the operation on a long term, at least for over one year. ***Under Fixed assets the intangible assets, tangible assets and investments should be classified.***



Have you found the “I” mark under “A”?

A./I. Intangible assets

Intangible assets are those non-financial assets (rights representing assets excluding rights representing assets related to property, business value or goodwill) that permanently serve the business activity, as well as advances given for intangible assets and value adjustments for intangible assets according to the law, but – at the discretion of the entrepreneur – the capitalised value of formation, promotion, restructuring and the capitalised value of research and development can also be stated here.

Thus, the items of intangible assets are as follows:

1. Capitalised value of formation, promotion and restructuring
2. Capitalised value of research and development
3. Rights representing assets
4. Trade marks, patents
5. Goodwill
6. Advances given for intangible assets
7. Value adjustment of intangible assets

A./I./*1. Capitalised value of formation, promotion, restructuring*

The ***capitalised value of formation, promotion and restructuring*** represents the costs associated with the start up, taking up, ***significant*** expansion, restructuring, reorganisation of business activity – ***that does not qualify as investment or renewal*** – invoiced by external contractors, as well as direct costs incumbent on prime costs incurred during an enterprise's own activity, which are ***expected to be recovered in revenues*** during the activity following the completion of formation, promotion and restructuring.

If you were to ask what these are: here belong – among others – the costs of activities concerning the quality system implementation, as well as such costs incurred in mineral resource exploration, which can not be taken into account for the related investment or renewal costs, provided that these costs as a income of research activities are expected to be recovered from the exploitation of extracted minerals.

A./I./*2. Capitalised value of research and development*

The ***Capitalised value of research and development***, is an invoiced amount incurred in favour of research and development ***recoverable in sales*** to be utilised in the future when exploiting the income of the capitalised value, and a cost incumbent on the direct prime cost incurred during own activity, which ***cannot be taken into account*** for a capitalised product (intellectual property, tangible assets, stocks)**,** since it exceeds the current value – or expected current value – of the product generated.

A./I./*3. Rights representing assets*

The ***rights representing assets*** are those acquired rights that are not related to property and do not belong to intellectual property.

These are notably:

- the lease rights, if not linked to property, e.g. long-lasting machinery lease rights;
- the right of use, if not linked to property, e.g. long-lasting machinery rights of use;
- asset management rights;
- the right to use intellectual properties;
- the concession rights, if not linked to property, e.g. television and radio frequency rights, gambling rights;
- the gaming rights, that does not belong to concession rights, for example player rights of sportsmen;
- the licences, with their purchase the entrepreneur obtains the right to undertake an activity.
- other rights not related to the property.

A./I./*4. Trade marks, patents*

The trade marks, patents: such long lasting, non-financial assets, by the application (employment) of which material goods and/or non-material goods may be generated.

For intellectual property (trade marks, patents), the accountancy act provides no conceptual definition, only an itemised list.

Its items may be for instance:

- works under industrial right protection (typical items: patents, use samples, design samples, know-how, trademarks, geographical labels, trade names),
- works protected by copyright and related rights (such are typically the software products, technical designs).
- intellectual property not under legal protection, but monopolised due to its secrecy,

…….regardless of whether these have been put to use or not..

A./I./*5. Goodwill*

In case of an acquisition ***Goodwill*** must be shown as an <u>amount of excess payment</u> executed in the hope of a future economic benefit.

What does *excess payment* mean? Excess compared to what?

The goodwill is linked to full or partial acquisition.

Acquisition

The entrepreneur in effect buys the company's assets and assumes its liabilities with a view to employ the purchased assets and the assumed liabilities item by item (full acquisition).

*The entrepreneur buys up the shares, business shares, partners' equities of a given company in order to obtain a **majority of decisive influence** with the partial acquisition (that is at least a 75% share).*

***For the company purchased, or at least for its 75% share one can pay more or pay less than its actual value. If it is for some reason worth more for me than its actual asset value, or its stock market price, then (positive) goodwill will arise, but if I obtain it for less** I will end up with a negative goodwill.*

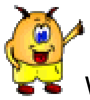
The negative goodwill cannot be shown under intangible assets, but must be listed under accrued expenses, as deferred income.

A./I./*6. Advances given for intangible assets*

The ***advances given for intangible assets*** are the amounts under this title remitted to or possibly paid in cash to creditors, excluding VAT.

The advances on intangible assets actually **represent receivables** against the creditor.

Receivables in the balance sheet are presented under B/II. Debtors (Receivables).



Why don't you find it!

In the balance sheet however the assets must be classified by their designation according to the future status, hence – in compliance with the accounting principles of primacy of content over form, – these should appear among intangible assets.

A./I./*7.* Value adjustment of intangible assets

The **value adjustment of intangible assets:** in case of rights representing assets and for trade marks/patents, insofar as the asset's market value at drawing up the balance sheet significantly exceeds the book value after extraordinary depreciation write-down, a difference can be shown between the two values under this title.

You could well see at international accounting standards that there is strong demand and effort to show the real financial position.

The principle of caution strongly predominates domestic relations. According to this no income can be stated, if its realisation is uncertain, however the loss-like effects should be reported in the books.

According to the principle of individual valuation the assets, liabilities should be evaluated individually at the time of their entry into the books, on preparation of the report. Let's see what this means!

We have an intellectual property, a technical design, which is worth three times of its HUF 5000k registered value on the market. We would also like to see this in the statement of assets.

What can we do? In ***line A./II/.4.*** *only HUF 5,000k can be entered, but for the assets to show the real value* ***the difference of HUF 10,000k can be shown in line A./II/.7.*** *This way, no assets were appreciated, but we followed the requirement for showing the real value, indicators concerning the assets turn out more favourable, which may come useful at borrowing. But everyone loves to look "beautiful"…!?*

This is a constituted asset. ***It too must have a source.***

And it has, the Valuation reserve under D./IV/.

Have you found it?

<u>Only marketable, stable assets can have value adjustment, and the entrepreneur decides whether or not to use the valuation option!</u>

It may even be that it's only worth half of its registered value. Again, we need to proceed by the principle of caution: this is a loss-like item, this must be endorsed. ***Accordingly in line /II/.4 only HUF 2,500 can be shown****.*

A / II. Tangible assets

…..again we'll need a printed out balance sheet! Find the tangible assets! "A" because it's Fixed assets and "II" because we are looking for the main group. What did you find?

Tangible assets are those material assets normally used or installed, such as earth, land, developed land, forests, plantations, buildings, other structures, technical equipment, machinery, vehicles, tools and equipment, other equipment, rights representing assets linked to property and livestock, which directly or indirectly on the long-term serve the activities of the company.

The accountancy act requires the investments, the advances given for investments and the value adjustments of tangible assets to be shown here.

Balance sheet items of tangible assets:

1. Land and buildings and related rights representing assets
2. Technical equipment, machinery, vehicles
3. Other equipment, furniture, fittings, tools, fixtures, vehicles
4. Livestock
5. Assets in course of construction, renewals
6. Advances (Prepayments)
7. Value adjustments of tangible assets

Important! Those ***material assets*** (tools, instruments, equipment, fittings, work clothes, uniforms, protective clothing), which according to the entrepreneur's decision serve the business activities for less than a year – that is not permanently – should before their use not be shown as tangible assets, but as stocks under the current assets.

Even this is regulated in accounting policy!!!

A./II./1. Land and buildings and related rights representing assets

Land is an area of land taken into intended use, as well as every such material asset that has been set up in a long-lasting relationship with land.

The following classify as land:

- the land area
- the plot,
- developed land,
- building, self-contained building,
- other structure
- property outside the scope of the plant.

Rights representing assets related to property:

- land use
- usufruct and use,
- tenancy right,
- easement,
- the right of use acquired on the grounds of payment of contributions – as specified by the law – as a prerequisite for the intended use of the property (water and drainage use

contribution, electrical development contribution, gas distribution network development contribution),
- other rights related to the property.

A./II./2. Technical equipment, machinery, vehicles

Technical equipment, machinery, vehicles normally used and installed, serving the activities of the entrepreneur ***directly***:

- engines
- power plant equipment,
- other machines, equipment,
- instruments and tools,
- means of transportation,
- telecommunications equipment,
- computer technology equipment,
- rail, road, water and air transport vehicles determining the activity profile,
- as well as activated investment or renewal performed on the earlier listed, and leased equipment.

A./II./3. Other equipment, furniture, fittings, tools, fixtures, vehicles

Other equipment, furniture, fittings, tools, fixtures, vehicles are the machinery, fittings, tools, fixtures, vehicles not belonging to normally used, installed technical equipment, machinery, vehicles, which indirectly serve the activities of the entrepreneur.

These are notably:

- the other factory (business) machinery, fittings, tools, fixtures, vehicles,
- equipment, furniture, fittings, tools, fixtures, vehicles outside the scope of the plant, as well as activated investment or renewal performed on the earlier listed and leased equipment.

The classification of tangible assets, technical equipment, machinery, vehicles or other equipment, fittings, vehicles must be carried out when putting them into operation according to whether the given asset is intended to directly or indirectly serve the activity of the enterprise.

Here's an example! Let us be Event Organiser Ltd. We buy two snow-white limousines. One is for the Managing Director, the other is to help us *organise the events. Where do we show these two cars in the balance sheet?*

*The **technical vehicle** will be serving the events, since it is serving a CHOSEN ACTIVITY, while the "boss's" car is also important, but it only serves "other" ends, for example it makes believe that this is a well-run and reliable business, hence it can only be classified, as **other vehicle**.*

A./II./4 Breeding stock

The ***Breeding stock*** are those animals, which are capable during their breeding, raising to produce separable products (population growth, other separable products like milk, wool, etc.), and the **sale of these products, or other exploitation** (draught capacity, guarding task, riding) **ensures the recovery of maintenance costs**, regardless of how long they serve the business activity.

The breeding stock must also be shown here, if their useful life-span – which is their keeping time in breeding – is shorter than one year (e.g. breeding hens are economically reared for 40 weeks). Of the ***breeding stock those cannot be shown*** that are resold by the entrepreneur without keeping them. According to their intended purpose these can be shown under stocks, as these were bought to be resold, so these are ***goods***.

A./II./5 Assets in course of construction, renewals

Among a***ssets in course of construction, renewals*** should be shown the cost of tangible assets not normally used, or not installed, together with the already used – not yet capitalised – cost of works performed on tangible assets related to expansion, designation change, conversion, lifetime extension. The value of acquired, produced tangible assets until their commissioning, or putting to proper use remains within assets in course of construction.

Construction activity is an activity performed for acquisition, creation, and production by one's own enterprise of tangible assets, in the interest of installation, putting to normal use until installation, putting to normal use of acquired tangible assets. (Among others the transport, customs clearance, mediation, foundation, installation costs, as well as all the activities, which can be linked to the acquisition of tangible assets, including the planning, preparation, implementation, cost of credit requisition, and the insurance fee too).

Construction in also an activity incomeing in the expansion, designation change, or conversion of the existing fixed assets, intended to directly extend its lifetime, performance, together with other activities listed above that can be linked to these activities.

Renewal is such a periodically repeated activity designed to restore the original state (capacity, accuracy) of the consumed tangible assets that by all means entails that the life of the given assets is extended, their original technical condition, performance is approximately or fully restored, or improved, the quality of the product made is improved or the use of the given assets is significantly improved and thus out of the ***additional renewal expenditures future economic benefits are realised.***

A./II./6 Advances (prepayments)

Advances (prepayments) the amounts – not containing the deductible previously charged value added tax – remitted (paid in cash) under this title to the investment supplier, to the entrepreneur performing the import purchases to the vendor of rights representing assets related to property.

A./II./7. Value adjustment of intangible assets

Value adjustment of intangible assets: the principle is the same as shown for intangible assets: in case of tangible assets installed and normally used, insofar as the asset's market value at drawing up the balance sheet significantly exceeds the book value after extraordinary depreciation write-down (net value determined by taking into consideration the planned depreciation write-off), a difference can be shown between the two values under this title.

A./III. Investments (Financial assets)

Investments (Financial assets) are those assets (shares, securities, loans, long-term bank deposits), which the entrepreneur has invested with other entrepreneurs, or yielded to other enterprises to realise with them a lasting income (dividends and interest), or to achieve influencing, management, or control opportunities.

Items of investments (financial assets):

1. Long-term participations in affiliated undertakings
2. Long-term credit to affiliated undertakings
3. Other long-term participations
4. Long-term loan to other affiliated undertakings
5. Other long-term loans
6. Securities signifying a long-term creditor relationship
7. Value adjustment of financial investments
8. Valuation difference of financial investments

Let us recap before continuing:

Tell us what does an affiliated undertaking mean?

<u>more than 20% ownership stake.</u>

Then, the other participation relation covers participation under 20%!

A./II./1. Long-term participations in affiliated undertakings

Long-term participations in affiliated undertakings should be shown in a balance sheet item as investments[3] signifying participations in affiliated undertakings that ensure long-term influencing, management, or control opportunities.

A./II./2. Long-term credit to affiliated undertakings

The ***long-term credit to affiliated undertakings*** balance sheet item contains those money loans, long-term bank deposits, where fulfilment of payment requests in monetary form and the deposit liquidation is not yet due in the financial year following the year under review.

A./II./3. Other long-term participations

The ***Other long-term participations*** balance sheet item contains all investments signifying ownership participation, which serves the long-term interests of the company, but is not in affiliated undertakings.

A./II./4. Long-term loan to other affiliated undertakings

The ***Long-term loan to other affiliated undertakings*** balance sheet item includes money on loan and long-term bank deposits against the debtors with other affiliated participations.

A./II./5. Other long-term loans

As ***Other long-term loans*** should be shown the money on loan and long-term bank deposits of debtors without affiliated participations, but a typical example here is financial leasing.

A./II./6. Securities signifying a long-term creditor relationship

As ***Securities signifying a long-term creditor relationship***[4][11] should be shown those securities purchased for investment purposes, the

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[3] ***Investments signifying ownership participation:*** all securities produced in printing or dematerialised, as well as any security, deed representing a right classified by the Acc. Act, wherein the ***issuer*** acknowledging the taking of ownership, or putting to use of a specific amount of money, or non-monetary assets assigned in money value, ***engages itself*** to guarantee to the holder of such security, deed certain ***asset related and other rights***.

- These include in particular:
- shares, business shares, proprietary shares,
- property notes, property deposits,
- investment tickets issued by an open-ended investment fund,
- venture capital tickets, venture capital shares.

[4] *Securities signifying creditor relationship:* all securities produced in printing or dematerialised, as well as any security, deed representing a right classified by the Acc. Act, wherein the issuer (debtor) acknowledging the placing of a certain amount of money at disposal engages itself to pay and make good the amount of money (loan), as

maturity and redemption of which is not yet due in the financial year following the year under review, and the entrepreneur does not intend to sell them in the year following the financial year.

A./II./7. Value adjustment of financial investments

Under ***Value adjustment of financial investments*** only (!!!) a significant difference between the market value at drawing up the balance sheet and the actual cost of participations (exceeding their cost) can be shown.

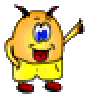
The ***classification*** of securities, participations, loans, bank deposits owned by the enterprise ***depends on the decision of the enterprise***. The accountancy act defines the classification aspects, on the basis of which the assets invested may be categorised as investments (financial assets), but essentially those that ***serve the business activities beyond one year***. If this aspect is no longer present, the asset should be ***transferred*** into the current assets. On drawing up the balance sheet, among current assets should be shown (transfer is optional) the part of investments (financial assets) due within one year. (E.g. bonds maturing within one year, long-term bank deposits maturing within one year, repayment portion of bonds due within one year, etc.).

A./II./8. Valuation difference of financial investments

In the case of valuing the assets at their real value, the difference between the real value and the book value.

Real valuation is beyond fundamentals, if you are interested, do look up in specialised books, but it's not part of our syllabus this time!

B Current assets



now find the current assets in the printed out balance sheet! Have you got it?

---

well as any interest or yield calculated in a particular manner to the holder of the security (creditor) at the time and manner. indicated.

- These include in particular:
- bonds, treasury notes, deposit slips,
- certificate of deposit, proprietary share, savings certificate,
- mortgage bond, bill of lading, warehouse dock,
- docket, certificate of pledge, compensation note,
- investment tickets issued by a closed-ended investment fund.

Current assets are those assets that serve the business activities for less than a year, therefore **not for long-term**.

Under the ***current assets*** should be classified the stocks (inventories), receivables not permanently serving the business activity, securities signifying creditor relationship, investments signifying ownership participation, and liquid assets.

Groups to be shown in balance sheet:

Stocks (inventories),
Receivables,
Securities,
Liquid assets.

B/I. STOCKS (INVENTORIES)

Stocks (inventories) are such assets directly or indirectly serving the business activity:

- which will be used during the making of the product to be sold or service to be rendered **(raw materials and consumables**).
- which, prior to sale are either in the phase of production, or processing (**goods in process, semi-finished product**), or are waiting to be sold as processed/ completed (**finished products**);
- which in the framework of regular (standard) business activity are obtained with the purpose of selling, and they remain in the same state between the purchase and the sale, although their value may change (**goods, empties, relayed services**).

Other stocks (inventories) by the law:

- until putting to use, those material assets (tools, instruments, equipment, fittings, work clothes, uniforms, protective clothing), which serve the entrepreneur's business activities at most for one year;
- the young (animals), rearing and other animals, regardless of how long they serve the business activity;
- the assets transferred from fixed assets
- from the date of putting to use those assets produced with the purpose of selling, which the entrepreneur put into use temporarily until their withdrawal from stocks, should be shown as **goods**.

Balance sheet items of stocks (inventories):

1. Raw materials and consumable goods
2. Work in progress and semi-finished products

3. Animals for breeding and fattening and other livestock
4. Finished goods
5. Goods
6. Advances (Prepayments)

According to their origin the items of stocks (inventories) can be divided into purchased and self-produced stocks.

Purchased stocks includes all stocks that were not made by the entrepreneur, which usually became the property of the entrepreneur by purchase (procurement). The law also interprets special cases. The non-monetary deposit (contribution in kind) also qualifies as purchased stock given by the founders in the company, regardless of what origin – purchased or self-produced – the stocks were, as well as stocks received free of charge, as a gift, bequest, and accepted for exchange as an asset in return for the termination of ownership.

Under the balance sheet items for purchased stocks come the raw materials and consumable goods, goods and advances (prepayments).

B./I./1. Raw materials and consumable goods

The **raw materials and consumable good**s are purchased stocks:

- which the entrepreneur has purchased to make the products, or to render services,
- which lose their shape during the making of the product, or rendering of the service, their value appears in the value of product made or service rendered, they generally take part in the activity process once or possibly several times.
- the wear and tear time in every case is under one year.

Its types:

- raw and basic materials (they make up a significant part of the product made or service rendered),
- consumables (constitute the secondary elements of the product made or service rendered),
- propellants and fuels (in general needed for the running, operation of tangible assets),
- maintenance materials (for the repair, maintenance, replacement of worn parts, accessories necessary for spare parts and accessories, replacements, repair materials, lubricants, etc. of the entrepreneur’s assets).

- construction materials (materials necessary to serve the investment, renovation and maintenance goals of the construction activity),
- material assets (fixtures and fittings, tools, production tools, work clothes, uniforms, protective clothing and equipment, etc. used for a period not exceeding one year),
- other materials (umbrella term, includes: packaging materials, forms and stationery, culinary materials, materials necessary for research and development, materials aiding the welfare – the social, cultural and sporting – activities, etc.).

The self-produced stocks are those stocks that were made, produced by the entrepreneur.

- The self-produced stocks include:
- work in progress and semi-finished products,
- animals for breeding and fattening and other livestock,
- finished goods.

The level of readiness for self-produced stocks is determined by the enterprise, and classifies it accordingly into the work in progress, semi-finished products or finished products, which are placed in the balance sheet based on this.

B./I./2. **Work in progress and semi-finished products**

Work in progress are considered to be those products under processing, or awaiting further processing, on which at least one considerable work operation has been carried out.

It follows from the essence of work in progress that the entrepreneur does not disclose it during the year, the stock taking of work in progress is feasible typically at the close of the year, based on the inventory compiled about work in progress.

Semi-finished products are all products of the entrepreneur that went through a complete work process, were taken as a semi-finished product to warehouse, or could be taken to warehouse, but couldn't be rated as finished products (at least one work operation needs to be performed on them).

Since owners of the business deal with bicycles, now I would like to mention one example about this.

If an enterprise makes bicycles, it usually does this so that different working groups perform one particular task. In our case, we employ four groups.

Bicycles need a frame, wheels and drive. One group only makes frames, the other wheels, the third only makes gearshifts, pedals and whatever else is needed for the drive. Everyone makes their own product into „finished", but compared to the bicycle these are simply parts, what accounting recognises as ***semi-finished product****. When the frame is completed it is not even "half" of the bicycle, yet it can be kept on stock, even sold, that is to say it has gone through an esteemable process in terms of accounting. And that is the point:* ***the semi-finished product is an independently appraisable unit of the finished product.***

While it is being ***assembled****, for instance the wheel in the first group, the gearshift in the second, the frame being painted in the third, until then we talk about* ***semi-finished product****s. By the time the incomes of partial processes in the manufacturing process become deliverable for assembly, or may perhaps even be sold, then these will become* ***semi-finished products****. When the fourth group assembles the bicycle frame, wheels and gearshift, than we can talk about* ***unfinished goods****. When wrapped up it waits to be shipped by the buyers, it becomes a* ***finished product****.*

It may also be the case that our business only makes gearshifts. In this case the gearshift would be a finished product. You know much better what could be a semi-finished product with a gearshift!

B./I./3. **Animals for breeding and fattening and other livestock**

The ***animals for breeding and fattening and other livestock*** are specific stocks, since as a income of production costs the breeding and fattening animals grow (their weight is increasing). For breeding and fattening animals bought for rearing it cannot be set apart, and recorded separately that out of the breeding and fattening base material purchased during the year, available on the balance sheet accounting day, which part of the animal was purchased and which part was fattened up by the entrepreneur. Consequently, the animals bought for rearing must be classified under the self-produced stocks.

– B./I./4. Finished goods

Finished goods are products placed on stock, received after relevant quality standards, and those that can be sold as finished goods.

– B./I./5. Goods

The ***commercial stocks in hand*** must be shown ***amongst the goods***, which the enterprise usually obtains with the purpose of selling, and passes on in unaltered state. In accordance with the accountancy act the ***relayed services*** up to reinvoicing and also the ***empties*** should be shown under the goods.

The **commercial goods** are products owned by the enterprise, and usually purchased with the aim to be resold (marketed) in unaltered state.

Relayed service: a service purchased by the entrepreneur in its own name and based on a contract concluded with a third person (the customer), as specified in the contract in whole or in part, but resold (reinvoiced) in unaltered state. With a relayed service, the enterprise is both a buyer and a seller of the service. The entrepreneur wholly or partly relays the purchased service, in such a way that the prospect of relay from the contract concluded with the customer, while the act of relay itself from the invoice can be clearly established (namely, that the entrepreneur sells not only his own, but the purchased service too in unaltered state, but not necessarily at the same price).

Empties, all the packaging material and vessels protecting the products from damage during transport and which can be reused several times in accordance with its intended purpose (bags, pallets, crates, boxes, bottles etc.), furthermore regarding which the issuer has a **redemption obligation** (deposit).

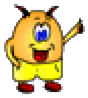
Again, we need to stop for a moment!

*Accountancy only handles the concept of **goods** in this respect. It is very often the case at examinations that based on their knowledge students say that an enterprise produces goods, what is probably acceptable in an Entrepreneurship course, but not in Accountancy.*

Now remember: everything that we buy in order to sell is goods. Anything, be it a country, prince or its horse, if it is bought to be sold represents GOODS. But, if I manufacture it, produce it, put it into its final state prior to sale, then it is a FINISHED PRODUCT, if it has only undergone one activity, a semi-finished product.

B./I./6. Advances (Prepayments)

As Advances (Prepayments) should be shown the amounts – not containing the deductible previously charged value added tax – remitted under this title to the supplier of material, deliverer of goods, provider of relayed service, entrepreneur executing import purchases.

 now find the Receivables in the printed out balance sheet! Have you got it?

B./II. RECEIVABLES

Receivables under the accountancy act are legitimate ***payment requests*** expressed in money value incomeing from a variety of transportation, business, service and other contracts, which are linked to payment requirements already performed by the entrepreneur, and approved by the other party, such as to recognised product sale, rendering of service, sale of securities, lending, down payments and to various others.

 Do remember the essence: the **receivables is a request for payment** !!!

The items of receivables:

1. Receivables from customers (trade debtors)
2. Receivables from affiliated undertakings
3. Receivables from other associated undertakings
4. Bills (drafts) receivable
5. Other receivables
6. Valuation difference of receivables
7. Positive valuation difference of derivative instruments

B./II./1. Receivables from customers (trade debtors)

All receivables from sale of products, rendering of services already performed by the entrepreneur, and approved by the purchaser, which exists not against affiliated undertakings or other associated undertakings, and furthermore it does not constitute a long-term money loan.

B./II./2. Receivables from affiliated undertakings

Those receivables, whereby the debtor is an affiliated undertaking and the receivables do not constitute a long-term money loan.

The feature of the balance sheet item is that it can contain accounts receivable, bills receivable and other receivables, as long as they are against affiliated undertakings.

B./II./3. Receivables from other associated undertakings

Those receivables, whereby the debtor is another associated undertaking and the receivables do not constitute a long-term money loan.

This balance sheet item – similarly to the previous one – can likewise contain accounts receivable, bills receivable and other receivables, as long as they are against other associated undertakings.

B./I./4. Bills (drafts) receivable

Bills (drafts) receivable are special short-term securities signifying a pecuniary (money) claim, against non-associated undertakings. The bills (drafts) receivable signify a money loan against bills receivable. The beneficiary of the loan is the so-called bill debtor, who is the issuer of a bill.

The lender, is the loan provider, whose books include the bills receivable. Since the maturity of the bill is a maximum of one year, bills receivable is always a current asset.

B./I./5. Other receivables

As other receivables must be shown in the amount to be paid:

- the employee debt,
- the refundable tax,
- the requested but not yet implemented assistance,
- the short-term funds lent,
- the instalments due within one year of the balance sheet date from the long-term loans,
- the purchased receivables,
- the receivables taken over free of charge and under other title, legally binding receivables from litigation awarded by the court before the balance sheet date.

B./I./6. Valuation difference of receivables

In the case of valuing the assets at their real value, the difference between the real value and the book value. *But we won't be dealing with this in this syllabus!*

B./I./7. Positive valuation difference of derivative instruments

An item related to valuing the assets at their real value. *Neither with this.*

Receivable-like items in the balance sheet can also be found at other places (other balance sheet line). These items in compliance with the "Primacy of content over form" accounting principle are placed where they contextually actually belong to.

Let's look at the balance sheet again! Find the examples!

These are:

- the advances, in truth receivables, but we show them for what they were given out, as in fact they "already are a bit" (advances given for intangible assets for domestic animals, those given for tangible assets support the investments, for advances (prepayments) it is often the case that shipment does not commence until the deposit has been paid.),
- the long-term loans (should be placed under investments (financial assets) if given for a period of over one year),
- certain cases of the accrued and deferred assets (interest due, income due, all that is due, but we didn't receive it yet),
- the subscribed but not paid-up capital, is part of the subscribed capital that the owners have not provided yet for the business.
- the bank deposits (invested financial assets, liquid assets, according to what time-span they cover).

B. /III. SECURITIES

Pull out the balance sheet again and find the B./III. group!

After the investments (financial assets) there is not a lot to be learnt, merely the characteristics.

Among the current assets, as ***securities*** should be shown the securities for trading purposes, purchased for short-term investment, signifying creditor relationship or ownership participation.

Items of securities:

1. Participations in affiliated undertakings
2. Other participations
3. Own shares and own partnership shares
4. Securities signifying a creditor relationship for trading purposes
5. Valuation difference of securities

The most important related concepts (investments signifying ownership participation, securities signifying long-term creditor relationship) were discussed at investments (financial assets). ***It may be useful to read through descriptions therein again.***

B./III./1. Participations in affiliated undertakings

Securities signifying ownership participations in affiliated undertakings purchased for trading purposes, usually for profit taking: shares, partnership shares, property deposits.

B./III./2. Other participations

All investments signifying ownership participation, purchased for trading purposes, which do not belong to ownership participations in affiliated undertakings.

B./III./3. Own shares and own partnership shares

Investments signifying ownership participation in own enterprise, redeemed by the entrepreneur (or otherwise acquired).

B./III./4. Securities signifying a creditor relationship for trading purposes

Those securities that are acquired by the enterprise for trading purposes and to achieve interest income, profit taking, furthermore those should be shown in the balance sheet that mature in the fiscal year following the year under review, as well as instalments due in the fiscal year following the year under review for securities signifying a creditor relationship shown among investments (financial assets).

These also include discount securities for trading purposes.

B./III./5. Valuation difference of securities

In the case of valuing the assets at their real value, the difference between the real value and the book value.

Shares and securities signifying creditor relationship are always bought by the entrepreneur with a purpose. If the **primary aim** is to achieve interest, dividends or share, as well as to influence, management voting rights, then the given securities should be classified under **Investments** (Financial assets). If the objective is profit taking, then such securities should be classified under the current assets.

See: the difference is essentially dependent on the entrepreneur's classification.

B./IV. Liquid assets

The l***iquid assets*** are shown among current assets as long-term uncommitted assets appearing as HUF, currency and foreign currency to be used for payment, including the electronic monetary assets too. The liquid assets include cash, electronic money and cheque, and additionally also the bank deposits.

Balance sheet items of liquid assets:

1. Cash, checks
2. Bank deposits

B./IV./1. Cash

The ***cash*** (petty cash) serves for implementation of the entrepreneur's cash payments and for the handling of the necessary sums of cash, together with the direct inflow of cash income.

Currency cash usually serves for the settlement of cash flow at the entrepreneur's foreign branches, workplaces. The foreign instruments of payment in the currency cash must be shown separately, broken down by currency.

Under ***cheques*** should be recorded the cheques accepted from the customer or other, e.g. letters of credit, the HUF value of a traveller's cheque.

B./IV./2. Bank deposits

The running of ***settlement deposit account*** serves the settlement of the entrepreneur's cash flow.

The entrepreneur is required – with the exception of funds for the purpose of cash payments – to keep its funds in a bank account, handle its cash flow through a bank account, and to this end to conclude a bank account contract.

The entrepreneur may for specific purposes allocate (or be required to allocate) some liquid assets with the credit institution. The ***separate bank accounts*** and their circulation are guided by separate contractual conditions. It includes: interest-bearing deposits, liquid assets from bond issue, liquid assets allocated for development purposes, liquid assets allocated for other purposes, housing deposit account.

The entrepreneur allocates its funds available in foreign currency in a ***foreign-exchange deposit account***.

Modern forms of payment have introduced new concepts you will most likely need in your work, but even in your private life.

Electronic money: *monetary value stored on electronic monetary instrument, issued against cash withdrawal and account money remittance, which is also accepted for electronic payment by others than the issuer.*

Electronic funds: *such cash-replacement means of payment – especially a value storage card, computer memory – which serves as an electronic money storage, and with which the customer can directly perform payment transactions.*

The electronic money (e-money) is a specific electronic payment instrument. The e-money like the banknotes and coins may be used to purchase goods and services in stores, shopping centres and in other places.

The e-money is capable of fulfilling all the functions of the physically existing money: it can be used for purchases, redeemed for physical money and even be exchanged. By fitting the card in the right place it can be used just the same in the physical world, as in the world of virtual technologies, without requiring a physical connection via the Internet, using a computer or a mobile phone.

The e-money can appear on many different electronic assets – electronic wallet – (magnetic tape, chip, etc.), and can be downloaded either from an automated teller machine (ATM) or with the most commonly used asset in recent times, the mobile phone from the Internet.

C. ACCRUED AND DEFERRED ASSETS

The ***accrued and deferred assets*** constitute a special tool group with entrepreneurs using the double-entry book-keeping, as a income of employment of the comparison principle and the principle of accruals.

The revenues and expenses (costs) should be credited or debited to the earnings income during the period in which they are economically incurred, regardless of their financial settlement, or whether they are invoiced or not invoiced. In enforcing the previous the accrued and deferred assets (and accrued expenses) play a role.

Items of accrued and deferred assets:

Accrued income

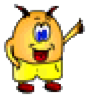
Accrued expenses

Deferred expenses

The accruals may be active or passive. I would like to show the gist of it in the next animation!

8.4 SOURCES (EQUITY AND LIABILITIES)

The origin, background of the company's assets is revealed by the sources, what is mentioned in a number of specialised literature as liabilities. Main groups of the sources: the shareholder's equity, the provisions, the liabilities and the accrued expenses.


now find the Sources page in the printed out balance sheet! Have you got it? And the Shareholder’s equity?

D.) SHAREHOLDER’S EQUITY

The ***shareholder’s equity*** is an own source placed – without time restrictions – at the enterprise’s disposal by the owners, or rather left with the entrepreneur following earnings after tax, a source freely available to the entrepreneur.

Items of shareholder’s equity:

I. Subscribed capital
II. Subscribed but not yet paid-up capital (–)
III. Capital reserves
IV. Accumulated profit reserve
V. Locked up reserve
VI. Rrevaluation reserve
VII. Retained profit (earnings)

D./I. Subscribed capital

The ***subscribed capital*** corresponds to the value of those assets placed at the company’s disposal by owners, investors, founders of the organisation when establishing the enterprise, raising its capital, which the investors made available to the company in order to obtain membership rights, ownership participation, or rather to increase it, and to benefit from the realised earnings in the form of dividends or shares.

According to company law, an enterprise is formed with incorporation, thus only the capital recorded at a Registry Court can be shown as subscribed capital, simultaneously with the registration.

D./II. Subscribed but not yet paid-up capital

According to the relevant laws it is not mandatory to immediately pay up the subscribed capital in full, what has not yet been made available for the enterprise is to be shown on this line. Until it is delivered, it in effect represents receivables versus the owners, but it still cannot be found in group B/II.

The ***subscribed but not yet paid-up capital*** is not yet an operating asset, therefore according to international accounting practices, it should be presented – with a negative sign – within shareholder’s equity, the subscribed capital being the modifying item.

The difference between the subscribed capital and the subscribed but not yet paid-up capital shows the actual ***working capital***.

The **assets cover** beyond the **subscribed capital** (primary, nominal capital) shall mean the shareholder's equity amount reduced by the subscribed capital, locked up reserve, and rrevaluation reserve.

D./III. Capital reserves

The ***capital reserve*** is a variable capital value regardless of the profitability of the business activity.

The owners make available the capital reserves to the established organisation permanently on foundation and at a capital increase, by transfer of funds or other assets. Beyond this, the capital reserves under the pretexts specified in the accounting law may increase, as well as decrease.

D./IV. Accumulated profit reserve

The ***accumulated profit reserve*** shows the accumulated amount of retained profit (earnings) for the business activity pursued in the years preceding the year under review. Insofar as the accumulated profit reserve is negative, it shows an accumulated loss reducing the shareholder's equity, if it is positive, then it shows an asset growth as a income of the activity.

D./V. Locked-up reserve

The locked up reserve includes the amounts locked up from the capital reserves and the accumulated profit reserve, and the amount of additional payment. These amounts are allocated by the entrepreneur based on statutory provisions, and on their own decision.

The locked up reserve has significance when calculating dividend payment, this part of the shareholder's equity does not provide cover for dividend payment and it can be considered as a limit on calculating the dividend.

D./VI. Rrevaluation reserve

The accounting act allows the valuation of fixed assets by the market value for enterprises using double-entry book-keeping, even in cases, if the market value of the asset included into the individual valuation is higher than the net book value.

The **amount of rrevaluation reserve** determined on the basis of market value **must be shown as value adjustment**. The rrevaluation reserve and value adjustment can only and exclusively change against each other and in the same amount.

The accountancy act imposes liability upon certain entrepreneurs, and provides others an opportunity with regard to valuing assets at their real value. This part of the rrevaluation reserve is the source of settled valuation differences inside the shareholder's equity, value adjustment is such an own asset that produces rrevaluation reserve.

So, rrevaluation reserve constituents are:

Rrevaluation reserve of value adjustments

Rrevaluation reserve of real valuation.

The rrevaluation reserve of value adjustments and the value adjustment, together with the rrevaluation reserve of real valuation and the revaluation difference, can only and exclusively change against each other and in the same amount. The other parts of the shareholder's equity cannot be supplemented against the rrevaluation reserve, no liabilities can be accorded against it.

D./VII. Retained profit (earnings)

The ***retained profit (earnings)*** is profit after tax for the year, increased by the accumulated profit reserve utilised for dividends, shares, interest on interest-bearing shares, and reduced by the approved dividends, shares, interest on interest-bearing shares, corresponding to the amount shown under this title in the operating statement.

E. Provisions

The ***provisions*** are assets constituted against profit before tax, providing cover for liabilities, expenses, costs incomeing from the current period, but probably arising in the forthcoming year or years.

The items of provisions:

1. Provisions for expected liabilities
2. Provisions for future expenses
3. Other provisions

The constitution of provisions follows from the principle of caution, according to which, "In the course of determining the profit for the current year the foreseeable risks and potential losses should be taken into account by settlement of depreciation and constitution of provisions, even if it becomes known between the balance sheet accounting day of the fiscal year and the balance sheet date."

Against profit before tax, **provisions have to be set** up for those payment obligations from the past, or for actual transactions, contracts with third parties, which on the balance sheet accounting day presumably or certainly exist, but their amount or due-date is still uncertain and for those the entrepreneur has otherwise not provided the necessary cover for.

Against profit before tax, **provisions may be set** up for such probable, significant and periodically repeating future expenses (especially for maintenance and restructuring costs, costs related to environmental protection) about which on the balance sheet accounting day it can be assumed or it is certain that they will arise in the future, but the amount or time of their emergence is still uncertain and which cannot be classified under accrued expenses.

Provisions for regular and ongoing expenses incurred in the normal course of business activity cannot be set up.

Hearing the word "Provision" may make us think that it's about "hiding something in the straw bag". The majority of students also imagine that we are setting some money aside.

*Provisions however **prevail via the effect over the profit (earnings)**. Let's think it over together!*

There is an office building that is painted for HUF 1,000,000 every 5 years. In every 5th year we get an invoice, which settled up as an expense reduces the profit (earnings) by one million. It may well be that we'll be loss-making in every 5th year. This may also worsen our borrowing position, in some cases we may have to pay a higher interest to obtain a loan...!

Let's face it this decoration is an „issue" for 5 years, thus its impact must also cover 5 years.

There is no contract or invoice, the exact amount is not known, so the endorsement of accruals is not an option. By setting up provisions there is a way to settle the planned amount in 5 instalments, that is HUF 200,000 annually against the profit (earnings) as expenditure.

1st year: we settle HUF 200k as provisions for other expenses: profit decreases by HUF 200k

2nd year: we settle HUF 200k as provisions for other expenses: profit decreases by HUF 200k

3rd year: we settle HUF 200k as provisions for other expenses: profit decreases by HUF 200k

4th year: we settle HUF 200k as provisions for other expenses: profit decreases by HUF 200k

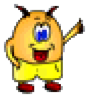
5th year: an invoice is received for HUF 1,065, 000 that will be expenses, and hence a profit mitigating item.

- *The settled provisions are dissolved, as + HUF 800,000 other income: profit increases!*
- *The invoiced, settled expenses HUF –1,065,000 profit reduces!*

Thus, the actual impact on profit in the 5th year is HUF 265,000!

If the amount invoiced is more, or less, it can be corrected in the last year, but still the expense is more proportionate for the years in question, and not all of the expenses are charged over one fiscal year's profit, but each and every "expense-producing" year takes its share.

F. LIABILITIES


now find the Liabilities in the printed out balance sheet!
Have you got it?

Liabilities are those ***recognised debts*** expressed in terms of money value and arising from transportation, business, service and other contracts, which are linked to assets that are already performed by the supplier, entrepreneur, service provider, creditor, lender, for the recognised, acknowledged transport, service, money provision, as well as to handling the assets constituting part of the treasury assets.


Do remember the essence:
Liabilities are recognised debts!!!

Groups of liabilities:
I. Subordinated liabilities,
II. Long-term liabilities
III. Short-term liabilities

F./I. Subordinated liabilities

The subordinated liabilities are such obtained loans:

- which the entrepreneur may include into its debt settlement,
- in the order of repayments it stands before the owners at the last place, in case of entrepreneur's liquidation or bankruptcy it is only settled after paying off other creditors.
- the repayment deadline of the loan is either indeterminate, or it depends on future events, but its original duration period is more than five years,
- repayment of the loan before the due date or expiry of the contractual notice period is not possible,

Items of subordinated liabilities:
Subordinated liabilities against affiliated undertakings
Subordinated liabilities against other associated undertakings

Subordinated liabilities against other enterprises.

F./II. LONG-TERM LIABILITIES

Long-term liabilities – according to a contract concluded with the creditor – the loan and credit obtained for a term exceeding one financial year (including a bond issue too), with the deduction of repayments due within one fiscal year following the balance sheet accounting day, as well as other long-term liabilities.

Items of long-term liabilities:

1. Long-term loans
2. Convertible bonds
3. Debts on issue of bonds
4. Investment and development credits
5. Other long-term credits
6. Long-term liabilities to affiliated undertakings
7. Long-term liabilities to other associated undertakings
8. Other long-term liabilities

F./II./1. Long-term loans

The ***long-term loans*** is the sum of loans obtained by the enterprise from other companies (not from a credit institution) private individual for a term of over one year.

F./II./2. Convertible bonds

Separately from the long-term loans should be shown the liabilities owing to ***convertible bonds*** (into shares). A convertible bond is a special type of bonds. Convertible bonds may be issued by public (incorporated) companies. The convertible bond may on request of the bond owner be transformed into shares.

F./II./3. Debts on issue of bonds

The ***debts on issue of bonds*** are liabilities existing against the owners of (other not convertible) bonds issued by the entrepreneur. Bonds can be issued by organisations authorised to do so by the relevant legislation. By issuing bonds the entrepreneur can obtain borrowed sources.

The bond issuer is the debtor, the buyer of the bond is the lender. The issuer of bonds repays the amount of money from the issue of bonds at a predetermined time, together with any interest due.

F./II./4. Investment and development credits

The ***Investment and development credits*** are credits for investment and development purposes given by credit institutions. The creditworthiness criteria, terms of the credit agreement (e.g. duration, date of expiry, rate if interest earned, etc.) are determined by the credit institutions based on the applicable regulations.

F./II./5. Other long-term credits

The ***other long-term credits*** received from credit institutions not for investment or development purposes are loans for a term of over one year.

B./II./6. Long-term liabilities to affiliated undertakings

On the ***Long-term liabilities to affiliated undertakings*** balance sheet line should be shown those long-term liabilities, where – in accordance with a contract concluded with an affiliated undertaking, as creditor – the expiration of payment obligations expressed in money value exceeds one year, including other liabilities due to convertible bonds, furthermore those from the issue of other bonds, if the financial settlement of those is not due yet in the year following the year under review.

F./II./7. Long-term liabilities to other associated undertakings

On the ***Long-term liabilities to other associated undertakings*** balance sheet line should be shown all those liabilities with a due-date exceeding one year against creditors of other associated undertakings (under 20% of ownership), for which the financial settlement is not due yet in the year following the year under review (long-term credits and loans, liabilities arising from convertible and other bonds, other long-term liabilities).

8) Other long-term liabilities

Among ***other long-term liabilities*** should be shown all those long-term liabilities, which cannot be classified under the previous items.

According to the law as Other long-term liabilities should be shown in case of the lessee the financially leased liability, corresponding to the asset invoiced by the lessor (or the vendor instead) as investment, as well liabilities linked – on the basis of a statutory provision or authorisation – to management of state- or municipal owned assets.

F./III. Short-term liabilities

Short-term liabilities are loans, credits not exceeding a due date of one fiscal year, including of the long-term liabilities the repayments due within one fiscal year following the balance sheet accounting day. As short-term liabilities usually include advances received from the purchaser, liabilities arising from the supply of goods and rendering of services, bill debt, dividends paid, shares, interest paid after interest-bearing shares, as well as other short-term liabilities.

Its items in the balance sheet:

1. Short-term credits
2. Short-term loans
3. Advances received from customers
4. Trade creditors (accounts payable)
5. Bills payable
6. Short-term liabilities to affiliated undertakings
7. Short-term liabilities to other associated undertakings
8. Other short-term liabilities
9. Valuation difference of liabilities
10. Negative valuation difference of derivative instruments

F./II./1. Short-term credits

The ***Short-term credits*** are the entrepreneur's short-term credit obligations (repayable within one year) against other entrepreneurs, private individuals (i.e. not credit institutions). In the balance sheet on a separate line – as informative data – should be shown the liabilities due within one year arising from a ***convertible bond issue***. In this balance sheet line should be entered the repayments for liabilities due in the year under review following the accounting day arising from long-term credits and a bond issue.

F./II./2. Short-term loans

The ***short-term loans*** are the entrepreneur's liabilities towards credit institutions arising from loans provided for maturity of less than one year. In this balance sheet line should be entered the repayment part of long-term loans due in the year under review following the accounting day.

F./II./3. Advances received from customers

The a***dvances received from customers*** are such funds remitted, paid by customers with regard to which the performance under the contract has not taken place yet. By the principle of gross settlement it should be shown as a liability. The received advances under this title should be shown under liabilities, until the performance under the contract, the product sale, rendering of the service takes place, or fails, or it is settled by some other means.

F./II./4. Trade creditors (accounts payable)

The ***trade creditors (accounts payable)*** are liabilities – previously billed by other entrepreneurs – arising from the supply of goods and rendering of services by other entrepreneurs including value added tax too, in the amount recognised and accepted by the entrepreneur.

The liabilities against trade creditors can feature in the records, and thus in the balance sheet too, as long as they are financially settled, levelled off with a bill, or possibly withdrawn as cancelled liability.

One of the most frequent errors is that the liability against the suppliers among the liabilities, and against the trade debtors are often mixed up by the students. This is due to the fact that concepts are mixed up at the beginning of their studies. It can often be heard that the customer's obligation is to pay the bill. And this is true, but this is a liability from the customer's viewpoint, that he needs to enter into the books, it doesn't concern us.

However, we delivered the product, goods, services and we "demand" the cost for it, we have a request for payment against it!

If we buy a car, the supplier requests its price to be paid, but it should be his problem, ours is that by accepting the invoice we have assumed ***liability*** for its financial settlement, payment.

*Let us systematize a bit more. The **accounts receivable** are assets, **the liabilities against trade creditors** are sources. If you learn the concepts at the beginning like this, it will be easier to classify the balance sheet items. Consequently, accounts receivable and liabilities against trade creditors!*

F./II./5. Bills payable

Among ***bills payable*** should be shown the bill debtor's obligations based on own bill issuer bills. **The bill usually includes the amount of obligation settled by the bill and the amount of interest too.** It is a special securities embodied liability, which the issuing entrepreneur uses to pledge payment on the nominal value at due date of the bill.

F./II./6. Short-term liabilities to affiliated undertakings

On the ***short-term liabilities to affiliated undertakings*** balance sheet line those short-term liabilities should be entered where the due-date of payment obligations expressed in money value under the contract concluded with creditors as affiliated undertakings does not exceed one year, including the repayment parts of long-term liabilities against affiliated undertakings due in the year under review following the accounting day.

F./II./7. Short-term liabilities to other associated undertakings

On the ***short-term liabilities to other associated undertakings*** balance sheet line all other liabilities with a due-date of less than one year should be shown against creditors of other associated undertakings, whose ownership is under 20%, and a financial settlement of liability is due in a year following the year under review, together with the related items transferred from the long-term heading.

F./II./8. Other short-term liabilities

Among ***Other short-term liabilities*** belong all those short-term liabilities, which cannot be classified under previous balance sheet items, such are for example liabilities related to employees, budget, local governments and other undertakings.

F./II./9. Valuation difference of liabilities

In case of valuing financial liabilities at their real value, the difference between the real value and the book value.

F./II./10. Negative valuation difference of derivative instruments

An item related to valuing things at their real value, the syllabus does not cover it in more detail.

G) ACCRUED AND DEFERRED EXPENSES

The ***accrued and deferred expenses*** constitute a special resource group for enterprises using the double-entry book-keeping, the formation of which incomes from employment of the comparison principle and the ***principle of accruals***.

Items of accrued and deferred expenses:

Deferred income

Deferred expenses

Deferred income

Once more, refer to their operation, if there is something that is not entirely clear!

8.5 TAKING STOCK OF ASSETS

So far we have familiarised ourselves with the asset elements of the accountancy act. All this was necessary, as the accountancy act regarding businesses/enterprises specifies mandatory provisions as to the ***time, method and form of taking into account*** their ***assets***, in other words the assets and liabilities.

According to the law the assets should be reported:

- on foundation of the company,
- at transformation and termination of the company, and
- on the balance sheet accounting day.

Remember! What does the accounting day mean?

The assets must be shown factually and systematically. For this, the assets must be systematised, taken into account by preparing two documents in a specific way. The first is the inventory, the second is the balance sheet.

8.5.1 The inventory, stock-taking

For the end-of-the-year closing of the books, preparation of a report and corroboration of the balance sheet, an inventory must be compiled, which on the balance sheet accounting day includes item-by-item, in a verifiable manner the company's disposable assets and liabilities in **quantity** and in **money value**.

The ***inventory*** is such a list-like report, which shows the company's existing assets and liabilities:

- in quantity and money value,
- item-by-item (in a verifiable manner),
- expressed for a given date (the balance sheet accounting day).

The purpose of inventory:

- to establish the company's actual financial standings (veracity of the balance sheet, ownership protection),
- to amend the accounting records in accordance with the actual situation.

The inventory can be made:

- by stock-taking **–** which can be a quantitative snapshot, or collation,
- based on the records.

The accountancy act leaves the "customisation" of inventory tasks up to the entrepreneur, but prescribes that these are put down in writing in the ***rules of inventory and stock-taking*** for assets and liabilities.

There are two options to choose from:

- to **keep continuous quantitative records** in compliance with the accounting principles,
  - **then about the veracity of data in the inventory –** before compiling the inventory **–** one is required to ascertain by stock-taking, at **regular intervals** defined in the rules of inventory and stock-taking for assets and liabilities, but at least every three years by a true quantitative snapshot. Stock-taking for the assets and liabilities expressed only in value, as well as assets stored at a borrowed place, for dematerialised securities must be performed by comparison.
- not to keep **quantitative records** in compliance with the accounting principles, or the keeping of these records is not continuous,
  - then about the veracity of data in the inventory **–** before compiling the inventory **–** one is required to ascertain by

stock-taking, and the inventory pertaining to the balance sheet date of the fiscal year must be performed by a quantitative snapshot, and by collation for assets and liabilities expressed only in value.

In the course of your work you will certainly need to help the stock-taking, the inventory work, hence it is important to know what is to be done during stock-taking.

Work stages of stock-taking:

- determining the actual stock of assets and liabilities, which may be:
  - for assets that can be expressed in quantity, by directly measuring, counting, estimation irrespective of the records;
  - for assets and liabilities that can be expressed in value only, by collation with various records, e.g. collation with a bank, customers, suppliers etc.;
- assets must be valued according to the rules of the accountancy act, the registered and market value is determined, which makes it possible to account for impairments, extraordinary depreciations and value adjustments;
- the true inventory differences also need to be accounted for: the differences noted in the accountancy records must be accounted for against profits, in case of a shortage, and in favour, in case of a surplus, so the inventory records are updated with real, true data.

A summary statement of the inventory record is the inventory, with basic records:

- inventory record tickets, sheets, attachments,
- records,
- stock-taking minutes.

INVENTORY RECORD SHEET and TOTAL of stocks
20.... .... (Y/M/D)

Tax payer: ____________________ Page number: ________________

Tax number: ____________________ Warehouse: ________________

Serial number	Inventory stock												Of deficit					
	Registration number	Denomination	Qty unit	Actual	Accounted	Deficiency	Surplus	Registration unit price	Actual	Accounted	Deficiency	Surplus	within standard		above standard			
				quantity		quantity			value		value		qty	value	chargeable to responsible person		unchargeable to responsible person	
															qty	value	qty	value

Compiled by: ____________________ Verified by: ____________________

22. Figure

INVENTORY RECORD SHEET and TOTAL of stocks
20.... .... (Y/M/D)

Tax payer: ____________________ Page number: ________________

Tax number: ____________________ Warehouse: ________________

Serial number	Tangible assets							Note
	Registration number	Denomination	Construction number	Accounted quantity (pc)	Actual quantity (pc)	Deficit in stock (pc)	Surplus in stock (pc)	

Compiled by: ____________________ Verified by: ____________________

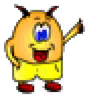
23. Figure

8.5.2 The balance sheet

The entrepreneur's assets and liabilities are in constant action, therefore it is necessary for market players that a comparably consolidated clear statement is made for specified periods, with reference to a specified date. This statement is the balance sheet.

The **balance sheet** is an accounting document that shows the assets and liabilities of an enterprise consolidated, grouped, in money value, rounded to the nearest thousand or million HUF, with reference to a given date.

The ***purpose of the balance sheet*** is to inform the owners, investors, creditors, and other stakeholders about the assets and financial situation of the entrepreneur, as well as about the incomes of the financial year.


again we'll need a printed out balance sheet!

The balance sheet shows two views of the company's assets:

- it can be established what assets the company is concretely made up of.
- the financing sources, the origin of the assets can be methodised.

The balance sheet by comparing the previous year's and the current financial year's data, shows the assets, and the change in assets and liabilities.

The mandatory itemisation detail of some balance sheet reports, balance sheet structure, its sequence of items, designation of certain items, lines and their content is determined by the accountancy act.

Unfortunately contextually it belongs here, but you have already used the uniform marking, break-down in the balance sheet, as defined by the accountancy act:

- **main group, indicated in capital letters (e.g. A = Fixed assets),**
  - **group, indicated in roman numerals (e.g. I. = Intangible assets),**
    - **item, indicated in Arabic numerals (e.g. 1. = capitalised value of formation, promotion and restructuring; (only balance sheets in annual reports contain item-depth breakdown).**

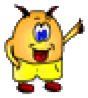
In connection with certain groups, items promoting the principle of essentiality, for stakeholders the disclosure of informative data with important information content is also necessary, e.g.

(D) I. Subscribed capital

Of this: repurchased ownership participation at nominal value

(F.III.) 1. Short-term credits

Of this: convertible bonds


find these in the printed out balance sheet!

The annual report and the balance sheet of the simplified annual report can be produced in variation "A" and "B". In variation "B" the liabilities appear in reverse order of liquidity. The entrepreneur may choose from the variations.

In the accountancy fundamentals system of requirements knowledge of the type "A" balance sheet is normative. Just what you've printed out. The assets of type "B" balance sheet are identical for both types, but the structure of liabilities is different. Do check with the type B balance sheet! What should be noticed: for this balance sheet on the liabilities side the liquidity line of main groups is changing, and you'll find more main groups serving economic, analytical purposes.

Considering its form the classical balance sheet is **bilateral** (which you should also have in front of you), where the left column lists the assets and the right the liabilities. Concordance of the two sides is ensured by setting the **retained profit (earnings) of the current year**. The profit, what is a surplus of assets, or a liabilities deficit is a liability with a positive sign; the loss, what is an asset deficit or a liabilities surplus with a negative sign within the liabilities is featured as part of the shareholder's equity on the retained profit line.

A so called ***one sided balance sheet*** can also be prepared, in which first the assets, then the liabilities are indicated in a sequence of items prescribed by the accountancy act. Such are No. 2. and 3 The balance sheets of the annual report All of the assets and liabilities are yet again identical to each other, the setting of retained profit (earnings) ensures concordance here too. This is the balance sheet's essential feature, natural basic requirement from the principle of balance sheet concordance.

According to what ***time the balance sheet pertains to***, we can distinguish between:

- opening balance sheet to be prepared at foundation, and at the beginning of the financial year,
- intermediate balance sheet, e.g. on paying advance dividends,
- closing balance sheet, compiled on termination, or at the end of a financial year.

The balance sheet must be compiled based on properly prepared updated inventory, accounting records supported and audited with certificates and must be kept for at least 8 years.

The balance sheet is also compiled from certificates, documents, the most important being **the inventory**.

The balance sheet's regularity and authenticity is verified by the person authorised to represent the entrepreneur, in cases regulated by the law the auditor's report is also essential.

8.6 SUMMARY AND QUESTIONS

8.6.1 Summary

The company's assets are a primary condition for operation. Every entrepreneur must take this into account at foundation, and continually record the occurring changes.

Based on appearance all assets are assets, and a liability based on origin. The classification of certain items is regulated, prescribed by the Acc. Act. The classification of items will be your practical task.

Always pay attention to the principle of balance sheet concordance!

Before continuing to the tasks, let's systematize.

For the practical tasks use the balance sheet of the simplified annual report!

SIMPLIFIED ANNUAL REPORT BALANCE SHEET
VERSION „A"

Denomination			Previous year	Significant amount corrections	Current year
A	**FIXED ASSETS**				
	I	Intangible assets			
	II	Tangible assets			
	III	Fixed financial assets			
B	**CURRENT ASSETS**				
	I	Stocks			
	II	Reveivables			
	III	Securities			
	IV	Cash, liquid assets			
C	**ACTIVE ACCRUALS**				
TOTAL ASSETS:					
D	**SHAREHOLDERS' EQUITY**				
	I	Subscribed capital			
		Of this: repurchased ownership participation at nominal value			
	II	Subscribed but not paid capital			
	III	Capital reserves			
	IV	Retained profit			
	V	Fixed reserve			
	VI	Revaluation reserve			
	VII	Balance sheet income			
E	**PROVISIONS**				
F	**LIABILITIES**				
	I	Subordinated liabilities			
	II	Long-term liabilities			
	III	Short-term liabilities			
G	**PASSIVE ACCRUALS**				
TOTAL LIABILITIES					

SIMPLIFIED ANNUAL REPORT BALANCE SHEET
VERSION „B”

Data in thousand HUF

Denomination			Previous year	Significant amount corrections	Current year
A	FIXED ASSETS				
	I	Intangible assets			
	II	Tangible assets			
	III	Fixed financial assets			
B	CURRENT ASSETS				
	I	Stocks			
	II	Reveivables			
	III	Securities			
	IV	Cash, liquid assets			
C	ACTIVE ACCRUALS				
D	LIABILITIES DUE WITHIN A YEAR				
E	PASSIVE ACCRUALS				
F	MARGIN BETWEEN CURRENT ASSETS AND SHORT EXPIARY LIABILITIES (B+C-D-E)				
G	TOTAL ASSETS AMOUNT REDUCED WITH THE LIABILITIES DUE WITHIN A YEAR (A ±F)				
H	LIABILITIES DUE OVER A YEAR				
	I	Long-term liabilities			
	II	Subordinated liabilities			
I	PROVISIONS				
J	SHARHOLDERS' EQUITY				
	I	Subscribed capital			
		Of this: repurchased ownership participation at nominal value			
	II	Subscribed but not paid capital (-)			
	III	Capital reserves			
	IV	Retained profit			
	V	Fixed reserve			
	VI	Revaluation reserve			
	VII	Balance sheet income			

24. Figure

The classification of asset elements should be done by the following principles:

First of all, have the balance sheet of the annual report in front of you! Choose the one with a balance sheet format! The balance sheets of the annual report

For example, where should the laptop brought into the Co. by Zita be entered in the enterprise's balance sheet?

Is the Laptop an asset or a liability?

Does it have a concrete appearance?

Yes, "it is tangible"!

So, it's an asset!

For how long can it be used in the interest of the business? For less than a year, or more than a year?

More than a year!

Then, it's a fixed asset!

Does it have a physical appearance?

It does!

Then it needs to be decided whether it's a tangible asset or (investment) financial asset!

Unequivocal: Tangible asset!

And it place is at: A/II!

Where is the money made available to the company by Fanni shown in the balance sheet? *Does it have a concrete appearance?*

Yes, "it is tangible"!

So, it's an asset!

For how long can it be used in the interest of the business? For less than a year, or more than a year?

This money finances the operation, day by day it is needed for something.

This can only be used for less than a year.

So, it's a current asset!

See, under the current assets the stocks, receivables, securities and liquid assets should be recorded.

So this is a liquid asset!

And it place is at: B/IV!

The practical examples will help, so that the classification of assets goes smoothly!

8.6.2 Self test questions

What do you think the following concepts mean?

- assets
- balance sheet
- assets
- fixed assets

- intangible assets
- tangible assets
- investments (financial assets)
- current assets
- stocks
- receivables
- securities
- liquid assets
- sources
- shareholder’s equity
- subscribed capital
- subscribed but not paid-up capital
- capital reserves
- accumulated profit reserve
- locked up reserve
- rrevaluation reserve
- retained profit (earnings)
- provisions
- liabilities
- subordinated liabilities
- long-term liabilities
- short-term liabilities
- accruals and deferrals
- inventory

8.6.3 Tasks for practice

In the appropriate column mark with x whether the mentioned asset portion figures among assets or liabilities in the balance sheet!

Designation	Assets	Sources
Finished goods		
Investment credits		
Subscribed capital		
Rights representing assets		
Receivables from customers (Trade debtors)		
Liabilities against trade creditors		
Goods in stock		
Trade marks, patents		
Capital reserves		
Deferred income		
Cash		
Bill debt		
Own shares and own partnership shares		
Retained profit (earnings)		
Deferred expenses		
Liabilities from bond issue		
Advances (Prepayments)		
Raw materials and consumable goods		
Accumulated profit reserve		
Liabilities against employees		
Provisions for future expenses		
Liabilities against social security (insurance)		
Goodwill		
Advances (Prepayments)		
Land and buildings		
Loans given		
Livestock		
Settlement deposit account		
Liabilities against the budget		
Locked up reserve		
Rrevaluation reserve		
Bills (drafts) receivable		

Solution:

Designation	Assets	Sources
Finished goods	X	
Investment credits		X
Subscribed capital		X
Rights representing assets	X	
Receivables from customers (Trade debtors)	X	
Liabilities against trade creditors		X
Goods in stock	X	
Trade marks, patents	X	
Capital reserves		X
Deferred income		X
Cash	X	
Bill debt		X
Own shares and own partnership shares	X	
Retained profit (earnings)		X
Deferred expenses	X	
Convertible bonds		X
Advances (Prepayments)	X	
Accumulated profit reserve		X
Liabilities against employees		X
Provisions for future expenses		X
Liabilities against social security (insurance)		X
Goodwill	X	
Advances (Prepayments)	X	
Land and buildings	X	
Loans given	X	
Livestock	X	
Settlement deposit account	X	
Liabilities against the budget		X
Locked up reserve		X
Recalled corporation tax	X	
Bills (drafts) receivable	X	

Determine which asset group the following items belong to! Mark with x!

Asset element	Intangible assets	Tangible fixed assets	Fixed financial assets	Stock	Receivables	Securities	Cash	Shareholder's equity	Long-term liabilities	Short-term liabilities
Housing loan provided to employee										
Young animals										
Paint intended for own use										
Long-term loan received										
Software purchased for own use										
Amount of own bill										
Long-term cash deposit at bank										
Value of purchased material not paid										
Corporate income tax										
Stationery and forms purchased for sale										
Debt toward social security										
Wage debt toward employees										
Lorry										
100 EUR										

Liquidity loans received										
Investment										
Internally produced ready machines for sale										
Positive earnings for the year										
Credit obtained for machine										
Assembly line for production purposes										
8 months maturity bond										
Rental fee – shop operated										
Cash										

Solution:

Asset element	**Intangible assets**	**Tangible fixed assets**	**Fixed financial assets**	**Stock**	**Receivables**	**Securities**	**Cash**	**Shareholder's equity**	**Long-term liabilities**	**Short-term liabilities**
Housing loan provided to employee			X							
Young animals				X						
Paint intended for own use				X						
Long-term loan received									X	
Software purchased for own	X									

use										
Amount of own bill										X
Long-term cash deposit at bank			X							
Value of purchased material not paid										X
Corporate income tax										X
Stationery and forms purchased for sale				X						
Debt toward social security										X
Wage debt toward employees										X
Lorry		X								
100 EUR							X			
Liquidity loans received										X
Investment		X								
Internally produced ready machines for sale				X						
Positive earnings for the year								X		
Credit obtained for machine									X	
Assembly line for production purposes		X								
8 months maturity bond						X				
Rental fee – shop operated		X								
Cash							X			

From the balance sheets of three different enterprises we have the following information (in thousands of HUF).

Balance sheet, 31st December 2013.

Assets	**A**	**B**	**C**	**Liabilities**	**A**	**B**	**C**
Fixed assets	25 000	15 000	10 000	Shareholder's equity		20 000	37 000
Current assets		27 000		Liabilities			
Stocks	5 000	7 000		Long-term	20 000		2 000
Receivables	2 000	10 000	15 000	Short-term	12 000	15 000	
Liquid assets			10 000				
Assets total:			42 000	**Liabilities total:**	42 000		

Task: Calculate the missing amounts!

Solution:

Assets	**A**	**B**	**C**	**Liabilities**	**A**	**B**	**C**
Fixed assets	25 000	15 000	10 000	Shareholder's equity	*10 000*	20 000	37 000
Current assets	*17 000*	27 000		Liabilities	*32 000*	*22 000*	*15 000*
Stocks	5 000	7 000		Long-term	20 000	*7 000*	2 000
Receivables	2 000	10 000	15 000	Short-term	12 000	15 000	*13 000*
Liquid assets	*10 000*	*10 000*	10 000				
Assets total:	42 000	42 000	42 000	Liabilities total:	42 000	42 000	42 000

Task:

Beyond classification, value is also added to the items, thus we'll be able to calculate the retained profit (earnings) of the enterprise!

Classify the assets together with their value and prepare a balance sheet for the year the 2014 for Picurka Plc, using the information below (figures in HUF)!

Use the simplified balance scheme provided below!

1.	Manufacturing process	120 000	16.	Shares purchased for trading	20 000
2.	Office building	70 000	17.	Social security (insurance) liabilities	10 000
3.	Raw materials and consumable goods	50 000	18.	Machine for production	180 000
4.	Customers	75 000	19.	Work in progress	15 000
5.	Cash	1 000	20.	Long-term bank loan	55 000
6.	Capital reserves	20 000	21.	Finished goods	65 000
7.	Investment credits	40 000	22.	Short-term loan	160 000
8.	Bill debt	33 000	23.	Long-term participations	50 000
9.	Other liabilities	20 000	24.	Accumulated profit reserve	25 000
10.	Trade marks, patents	20 000	25.	Goods	10 000
11.	Lon-term bank loan	60 000	26.	Unpaid taxes	15 000
12.	Software	40 000	27.	Accounts payable	35 000
13.	Retained profit (earnings)	………	28.	Receivables against employees	5 000
14.	Unpaid wages to employees	20 000	29.	Subscribed capital	400 000
155.	Loans given (3 months)	40 000	30.	Settlement deposit account	74 000

BALANCE SHEET 2014……………… Valuables: 1000 HUF

ASSETS (ACTUAL ASSETS)			SOURCES (EQUITY & LIABILITIES)		
DENOMINATION	Previous year	Current year	DENOMINATION	Previous year	Current year
FIXED ASSETS			*SHAREHOLDER'S EQ.*		
INTANGIBLE ASSETS			CALLED UP SHARE C.		
			Subscr, but not paid...		
			CAPITAL RESERVES		
TANGIBLE ASSETS			ACCUM. PROF. RES.		
			LOCKED UP RESERVE		
INVESTMENTS (FIN. ASS.)			VALUATION RES.		
			RETAINED PROFIT		
CURRENT ASSETS			*PROVISIONS FOR F. E.*		
STOCKS (INVENTORIES)			*LIABILITIES*		
RECEIVABLES			SUBORDINATED LIA.		
SECURITIES			LONG-TERM LIAB.		
LIQUID ASSETS			SHORT-TERM LIAB.		
Accrued and def. assets			*Accrued and def. expe.*		
ASSETS TOTAL:			SOURCES TOTAL:		

Solution:
BALANCE SHEET 2014……………… Valuables: 1000HUF

ASSETS (ACTUAL ASSETS)			SOURCES (EQUITY & LIABILITIES)		
DENOMINATION	*	Current year	DENOMINATION	*	Current year
FIXED ASSETS		540	*SHAREHOLDER'S EQ.*		507
INTANGIBLE ASSETS		180	CALLED UP SHARE C.		400
120+20+40+			Subscribed but not paid...		
			CAPITAL RESERVES		20
TANGIBLE ASSETS 70+180+		250	ACCUM. PROF. RES.		25
			LOCKED UP RESERVE		
INVESTMENTS (FIN. ASS.) 60+50		110	VALUATION RES.		
			RETAINED PROFIT		62
CURRENT ASSETS		355	*PROVISIONS FOR F. E.*		
STOCKS 50+15+65+10		140	*LIABILITIES*		388
RECEIVABLES 75+40+5		120	SUBORDINATED LIA.		
SECURITIES 20		20	LONG-TERM LIAB. 40+55		95
LIQUID ASSETS 1+74		75	SHORT-TERM LIAB. 33+20+20+10+160+15+ 35		293
Accrued and def. assets			*Accrued and def. expe.*		
ASSETS TOTAL:		895	SOURCES TOTAL:		895

* Previous year

8.6.4 Tests for practicing

Select and underline the "odd one out" from the following groups!

Raw materials and consumable goods Goods Cost of materials Finished goods	Bill debt Unpaid wages to employees Wage cost Personal income tax	Shareholder's equity Fixed assets Liabilities Provisions
Accumulated profit reserve Investment creditors Investment credits Assets in construction	Bonds purchased for investment Receivables Intangible assets Land and buildings	Unpaid wages to employees Social security (insurance) liabilities Domestic creditors Investment and

		development credits
Short-term loan obtained Accounts payable Assets in construction Investment credit	Buildings Liquid assets Accounts payable Raw materials and consumable goods	Animals for breeding Goods Own empties Bank deposits
Finished goods Goods Accounts payable Raw materials and consumable goods	Bonds purchased for investment Settlement deposit account Bonds purchased for trading Cash	Goodwill Rights representing assets not related to property Trade marks, patents Assets in course of construction, renewals
Fixed assets Current assets Accrued and deferred liabilities Accrued and deferred assets	Raw materials and consumable goods Goods Finished goods Livestock	Stocks Securities, Liabilities Liquid assets
Accounts receivable Bills (drafts) receivable Other receivables Subscribed but not paid-up capital	Accumulated profit reserve Capital reserves Settlement deposit account Retained profit (earnings)	Loan given to employees Bill debt Domestic creditors Short-term loan obtained

Select and underline the “odd one out” from the following groups!

Raw materials and consumable goods <u>Cost of materials</u> Goods Finished goods	Bill debt Unpaid wages to employees <u>Wage cost</u> Personal income tax	Shareholder’s equity <u>Fixed assets</u> Liabilities Provisions
Accumulated profit reserve Investment creditors Investment credits <u>Assets in construction</u>	Bonds purchased for investment <u>Receivables</u> Intangible assets Land and buildings	Unpaid wages to employees Social security (insurance) liabilities Domestic creditors <u>Investment and development credits</u>
Short-term loan obtained Accounts payable <u>Assets in construction</u> Investment credit	<u>Accounts payable</u> Buildings Liquid assets Raw materials and consumable goods	Animals for breeding Goods Own empties <u>Bank deposits</u>
Finished goods Goods <u>Accounts payable</u> Raw materials and consumable goods	<u>Bonds purchased for investment</u> Settlement deposit account Bonds purchased for trading Cash	Goodwill Rights representing assets not related to property Trade marks, patents <u>Assets in course of construction, renewals</u>
Fixed assets Current assets <u>Accrued and deferred liabilities</u> Accrued and deferred assets	Raw materials and consumable goods Goods Finished goods <u>Livestock</u>	Stocks Securities, <u>Liabilities</u> Liquid assets
Accounts receivable Bills (drafts) receivable Other receivables <u>Subscribed but not paid-up capital</u>	Accumulated profit reserve Capital reserves <u>Settlement deposit account</u> Retained profit (earnings)	<u>Loan given to employees</u> Bill debt Domestic creditors Short-term loan obtained

9. EVALUATION IN ACCOUNTING

9.1 OBJECTIVES AND COMPETENCIES

It is very had to tell how much is a particular car worth, if we want to buy one. If we bargain in the market, we arrive at some price, but is it really worth that much? If we are good brokers, we may boast about how we got a super car below price.

Anything that can be obtained on the market has a different value for every customer. And an additional question is raised: in what way their value is changing during usage?

We cannot decide haphazardly, the accountancy act complying also with the principles of international regulations, prescribes the rules for the cost and value change.

The objective now is very simple:

- that you correctly use the concept of cost,
- that you could assign cost to different assets, and
- that you properly use accounting for changes in value.

Hopefully, you'll be able to apply what you've learned in other fields too, e.g. preparing plans!

9.1.1

The time required due mainly to the training examples will be 14 hours.

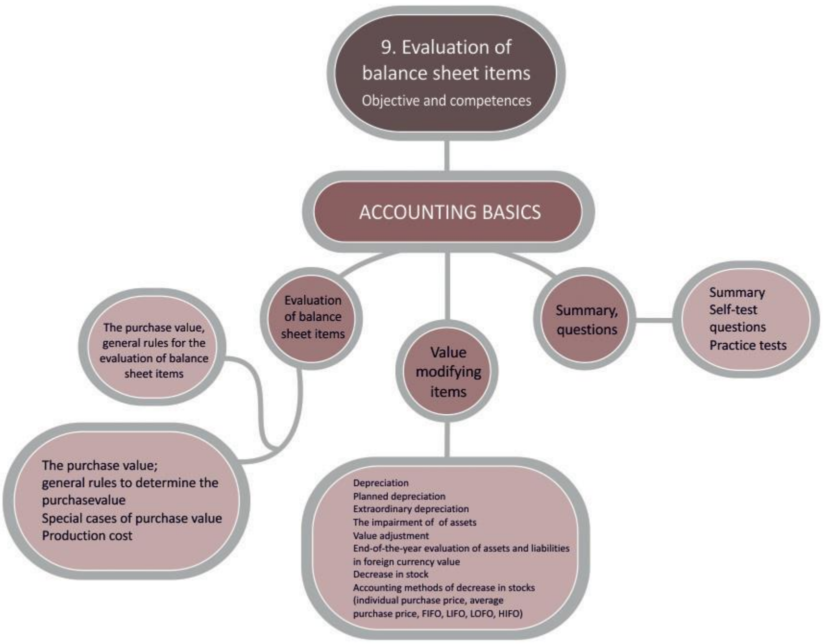
Key expressions:

- purchase value
- cost of production
- planned depreciation
- extraordinary depreciation
- extraordinary depreciation reversal
- impairment
- reversal of an impairment (write-down)
- consolidated difference in exchange
- residual value

- useful life-span
- impairment
- reversal of an impairment (write-down)
- value adjustment
- FIFO method
- sliding average price

9.2 EVALUATION OF BALANCE SHEET ITEMS

Please, look at the learning chart!



25. Figure

9.2.1 General rules for the evaluation of the cost and the balance sheet items

Again, we need to refer to what we have learned about accounting principles. Both domestic and international regulation brings the same principles to the fore, emphasizing 4 accounting principles in evaluation.

Evaluation of the balance sheet items must be started with the ***continuation of the business principle***, if the emergence of this principle is not inhibited by other regulation, and no conflicting factor or condition to continue with the business activity exists.

- According to the ***continuation of the business principle***, on preparation of the report and during book-keeping it must be assumed that the entrepreneur will be able to keep functioning, to continue his activity, no suspension of operation or its significant decline for any reason is expected.

The rules of the accountancy act cannot be applied, if this principle is not observed. Deviations from the overall evaluation process are governed by specific laws.

Special valuation rules must be applied at foundation, transformation, liquidation or termination of the enterprise, at valuation prior to selling the enterprise, at revaluation of the assets, and at measuring the impact of inflation.

- When preparing the balance sheet the provisions of the ***continuity principle*** must also be taken into account. The opening data of the financial year must correspond to the appropriate closing data of the previous financial year. In successive years, the valuation of assets and liabilities, the profit calculation may vary only in accordance with the rules set out in the accountancy act.

This means that evaluation employed in the previous financial years must continuously, consistently be provided, in successive years, the valuation of assets and liabilities may vary only in accordance with the rules set out in the accountancy act. The valuation principles applied in the previous financial year's balance sheet preparation can only be changed if the factors leading to changes are present for a long-term – at least one year – and hence the change is deemed to be permanent, prolonged, but the factors leading to the change and their quantified impact should be specified in the annex.

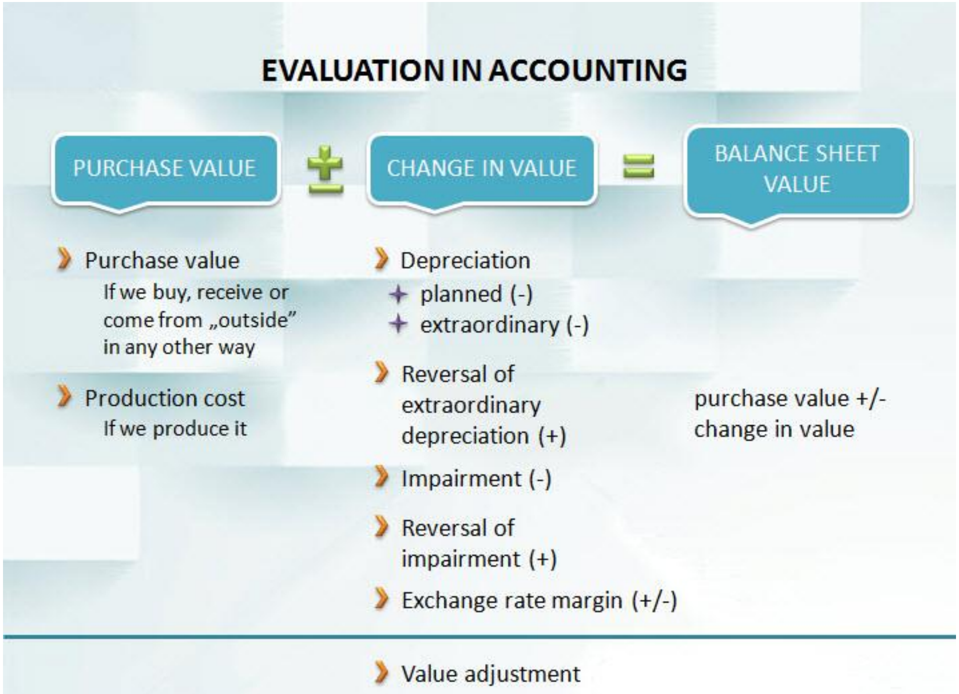
- The prerequisite of balance sheet preparation is a review of the company's available material and non-material assets. The assets and liabilities must be verified by stock-taking, collation and individually evaluated, this is the ***principle of individual valuation***.
- Valuation of the assets and resources can directly affect the income. According to the ***principle of caution*** depreciations, impairments, provisions should be accounted for, regardless of whether the outcome of the current year is a profit or a loss. This means that when determining the income shown in the balance sheet, during the carefully performed evaluation of the balance

sheet items, all depreciations, impairments must be taken into account that affect the assets existing on the balance sheet accounting date, and have occurred and become known by the day of balance sheet preparation.

In addition to valuation rules and the incomeing accounting principles formulated on those, it is a requirement that the assets featuring in the ***balance sheet*** should – ***as a rule*** – ***be evaluated at cost***, but the cost must be reduced by the planned and over the plan depreciation, impairment and increased by the amount of reversal. Thus, the assets will feature in the balance sheet at cost (purchase, production) value, or at a lower value.

The valuation rules are systematised based on the following aspects:

- ***Cost (activation) value:*** the value by which we take the assets and liabilities into stock in accounting records at their formation, and when those get into the ownership, tenure of the company. The fixed assets, the current assets should be evaluated by their ***cost***, or ***cost of production*** value. (The cost of intangible assets and tangible assets is called a ***gross value***.) There are certain assets – and there may be such resources too –, which are arising, getting into the ownership, into tenure of the company on the basis of some sort of legislation. In this case the cost is the ***value according to contract, agreement, legislation***.
- ***Value changes:*** may occur owing to deterioration of assets, market value judgement and exchange rate changes. Its forms: ***depreciation, impairment, value adjustment, valuation differences, exchange rate change***. The amount of extraordinary depreciation and impairment accounted for earlier is reduced by the amount of reversal.
- ***Value at balance sheet preparation:*** by correcting the cost with the value changes we arrive at the value, whereon the assets and resources are shown in the balance sheet. (The value of intangible assets and tangible assets at balance sheet preparation time is called a ***net value***.)



26. Figure

The value adjustment placed under the line denotes that those are not contained in the balance sheet value of the particular asset, since, as we have seen, the difference between the book value and the market value within a balance sheet group appears as the last item on a separate line.

The accountancy act regulates assuming a market economy in compliance with international efforts, however at the evaluation of balance sheet items the market's assessment is still not decisive. Instead of the market's assessment an ***evaluation based on historical data*** employed also in international accounting practices is prescribed, i.e. past purchasing and production costs are assigned to the current sales revenues.

The evaluation in respect of the assets based on historical data means that the ***highest value of the assets in the balance sheet is their purchase value, and their production cost.*** Following the principle of caution this value may only be reduced – except for the exchange gain –, because the accountancy act prescribes that for assets taken into stock on their purchase value and production cost, the depreciations and impairments must also be accounted for. In this way the value of assets in the balance sheet in most cases is equal to their purchase value or production cost, or a value lower than that.

In formulating the essence of evaluation based on historical value, the intention was to prevent the enterprise from valuing its assets above the original (historical) cost, and not to undervalue its liabilities. The change in international accountancy regulations however increasingly tends to follow the principle of the company's assets to be shown at their current market, real value.

Let us imagine, how much more relevant an information is for instance about how much a building is worth now than, perhaps for how much we bought it for when founded 20 years ago. It can be said therefore that the original phrasing, whereby assets are shown by their historical value, is going through some quite important changes, the main evidence of which is value adjustment, and the emergence of a possibility to evaluate at the real value.

9.2.2 The cost

The objective of regulating the cost is for the expenses related to the purchase and production to reduce the earnings in a period, when the cover for those – during the use of the given assets – is showing up in the revenues. This is how the comparison principle prevails.

The cost (purchase, production value) is in essence the total sum of items that can be individually linked to assets in the interest of procuration, creation, putting into operation, incurred until putting into operation, delivery to the warehouse.

The cost of acquired assets is the purchase value, while for self-produced assets it is the cost of production.

The general rules for determining the purchase value

The accountancy act defines the items to be considered when determining the purchase value, their method and date of accounting, the cases of cost amendment. Hereinafter follows an overview of these rules.

The purchase value includes:

- the purchase price, which may be reduced by discount, increased by premium
- charges incurred in connection with procurement, putting into operation, delivery to the warehouse of assets:

  - transportation, lading,
  - foundation,
  - installation,
  - putting into operation
  - intermediary activity considerations and fees (in case of performing the activity as part of own enterprise the capitalised value of the direct cost-price).
- commission fee,
- taxes related to the acquisition,
- customs duties,
- fees closely related to the acquisition of assets:
  - duties [for acquiring assets (gift, inheritance, trading, fees due after exchange)],
  - previously charged but non-deductible value added tax,
  - administrative official, service charges based on legislation,
  - other administrative official, service charges,
- a purchased call option fee (not compulsory for the cost of securities for trading purposes),
  - costs used for the purchase, production of assets directly related to:
  - charge for credit, paid before obtaining a loan, bank guarantee fee as a condition for a credit or a loan,
  - notarial certification of contract fees for a credit, or a loan,
  - interest accounted for until the period of putting into operation, delivery to the warehouse of assets after obtaining a credit, a loan.

The deductible previously charged value added tax is ***not part of the purchase value***, and neither is the pro-rata divided non-deductible portion of the previously levied value added tax in proportion to the consideration under the VAT Act.

The Acc. Act. especially stresses that the cost of transactions is not reduced by the amount of assistance received for the investment. The amount of assistance must be accounted for as extraordinary income, then accrued as deferred income, which on settlement of the related cost, expenditure is proportionately released.

Special cases of the cost

Import purchasing is an area worth special attention.

The purchase of assets, services must be settled as import purchases

- in foreign trade purchasing is done from overseas[5] (product import),
- the ***service rendered by foreigners*** utilised either at home or abroad, whereby the seat of economic activity of the service provider, or its permanent site of business, or in their absence the domicile or habitual residence is to be found abroad (services import),

regardless of whether the consideration is paid off in foreign exchange, currency, export goods, export services or settled in HUF from a HUF account, as defined by a trade agreement.

Determination of the value of import purchasing is also prescribed by law, so in this case the cost is:

- if the payment is settled on the basis of an account in HUF, then an invoiced – deductible not including value-added tax – HUF value,
- if the payment is settled based on an invoice in foreign exchange, currency, then the invoiced value in HUF – not including a deductible value-added tax – converted at the exchange rate as set out in the accounting policy at the time of performing the foreign exchange, currency conversion,
- if payment is settled by export goods, export services of the same foreign exchange value (barter transaction), the value in HUF converted at the foreign exchange rate as set out in the accounting policy pertinent to the first day of performance (the value of import purchasing and export sales revenue in HUF value is the same).

The cost of assets and liabilities in foreign currencies

Book-keeping is exclusively in Hungarian language and the report must also be prepared in Hungarian, while data must be given in thousands, and millions of HUF. Consequently, the value of assets and liabilities denominated in foreign currency must be shown in the books and featured in the reports converted into HUF.

[5] From the aspect of accounting the import purchasing, abroad: is the area outside the borders of the Republic of Hungary. It qualifies as import purchase under the conditions laid down in the act on purchases from public and private warehouses, customs law, customs procedures and customs administration.

Balance sheet items affected upon determining the HUF value, that is to say the cost:

- currency cash,
- foreign-exchange deposit account
- investments (financial assets) in foreign currency value:
- receivables in foreign currency value,
- securities in foreign currency value,
- liabilities in foreign currency value.

The cost of foreign exchange denominated assets and liabilities the value in HUF pertinent to the cost, or converted at the foreign exchange rate as set out in accounting policy at the date of performance under the contract, in case of foreign currency bought for HUF, the amount actually paid.

The exchange rates applicable for determining the HUF value under the general rule, the currency, foreign exchange must be converted into HUF at the average foreign currency exchange rate advertised by the chosen credit institution, or at the exchange rate quoted by the Hungarian Central Bank.


The solution used by the entrepreneur must be fixed in the accounting policy.

The rules for special asset valuation movements between the company and the shareholders, such as rules for the valuation of assets with asset movements linked to foundation, capital raising, capital reduction, acquisition, transformation, amalgamation is separately regulated by the accountancy act.

Of the special asset movements let us review the most specific main rules for determining the cost:

For companies the cost (purchase value) determined at foundation, at raising of capital assets adopted (received) as non-monetary (asset) contribution (in-kind), in deed of formation[6], and in its amendment, as well as the value set by a general assembly, foundation, membership

[6] Deed of formation: the statutory document required for the establishment of an enterprise (deed of partnership, deed of foundation, statute, otherwise called agreement between the owners).

meeting. In case of transformation, the value specified in the deed of formation appearing in the company's final balance sheet established by transformation should be considered as its value.

The cost (purchase value) of goodwill in case of acquisitions

- The acquired company's assets and liabilities are taken into stock item-by-item: the cost value of Goodwill is the difference between the paid consideration and the market value of assets reduced by the value of the assumed liabilities, provided that the paid consideration is the higher,
- The given company's shares are obtained by the customer in such a way, that it acquires a qualified majority influence[7] within the given company, and the given company's shares are listed and traded on the stock-exchange, and the paid consideration for the shares of the given company is considerably higher than the market value of the acquired shares, then the difference between the paid consideration and the market value is the cost of *Goodwill*.
- When a given company's shares, business shares, partners' equities are acquired by the customer in such a way that a qualified majority influence is reached in the given company, and the given company's shares, business shares, partners' equities are not listed or traded on the stock-exchange, part of the value of shareholder's equity in the enterprise is examined. If the paid consideration is significantly higher than the value of this investment, the positive difference between the two is the cost of *Goodwill*.

The positive difference is the goodwill, which must be shown as assets under intangible assets.

The difference can be negative too. ***The negative goodwill cannot be shown under intangible assets, it must be listed under accrued expenses*** (accrued expenses, deferred income).

In case of a negative difference, when the assets and liabilities of the purchased company, its site, business network are taken into stock item-by-item by the customer, the requirement is that the difference must be reduced by proportional reduction of the real value of the acquired, intangible assets, tangible assets and stocks featured in the balance sheet, and only the remaining margin represents negative goodwill.

c) ***The cost*** (purchase value) ***of ownership participation in a company***

[7] ***Qualified majority influence:*** when a shareholder, member in a controlled company disposes over at least three quarters (minimum 75%) of the votes.

- ***at purchase*** the paid considerations (purchase price) for shares, partnership shares, partners' equities, at acquisition – in case of goodwill, or negative goodwill shown – the paid considerations (market value) reduced by goodwill, increased by negative goodwill.
- ***at foundation, raising of capital*** the combined value in the deed of formation, its amendments, and in resolution by a general assembly, foundation, membership meeting as cover for the subscribed capital, together with an asset contribution defined as the difference between the subscription, issue and nominal value corresponding to the amount of actually paid in monetary deposit and the available non-monetary deposit.

The invoiced, certified value of the cost (purchase value) of ***assets assumed as receivables*** under agreement, exchange contract, or asset allocation proposal.

The cost (purchase value) of ***assets acquired by barter***, the barter-contract value of the asset, in case of a different contract, or in the absence of agreement the selling price for the assets provided in exchange.

The ***cost (purchase value) of interest bearing securities*** signifying creditor relationship ***may neither contain*** the (accumulated) **amount of interest**[8] ***making up the purchase price***, nor the market, sales, offset value defined in the issuing document, barter-contract, asset allocation proposal, it should be accounted for as an item reducing the interests received upon purchasing.

The cost (purchase value) of assets received free of charge (without obligation to return), as gift, as bequest, or discovered as surplus, its market value known at the time of taking it into stock.

The asset ***discovered as surplus*** may be taken into stock at market value exclusively in case, if it is not a surplus due to administrative deficiency, i.e. the cause of surplus formation cannot be determined. Insofar, as it can be established that for instance the material was released for use, but in reality it wasn't utilised and wasn't taken back to warehouse, then this

[8] Securities signifying creditor relationship – excluding the moment after interest payments – it also entitles to interest receivable. Consequently, the purchase price of interest bearing securities includes interest, the amount of which also depends on how much time has elapsed since the last interest payment (or since its issue). There are interest-bearing securities, which pay interest, not annually, but – in a lump sum – only on maturity. In this case, the interest is calculated from the issue, and it is called ***accumulated interest***. In this case the accumulated interest cannot form part of the purchase value.

administrative deficiency must be substituted and no surplus cannot be accounted for.

An exceptional revenue growth must be accounted for ***at the same time with taking into stock*** of assets received free of charge, as gift, bequest, or discovered as surplus.

The cost of production

The cost of self-produced assets and supplies, and of services provided, rendered is the cost of production.

Part of the asset's ***cost of production*** are those costs, which:

- have directly arisen during the asset's production, putting into operation, expansion, change of designation, transformation, restoration to its original state
- were demonstrably closely related to the production,
- by the help of indicators, specifications suitable for the asset (product), can be accounted for.

All the above together are termed ***direct cost price***.

The direct cost price cannot include the cost of sales and production costs not directly related to administration and other universal expenses. The previous items in the sales of convention income statement appear as indirect costs of sales in the amount incurred during the financial year.

The total cost method income statement also contains this amount, without separately specifying them, but broken down together by type – e.g. material expenses, personnel type expenses, depreciation – and contrasted against the sales revenue.

9.3 VALUE MODIFYING ITEMS

9.3.1 Depreciation

The intangible assets, tangible assets due to permanent use, continuous physical wear and tear and nominal obsolescence gradually lose their value.

Depreciation is the monetary value of physical wear and tear and nominal obsolescence of intangible assets and tangible assets.

Accounting for depreciation may be against the profit (earnings):

during the expected use, life-span of the asset in a way designed by the entrepreneur, which is a **planned depreciation,** as a income of specific events (e.g. depreciation of market value, damage, destruction, etc.) on an occasional basis, which is an **extraordinary depreciation.**

Planned depreciation

The cost of intangible assets, tangible assets – reduced by the residual value expected at the end of the useful life-span – should be accounted for divided between those years, over which these assets will in all probability be used. According to international accounting practices the entrepreneur is to decide at the time of intended use, or putting into operation that under what useful life-span, what annual amount, what method, what residual value will the cost value be accounted for against the profit (earnings).

During your work, you will probably be expected to do projection. Among the costs, depreciation can be significant, while it is also important, which financial year is affected and in what proportion. For this reason, the methodology of depreciation will be introduced in detail.

Let us start with the related concepts!

Under the concept of useful life-span, the law understands a period, during which the entrepreneur account for the amortisable asset pro-rata or based on performance **<u>against the profit (earnings)</u>**.

It is very important: the duration is not while you are using it!!!!!!

The **residual value** at the time of intended use, or putting into operation is the asset's specific value[9] to be prospectively realised at the end of its useful life-span. The residual value may be zero, if its value according to the accounting policy is in all probability not significant.

The amount of **depreciation to be accounted for annually** must be planned by taking into consideration the expected use of the individual asset, its incomeing life-span, physical wear and tear and nominal

[9] sales price, recyclable or its scrap value

obsolescence, the conditions specific to the given business activity, and after taking those to be entered into records, should be applied starting from the time of intended use, or putting into operation. Putting into operation must be documented in a credible manner, as required by the principle of documentation.

The methods suitable for determining the amount of annual depreciation:

1. Based on gross value

a) pro-rata depreciation

- linear depreciation
- degressive depreciation
  - numbers multiplier method
  - number of years sum method (arithmetic progression)
- progressive depreciation
  - numbers multiplier method
  - number of years sum method (arithmetic progression)
- absolute sum depreciation

b) performance-based

2. Based on net value

a) pro-rata

- degressive depreciation
  - constant rate (geometric progression)
  - combined method

b) production proportional depreciation

3. Lump-sum depreciation

How should each of these be calculated?

With the **linear depreciation** method, for the years of wear and tear the same amount of depreciation should be accounted for annually. Determination of the annual amount is done using a depreciation key.

$$Depreciati\ \ onkey\ \ (D) = \frac{1}{n}\ x\ 100\ ,\ where\ \ \ n = useful\ \ \ life\ \ (year\ \ )$$

The amount of annual depreciation = (G – R) x D

(G = gross value, R = residual value,)

At 4 years of useful life the depreciation rate is 25% (1/4 = 0.25), annually over four operating years 25% of the gross value reduced by the residual value of tangible assets should be settled as depreciation. At the end of the fourth operating year the asset has been written off, the net value is the same as the residual value.

With the **degressive depreciation** settlement method for the years of wear and tear annually or sectionally (for several years) a different – ever decreasing – amount, intersectionally an identical amount of depreciation is accounted for. It can be done using the numbers multiplier, or number of years sum method.

Numbers multiplier method: it is done by determination of the average annual amount using a depreciation key, which is calculated by the method described under linear depreciation. The diversion ratio depends on the decision of the enterprise. The sum of multiplier numbers specified by the enterprise must correspond to the number of years (useful life-span).

Assuming a four-year useful life-span, the average depreciation rate is 25%. Let us set the diversion ratio, with which the average depreciation key should be multiplied:

in the 1st year	1.8
in the 2nd year	1.2
in the 3rd year	0.8
in the 4th year	0.2

Based on the foregoing, the depreciation keys: in the 1st year 45% (25% x 1.8), in the 2nd year 30%, in the 3rd year 20%, in the 4th year 5%.

Have you noticed that the annual depreciation percentages represent 100%!?

Annually, the percentage (%) of the previously specified gross value reduced by the residual value should be accounted for as depreciation. At the end of the 4th year the asset has been written off, its net value is equal to the residual value.

With using the number of years sum method, the sum of depreciation to be accounted for annually is reduced by the same amount every year. Determination of the annual sum of the gross value reduced by the asset's residual value, as well as the value arising from summarisation (arithmetic progression) of the number of years of useful life-span is done based on the quotient. By multiplying the incomeing sum by the absolute numerical value of the reversed order of the numbers, the depreciation to be accounted for in the given year can be determined.

Assuming a four-year useful life-span the sum of the number of years:

1 + 2 + 3 + 4 = 10

Depreciation to be accounted for annually:

$$1.\ \text{év} : \frac{G - R}{10} \ x\ 4$$

$$2.\ \text{év}: \frac{G - R}{10}\ x\ 3$$

$$3.\ \text{év}: \frac{G - R}{10}\ x\ 2$$

$$4.\text{év}: \frac{G - R}{10}\ x\ 1$$

With the pro***gressive depreciation*** settlement method, similarly to the degressive method, for the years of wear and tear annually or sectionally (for several years) a different – in contrast to the degressive method ***ever increasing*** – amount, intersectionally an identical amount of depreciation is accounted for. The numbers multiplier, or number of years sum method can be used here too, only the calculation needs to be done first with the smallest and last with the largest multiplier.

When accounting for the ***absolute sum*** depreciation, the entrepreneur determines the gross value reduced by the asset's residual value specified in advance during the years of useful life-span, possibly annually, in a variable amount.

With the ***performance-based depreciation*** method for the years of wear and tear the amount of depreciation is determined annually on the basis of performance, and it is set within the function of the useful life-span, life performance and annual utilisation. Performance should be expressed in natural units (pc, kg, hr, km, etc.).

The calculation

During the course of determining the gross value (GV) reduced by residual value per performance unit, the sum of depreciation per performance unit is obtained:

$$\text{GV} = \frac{\text{G} - R}{\text{planned performanc e}}$$

The depreciation to be accounted for annually represents the sum weighted with performance.

T x actual performance in the given year

With the method of accounting for depreciation determined ***based on net value by constant rate***, for the years of wear and tear a decreasing amount of depreciation is accounted for annually. The depreciation key (%) is usually 2-3 times the key used for the linear method. The key determined in this way is constant, the annual amount of depreciation should be determined every year with this, based on the net value of the asset. At this method, at the end of the period of use a residual value arises. The remaining net value could be perceived so, that this sum is recovered from residual, recovered materials, sales revenues during the disposal of the asset.

Determination of the depreciation key (D):

$$D = 1 - \sqrt[n]{\frac{R}{G}}, \ where \quad n = numberofye \quad ars$$

The depreciation to be accounted for annually = D x net value

With using the ***combined method*** (at the end of the period of use – e.g. in the last two years – with a move to the linear method) no residual value is created.

According to the regulations of the accountancy act ***rights representing assets, trade marks, patents, tangible assets under HUF 100k of individual cost, production value***, the cost of so called "small value" – depending on the entrepreneur's decision – at putting into use can be accounted for as depreciation write-off in a lump sum against the profit (earnings), this is the ***lump-sum depreciation***.

Time limits have also been specified in accounting for the planned depreciation:

completed pilot development, furthermore

the capitalised value of formation, promotion and restructuring can be written off in 5 years or less.

- ***No planned depreciation can be accounted for:***
- after land area, plot (with the exception of a land area, plot used to exploit a mine, or to store hazardous waste), forest, for the cost (purchase value) of works of art, archaeological finds,
- investments that were not put into operation,
  in case of such assets, which during use do not lose their value, or the value of which – due to their particular situation, unique nature – is increasing year in year out,
  in case of intangible and tangible assets that have reached the planned residual value.

No planned, and extraordinary depreciation can be accounted for in case of already fully written off intangible assets and tangible assets.

Planned depreciation must be accounted for as expenses.

Extraordinary depreciation

Depreciation may also occur during the use of intangible assets and tangible assets, which over and above the continuous – planned –

settlement of depreciation must be accounted for, when the conditions set in the accountancy act come true. This is extraordinary depreciation.

The settlement of extraordinary depreciation can have various instances (legal titles).

Extraordinary depreciation must be accounted for with intangible assets and tangible assets in case, if

the book value of the asset falling under ***intangible assets,*** and ***tangible assets (not including investments)*** is permanently and significantly higher than the market value of this asset,

a. the value of ***intangible livestock, tangible assets (including investments)*** is persistently decreasing, because the intangible livestock, tangible assets (including investments) have become redundant due to changes in the business activity, or through damage, destruction, and shortage they cannot be used for their intended purpose, or they are unserviceable,
b. the ***rights representing assets*** due to amendment of the contract can only be enforced within limits or not at all,
c. the activity realised through ***completed research and development*** is restricted or terminated, or it remains ineffectual.
d. the book value of ***Goodwill*** – due to changes in circumstances affecting expectations about future economic benefits – persistently and significantly exceeds its market value, or the value specified as the sum of expected return.

Reduction of the value should be performed until such a degree that assets belonging to intangible assets, tangible assets, in line with usability of the investment appear at ***market value valid during preparation of the balance sheet***. Insofar as the asset belonging to intangible assets, tangible assets, according to the intended purpose of the investment cannot be used, or is unserviceable, destroyed or missing, it must be withdrawn from among intangible assets, tangible assets or investments.

Extraordinary depreciation reversal

In the years following settlement of the extraordinary depreciation the asset's market value may rise.

For ensuring a true and fair overall picture the positive shifts in market sentiment must be considered with the reversal of the depreciation.

According to the accountancy act, if the asset belonging to intangible assets, the book value of tangible assets is lower from its net value determined by making allowance for planned depreciation, and the reasons for evaluation at a lower value (settlement of extraordinary depreciation) no longer exists or exists only in part, the amount of extraordinary depreciation already accounted for must be reduced. The asset belonging to intangible assets, tangible assets must be retro-evaluated to ***its market value, at best to the net value determined by making allowance for planned depreciation***.

Attention! Because of market value fluctuations in case of investments, extraordinary depreciation cannot be accounted for, therefore no reversal is possible either.

The settling of extraordinary depreciation and its reversal in accounting

The extraordinary depreciation must be accounted for as ***other expenses***, and the reversal as ***other income***.

9.3.2 The impairment of assets

In domestic regulations the deterioration, wear and tear of intangible assets and tangible assets is accounted for under depreciation. For all other assets if they lose from their value, it is **impairment**.

- Impairment must be accounted for
- with investments signifying ownership participation in a company,
- with securities signifying creditor relationship with a due-date of over one year
- with receivables,
- with stocks.

Impairment of participations, securities signifying a creditor relationship

The investments signifying ownership participation and securities with a due-date of over one year, depending on the investment objective of the entrepreneur should be classified under fixed or current assets.

- With ***investments signifying ownership participation, securities signifying creditor relationship with a due-date of over one year*** in a company – irrespective of whether they are included under current assets, or financial assets (investments) – an impairment should be accounted for, if there appears to be ***persistent and significant loss-type difference*** between the book value and the market value of the investment.

To simplify: impairment should be accounted for, if the book value of investment, securities signifying creditor relationship with a due-date of over one year persistently and significantly exceeds its market value.

Long-term is deemed to be a period of more than one year. The significant limit must be fixed in accounting policy (%, absolute amount, or a combination of the two).

The amount of impairment: The loss-type amount of a difference between the book value and market value.

Last year we bought shares in ”XY” Plc. for HUF 100,000. The shares are worth HUF 85,000 on the availability day of the current financial year and HUF 80,000 on the balance sheet-day. The fall in prices lasts for two years, so it’s long-term.

Our enterprise has stipulated it in accounting policy that a change of 10% or more (reduction or increase) in the market value is to be deemed as significant.

Knowing the above data, let us see at what value our enterprise presents the participation in the balance sheet of the given financial year!

The fall in market prices is HUF20,000, which is 20%!

The trend of market value decline is thus long-term (lasts for two years), and significant (price change exceeds 10%), therefore based on the principle of caution it must be evaluated.

Which date is to be decisive?

The assets with the exception of foreign exchange assets must be evaluated at a price valid on the balance sheet date.

Consequently: HUF100,000 – HUF80,000 = HUF20,000 impairment must be accounted for!

Reversal of impairment (write-down)

Market sentiment may change to positive following settlement of the impairment, in other words the market value of ownership participation may be increased.

Insofar as for investments signifying ownership participation, securities signifying creditor relationship with a due-date of over one year in a company – irrespective of whether they are included under current assets, or financial assets (investments) – the market value at the ***balance sheet accounting day is significantly and persistently higher than its book value***, the previously accounted for difference in impairment must be reduced by reversal. By reversal of the impairment the book value of the investment ***must not exceed the original***

purchase value, the nominal value for securities signifying creditor relationship with a due-date of over one year.

The settling of depreciation and reversal in accounting:

- settling of impairment: among expenses from financial operations,
- settling of reversal: done for the reduction of ***expenses from financial operations***.
- ***Impairment of receivables:*** The customer must account for, based on its credit history, for financially not settled receivables existing on the balance sheet date of the financial year and by the balance sheet accounting day – based on information available at the balance sheet preparation time – in the amount reflecting a (loss-type) difference ***between the book value of receivables and the amount of probably recoverable receivables***, if the difference appears to be persistent and significant.

On evaluating the impairment the receivable-like items appearing between fixed assets must be handled as receivables, furthermore various receivables shown under current assets, which are as follows:

- advances given for intangible assets,
- advances given for investments,
- long-term loans,
- advances (prepayments),
- receivables (trade debtors, bills receivable and other receivables).

During evaluation it may emerge that some receivables – in whole or in part – are irrecoverable. ***Irrecoverable receivables*** must be accounted for among other expenses against profit (earnings) as lending losses, at the same time with the reduction of receivables, i.e. no depreciation can be accounted for.

Reversal of impairment (write-down)

The conditions encountered during certification as a basis for impairment may later turn more favourable, which may bring about a reduction of the earlier settled amount of impairment.

Insofar as for the customer, based on its credit history the amount of probably recoverable receivables significantly exceeds the book value of the receivables, the previously settled difference in impairment must be reduced by reversal By reversal of the impairment ***the book value of the receivables must not exceed the amount for its registration.***

The settling of depreciation and reversal in accounting

- the impairment as ***other expenses***,
- the reversal should be accounted for as ***other income***.

Impairment of stocks (inventories)

Similarly to other assets, impairment must be accounted for stocks too, but not only because of market value decline, but also, if the quality is deteriorating. Impairment established by observing the market value judgments for all assets – thus for stocks too – is settled at the end of the financial year, while the impairment due to quality deterioration of stocks may occur at any time during the year and it can be accounted for.

For stocks impairment must be accounted for:

if the purchase value, book value of the bought stocks is ***significantly and persistently*** higher than its market value known at preparing the balance sheet, then it should be included in the balance sheet at its actual market value;

if the production, or book value of the self-produced stocks (work in progress, semi-finished and finished products, animals) is ***significantly and persistently*** higher than its known and expected selling price at preparing the balance sheet, then it must be shown in the balance sheet with a selling price that is reduced by the costs expected to be incurred yet, and increased by the expected assistance;

if the purchased or self-produced stocks ***do not correspond to the relevant regulations*** (standard, delivery conditions, professional instructions, etc.), ***and to its original function***, if ***damaged***, its ***use***, or ***sale has become doubtful***, the cost value of stocks must be shown reduced[10], to appear in the balance sheet in conformity with its actual value.

Reversal of impairment (write-down)

Insofar as the asset's ***market price significantly and persistently exceeds its book value***, the earlier settled impairment with the difference must be reduced by reversal. By reversal of the impairment the book value of the stocks must not exceed their cost.

The settling of depreciation and reversal in accounting

settling of impairment: as ***other expenses***,

settling of reversal: is done as ***other income***.

---

[10] The reduction in the cost value of stocks – by accounting for the difference as impairment – should in this case be performed to such degree, that the stock corresponding to usability (marketability) at (known) market value and valid at balance sheet preparation or at time of certification is featured in the balance sheet at least at recyclable price, or rather at (known) market value valid at the time of certification (at least at recyclable price, or scrap value).

9.3.3 Value adjustment

At the end of a financial year – in the evaluation prior to the balance sheet preparation – the ***market value of assets at balance sheet preparation may exceed the book value***. In the above we could see that if this difference is persistent and significant, and earlier with intangible assets and tangible assets extraordinary depreciation, while with other assets depreciation was accounted for because of market value decline.

As seen, it happened that a positive change had to be considered too with the reversal of extraordinary depreciation, and impairment. The amount of reversal can neither exceed the amount of earlier accounted for extraordinary depreciation, nor the amount of impairment.

It is possible, however, that the market value is still higher than the book value even after the reversal.

Because of the principle of caution, no assets may be revalued. The accountancy act – for specific, long-term assets – provides an ***opportunity for*** taking into account ***the difference significantly exceeding the book value after reversal***. ***This difference is called value adjustment***, and based on this, insofar as serving the long term business activity, the market value of

- rights representing assets,
- trade marks, patents,
- tangible assets (except for investments and advances given for investments)
- investments signifying ownership participation

significantly exceeds the book value of the given ***asset after reversal,*** the difference between the market value and the book value in the balance sheet ***can be shown*** as ***"Value adjustment"***, and as ***"Rrevaluation reserve"*** within shareholder's equity.

The accountancy act therefore leaves it to the entrepreneur whether it wishes to use the opportunity to account for value adjustment, and it should be stipulated in accounting policy. In case it takes up the opportunity, it will not actually be revaluing its assets, since value adjustment must be shown in the balance sheet separately among assets, under a separate balance sheet item. The settling of value adjustment has no impact on the profit (earning), the same amount of source increase is shown in rrevaluation reserve being part of the shareholder's equity.

The evaluation must be made for for individual assets, and accordingly the ***amount of value adjustment and its changes must be recorded as individual assets in the books separately.***

Settlement of the value adjustment in the next, second and subsequent business years is amended in line with the market value.

If the amount of value adjustment specified as individual assets significantly deviates from the amount of value adjustment revealed on the previous financial year's balance sheet date, then the difference backed up by stock-taking

increases the amount of value adjustments against the rrevaluation reserve, ***if the current year's value adjustment exceeds the previous year's,***

reduces the amount of value adjustments against the rrevaluation reserve, ***if the current year's value adjustment is lower*** from the previous year, at best up to the amount of value adjustment revealed on the previous financial year's balance sheet date. ***The difference exceeding the value adjustment must be accounted for as extraordinary depreciation, impairment.***

On account of striking out the assets from the books, the separately recorded value adjustment linked to individual assets must also be cancelled against the rrevaluation reserve.

The correctness of the evaluation must be certified by an auditor.

9.3.4 The end-of-the-year evaluation of assets and liabilities in foreign currency value

The cost in currency, foreign exchange denominated assets and liabilities must be determined in HUF as described earlier in this chapter.

Prior to the balance sheet evaluation, classification tasks must be performed, the assets and liabilities must be cleaned from changes, in other words the following must be accounted for first:

- the credit losses,
- the impairments,
- the reversal of impairments.

The (previous) items to be accounted for in connection with the classifications must be specified in foreign exchange, and then converted into HUF at the exchange rate stipulated in the accounting policy. Differences in exchange arising from the accounting day evaluation can then be determined.

The assets and liabilities in foreign currency value must be shown in the balance sheet in HUF value converted at the applicable foreign exchange rate on the balance sheet date of the financial year.

During the balance sheet accounting day evaluation, assets and liabilities in foreign currency value must be evaluated separately, which means that exchange value on the balance sheet accounting day is compared with the registered exchange value of the assets and liabilities, and the amount of exchange gain or exchange loss is established separately.

Next, we establish the amount of <u>consolidated difference in exchange</u>.

If there is a

- consolidated loss: its balance should be accounted for under expenses from financial operations,
  consolidated profit: its balance should be accounted for under incomes from financial operations.

With the assets and receivables in foreign currency value included into the evaluation the exchange gain or exchange loss must be settled separately.

But, let us see this in an example!

9.3.5 Accounting methods of decrease in stocks

For the stocks introduced a concrete value must be assigned during their release. In general, it is hard to apply the actual purchase price with these assets.

Let us think it over! We will be buying screws, of up to 100 boxes each week. If they are required in production, do we know for sure the concrete price for each box?

Not really, hence we need to employ some kind of evaluating solution, and thus assign a purchase price to the decrease in stocks.

According to international regulations the best-known evaluation methods in case of evaluating on the actual purchase price:

- ***the individual (individually item-by-item attributable) purchase price:*** its application is practical, if the type of stock to be evaluated in a balance sheet comes from a single purchase, thus a concrete purchase price can be assigned to the given stock, or it has typical details distinguishing it from the others, for example a serial number.
- ***the FIFO*** (first in – first out) method: in its essence means, that the decrease in stocks must always be cancelled starting with the oldest existing, i.e. with the value of earliest included stock, thus the value of stock in the balance sheet, existing on the balance sheet accounting day is determined by the latest purchases.
- ***HIFO*** (highest in – first out) method: the decrease in stocks must always be cancelled starting with stock purchased at the highest price, thus the value of stock in the balance sheet, existing on the balance sheet accounting day is determined by the lowest purchase price.
- ***LIFO*** (last in – first out) method: it assumes that the stocks purchased last would be used up or sold first. In this case the stand of stocks existing on the balance sheet accounting day consist only of the stocks purchased first,
- ***LOFO*** (lowest in – first out) method: it assumes that decreases in stocks are accounted for at the lowest purchase price, thus the value of stocks existing on the balance sheet accounting day is always determined by the highest purchase price.

Of the listed evaluation procedures the HIFO, LIFO and LOFO method does not comply with the accounting principles (principle of caution and veracity). The HIFO method irrespective of price trends undervalues compared to the average price. At certain price trends both the LIFO method, and the LOFO method overvalue the stocks irrespective of price variations, namely it values the closing stock at a higher value than its average price.

All these considered, the value decreases in stocks within domestic conditions can only be calculated with the help of the following methods:

- the ***FIFO method***, whereby the assets purchased, produced first are sold, used up first, consequently the items remaining among the assets at the end of the period are the most recently purchased, produced items. *(The asset received first is released first.)*

– ***Average purchase price or sliding average price***, whereby for assets taken into stock at different times and at a different cost a weighted arithmetic average is calculated from the costs, then the value of asset reduction is calculated as the product of the so determined average price and quantity. The value of assets remaining on stock is also determined by the average price. The average price must be recalculated, if a stock increase, new purchase, or production takes place, but it can certainly be calculated for specific periods too, as stipulated in the accounting policy, e.g. on a quarterly basis, and the value of relevant asset reductions in the next period should also be calculated on this basis.

The following details are available about the company's material stock turnover:

Designation	*Purchase*			Release (kg)	Release unit price (HUF/kg)
	Qty (kg)	*Purchase unit price (HUF/kg)*	*Purchase value* (HUF)		
Opening stock	*50.000*	*105*	*5.250.000*		
1st purchase	*30.000*	*109*	*3.270.000*		
1st use				*35.000*	
2nd purchase	*40.000*	*112*	*40.480*		
3rd use				*30.000*	

Additional information:
The enterprise keeps interim purchase price records.
The cost settlement of stocks is done by **sliding average price**.
The cost settlement of stocks is done by the **FIFO** method.

Task:
Determine the settlement prices for the stock movements!

Determine the book value of the closing stock!

➔ ***Sliding average price***

$$\frac{50{,}000 \times 105 + 30{,}000 \times 109}{50{,}000 + 30{,}000} = 106{,}5$$

The unit price of the first use:

At the second we start with the closing stock of the previous period!
There was 80,000 kg at the unit price of HUF 106.5 per/kg
Used up 35,000 kg, remained 45,000 kg, at the average price of HUF 106,5 per/kg, another 40,000 kg bought, at the average price of HUF 112 per/kg.

The formula is:

$$\frac{45{,}000 \times 106.5 + 40{,}000 \times 112}{45{,}000 + 40{,}000} \quad \sim 109$$

Designation	Purchase			Release (kg)	Release unit price (HUF/kg)
	Qty (kg)	*Purchasing unit price (HUF/kg)*	*Purchase value* (000 HUF)		
Opening stock	*50,000*	*105*	*50,250*		
1st purchase	*30,000*	*109*	*30,270*		
1st use				*35,000*	*106,5*
2. purchase	*40,000*	*112*	*40,480*		
3rd use				*30,000*	*~109*

➔ FIFO method

Designation	Purchase			Release (kg)	Release unit price (HUF/kg)
	Qty (kg)	*Purchasing unit price (HUF/kg)*	*Purchase value* (HUF)		
Opening stock	*50,000*	*105*	*5,250,000*		
1st purchase	*30,000*	*109*	*3,270,000*		
1st use				*35,000*	*105*
2nd purchase	*40,000*	*112*	*40,480*		
3rd use				*30,000*	*107.5*

1. ***unit price of use:***

   35,000 kg is realised from the opening stock: 35,000 x 105 = HUF 3,675,000

   And remains: 15,000 x 105 = HUF1,575,000 worth

2. ***of use 40,000 kg. The reminder is used from the opening stock and 25,000 is needed from the first purchase!***

15,000 x HUF 105 per/kg + 25,000 x 109 = 4,300,000 the total value of the use, projected per kg, that is HUF 107.5 per/kg!

PLEASE PRACTICE!!!!!

9.4 SUMMARY AND QUESTIONS

9.4.1 Summary

The statement of a company's assets is a task of accounting.

The registered value of certain assets as a framework is determined by the law, of the options provided by the law the entrepreneur decides about the concrete application of certain procedures.

The cost is the registration value of the given asset, which depending on the way it is acquired could be the purchase value, cost of production, as well as value by contract, regulation or agreement.

After the registration the value of the assets may fluctuate, e.g. the tangible assets wear out or the stock is destroyed, or perhaps the exchange rate changes. The cost can therefore be modified by value modifying items, considering of which the value of an asset in the balance sheet is formed.

9.4.2 Self-test questions

You need to know the concepts below:

? The concept of cost

? Value of import purchasing

? Cost of foreign exchange denominated assets and liabilities

? Cost of contribution in kind

? Cost of interest bearing securities

? The cost of assets received free of charge, as gift, bequest, or discovered as surplus

? The asset's cost of production
? The concept of depreciation
? Useful life-span
? Residual value
? The methods for determining depreciation
? Prohibitions related to accounting for depreciation
? Ownership participation, Impairment of securities signifying creditor relationship
? Impairment of receivables
? Value adjustment
? The value of assets and liabilities in foreign currencies in the balance sheet
? Accounting for the difference in exchange
? FIFO method
? Weighted average price

9.4.3 Tasks for practice

➔ ***Determining the Goodwill at acquisition***

The enterprise has acquired a company, with the value of its assets and assumed liabilities contained in the following table (data in thousands HUF).

Designation	**Market value**
Trade marks, patents	2 900
Rights representing assets	7 100
Land and buildings	53 000
Technical equipment	31 000
Raw materials and consumable goods	18 700
Receivables	19 500
Total assets received:	***132 200***
Investment and development credits	20 000
Advances received from customers	3 100
Accounts payable	23 500
Short-term loans	15 000
Other short-term liabilities	9 100
Assumed liabilities	***70 700***

The purchase price:
a) HUF 50 000k
b) HUF 61 500k
c) HUF 70 000k
Do not forget! Positive goodwill will arise, in case “If more is paid for it from its actual value”!
Solution:

thousand HUF

Numbe r	Designation	Variations		
		a)	b)	c)
1.	Purchase price	50 000	61 500	70 000
2.	Market value of assets	132 200	132 200	132 200
3.	Value of liabilities	70 700	70 700	70 700
4.	Difference (2–3)	61 500	61 500	61 500
5.	***THE PAID CONSIDERATION***	50 000	61 500	70 000
6.	***Goodwill***	***–11 500***	**–**	***8 500***

Under version a) the negative goodwill is only going to be HUF ***11 500***, which must be listed under accrued expenses.

➔ ***Example for the cost value of interest bearing securities***

A limited company wants to invest its liquid assets (cash) into securities. It classifies the purchased bonds are under investments (financial assets). The number of purchased bonds is 500 pc, the issue date is 5th June of the current year, the nominal value is HUF10 000 per/pc, the rate of interest 12%, purchase date 5th September, so the purchase price is

a. HUF 10 300 per/pc
b. HUF 10 500 per/pc
c. HUF 10 000 per/pc

Task: Determining the cost of the bonds.

Solution:

The cost of bonds (interest bearing securities) cannot include interest as part of the purchase price.

The amount of interest as part of the purchase price: the pro rata interest from its issue (for securities issued in the previous year, years from the last interest payment) for a period of up to the date of purchase, i.e.

$$\frac{10\ 000\ \ HUF\ \ \ x\ 12\,\%}{12\ \ months}\ x\ 3\ months\ \ = 300\ \ HUF\ /\text{piece},\ \ \ \text{total}\ \ 150\ \ 000\ \ HUF$$

The cost of the bonds:
(HUF 10 300 per/pc – HUF 300 Per/pc) x 500 pc = HUF 5 000,000
(HUF 10 500 per/pc – HUF 300 per/pc) x 500 pc = HUF 5 100,000
(HUF 10 000 per/pc – HUF 300 per/pc) x 500 pc = HUF 4 850,000

➔ Task for practicing the use of stocks

The following details are available about the company's material stock turnover:

Designation	Purchase			Release (pc)	Release unit price (HUF/kg)
	Qty (pc)	Purchase unit price (HUF/kg)	Purchase value (HUF)		
Opening stock	40	12.000	………..		
1st purchase	50	12.500	………..		
1st use				60	………
2nd use				20	………
2. purchase	70	11.800	………..	……….	
carriage		300			
3rd use				80	………

Task: work out the amounts for the dotted lines!
Additional information:
The enterprise keeps interim purchase price records of its stocks.
The cost accounting of stocks is done by the FIFO principle.
by the FIFO principle

Designation	Purchase			Release (pc)	Release unit price (HUF/kg)
	Qty (pc)	Purchase unit price (HUF/kg)	Purchase value (HUF)		
Opening stock	40	12.000	480.000		
1st purchase	50	12.500	625.000		
1st use				60	12667
2nd use				20	12500
2nd	70	11.800	………..	………	

purchase				.	
carriage		300			
3rd use				80	………

1st use: from opening stock 40 x 12 000 = 480 000
1st purchase: 20 x 12 500 = 250 000
Total = 730 000
projected to 1 piece: HUF 12 667 per/pc

2nd use: 1st purchase 20 x 12 000 = 240 000
from 1st purchase remains 10: 10 x 12 000 = 120 000
from 2nd purchase 70 needed: 70 x 12 100 = 847 000
Total = 967 000
projected to 1 piece: HUF 12,075.5 per/pc

Note: let us must not forget, what can be part of the cost! The cost of carriage unequivocally is!

9.4.4 Practice tests

		correct answer	wrong answer	wrong answer	wrong answer
1	*The concept of purchase cost*	The total amount of items that can be individually linked to assets in the interest of procuration, creation, putting into operation, incurred until putting into operation / delivery to the warehouse.	The total amount of items that can be individually linked to assets in the interest of sale, incurred until putting into operation / delivery to the warehouse.	The total amount of items that can be individually linked to assets in the interest of operating the assets, incurred until putting into operation / delivery to the warehouse.	Any such amount that had to be paid out.

2	*Cost of foreign exchange denominated assets and liabilities*	The value in HUF pertinent to the cost, or converted at the foreign exchange rate as stipulated in accounting policy at the date of performance under the contract, in case of foreign currency bought for HUF, the amount actually paid.	The value in HUF pertinent to the cost, or converted at the foreign exchange rate as set out in the accountancy act at the date of performance under the contract, in case of foreign currency bought for HUF, the amount actually paid for.	The value in HUF pertinent to the cost, or converted at the foreign exchange rate as set out by the credit institution maintaining the account at the date of performance under the contract, in case of foreign currency bought for HUF, the amount actually paid for.	The value in HUF pertinent to the cost, or converted at the foreign exchange rate as set out by the Hungarian Central Bank at the date of performance under the contract, in case of foreign currency bought for HUF, the amount actually paid for.
3	*The cost (purchase value) of interest bearing securities*	May not contain the amount of accumulated interest	Amount of interest,	Always the market value	Always the paid consideration.
4	*The cost (purchase value) of assets received free of charge (without obligation to return), as gift, as bequest, or discovered as surplus*	its market value known at the time of taking it into stock	its registered value known at the time of taking it into stock	its waste value known at the time of taking it into stock	• Its net value known at the time of taking it into stock
5	*Depreciation*	the monetary value of	the monetary value of	the projected value of	the recognised

		physical wear and tear and obsolescence of intangible assets and tangible assets.	physical deterioration, wear and tear of intangible and tangible assets.	physical wear and tear and obsolescence of intangible and tangible assets	value of physical wear and tear and obsolescence of intangible and tangible assets
6	*FIFO* method	in its essence means, that the decrease in stocks must always be cancelled starting with the oldest existing, i.e. with the value of earliest included stock, thus the value of stock in the balance sheet, existing on the balance sheet accounting day is determined by the latest purchases.	the decrease in stocks must always be cancelled starting with stock purchased at the highest price, thus the value of stock in the balance sheet, existing on the balance sheet accounting day is determined by the lowest purchase price.	it assumes that the stocks purchased last would be used up or sold first. In this case the stand of stocks existing on the balance sheet accounting day consist only of the stocks purchased first,	it assumes that decreases in stocks are accounted for at the lowest purchase price, thus the value of stocks existing on the balance sheet accounting day is always determined by the highest purchase price.
7	*HIFO* method	the decrease in stocks must always be cancelled starting with stock purchased at the highest price, thus the value of stock in the balance sheet, existing on the	in its essence means, that the decrease in stocks must always be cancelled starting with the oldest existing, i.e. with the value of earliest included stock, thus	it assumes that the stocks purchased last would be used up or sold first. In this case the stocks inventories existing on the balance sheet	it assumes that decreases in stocks are accounted for at the lowest purchase price, thus the value of stocks existing on the balance sheet

		balance sheet accounting day is determined by the lowest purchase price.	the value of stock in the balance sheet, existing on the balance sheet accounting day is determined by the latest purchases.	accounting day consist only of the stocks purchased first,	accounting day is always determined by the highest purchase price.
8	*LIFO* method	it assumes that the stocks purchased last would be used up or sold first. In this case the stocks inventories existing on the balance sheet accounting day consist only of the stocks purchased first,	it assumes that decreases in stocks are accounted for at the lowest purchase price, thus the value of stocks existing on the balance sheet accounting day is always determined by the highest purchase price.	in its essence means, that the decrease in stocks must always be cancelled starting with the oldest existing, i.e. with the value of earliest included stock, thus the value of stock in the balance sheet, existing on the balance sheet accounting day is determined by the latest purchases.	the decrease in stocks must always be cancelled starting with stock purchased at the highest price, thus the value of stock in the balance sheet, existing on the balance sheet accounting day is determined by the lowest purchase price.
9	*LOFO* method	it assumes that decreases in stocks are accounted for at the lowest purchase	it assumes that the stocks purchased last would be used up or sold first. In	the decrease in stocks must always be cancelled starting with stock purchased at	in its essence means, that the decrease in stocks must always be cancelled starting with

		price, thus the value of stocks existing on the balance sheet accounting day is always determined by the highest purchase price.	this case the stocks inventories existing on the balance sheet accounting day consist only of the stocks purchased first,	the highest price, thus the value of stock in the balance sheet, existing on the balance sheet accounting day is determined by the lowest purchase price.	the oldest existing, i.e. with the value of earliest included stock, thus the value of stock in the balance sheet, existing on the balance sheet accounting day is determined by the latest purchases.

10. THE PROFIT AND LOSS STATEMENT AND THE BALANCE SHEET

10.1 OBJECTIVES AND COMPETENCES

All the previous chapters served this one, i.e. the calculation of the profit. Let's see the income of the economic activity!

Business entities have assets, as you could see it in the video. Gábor has apported his bicycles, Zsolti his garage, Rita her computer into the undertaking, while Fanni has taken her money in acquiring ownership in the undertaking created. All of them wish to take part in the work, but their purpose is to gain profit as a income of their work, which will be spent in accordance with the needs for their own use, or left in the company for development. The point is: they want to be millionaires!!!

In addition to the magnitude and the positive or negative sign of the profit-and-loss, for an entrepreneur it is also important to know what were the main factors affecting the generation of the profit, what were the components of the profit-and-loss, where income or loss comes from. All know that ***more revenue must be achieved than expenditure has been spent on the operation of the business***, since this is the only way to generate income, that is profit.

Using the course material you will learn the essential context for making a balance sheet, which is the already a little easier if we can rely on what has been said so far.

The context must be presented uniformly, so that all business entity could use the same concepts with the same content.

Now, the aim is that you become a partner in this job, that you understand and be able to apply to the basic concepts, the content of each item, and to make a profit and loss statement on the basis of the essential correlations.

Time Required: in this case again, a bit more is requires as you need to exercise more; to acquire durable knowledge you will need at least 14 hours. In particular, the revisions require more time.

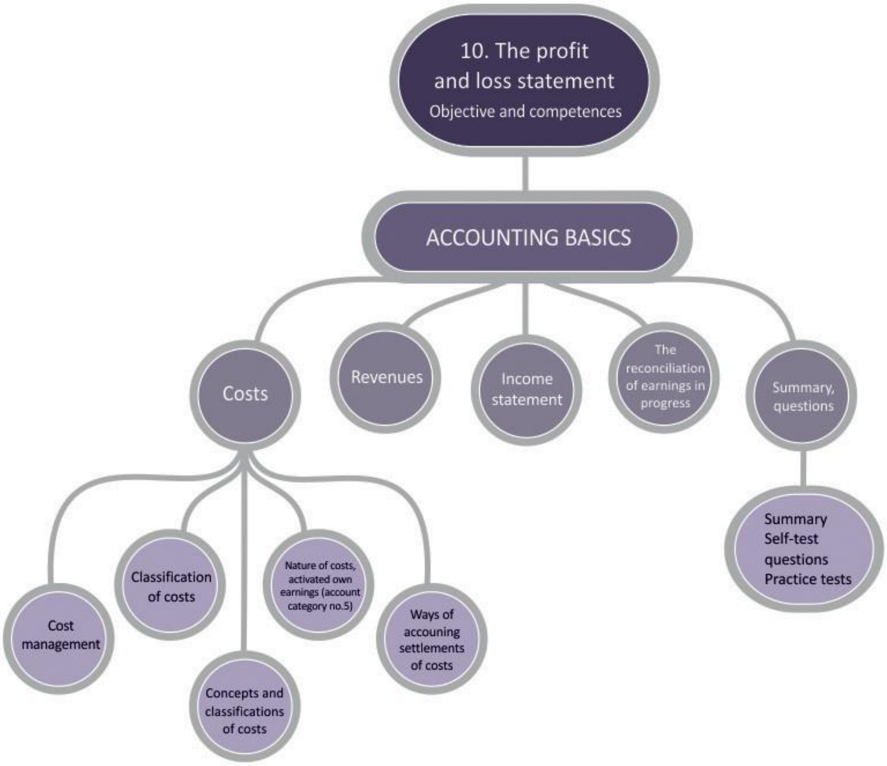
My well-intended advice:

Take a sheet of paper and a pen and write what you want to remember. Organise what you have learned in your own logic and approach.

Key expressions:

- Cost
- Cost budgeting
- Recalculation
- Direct cost
- Indirect cost
- Attributable cost
- Indivisible cost
- Adjusted direct costing
- Nature of costs
- Activated own earnings
- Expenditure
- Other charges
- Expenditures on financial operations.
- Extraordinary charges
- Revenue
- Turnover
- Other income
- Revenue of financial operations.
- Extraordinary income
- The income-statement formula
- Categories of earnings
- (A) Operating (business) activity earnings
- (B) Financial operations earnings
- (C) Ordinary business earnings
- (D) Extraordinary earnings
- (E) Pre-tax earnings
- (F) Post-tax earnings
- (G) Balance sheet earnings

Let's look at the learning chart first.



27. Figure

10.2 COSTS

As you already know, an enterprise is a business entity, which carries out a production or service activity on its own behalf and at its own risk, in order to make profit and assets on business basis, for consideration.

In the course of the production or service activity carried out on business basis, the enterprise utilises resources, i.e. assets, and labour. **Cost** is the value of the assets and labour used in order to perform the business activity.

During the activity new assets, services are created, the value of which is equal, under the UAA, to the value of the equipment and labour used to create them, that is, to the production cost.

On the basis of the foregoing a business activity constitutes at the same time

- a consumption process, since it uses resources and
- a value generating process, because a new assets, products are created.[11]

On this basis of this, the concept of cost may also be determined in two approaches:

the most common definition says that it is the value of **the assets and work performances *used in pursuit of the activity,*** expressed in monetary value, which always:

occurs in favour of the activity, during some technical or economic activity,

means the assets and labour use to be expressed in monetary value.

In other words, cost is **the value expressed in money value of the assets and labour (staff and materialised labour) used** directly or indirectly **in the course of the business** in a specific period (for example, a business year).

10.2.1 Cost management

Cost means the use of some kind of resource. The majority of the resources are limited; furthermore, to obtain or use them incurs a cost increase. The most important possibility of increasing the earnings is the more effective use of the available resources. The optimisation of the costs does not only improve the profitability of the company, but also means the economical usage of Nature's resources.

We mean by cost management the activity aiming to use the available resources, production factors, (assets, labour) effectively and economically.

Cost management is not cost reduction in all cases, at all costs. The production processes can be performed by a certain quantity and quality of resources. This entails a certain cost level. If it cannot be ensured, the quality can be compromised, or possibly the partners' or workers' interests will not be met.

Therefore, in the cost management we are to endeavour that during the activity the **necessary and justified** cost-items should be displayed in the necessary and justified quantity and time.

[11] The collection and the record of costs related to consumption process is called input costing, and the costs related to the value generating process are called output costing.

Therefore, a very important responsibility of the company is to monitor the costs constantly. C**ost management shall include the following tasks:**

The planning of the necessary and justified costs before the production process starts. During this, it is worth doing **cost budgeting** for the product or service, during which is planned what cost-items in what quantity are required, that is what will be the estimated production cost of the product or service. In the planning **the standards should be set**, that is, the workflow shall be broken down into the phases, and the time and assets requirements of each operation shall be established.

During the preparation of the production process the **certification and remittance schedule of the costs is to be established**, which provides a good basis for the completion **control** either ex-post or built in the process of production.

When accounting for the costs incurred, the company shall register the costs incurred. In the double-entry accounting **there are several ways** to do this.

In accordance with the needs of managers in parallel with the process of production, but not later than after it, the **analysis and control of the costs is necessary,** in which the need of the cost elements occurred, their comparison with the plan data, the justification of the dynamics of the cost increases are examined. **Recalculation** is carried out in order to be able to deduce conclusions in the future to tell in what way the cost management could be more effective.

10.2.2 The concept and classification of costs

Perhaps one of the most difficult things for students is to understand two basic earnings-reducing concepts, to make a distinction between cost and expenditure.

Cost is the monetary valuation of the assets and labour used in order to perform the business activity in a period, for the analysis, and during the financial year for reporting.

Expenditure: actual or expected outflows, and other items of the nature of loss. This includes the assets decreases and the obligation increases values other than within the circle the production and/or services.

An umbrella term, which includes:

- costs which have become expenses
- other charges,
- expenditures of financial operations,
- extraordinary charges.

There are components of the expenditure, which

- we have recorded previously as a cost, and will become expenditure depending on the issue, for example on the sales (e.g. finished products sold, direct cost of services provided),
- are to be charged directly as an expense on the earnings side, the cost of which does not appear as a cost, such as the cost of goods sold, other charges, etc.

My students generally understood the difference between the two concepts, when we the earnings-reducing item was attached to the objective undertaken of the enterprise.

*If we use the telephone, build in parts, settle wages, pay banking charges – these are all earnings-reducing items which incur related to the repair and trade of the bicycles, so they are **costs**.*

*If we take a loan, it also serves the interests of the undertaking, but we cannot repair with its interest, it does not directly serves the chosen activity, and therefore the interest paid is **expenditure**.*

10.2.3 Classification of costs

Costs can be classified on the basis of several criteria, but here we emphasise the types, which are closely related to the course material.

The costs ***can be grouped by:***

- presentation form, i.e. nature of costs,
- settlement mode, i.e. as direct or indirect items,
- on the basis of other aspects.

(b) The classification of costs by settlement mode

According to how the costs are settled, we can speak about direct and indirect costs.

To establish the profitability of the product produced or the service provided, by the firm's service or, it is necessary to accurately establish the product or service by the enterprise, it is necessary to see the production cost of one unit of the product or the service, its direct cost, but for some of the undertakings the Accountancy Act requires in the provision on the cost regulation obligation that the cost of the internally generated assets or that of the services provided shall be established by the method of recalculation.

The establishment of the production cost and the direct cost requires making a distinction between direct and indirect costs:

- The costs, which can be settled **direct**ly related to the activity, we can determine at the time of their incurrence at the spending of which product or activity, in the accounting terminology, of which <u>cost bearer</u> they shall be charged.
- In the case of indirect costs, at the time of their incurrence, only their location, to use the accounting terminology, the <u>cost centre</u> can be established, and cannot be accounted directly for any cost bearer, assets, product or activity.

To meet the needs for costing, the Accountancy Act provides the opportunity for such clustering of costs by the application of the classes of accounts N° 6 and 7. Although there are no mandatory provisions for the names of these classes of accounts, they can be the following:

Cost centres (general costs)

Cost bearers (costs of activities)

It is not mandatory to apply these classes of accounts, but if the entrepreneur opts for them, it is also necessary to register costs by nature, since the costs are to be presented broken down by nature in the notes to accounts.

The arrangement of the costs by cost centres classifies costs by the location of causation. Costs centres are physically or conceptually limited organisational units under the control of a responsible manager, designated to account for the costs.

A cost centre can be a plant, a plant unit, sector, commercial, administrative or organisational unit, etc.

*Beside the provisions of the Accountancy Act, the arrangement of **cost centres** and the creation of cost categories are affected by a number of factors, for instance, the organisational structure, the regional location, the technology, the internal analysis needs.*

The costs recognised for cost centres can be divided into two subgroups:

Attributable costs can be recognised in close connection with the assets produced and the services provided, and with the help of appropriate indicators, characteristics of the assets and services. This part of the indirectly recognised costs shall be transferred from the cost centre to the cost bearer at the end of the period, but not later than at the end of the business year, i.e. these distributed items shall be included in the production cost.

Please, remember. Under the provisions of the Accountancy Act, the direct ***(production) cost*** *of a product or a service is composed by the following costing factors:*

- the costs incurred directly during the production of the product (service),
- the costs demonstrably closely related to the production
- the costs, which can be recognised at the spending of the product (service providing) using appropriate indicators and characteristics.

The costs of products, services, assets can be calculated, therefore, with the following model:

+ Direct material costs
+ Direct labour costs and contributions
+ Other direct costs

= **Direct costing**

\+ The allocated part of the operating general costs

= Adjusted direct costing

THE ADJUSTED DIRECT COSTING is the registration value, which is recognised as a (historical) cost by the Accountancy Act.

In your work, always take the greatest care to check the reasonableness and appropriateness of the recognised costs, but also pay attention to the fact that the attributable costs should be realistic and justified. This item may often define your premium and bonus and those of your subordinates.

The “residual” costs left after the allocation of costs are the **indivisible costs**, which shall not be included in the production cost. These costs shall be implemented among the direct costs in the profit and loss statement based on the cost of sales at end of the business year.

Cost bearers are the products, product groups, activities, activity groups and services, during the production or execution of which the assets and labour has been used.

The primary purpose of the accounting by cost bearers is to establish the manufacturing cost of the product or service.

10.2.4 Cost-accounting possibilities

In the area of cost-accounting, the Accountancy Act leaves ***choice*** *for businesses* subject to the proviso that the detailed registration of costs by nature and the possibility of establishing the activated value of internally generated assets should be ensured during the year.

When making the choice, ***the form of the profit and loss statement*** is decisive***.*** In the profit and loss statement based on costing by nature the outlining of the material costs, the staff costs and the depreciation is required; the procedure based on costs of sales requires the separation of direct and indirect costs.

The preparation of a profit and loss statement based on costs of sales shall not give exemption either to the collection of costs by nature or the establishment of the value of the activated own earnings, since these are to be presented in part of the notes to accounts related to the profit and loss statement.

When creating the cost-accounting system, the following should be taken into consideration:

- the form of the profit and loss statement,
- the capabilities of the business entity,
- the need for information of the business entity,
- the mode of the stock accounts.

The possible versions of cost-accounting may broaden depending on whether the company has internally produced stocks, whether it has a registration about them during the year, or not.

The optional cost-accounting methods:

- The costs of the undertaking are accounted only under **Nature of the cost**.
- The costs of the undertaking are primarily accounted under **Nature of the cost**, secondarily under ***Cost centres (General costs)***, collected among the costs by ***Cost bearers (costs of activities)***.
- The costs of the undertaking are primarily accounted under ***Cost centres (General costs)***, among the costs by ***Cost bearers (costs of activities)***, secondarily under **Nature of the cost**.

Beside these basic types, additional versions can be found in practice.

10.2.5 Nature of costs, activated own earnings

Under the nature of costs the following items shall be recognised:

- Material costs
- Cost of services received
- Costs of other services
- Labour costs
- Other payments of personnel nature
- Wage contributions
- Depreciation
- **Value of activated own performance**

NATURE OF COSTS

Within this class of accounts, the entrepreneur applying the classification of costs by nature, shall present separately the change in value of the **activated own earnings** in the current year (otherwise not qualified to be a nature of cost or cost recovery) as the coverage of the indirect costs of its size and the equal value with the indirect cost of the performance, which has not been subject matter for sale.

Having clarified the concepts of costs incurred in the business year and costs having become expenditure in the business year, let us see the interpretation of expenditure.

Expenditure: an umbrella term, which includes:

Costs having become expenses (costs, which can be set against sales revenues): the total amount of the cost of stocks (products, materials, goods) sold and the services provided in the business year and of the costs not included in the production cost of the current year (the indirect costs of sales);

Other charges: payments and other items of nature of loss directly or indirectly related to the sales revenue, which occur during the regular activity and are neither expenditures on financial operations nor extraordinary charges.

Expenditures on financial operations: the exchange loss of the invested financial assets, the interest to be paid, interest-featured expenses, other expenditures on financial operations, the loss in value of shares, securities and bank deposits;

Extraordinary charges: the assets depreciation and payments independent from the activity of the company, occurring in addition to usual business, not related to the ordinary entrepreneurial activity.

Let us see a couple of examples for each cluster of expedniture.

Costs having become expenses: *in the starting business that you could see in the video, Gábor has undertaken the renovation of a bicycle. He used parts for the reparation. At first, this had to be booked in the class of accounts N^o 5, and from there, depending on the form of the profit and loss statement, was moved to the class of accounts N^o 8, among expenditure as a cost becoming expenditure.*

Other charges: *a bicycle had to be discarded, because after having been rented, it had an accident. They had insurance on it, and the insurance company recognised the damage. The value of this bicycle in the register must be presented as an item of other charge reducing the earnings.*

Expenditures on financial operations: *instruments and bicycles have been purchased, but to be able to do so, they had to have credit from the OTP Bank. The interest paid on the credit is expenditure on financial operations.*

Extraordinary charges: *a refurbished bicycle has been given as a gift to the elderly people's home in the next building. Its value in the register is an extraordinary charge.*

10.3 THE REVENUES

In everyday life, we mean by revenue the amounts in the "pocket". In accounting, we are to adopt other thinking.

I will give you a loan of a thousand HUF. You will have a money income, but you will not have more property, because you have to pay it off. This is not an income in terms of accounting. When the SIKER Ltd. invoices the overhaul cost of the bicycle, the customer has not paid yet, but revenue has already been generated, based on the invoice, despite the fact that the cash flow, the payment of the service is due later. If the repair is paid in cash, the increase of the income and the money income coincides, but you must not forget that the two concepts are not the same.

Therefore, ***revenue*** *is* a generic term, in which are included:

- ***the turnover :*** the consideration with value added tax excluded received for the stocks sold (products, materials, goods) and the services provided in the business year
- ***other income :*** other income, not part of the revenue, which are created during the regular activity (business) and are not considered to be neither revenue of financial operations, nor extraordinary income;
- ***revenue of financial operations:*** the received (due) dividends and business share, the exchange gain from the sale of shares, the interests and the exchange gain of the invested financial assets, other received (due) interests or interest-featured income, other revenues for financial transactions.
- ***extraordinary income:*** the income independent from the business activity of the company, occurring in addition to usual business, not related to the ordinary entrepreneurial activity.

So, there are four income categories between which a distinction has to be made. With examples it might be easier to understand them.

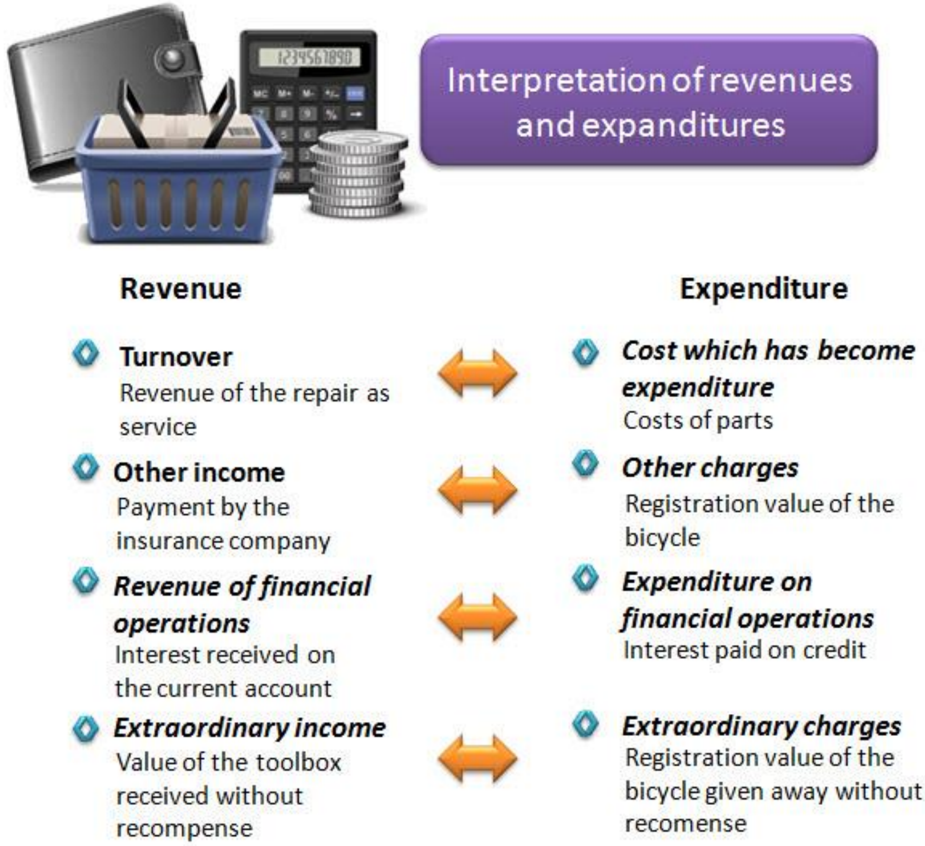
Turnover: *The SIKER Ltd. invoiced the renewal of the bicycle that Gábor has carried out.* ***The point: the revenue achieved as a income of the chosen activity.***

Other income: *the insurance company has transfered the value of the damaged bike. It comes with the operation that accidents may occur, but this is not the purpose of the undertaking. All such income may only be other income!* ***The point: it is an item appearing during operation, but not a turnover, and neither revenue of financial operations, nor extraordinary income.***

Revenue of financial operations: *the SIKER Ltd. has received interest on the amount of money on its current account at the OTP Bank.* ***It is strictly revenue accompanying a financial transaction!***

Extraordinary income: *since Gábor and the others had given a bicycle as a gift, one of the inhabitants in the elderly people's home next door, in exchange for their kindness, –- gave them his toolbox as a support.* ***It is not an ordinary event. This is extraordinary income.***

Each income and expense can be set against each other. Based on the previous examples, the figure here below shows this.



28. Figure

10.4 PROFIT AND LOSS STATEMENT

If you take the Forms of profit and loss statement, and follow the course material there too, we shall go faster!

We have considered all the main groups which increase or decrease the income in order to calculate the income. The total amount of these with the right positive or negative sign would not provide any explanation, what we were good or bad at during the business activity. For that purpose the UAA has named the **income categories** and gave their wording as well.

CATEGORIES OF EARNINGS:

Look for them in the profit and loss statements!

(A) Earnings on operating (business) activities
(B) Earnings on financial operations
(C) Earnings on ordinary business
(D) Extraordinary earnings
(E) Pre-tax earnings
(F) Post-tax earnings
(G) Balance sheet earnings
(A) Earnings on operating (business) activities

This is the income of the "substantial", basic, ordinary activity of the undertaking, which has a major role in calculating the balance sheet earnings.

Always look at the evolution and tendency of this category in a business!

For our enterprise it can be considered to be an operating (business) activity, if a bicycle, is bought and sold, or it may include the service provided in the workshop, or even if they sell the computer (which, within the category, will be other income for the amount received/other charge at the registration value!). But, if they invest in another, well running business, and they will have participiation from there in form of dividends, it would be an ordinary event, however not income from the operating (business) activity but from a financial activity.

In accordance with the international accounting practice the Accouncy Act provides two methods of determing the operating (business) earnings, leaving the choice to the entrepreneur. The two methods lead to the same income, although the data, or a part of them, used to calculate the earnings are different.

The essence of the total cost procedure is that from the total amount of the net sales turnover recognised in the calendar year, the value of own performance registered under the assets and the other incomes – which is the total amount of items increasing the income from the operating or business activity – we subtract the total amount of costs

– material-related expenditures[12], staff-related expenditures, depreciation – and other expenditures recognised in the calendar year, which are income-decreasing items.

The total cost procedure is a gross procedure in its nature, it reduces the total performance – either sold or not[13] – of the current year with the total amount of costs occurred in the current year.

The essence of the cost of sales procedure is that from the total amount of the net sales turnover and other incomes recognised in the calendar year – as items increasing the income – we subtract the total amount of the direct and indirect costs of sales and other charges – as items decreasing the income.

The cost of sales procedure shows the net operating earnings of the enterprise, it reduces the sales income with the direct and indirect costs of sales.

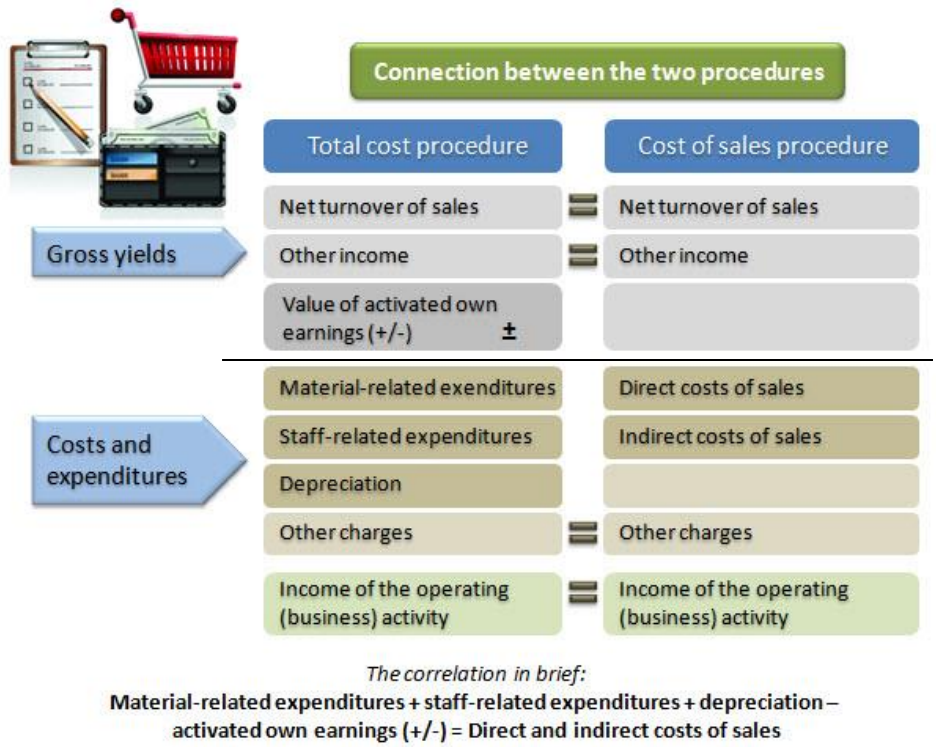
The income established with both procedures is the same, despite the fact that the profit and loss statements do not use the same data. The reason for this is that in the accounts the realised income shall be shown, which is primarily created in the sales process.

The essential difference between the two procedures is that the expenditures have different content. ***In the total cost procedure the total expenses incurred in the current year are included in the expenditures, as well as the inherent expenditure, the costs of goods sold, and transmitted service are included; while in the cost of sales procedure, the income-reducing items include the costs of products sold, to which is the costs of goods sold and the transmitted service are added.***

<u>The difference is in the value of the activated own earnings and the content of the costs.</u>

[12] The Accountancy Act also applies the term expenditure to name certain costs, such as material-related expenditure and staff expenditure. Despite the ambiguous name, they are in fact costs on the basis of their content.

[13] In the business year, the total costs include as well the costs of production of assets and stocks produced but not sold in the current year, but do not include the cost of production of the stocks sold in the current year but produced in the previous years. These items are included in the value of the activated own earnings.



29. Figure

(B) Earnings on financial operations

It is the margin between the income and expenditure of financial operations. The statement of it as a separate item is justified, one the hand, by its allowing to show clearly and to analyse the effect of the financial operations on the balance sheet earnings (e.g., the impact of the interest paid, how it affects the income) and, on the other hand, these revenues and expenses are separated in the international accounting practice, too.

(C) Earnings on ordinary business

***It is the income of the operating (business) activities and the income of the financial operations together are the* Income of ordinary business.** It shows the income coming from the systematic and continuous activity of the business.

(D) Extraordinary earnings

It is the margin between extraordinary revenues and extraordinary charges. Its separation is justified by the fact that its impact on the balance sheet earnings can be clearly identified thereby, and that with this process, the profit and loss statement meets the international accounting requirements as well.

(E) Pre-tax earnings

It is summed up from the income of ordinary business and the extraordinary income. This type of income shall be modified by the income-increasing and income-decreasing items as defined in the act on taxation of all times, and so is given the income underlying taxation.

(F) Post-tax earnings

It is the margin between the profit before tax and the corporate tax to be paid (or paid) on the basis of the income tax declaration, as defined by the act on taxation. Dividends and shares are paid to the owners after approval at the charge of the post-tax earnings.

(G) Balance sheet earnings

It is an Shareholder's equity share, which is no longer decreased by tax or dividends or any participation. Thus, it appears under the resources of the current year in the box of **Balance sheet earnings.** It is calculated from **the post-tax earnings reduced with *the dividends and shares to be paid to the owners, and the interest on the interest share***.

The compilation of the profit and loss statement, and within that the statement of the income of the operating (business) activity can be done, with regard of its content, in two ways (depending upon the decision by the entrepreneur), and with regard of its form, in other two ways, so in a total of

!!! *four different ways*:

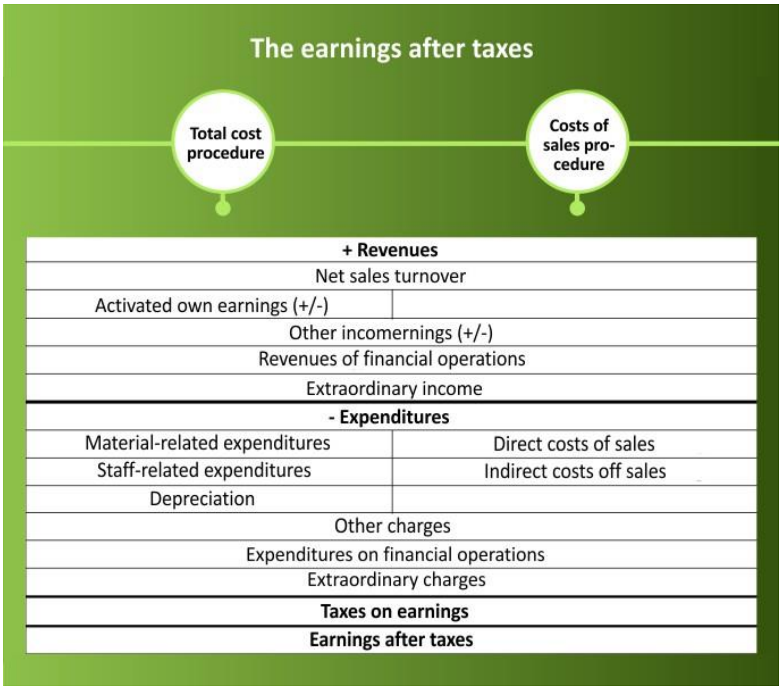
With total cost procedure in a structure in levels (A)

With cost of sales procedure in a structure in levels (A)

With total cost procedure in a balance sheet structure (B)

With cost of sales procedure in a balance sheet structure (B)

In the levelled structure (versions A), under the revenue appear in the costs and expenditures (one after the other). In the ***balance sheet structure (versions B), they are set against each other***, i.e. revenues on the right side, expenditures on the left side, and the two sides are equalised by the earnings.



30. Figure

You can find the different versions of the profit and loss statement, as you have already seen it – in the figures ***Forms of profit and loss statement***.

The profit and loss statement, as part of the annual report, shall be presented in the structure provided by the Accountancy Act and at least in the provided layout, taking into consideration of the rules of the sub-classification and the merging of items, on the basis of the data of duly led double-entry accounts, supported by documents, in a clear and transparent form **in Hungarian**; and the figures are to be given in ***thousand HUF (thHUF)*** . If the total assets of the balance sheet of the annual of the business entity exceed a hundred million HUF, the figures are to be given in ***million HUF (mHUF)***.

In the profit and loss statement, like in the balance sheet, the uniform signs and layout defined in the Accountancy Act shall be used:

main group – which is in capital letter. The main groups are identical with the categories of earnings (e.g. A = the earnings on operating (business) activities).

group – which is designated by a Roman numeral. The groups are the specific costs, expenses, and revenues (e.g. I = net sales turnover).

item – which is identified by an Arabic numeral. Items mean the sub-categories of groups (e.g. 01 = net domestic sales turnover).

The items of the profit and loss statement **can be broken down further**, if it is needed for giving details of the specific items in order to see or support the evolution of the actual value of the earnings. ***New items can also be added***, if their content under legislation is not covered by any of the denominations or content of the items in the scheme prescribed by the Accountancy Act.

10.5 THE CALCULATION OF EARNINGS IN PRACTICE

Now, let's see how all this works in practice.

Revenues of the SIKER Ltd. in the current year:

Bicycles sold	*60 000 thHUF*
Servicing activities (service)	*6 500 thHUF*
Sales of parts	*30 thHUF*
Sales of diagnostic instrument	*200 thHUF*
Interest credited after bank deposit	*20 thHUF*
Market price of asset received without recompense	*5 000 thHUF*

May the categories of costs and expenditures incurred be the following:

Purchase value of bicycles sold (PVGS)	*45 000 thHUF*
Purchase value of parts (Material costs)	*5 000 thHUF*
Wages of mechanics – in fact it's Gábor's (Labour)	*1 000 thHUF*
Public contributions of wages (Wage contributions)	*300 thHUF*
Rent fee of special instruments (Service received)	*1 500 thHUF*
Amount paid to subcontractor (Transmitted service)	*50 thHUF*
Depreciation	*30 thHUF*
Registration value of diagnostic instrument	*120 thHUF*
Debit interest	*100 thHUF*
Registration value of asset given to partner without recompense	*10 thHUF*

Dividends planned:	*10 000 thHUF*

Let us see what earnings our business gained during the current period **(data in thHUF)**:

Revenue		**Expenditure**	
Bicycles sold	60 000	Purchase value of bicycles sold	45 000
Servicing activity	6 500	Value of parts, wages of mechanics, contributions thereof, rental fee of a new workshop	7 800
Sales of parts	30	Subcontractor invoices, depreciation	80
Turnover	**66 530**	**Cost become expenditure**	**52 880**
Sales of diagnostic instrument	200	Registration value of diagnostic instrument	120
Other income	**200**	**Other charges**	**120**
(A) EARNINGS OF OPERATING ACTIVITIES:			**13 730**
Interest credited after bank account deposit	20	Debit interest	100
Revenue from financial operations	**20**	**Expenditures of financial operations**	**100**
(B) EARNINGS OF FINANCIAL OPERATIONS:			**– 80**
(C) ORDINARY BUSINESS EARNINGS:			**13 650**
Market price of asset received without recompense	5 000	*Registration value of asset given to partner without recompense*	10
Extraordinary income	**5 000**	**Extraordinary charges**	**10**
(D) EXTRAORDINARY EARNINGS:			**4 990**
E) PRE-TAX EARNINGS:			**18 640**[14]
		Corporate income tax 10%[15]	1 864
(F) POST-TAX EARNINGS:			**16 776**
		Taken as dividends	10 000
(G) BALANCE SHEET EARNINGS: The capital-increasing income remaining in the enterprise			**6 776**

[14] Pre-tax earnings is not tax base, but you may already know it after what you have learnt in taxation studies, there may be items, which increase/decrease the tax base, the total value of which will give the taxable amount. Int he exercise, it is assumed that the consolidated balance of the correction items is 0 HUF.

[15] 2014:The rate of corporate income tax is 10% up to 500 million HUF, and 19 % for the parts above this value limit.

Now we can set up the profit and loss statement.
Total cost profit and loss stateme (version "A") ***SIKER Ltd.***
Data in thHUF

Serial Number	Description of the item	Previous Year	Current Year
I	**Net sales turnover**		**66 530**
II	**Activated own earnings**		
III	**Other income**		**200**
IV	**Material-related expenditures**		**51 550**
V	**Staff-related exenditures**		**1 300**
VI	**Depreciation**		**30**
VII	**Other charges**		**120**
A	**EARNINGS OF OPERATING (BUSINESS) ACTIVITIES**		**13 730**
VIII	**Revenue of financial operations**		**20**
IX	**Expenditures on financial operations**		**100**
B	**EARNINGS OF FINANCIAL OPERATIONS**		**- 80**
C	**EARNINGS OF ORDINARY BUSINESS**		**13 650**
X	**Extraordinary income**		**5 000**
XI	**Extraordinary charges**		**10**
D	**EXTRAORDINARY EARNINGS**		**4 990**
N	**PRE-TAX EARNINGS**		**18 640**
XII	**Tax liability**		**1864**
F	**POST-TAX EARNINGS**		**16 776**
G	**BALANCE SHEET EARNINGS**		**6 776**

This is only one of the four possible variants of the profit and loss statement.

10.6 SUMMARY, QUESTIONS

10.6.1 Summary

The Accountancy Act does not provide accounts to be mandatorily applied, only a frame, the so-called chart of accounts, that is to say 10 classes of accounts and contents thereof are defined.

The creation and details of the accounts applied by the business entity is the responsibility of the enterpreneur, but it requires that the entrepreneur have them in writing.

The main aim of the operators of economic life, the undertakings is to acquire profit from their activities. Due to a number of other conditions, however, losses can also be generated. The income, therefore, may be positive, i.e. profits, or negative, i.e. loss. The income is calculated by determining the difference between Revenues and Expenditures, with a formula:

Res = Rev – E

The relationship between incomes and expenditures indicates what effect the item has on the outcome, but we have seen that all revenue corresponds to an expense.

The profit and loss statement with regard to its content can be set up in two ways, in total cost procedure, or cost of sales procedure. Both of these have two versions of form, in levelled or balance sheet structure, and therefore there are all together four profit and loss statement versions to exist.

In the profit and loss statement, by the reconciliation of all revenue with expenditure, we calculate earnings categories that help in the evaluation of the operation of the undertaking.

The difference between the total cost and the cost of sales procedures is that in the total cost approach, all the charges are included in the expenditures of the current year, complemented by the purchase value of goods sold (PVGS) and the value of transmitted services, in the cost of sales approach, however, cost of sales provides the income-decreasing items together with the purchase value of the goods sold and the value of transmitted services.

The two procedures should give the same income.

In the total cost approach of the profit and loss statement, the total cost is subtracted from the sales turnover, but with this amount of costs we may have produced more or less than what has been sold. Therefore, there is need for a modifying item, which occurs under the revenues on the side of the gross yield in the profit and loss statement made by the total cost procedure, and shows the value, that is the cost of items not *yet sold, ensuring the connection between the two procedures. This modifying item is the value of Activated own earnings.*

10.6.2 Self-test questions

1. What is the purpose of the standard chart of accounts?
2. List the number and the name of each account category.
3. Present the connections between the account lines!
4. What does the concept of account system mean?
5. What is the compulsory content of the account system?

What do the following concepts mean:

1. The cost
2. Cost budgeting
3. Recalculation
4. Direct cost
5. Indirect cost
6. Attributable cost
7. Indivisible cost
8. Adjusted direct costing
9. Nature of costs
10. Activated own earnings
11. Expenditure
12. Other charges
13. Expenditures on financial operations
14. Extraordinary charges
15. Revenue
16. Turnover
17. Other income
18. Revenue of financial operations
19. Extraordinary income
20. The income-statement formula
21. Categories of earnings
22. Operating (business) activity earnings
23. Financial operations earning
24. Ordinary business earnings

25. Extraordinary earnings
26. Pre-tax earnings
27. Post-tax earnings
28. Balance sheet earnings

10.6.3 Practice tests

1. Decide whether the items listed are considered to be expenses, costs or revenue.

Mark with an X the classification, which you think correct! You can include more than one item in one row!

Description of the item	Expense	Cost	Expenditure	Revenue
1) Price of lubricant used				
2) Value of forms purchased for cash				
3) Interest paid				
4) Price of lubricant sold				
5) Repair costs of machines invoiced				
6) Salary charged				
7) Net wages paid				
8) Cleaning cost				
9) Interest received				
10) Aid given for development				
11) Price of sold building				
12) The payment of travel expenses from the cash at hand				
13) Interest charged on the machinery leasing fee				
14) Exchange gains realised on sale of securities				
15) Money issued to the purchaser at recognition				
16) Indemnity of insurance				

Solution:

	Description of the item	Expense	Cost	Expenditure	Revenue
1)	Price of lubricant used		X		
2)	Value of forms purchased for cash	X	X		
3)	Interest paid			X	
4)	Price of lubricant sold				X
5)	Repair costs of machines invoiced		X		
6)	Salary charged		X		
7)	Net wages paid	X			
8)	Cleaning cost		X		
9)	Interest received				X
10)	Aid given for development			X	
11)	Price of sold building				X
12)	The payment of travel expenses from the cash at hand	X	X		
13)	Interest charged on the machinery leasing fee			X	
14)	Exchange gains realised on sale of securities				X
15)	Money issued to the purchaser at recognition	X			
16)	Indemnity of insurance				X

2. Decide and mark with an X which category of earnings is affected by the economic events:

The economic event		Operating earnings	Financial earnings	Extraordinary earnings	None of them
1)	Material use				
2)	Settlement of gross wage				
3)	Borrowing				
4)	Compensation paid				
5)	Interest on securities				
6)	Computers transfer free of charge				
7)	Depreciation charged				
8)	The payment of cash to current account				
9)	Machines given in apport				
10)	Dispatching of goods				
11)	Raising subscribed capital				
12)	Dividends received				
13)	Dividends paid				
14)	Machines depreciated				
15)	Invoiced value of service without VAT				
16)	Lending				
17)	Advance to employee				
18)	Damage due to flood				
19)	Advertising fee				
20)	Invoiced water consumed				

Solution:

	The economic event	Operating earnings	Financial earnings	Extraordinary earnings	None of them
1)	Material use	X			
2)	Settlement of gross wage	X			
3)	Borrowing				X
4)	Compensation paid	X			
5)	Interest on securities		X		
6)	Computers transfer free of charge			X	
7)	Depreciation charged	X			
8)	The payment of cash to current account				X
9)	Machines given in apport			X	
10)	Dispatching of goods	X			
11)	Raising subscribed capital				X
12)	Dividends received		X		
13)	Dividends paid				X
14)	Machines depreciated	X			
15)	Invoiced value of service without VAT	X			
16)	Lending				X
17)	Advance to employee				X
18)	Damage due to flood	X			
19)	Advertising fee	X			
20)	Invoiced water consumed	X			

3. Which procedure of the profit and loss statement the following items are parts of? Mark with an X.

Description of the item		*Total cost procedure*	*Cost of sales procedure*	*None of them*
1)	Interest credited on bank account			
2)	Employees' labour costs			
3)	Direct cost of sales			
4)	Bank account statement			
5)	Net sales revenues of export			
6)	Administrative cost			
7)	Cost of electricity			
8)	Retained profit			
9)	Indemnity received from insurance company			
10)	Purhase value of goods sold			
11)	Post-tax earnings			
12)	Wage contributions			
13)	Subscribed but not paid capital			

Solution:

Description of the item		*Total cost procedure*	*Cost of sales procedure*	*None of them*
1)	Interest credited on bank account	X	X	
2)	Employees' labour costs	X		
3)	Direct cost of sales		X	
4)	Bank account statement			X
5)	Net sales revenues of export	X	X	
6)	Administrative cost		X	
7)	Cost of electricity	X		
8)	Retained profit			X
9)	Indemnity received from	X	X	

	insurance company			
10)	Purhase value of goods sold	X	X	
11)	Post-tax earnings	X	X	
12)	Wage contributions	X		
13)	Subscribed but not paid capital			X

11. GENERAL CHARACTERISTICS OF DOUBLE-ENTRY ACCOUNTING: THE ACCOUNTING ACCOUNTS

11.1 OBJECTIVES AND COMPETENCES

During the operation of an enterprise the economic events occur daily in high abundance.

The basic economic events change the balance, while the compound economic events have an effect on the income, too. The balance sheet accounts help in recording continuously the changes in each group of assets in the financial year, and also in composing the balance sheet based on these data at the end of the year; of course, by monitoring the costs, expenses and the revenues, the income accounts are of great help when setting up the profit and loss statement. I want to show you the economic events in the following section, but before this we must be familiar with the basic records of the double-entry accounting. So, now the task is to learn everything about the general ledger account, the registers, as well as about the operation and the connection net thereof in the double-entry accounting.

By the end of the section, you should understand the contents and the actual role of the “gallows-tree” (T-chart) and the basics of the four-line accounting theory.

10 hours will be required now because of practicing.

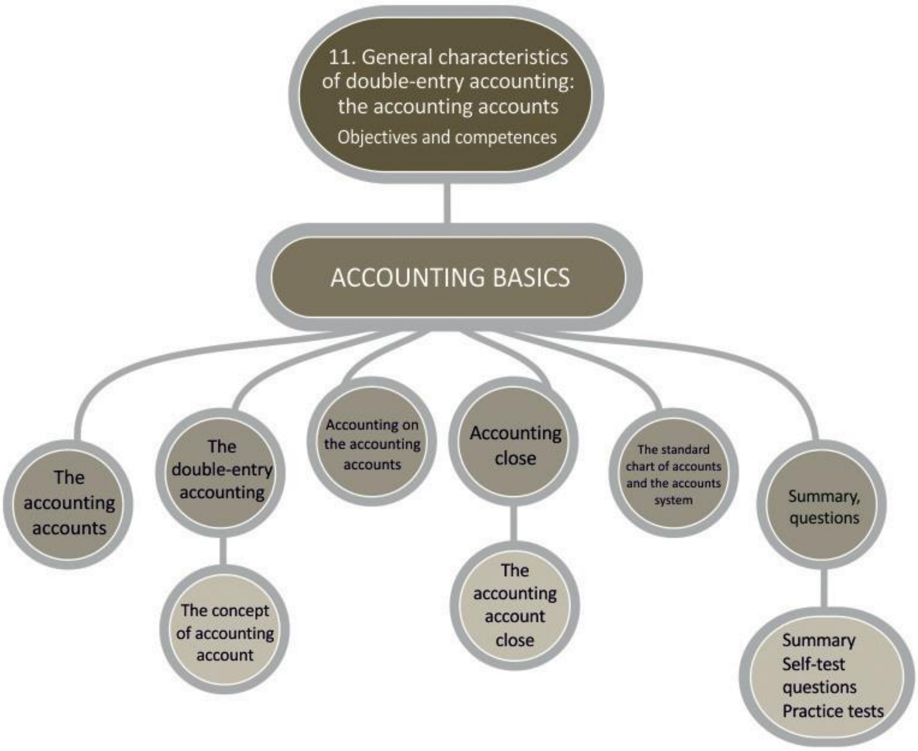
Key expressions:

- The concept of accounting account
- Groups of accounting accounts
- The concept of accounting journal
- Characteristics of active accounts
- Characteristics of passive accounts
- Opening balance
- Closing balance
- Debit traffic
- Credit traffic
- Balance
- End-of-the-year close
- The uniform chart of account

- Numbers and names of classes of accounts
- Accounts system

11.2 THE ACCOUNTING ACCOUNT

First let's look at the map of learning!



31. Figure

Under the UAA, the enterprise doing the double-entry accounting is to keep accounting records of the assets in its use, management and possession, of the resources thereof, as well as of the economic operations, which gives a review of the changes occurred in the assets and resources in a closed system and in a transparent way.

11.3 THE DOUBLE-ENTRY ACCOUNTING

One of the features of the double-entry accounting is that the recording and accounting of the economic events are entered **in general ledger accounts by their economic content**, and **in general journals in chronological order. So, we keep two parallel sets of records. It is important for control purposes.**

By using the account sheets, the aim is to be able to show the assets, resources, costs, expenditures and revenues separately.

In the general ledger accounting, in parallel with the recording of content correlations, the items are also recorded in the **journals in chronological order, "**in timelines"**.** If the aim is only the chronological recording, it is insufficient to apply a so-called **blend journal**, but if we want the items to be ordered together from a certain aspect, other types of journals may also be used. The opening and closing journals have technical functions. We account in the opening journal at the beginning of the year, and in the closing journal when doing the end-of-the-year closing.

Bank certificates are accounted **in the bank journal,** cash certificates **in the cash journal,** customer-related certificates **in the customer journal,** documents relating to suppliers, **in the delivery journal**.

11.3.1 The concept and types of accounting accounts

In accordance with the concept, the **accounting accounts** is a two-sided invoice register, on one side if which the increases, on the other side, the decreases are settled (thereby the one-way movements can be summed and set against each other). The left-hand side of the accounting account is called the Debit (D) side, the right-hand side is the Credit (C) side.

The accounting account as we usually can see:

Name of the account

As you could see, in practice the accounting accounts are more detailed than this draft, their actual data content is adjusted to the actual work carried out.

When the double-entry accounting was developed, the accounting accounts were created from **the division of the balance sheet**, i.e. for each item of the balance sheet and for each asset and resource an accounting account had been assigned in order to record the continuous change in them. The ones on which the assets and the changes thereof are accounted, are called **assets accounts**, based on their content; the accounts on which the resources and the changes thereof are accounted, are called **resource accounts**.

In other terms, the two concepts are also called **assets and liabilities**. From the items of assets active accounts have been created, and from the items of resources accounts of passive nature have been generated.

On active accounts, increases are accounted on the Debit (D) side, and decreases on the Credit (C) side.

On passive accounts, increases are accounted on the Credit (C) side, and decreases on the Debit (D) side.

Accounting accounts are to be adapted to accounting. This means that you have to open the balance sheet accounts, i.e. the related asset or resources is to be posted as the **opening balance**. This shall be carried out in all cases when the company is created, and for the first date of the business year, generally from 1st January.

Balance cannot be presented on income accounts; therefore, they may “only” be made suitable for use, in terms of accounting we ***administer*** them. In case of computer programmes, this means that we create the master database of the general ledger accounts.

The total amount of the items accounted on the Debit side of the accounts is called **Debit traffic**; the total amount of the items accounted on the Credit side of the accounts is called **Credit traffic.**

The Balance is the difference between the total amounts booked on the two sides of the account; it may be Debit or Credit by nature, but its nature is always determined by the larger traffic amount. On the assets accounts, with certain exceptions, it is only the Debit balance which is understandable, since only as many assets can be used as we have. The resource accounts have Credit balance, in general.

The Closing balance is the value of existing assets and resources on the last day of the financial year, usually on 31st December, or at the cessation of the business, which should be included in the closing balance sheet.

The assets and resource accounts in themselves only allow recording essential economic events, and the income appears globally on a resource account, **the income account for the current year,** but the factors affecting the income, the income-reducing costs and the income-increasing revenues cannot be observed in this way.

During the development in the accounting job, the need for monitoring the production and sales processes, the recognition of their impact on the income has become of importance, so other accounting accounts have been added to the applied ones, namely the ***expenditure and revenue*** accounts. This, however, had the income that the income cannot be established any longer from the balance of a resource account. To do this, the total balance of all the expenditure and revenue accounts shall be calculated, and then we can tell the income as the difference between revenues and expenses. The former means that we do not present the income on the accounting account during the year, only its components. *In our computerised world it is only a click to make a query of the income at any time during the year.*

The accounting accounts can be grouped by more than one aspect:

- -In accordance with the rules of the accounts.
  - Active accounts (A)
  - Passive accounts (P)
- On the basis of their content they may be:
  - Balance sheet accounts:
    - Assets accounts (A)
    - Resource accounts (P)
  - Financial statements:
    - Expenditure (cost) accounts (A)
    - Revenue accounts (P)

The rules in short for accounting on accounting accounts:

D	Asset (active account)	C
01.01. Opening balance (+)		
Increase (+)		Decrease (-)
		12.31. Closing balance (-)

D	Resource (passive account)	C
		01. 01. Opening balance (+)
Decrease (-)		Increase (+)
12.31. Closing balance (-) .		

D	Expenditure (active account)	C
Increase (+)		Decrease (-)
		12.3. Close (-)

D	Revenue (passive account)	C
Decrease (-)		Increase (+)
12.31. Close (-)		

The economic events are recorded on the accounting accounts on the basis of the supporting documents properly issued, after the book-entry having been edited.

The assignment of the **book-entry** means that we decide on the Debit side of which account and on the Credit side of which account the economic event is to be recorded; editing it is called account assignment or invoice processing for accounting.

The book-entry includes:

- the accounting date,
- description of the economic event,
- the account assignment (on the Debit side of which account and on the Credit side of which account the invoice is to be recorded),
- the amount to be assigned (recorded).

Before editing the entry, the economic event must be analysed on the basis of the following criteria:

- the change affects the balance sheet, or the income as well,
- If balance sheet is affected,
  - assets
  - resources

  - or asset and resource are concerned.

- If the income is also affected by the change in assets, then
  - revenue
  - cost, or expenditure is concerned from the income accounts

Remember that every economic event causes a change in two factors at the same time.

And it is important what kind of change they cause: increases or decreases?

After the analysis, the book-entry is edited on the basis of the characteristics of the economic event and in accordance with the accounting rules.

- When editing the book-entry, the ***principle of dual recording*** is to be taken into consideration, according to which:
- all economic events are recorded in two accounting accounts,
- on the Debit (D) side of one of them and on the Credit (C) side of the other,
  - in the same amount (Debit=Credit),
  - in mutual (content) conjunction with each other.

11.4 ACCOUNTING IN THE ACCOUNTING ACCOUNTS

The accounting process

1. Opening the accounting accounts.
2. Continuous accounting.
3. Closing the accounting accounts.

Opening the accounting accounts:

- it is carried out with the help of the opening balance, based on the closing balance of the previous year.

In compliance with the principle of duel recording, the recording of the opening is also always done in two accounts, that is, not simply “copy and paste” from the opening balance sheet the opening balances of the assets on the Debit side of the assets accounts, and the opening balances of resources on the Credit side of the resource accounts. For the opening, we use a technical account, a so-called ***Opening balance sheet account*** are used. The recording of the opening is carried out in the following way:

D Assets account – C Opening balance sheet account

D Opening balance sheet account – C Resource account

Since the value of the assets and liabilities is equal, after the opening book-entries made, the opening balance sheet account balance is zero. (This account is only used for the opening.)

The income accounts have no opening balance! The balance sheet earnings presented in the opening balance sheet is the earning in the previous year, which shall be brought over into the retained profit.

The continuous accounting: the economic events occurred shall be recorded in chronological order, in full compliance with the accounting rules, in the accounting accounts.

The most important ***methods used in double-entry accounting***

Documentation: all economic events shall be certified and supported by invoices and the documentary principle is to be enforced.

Application of a single unit: all business transactions – in addition to the quantitative measuring mode – shall be expressed in monetary terms in order to ensure the aggregation and the comparability of data.

Application of journals: the economic events shall be recorded in chronological order as well.

Application of accounting accounts: on the basis of their content, the economic events are recorded in accounts beside the journals, in a numerical conformity with them.

Application of the balance sheet method: to establish the property, that is the assets and resources, the undertakings prepare opening and closing balance sheets, and the balance sheet total assets are the total amount of assets and liabilities.

Application of the principle of dual record.

all economic events are recorded in two accounting accounts, on the Debit (D) side of one of the accounts and on the Credit (C) side of the other account,

- in the same amount (Debit=Credit),
- in mutual (content) conjunction with each other.

This implies that the double-entry accounting is a numerically self-controlled, closed system.

11.5 ACCOUNTING CLOSE

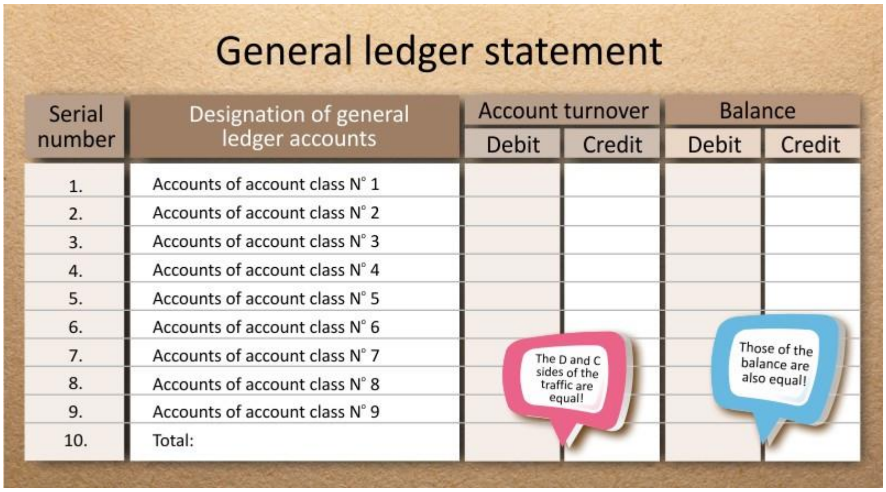
Accounting closing is a series of additional, corrective, conciliating and cumulative accounting jobs, completing the continuous accounting, which will allow the closing of the general ledger accounts and in some cases, the check of the context as well. During the accounting close it is necessary to make sure that the continuous accounting is correct (both the content and the numerical side of it), and the current accounting accounts are to be completed.

The reconciliation and the checking of the accounting accounts are assisted by the compilation of the **general ledger statement**.

Periodically, as chosen, but at least prior to the creation of the report and to any other statutory accounting data-based performance, the business entity that keeps accounting by double-entry, **shall prepare a general ledger statement** to support all the data provided.

From the point of view of the continuous business, for undertakings it is usually not sufficient to do the closing once a year, it is recommended to do it once a month, or at least on a quarterly basis. Its frequency and the tasks to be performed shall be recorded in the accounts system.

The general ledger statement 08_11_k21 is the summary statement based on the accounting accounts, which has two pairs of boxes, the account turnover and the balance. In the pair of boxes of the traffic the aggregated account turnovers of the accounts are recorded; in the pair of boxes of the balance, the balance of each account in accordance with their nature.



General ledger statement

Serial number	Designation of general ledger accounts	Account turnover		Balance	
		Debit	Credit	Debit	Credit
1.	Accounts of account class N° 1				
2.	Accounts of account class N° 2				
3.	Accounts of account class N° 3				
4.	Accounts of account class N° 4				
5.	Accounts of account class N° 5				
6.	Accounts of account class N° 6				
7.	Accounts of account class N° 7				
8.	Accounts of account class N° 8				
9.	Accounts of account class N° 9				
10.	Total:				

32. Figure

Pursuit to the dual record mode, it should be equal to the Debit and Credit turnovers of all the accounts. The balance is the difference between the two amounts of the account turnover, consequently it should be equal to the Debit and Credit balances of all the accounts. These correlations can be traced back to the four-line accounting theory. When compiling the general ledger statement, only numerical checks can be carried out, content errors cannot be filtered by the numerical equality of the turnover and the balance.

For the preparation of the annual report, the end-of-the-year closing is carried out in two steps

- The first step is to complete, check and aggregate the economic events occurred in the current period; the compilation of the general ledger statement.
- The second, accounting the correction book-entries incomeing from the change of the economic events and the market conditions occurred between the balance sheet date and preparation date of the balance sheet. (The correctness of the accounting shall be checked again after this by a general ledger statement.)

11.5.1 Closing the accounting accounts

The accounting accounts shall be closed prior to the preparation of the report.

The closing sequence follows the following algorithm:

There is worth starting the closing only after having checked whether our accounting is correct. For doing this, the equalities of the general ledger statement provide assistance.

If the accounts are correct on the basis of the correlations, the cost accounts shall be accounted in the expenditure accounts, because to state the income we only use expenditure accounts.

Then, the income accounts shall be closed, so that their balances should be carried over in the ***Post-tax earnings account***. The **final balance of this account is the earnings for the current year**, which will be brought over among the resources, to ensure thereby the consistency between assets and liabilities.

Its booking:

D Post-tax earnings account – C Expenditure

D Revenues – C Post-tax earnings account

After this, the pre-tax earnings can be seen in the post-tax earnings account. This will be the starting point for calculating corporate tax due.

In the course of Taxation studies the tax base correction is explained, we will not do so now!

We pay dividends from the income after tax, if it is not sufficient, we can also use the income of the previous years, the free retained earnings.

After accounting for the corporate tax and dividends the Post-tax earnings account balance shows the earnings, which shall be carried over to a resource account, <u>the balance sheet earnings account</u>. Last step, the balance sheet accounts are to be closed, to which the ***Closing balance sheet account*** is used.

Its booking:

D Closing balance sheet account – C Assets

D Resources – C Closing balance sheet account.

After the close of the balance sheet accounts, none of accounts shows a balance, that is the balance is zero.

11.6 THE UNIFORM CHART OF ACCOUNT AND THE SYSTEM OF ACCOUNTS

Before explaining the content compilation rules for certain parts of the report, we will need to be familiar with the legal specification ensuring the connection, which is system od accounts.

For certain enterprises, because of the large number and the diversity of the economic events, as well as because of the need for information of the entrepreneur, quite a lot of types of accounts are to be used. The organisation of the continuous accounting job requires the classification of the accounting accounts on the basis of their function or economic considerations, thus facilitating the orientation among the accounting accounts. It is also a very important aspect is that information should be provided for the report with uniform content, so in this way, the reports of various undertakings will be comparable and easily interpreted by anyone.

The accounting accounts shall be included into a system by the uniform chart of account, taking into consideration the characteristics discussed in the previous section.

The purpose of the uniform chart of account is to provide help in organising the accounting of the business by incorporating the impact of the enterprise's assets and liabilities and that of the economic operations on the income in a single system; it is also to provide the basic information required for the preparation of a report in compliance with the Accountancy Act and the related government provisions.

The uniform chart of account is based on the decimal system. According to it, the general ledger accounts are classified in ten large groups on the basis of their economic content, which are known as classes of accounts. Within the classes of accounts the balance sheet accounts, the costs accounts and the earnings accounts are sharply distinguished from each other.

Denomination and content of the classes of accounts

The account classes from N^o 1 to 4 include the balance sheet accounts. Within them the account classes from N^o 1 to 3 include the assets accounts, and N^o 4 includes the resource accounts. The accounts of these classes of accounts ensure the information required for the balance sheet.

Class* N^o 1*: Fixed assets

The intangible fixed assets, the tangible assets, and the accounts for the registration of the invested financial assets are included in here.

Class* N^o 2*: Stocks

This class includes the purchased and the internally produced stocks.

Class* N^{o} 3*: Receivables, financial assets and active accrual payments

It includes the accounts for the current assets (cash, securities, the receivables from customers, debtors, employees, members, the state budget, the claims against other organisations), and the accounts of active accrual payments, except for the stocks.

Class* N^{o} *4: Resources

Here shall be recorded the resources of the assets. It includes the Shareholder's equity, provisions, the subordinated long and short-term liabilities, as well as the passive accruals accounts. (Here will be displayed the accounts needed for the opening, the income statement and the closing, also called the "Annual balance sheet accounts".)

The data needed to make the profit and loss statement and the balance sheet earnings statement are included in the in the classes N^{o} 8 and 9, except for the value of activated own earnings statement needed for the accounts prepared with the total cost procedure.

Class* N^{o} *5: Nature of costs

It includes costs classified by their nature. The nature of costs may be:

- raw material costs,
- costs of services received,
- costs of other services,
- costs of labour,
- personnel-related other payments,
- wage contributions,
- depreciation.

Within this class of accounts, the business entities preparing a profit and loss statement by the total costs procedure shall show separately the changes of the value of the activated own earnings during the current year – which otherwise are not considered to be a nature of costs or a cost return – as the coverage direct costs of the same size, and the value equal with the direct costs of the earnings, which has not been subject for sale.

Classes* N^{o} 6 and *7: can be used in accordance with the decision of the business entity to ensure information to the management. The free application of these classes of accounts will allow the accounting of units within the undertaking, the development of a specific system for cost management and costing.

Class* N^{o} *6: Cost centres, general costs

This class of accounts includes the directly accountable (attributable) costs and indirect (indivisible) costs.

Class* N° *7: Cost-bearers (Production costs)

In the accounts of this class the expenses directly incurred may be accounted for, and the indirect costs distributed with the help of a feature, which thus become direct costs.

Class* N° 8*: Recognised costs of sales and expenditures

It includes for the profit and loss statement made by the **total cost procedure**

- the material-related expenses
- the personnel-related expenses
- the depreciation expenses.
- It includes for the profit and loss statement made by the **cost of sales procedure**

direct costs of sales,
indirect costs of sales,
In addition:
expenditures (other, financial and extraordianry),
taxes on the earnings.

Class* N° *9 Sales revenue and other revenues.

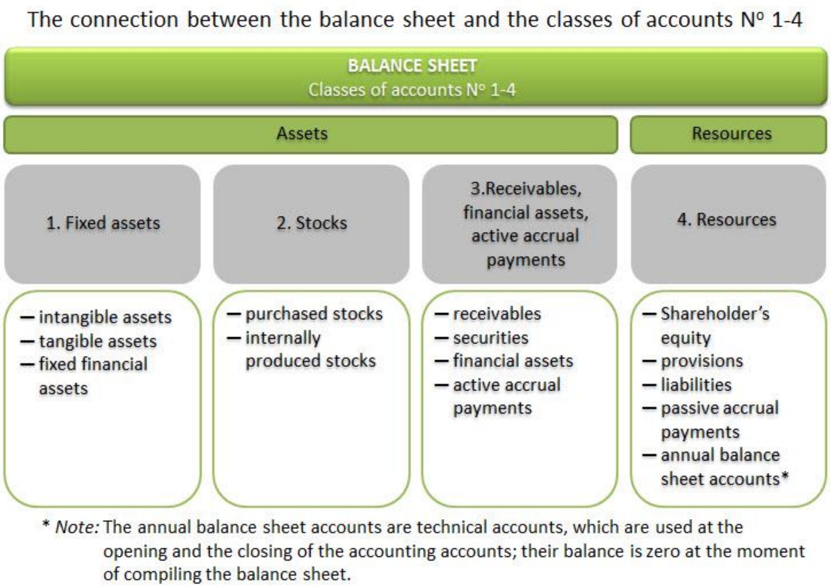
Here shall be included the sales revenue, other revenues, revenues from financial operations and the extraordinary income.

Class* N° 0*. Registration accounts.

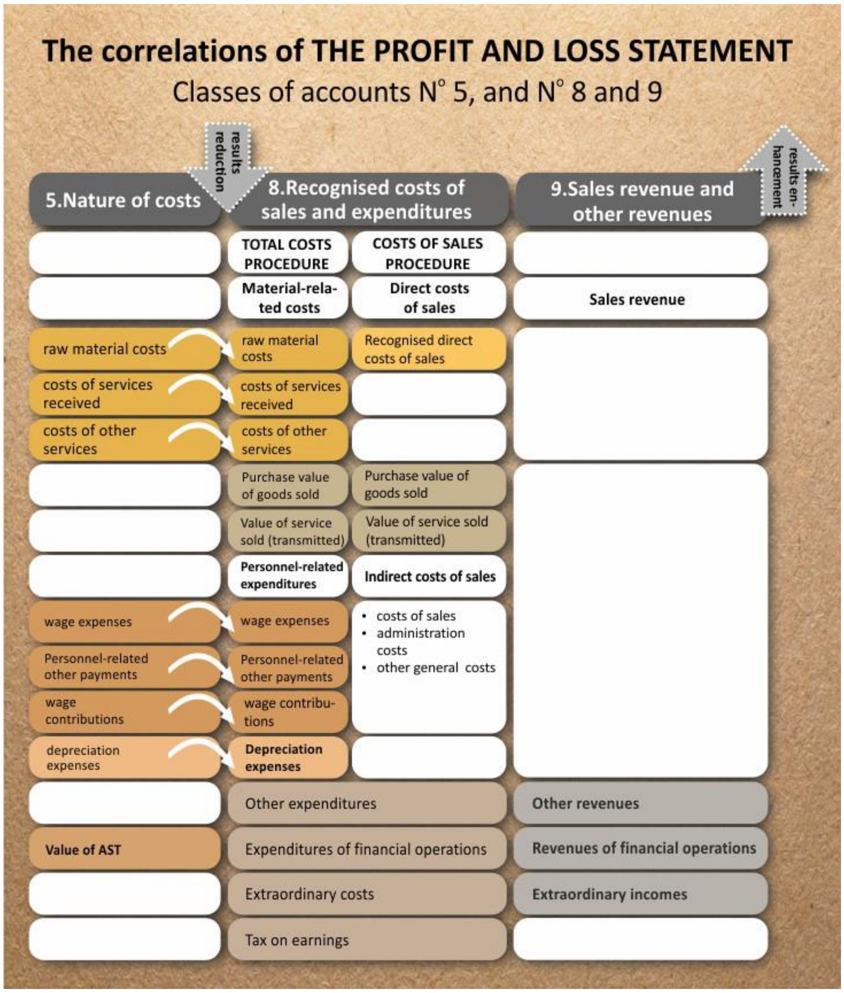
Here are given the registration accounts, in which the items shown do not affect directly the balance sheet earnings of the current financial year or the amount of the Shareholder's equity on the balance sheet date. Off-balance sheet items are also to be presented here.

The classes of accounts mean the uniform system of accounts, the content of which is the following:

33. Figure



34. Figure



35. Figure

The standard chart of accounts is built on the four-line accounting theory and is based on the gross settlement principle, which says that revenues and costs and expenditures may not be recorded against each other.

The four-line accounting theory separates sharply the balance sheet accounts and the earnings accounts, allowing the compilation of the balance sheet and the profit and loss statement. The balance sheet accounts and earnings accounts are complementary to the accounts of the class of accounts N^{o} 6 and 7. The balance sheet is made from the assets and resource accounts, the core of the profit and loss statement consists of the expenditures accounts one hand, and turnover and revenue accounts on the other hand.

The four lines comprise the following:

Line of assets accounts
Line of resource accounts
Together: balance sheet accounts
Line of expenditures accounts
Line of turnover and revenues accounts
Together: earnings accounts.

Links between the set of account lines:

Asset – Resource = Earning → A – R = Ea
Turnover, revenue – Expenses = Earning → T – Ex = Ea,

That is:

$$\boxed{A - R = T - Ex}$$

Meaning: the difference between the balances of the assets and resource accounts (earning) is equal to the difference between the balances of the revenue and expenditure accounts (earning).

But, as we all know, the assets, costs and expenditure accounts are **active** accounts, the resources and income accounts are **passive** accounts.

The correlation can be rearranged in the following way:

Based on their content:

$$A + R = T + Ex$$

In accordance with the accounting rules:

$$A - P = P - A$$

After rearrangement:

$$A = P$$

The correlation means that the total of the balances of the assets and expenditure accounts, i.e. the active accounts is equal to the total of the balances of the revenue and resource accounts, that is, the passive accounts.

We use the correlations here above to check the correctness of the accounting in the general ledger accounts: the four-line theory is to check the content, the rearranged formula thereof is to check the numerical correctness. This is how the double-entry accounting becomes a self-controlled and closed system:

Application of the principle of the gross settlement – which is applied to all the accounts of the chart of accounts –, means that the balance of the accounting account is the difference between the total amount of increase the total amount of decrease.

This principle is not the same as the accounting basic principle of the same name.

The standard chart of accounts, as we have seen it, provides the most basic accounting standards; the undertakings need more detailed rules for the creation of the accounting system and execution of the continuous job.

36. Figure

The business entity keeping its accounting by double-entry shall create a system of accounts with regard to the standard chart of accounts, which ensures the accounting allowing the preparation of a report in fully compliance with the provisions of the Accountancy Act.

The system of accounts is the internal rules and regulations based on the standard chart of accounts, which determines the company's accounting procedures. The accounting according to the system of accounts provides the information necessary to create a report, and it satisfies the management information needs.

The mandatory content of the system of accounts:

- the identifier number and text title of each account selected for application (account heading),
- the content of the account, if the name of the account does not indicate it clearly
- the titles of increase and decrease in value, the economic events affecting the account and the connection thereof with other accounts,
- the connection between the general ledger account and the analytical registration,
- the system of certificates supporting what is included in the system of accounts.

The requirements of the system of accounts

it is to ensure that the accounting support the preparation of the annual report properly.

it is to help the enforcement of the accounting principles during the book-keeping.

it is to reflect the company's accounting policy.

it is to reflect the company's activities, composition and size.

it is to provide appropriate instructions to the professionals in the business of how to account in compliance with the rules, so that makes the content and correlations of the accounts clear in concise explanations, and it allows to understand the economic events.

The newly formed business entity – covered by the Accounting Act and accounting by double-entry – shall create the system of accounts within 90 days of the establishment date of the enterprise; while the entity making a transition from single-entry accounting to double-entry accounting shall draw it up before the date of transition. In the event of a change in the Accountancy Act the necessary modification of the system of accounts shall be carried out within 90 days after the legislation change enters into force.

For compiling the system of accounts, for its continuous maintenance, for the correct book-keeping, the responsible is the person authorised to represent the enterprise.

Hereinafter, let's see how the chart of accounts can be created with the standard chart of accounts taken into consideration.

Each class of accounts is broken down into groups of accounts, which are indicated by two-digit numbers.

The account groups can also be broken down into accounts, indicated by three-digit numbers. The accounts can be broken down again into sub-accounts, marking them with three-digit numbers, and if needed, further detailed accounts can be created with five, six, etc. digits

and the information needs of the business entity; therefore, the Accountancy Act does not provide detailed instructions for it.

11.7 SUMMARY, QUESTIONS

11.7.1 Summary

In the double-entry accounting, accounting accounts and journals are used for accounting for the economic events occurred during the year.

The continuous and reliable book-keeping in a closed system is the condition to the trustworthiness of the report.

The accounting is based on the four-line accounting theory.

The accounting accounts, in accordance with the rules of accounting, can be grouped into active and passive accounts, and according to their content, into balance and income accounts. The assets, costs and expenditures accounts are active, they increase on the D side, and decrease on the C side; the resource and revenue accounts , are passive, and we record decrease in the D side, and increase on the C side.

The accounting begins with the opening of the accounts at the beginning of the year, which is carried out based on the opening balance sheet and using a technical account. During the course of the continued work, the economic events are recorded on the basis of the supporting documents following the concept of dual record, in chronological order and in account lines, and then, at end of the year, after the closing of the accounts, the profit and loss statement, balance sheet and the notes, i.e. the report is prepared.

The Accountancy Act does not provide mandatorily applicable accounts, only a chart, that is to say it defines 10 classes of accounts and the contents thereof.

It leaves the details and the creation of the accounts to be applied to the entrepreneur, but requires that they should be drawn up in writing.

11.7.2 Self-test questions

Answer the following questions:

1. What are the types of the basic economic events?
2. What are the types of the complex economic events?
3. What are the accounting accounts?
4. What are the groups of the accounting accounts?
5. What are the phases of the end-of-the-year closing?
6. What is the purpose of the standard chart of accounts?
7. List the number and the name of each class of account.
8. Present the correlations between the account lines.
9. What is the system of accounts?
10. What is the mandatory content of the system of accounts?
11. Classify the accounting accounts.
12. What is an accounting journal?
13. What are the characteristics of the Active accounts?
14. What are the characteristics of the Passive accounts?
15. What is an Opening balance?
16. What is a Closing balance?
17. What does the Debit turnover mean?
18. What does the Credit turnover mean?

11.7.3 Practice tests

1. Determine which assets group the following items belong to and them mark with A, if they are Active in accordance with the accounting rules, and with P, if they are passive accounts.
2.

Asset element	Intangible assets	Tangible fixed assets	Fixed financial assets	Stock	Receivables	Securities	Cash	Shareholder's equity	Long-term liabilities	Short-term liabilities
1. Housing loan provided to employee										
2. Young animals										
3. Paint intended for own use										
4. Long-term loan received										
5. Software purchased for own use										
6. Amount of own bill										
7. Long-term cash deposit at bank										
8. Value of purchased material not paid										
9. Corporate income tax										
10. Stationery and forms purchased for sale										
11. Debt toward social security										

12. Wage debt toward employees										
13. Lorry										
14. 100 EUR										
15. Liquidity loans received										
16. Investment										
17. Internally produced ready machines for sale										
18. Positive earnings for the year										
19. Credit obtained for machine										
20. Assembly line for production purposes										
21. 8 months maturity bond										
22. Rental fee – shop operated										
23. Cash										

Solution

Asset element	Intangible assets	Tangible fixed assets	Fixed financial assets	Stock	Receivables	Securities	Cash	Shareholder's equity	Long-term liabilities	Short-term liabilities
1. Housing loan provided to employee			A							
2. Young animals				A						
3. Paint intended for own use				A						
4. Long-term loan received									P	
5. Software purchased for own use	A									
6. Amount of own bill										P
7. Long-term cash deposit at bank			A							
8. Value of purchased material not paid										P
9. Corporate income tax										P
10. Stationery and forms purchased for sale				A						
11. Debt toward social security										P
12. Wage debt toward employees										P
13. Lorry		A								
14. 100 EUR							A			

15. Liquidity loans received										P
16. Investment		A								
17. Internally produced ready machines for sale				A						
18. Positive earnings for the year								P		
19. Credit obtained for machine									P	
20. Assembly line for production purposes		A								
21. 8 months maturity bond						A				
22. Rental fee – shop operated		A								
23. Cash							A			

3. Determine whether the following items are active or passive accounts in accordance with the accounting rules. Mark with A, if it is active, and with P, if you think it is a passive account.

The economic event | Active/Passive account.

1. Material use
2. Gross wage cost
3. Loan received
4. Compensation paid
5. Interest income
6. Extraordinary charges
7. Depreciation charged
8. Cash
9. Extraordinary income
10. Turnover
11. Subscribed capital

12. Dividends received
13. Invoiced value of service without VAT
14. Advance provided to employee
15. Revenue from sales of tangible asset
16. Advertising fee
17. Invoiced water consumed

Solution:

	The economic event	Active/Passive account.
1)	Material use	A
2)	Gross wage cost	A
3)	Loan received	P
4)	Compensation paid	A
5)	Interest income	P
6)	Extraordinary charges	A
7)	Depreciation charged	A
8)	Cash	A
9)	Extraordinary income	P
10)	Turnover	P
11)	Subscribed capital	P
12)	Dividends received	P
13)	Invoiced value of service without VAT	P
14)	Advance provided to employee	A
15)	Revenue from sales of tangible asset	P
16)	Advertising fee	A
17)	Invoiced water consumed	A

Mark with an X which group the following accounting accounts belong to on the basis of their content, or according to the accounting rules (their form).

	Content				**Form**	
DESCRIPTION	**Balance** account		**Income** account		**Active** account	**Passive** account
	A	Re	C, Ex	T		
Building						
Customer						
Supplier						
Net sales revenues						
Material costs						
Materials						
Subscribed capital						
Short-term loan						
Interest received						
Interest paid						

Solution:

	Content				**Form**	
DESCRIPTION	**Balance** account		**Income** account		**Active** account	**Passive** account
	A	Re	C, Ex	T		
Building	X				X	
Customer	X				X	
Supplier		X				X
Net sales revenues				X		X
Material costs			X		X	

Materials	X				X	
Subscribed capital		X				X
Short-term loan		X				X
Interest received				X		X
Interest paid			X		X	

3. In which class of accounts the following accounts can be found?

Material costs … … … … … ……
Customers … … … … … ……
Income account … … … … … ……
Revenue of goods sold … … … … … ……
Buildings … … … … … ……
Government bonds (for investment purposes) … … … … … ……
Packing materials deposit … … … … … ……
Domestic suppliers … … … … … ……
Shares … … … … … ……
Claims for indemnity … … … … … ……
Other income … … … … … ……
Other charges … … … … … ……
Investments … … … … … ……
Advances received … … … … … ……

Solution:

Material costs	5. Nature if costs
Customers	3. Receivables, financial assets, active accrual payments
Revenue of goods sold … … … … … ……	9. Turnover, revenue
Buildings	1. Fixed assets
Government bonds (for investment purposes)	1. Fixed assets
Packing materials deposit	2. Stocks
Domestic suppliers	4.Resources
Shares for dealing purposes	3. Receivables, financial assets, active accrual payments
Claims for indemnity	3. Receivables, financial assets, active accrual payments
Other income	9. Sales revenue, other revenues
Other charges	8. Costs of sales, expenditures
Investments	1. Fixed assets
Advances received	4. Resources

12. ECONOMIC EVENTS AND BOOK-KEEPING

12.1 OBJECTIVES AND COMPETENCIES

In this present chapter I will acquaint you with economic events having effect on the assets and on the income of an enterprise.

Get prepared to use „gallows" but only on the level of simple correlations.

By the end of this chapter you will be able to understand when and why we account either on the debit or on the debit side of the book-keeping invoice.

Timeframe: in this case you will need at least 9 hours to acquire lasting knowledge. Mostly *practicing* will consume more of your time.

At the end of the chapter I will show you „how to think with the brain of an accountant"!

Key expressions:

- economic events
- basic economic events
- complex economic events
- circulation of assets
- circulation of liability
- asset raising
- asset withdrawal
- complex economic events
- accounting of expenses and expenditures
- accounting of income

12.2 ECONOMIC EVENTS

Let's begin again with the learning chart!

37. Figure

Assets and liabilities as well as the value and the composition of an enterprise will change continuously. Financially expressible elements and phases of these changes concerning assets and liabilities are economic transactions i.e. documented ***economic events.***

Each economic event changes the stock and the composition of assets and liabilities and consequently the balance sheet as well.

What is an economic event? Let's see a few examples!

- An acquaintance, Jocó comes around to our small enterprise. He gazes at one of the bicycles and he decides to buy it.
- Does the property of the SIKER KFT change? NO! So this is **not an economic event.**
- When Fanni writes out a transfer order and hands it over to their bank to fulfil an advance payment to the BICYCLE MANUFACTURER for some new bicycles, there is no economic event happening as there is no change in the property. The bank transfer might not happen. The bank account number may be incorrect and there may not be enough money on the account!
- When the bank sends the debit note which is the certificate of the actual cash movement, then we can talk about an economic event as there is a **(double)** change in the property. On one hand there will be less money on the bank account of the SIKER KFT and on the other, there will be a claim against the BICYCLE MANUFACTURER.
- Gábor repairs a bicycle for 20.000 HUF. This amount will be their income.

Depending on the effect of the change to the property and the income of the enterprise there are two types of groups of events:

- basic and
- complex economic events.

12.3 BASIC ECONOMIC EVENTS

This group includes those economic events where the financial situation of the enterprise changes but the composition, the value and the income would not.

There are four different types of basic economic events:

– ***circulation of assets-*** when one asset account increases, the other will decrease by the same value ($+A_1$, $–A_2$, where $A_1 = A_2$). As a income of the economic event the composition of the ASSETS changes and the balance sheet total remains the same;

– ***circulation of liabilities –*** when a Liability account increases, the other will decrease by the same value ($+L_1$, $–L_2$, where $L_1 = L_2$). As a income of the economic event the composition of the LIABILITIES changes and the balance sheet total remains the same;

– when ***raising assets*** we have to consider the fact that each asset must have its source. If we raise assets the asset account increases but the liability must increase parallelly: $+A_3$, $+L_3$, where $A_3 = L_3$. If the total value of assets and liabilities increases the balance sheet total will also increase;

– when ***withdrawing assets, the situation is the same, only the direction of the movement will change:***$-A_4$, $-L_4$, where $A_4 = L_4$, and as the total value of assets and liabilities decreases the balance sheet total will also decrease.

Symbols:

A_1; A_2 … A_n = asset

L_1; L_2 … L_n = liability

Relation between basic economic events and the balance sheet is summarised in animation **08_10_A08** (the figure contains the above mentioned symbols).

Relation between basic economic events and the balance sheet

Balance sheet

Assets	Liabilities
Circulation of assets: + Asset$_1$ (A_1) – Asset$_2$ (A_2), where: $A_1 = A_2$	
	Circulation of liabilities: + Liability$_1$ (L_1) – Liability$_2$ (L_2), where: $L_1 = L_2$
Asset and liability raising: + Asset$_3$ (A_3) where: $A_3 = L_3$	+ Liability$_3$ (L_3)
Asset and liability withdrawal: – Asset$_4$ (A_4) where: $A_4 = L_4$	– Liability$_4$ (L_4)

Here is the opening balance of an enterprise:

Assets		Liabilities	
Properties	5 800 M HUF	Equity	7 100 M HUF
Materials	1 200 M HUF	Suppliers	2 000 M HUF

Customers 1 700 M HUF	Short term loans 900 M HUF
Cash 200 M HUF	
Settlement deposit account 1 100 M HUF	
Total assets: 10 000 M HUF	Total liabilities: 10 000 M HUF

Circulation of assets and their effect on the balance sheet:

An amount of 300 M HUF has been withdrawn from the settlement deposit account.

What happened was:

The amount on the settlement deposit account has decreased by **300 M HUF (A–)**, the sum in the cash has increased by the same amount **(A+)**, the total balance sheet remains unchanged.

Balance sheet after first economic event

Assets		Liabilities	
Properties	5 800 M HUF	Equity	7 100 M HUF
Materials	1 200 M HUF	Suppliers	2 000 M HUF
Customers	1 700 M HUF	Short term loans	900 M HUF
Cash + 300 M HUF	**500 M HUF**		
Settlement deposit account – 300	800 M HUF		
Total assets:	10 000 M HUF	Total liabilities:	10 000 M HUF

Circulation of liabilities and their effect on the balance sheet:

The credit institution holding the account sends a notification that 800 M HUF was paid to suppliers on credit.

Liabilities against suppliers have decreased by 800 M HUF **(L–)**, the short term loan has increased by the same amount **(L+)**, the balance sheet total remains unchanged.

Balance sheet after second economic event

Assets		Források	
Properties	5 800 M HUF	Equity	7 100 M HUF
Materials	1 200 M HUF	***Suppliers***	***1 200 M HUF***
Customers	700 M HUF	***Short term loans***	***1 700 M HUF***
Cash + 300 M HUF	500 M HUF		
Settlement deposit account – 300	800 M HUF		
Total assets:	10 000 M HUF	Total liabilities:	10 000 M HUF

Raising assets and its effect on the balance sheet:

We purchased spare parts for 2.000.000 HUF on 2nd February but the deadline for payment is 10th March.

Spare parts are enlisted among materials. The value of materials **(A+)** and liabilities against suppliers **(L+)** increase by 2 000 M HUF so, the balance sheet total will also increase by the same amount.

Balance sheet after third economic event

Assets		Liabilities	
Properties	5 800 M HUF	Equity	7 100 M HUF
Materials +2 000	***3 200 M HUF***	***Suppliers + 2 000***	***3 200 M HUF***
Customers	1 700 M HUF	Short term loans	1 700 M HUF
Cash	500 M HUF		
Settlement deposit account	800 M HUF		
Total assets:	***12 000 M HUF***	***Total liabilities:***	***12 000 M HUF***

Withdrawal of assets *and* its effect on the balance sheet:

The credit institution holding the account sends a notification that it has fulfilled our 500 000 HUF transfer order in connection with credit repayment from the settlement deposit account.

Effect: the settlement deposit account **(A–)** and the short term loan decrease **(F–)** so, the balance sheet total will also decrease by the same amount.

Balance sheet after fourth economic event

Assets		Liabilities	
Properties	5 800 M HUF	Equity	7 100 M HUF
Materials	3 200 M HUF	Suppliers	3 200 M HUF
Customers	1 700 M HUF	***Short term loans* *–500***	***1 200 M HUF***
Cash	500 M HUF		
Settlement deposit account –500	300 M HUF		
Total assets:	***11 500 M HUF***	***Total liabilities:***	***11 500 M HUF***

12.3.1 Problem solving concerning economic events

Let's practice a little, but watch first the video!

And now, try it by yourself!

The enterprise has purchased goods for an amount of 200. 000 HUF cash.

The enterprise sets reserves of 30.000 HUF out of the committed retained profit.

The investment is then activated – the cost is 40.000 M HUF.

The phone bill has arrived. It is 80.000 HUF and the deadline for the transfer is 15 days.

Record the economic events in the books. Determine what economic events have happened, which type they belong to and what will change and to what extent as an effect of the economic event!

Elements and type of economic event	Effect	Assignment

12.4 COMPLEX ECONOMIC EVENTS

Complex economic events are economic events that lead to a change both in the *financial situation* and the *income* of the enterprise at the same time.

Types of complex economic events:

– ***accounting of cost (C), expenditure (E):*** when there is an increase in the cost or in the expenditure, at the same time there is a decrease in the asset or an increase in the liabilities

+C,E and –A_5 or +L_5; where C,E = A_5 or C,E = L_5

The credit institution holding the account sends a notification that due interest of the short term loan, 100 M HUF has been transferred from the settlement deposit account **(S–).**

*Let's think together!*

Interest: I have to pay it so, it worsens my income, meaning this is an item reducing the profit. It can only be either a cost or an expenditure. So, which one? I cannot repair bicycles with the interest and I cannot serve directly my business objectives either so, it cannot be a cost!

This is only expenditure but is it a financial, an extra or expenditure?

Of course: this is an expenditure of a financial transaction**, and it increases the items above! E+** In case it affects the income, then this is a complex economic event!

So, as an effect of the economic event the

Expenditure increases by 100M HUF — the income decreases
Asset decreases by 100M HUF — by 100 M HUF

Both asset and expenditure are affected so, according to the correlation this is an accounting of the expenditure!

– ***income (I) recognition:*** when there is an increase in the income, at the same time there is an increase in the asset or a decrease in the liabilities as well

+I and +A_6 or –L_6; where I = A_6 or I = L_6

The credit institution holding the account sends a notification that interest of our long term bank deposit, 200 M HUF has been paid to our settlement deposit account **(S+)**.

<u>Settlement deposit account? WHAT ACCOUNT?</u>

Take the balance sheet! And the income statement too!

Follow me!

Balance sheet or income statement?

Sure it is the balance sheet!

Asset or liability?

Of course it is an asset?

Am I using it within a year or over a year?

There is a daily transfer to the deposit account so, it is a current asset.

Stock, liability, security, cash?

Yes! It is cash!

So, there is an asset increasing by 200 M HUF!

<u>Interest? WHICH ACCOUNT?</u>

This ameliorates my income so, it can only be an income! Sales revenue, financial, extra, other? Sure it is an income from financial transactions and **I+!**

Effect: I increases by 200 M HUF
A increases by 200 M HUF

income increases by 200 M HUF

Gábor is repairing one specific Bicycle in the SIKER KFT. The cost of repair is 50 M HUF for which he issues an invoice of 60 M HUF. The correlation between the income and the expenditure is evident as income appears only at the cost of expenses which will turn into expenditure at the time of sale depending on the form of the income statement.

BUT how did we calculate the income? Re = I – E. Let's replace the numbers: we have gained 10 M HUF by deducting 50 M HUF service expenses, i.e. expenses that have become expenditure, from the 60 M HUF income:

Re	=	*I*	–	*E*
10 M HUF	=	*60 M HUF*	–	*50 M HUF*
		Income recognition		*Accounting of expenditure*

Complex economic events relating to production/sales must always be approached from two sides: whether they increase or decrease the income!

12.5 SUMMARY, QUESTIONS

12.5.1 Summary

You probably will not have to book during your work, but you will surely have struggled with the handling of the accounts!

Let's sum it up again!

12.5.2 Self-test questions

What are the following expressions:
Economic events?
Basic economic events?
Complex economic events?
Circulation of assets?
Circulation of liabilities?
Raising of assets?
Withdrawal of assets?
Complex economic events?
Accounting of cost and expenditure?
Income recognition?

12.5.3 Practice tests

		correct answer	wrong answer	wrong answer	wrong answer
1	Basic economic events:	Affect only balance sheet accounts.	Affect only outturn accounts.	Do not affect any account.	Affect both balance sheet and outturn accounts.
2	Complex economic events:	Affect both balance sheet and outturn accounts.	Affect only balance sheet accounts.	Affect only outturn accounts.	Do not affect any account.
3	Circulation of assets	we only use asset accounts	we only use liability accounts	we only use income accounts	we only use expense accounts
4	Circulation of liabilities	we only use liability accounts	we only use expense accounts	we only use asset accounts	we only use expenditure accounts
5	Raising of asset	both asset and liability will increase	both asset and liability will	asset will increase, liability will	asset will decrease, liability will

			decrease	decrease	increase
6	Withdrawal of asset	both asset and liability will decrease	asset will decrease, liability will increase	both asset and liability will increase	asset will increase, liability will decrease

The enterprise has used material of 500. 000 HUF.
Based on the bank statement 80.000 HUF interest was credited.
Our enterprise has purchased goods for 300.000 HUF. The deadline for payment is 15 days upon delivery.
We have transferred our debt to supplier; the notification of our bank has arrived.
The enterprise creates a committed reserve of 30.000 M HUF from the retained profit.
Prepared investment is then activated; the cost is 40.000 M HUF.

Book given economic events! Determine what economic events have happened, which type they belong to, what changes and to what extent as an effect of the economic event!

Elements and type of economic event	Effect	Assignment
1) The enterprise has used material of 500. 000 HUF.		
2) 80.000 HUF interest was credited based on the bank statement.		
3) Our enterprise has purchased goods for 300.000 HUF. The deadline for payment is 15 days upon delivery.		
4) We have transferred our debt to supplier; the notification of our bank has arrived.		

5) The enterprise creates a committed reserve of 30.000 M HUF from the retained profit.		
6) Prepared investment is then activated; the cost is 40.000 M HUF.		

Solution:

<table>
<tr><td>Elements and type of economic event</td><td>Effect</td><td>Assignment</td></tr>
<tr><td colspan="3">1) The enterprise has used material of 500. 000 HUF.</td></tr>
<tr><td>material/B/A/2/-
material usage= material cost: R/C/5/+
That is:
Complex economic event, cost accounting</td><td>R decreases</td><td>T 5 material cost-
C2 material of 500 M HUF</td></tr>
<tr><td colspan="3">2) 80.000 HUF interest was credited based on the bank statement.</td></tr>
<tr><td>bank statement:
bank account /B/A/3/+
Interest: credit, ergo: income/R/I/9/+
Complex economic event, income accounting</td><td>R increases</td><td>T3 bank-
C9 interest income 80 M HUF</td></tr>
<tr><td colspan="3">3) Our enterprise has purchased goods for 300.000 HUF. The deadline for payment is 15 days upon delivery.</td></tr>
<tr><td>Goods/B/A/2/+
we have not paid to the supplier so, it is a liability
Liability against supplier:B/L/4/+
Economic event affects only balance sheet accounts!
So it is basic, both asset and liability will increase. This is raising of assets!</td><td>Balance sheet total increases!</td><td>T2 goods-
C4 supplier 300 M HUF</td></tr>
<tr><td colspan="3">4) We have transferred our debt to the supplier; the notification of the bank has arrived.</td></tr>
<tr><td>supplier/B/L/4/-
bank/B/A/3/-
Both of them balance sheet</td><td>Balance sheet total decreases!</td><td>T4 supplier-
C 3 bank 300 M HUF</td></tr>
</table>

accounts ergo, basic economic event, but as both asset and liability decrease this is a withdrawal of assets		
5) The enterprise creates a committed reserve of 30.000 M HUF from the retained profit.		
retained profit/B/L/4/- committed reserve B/L/4/+ Only balance sheet accounts and only liability accounts – one of them increases the other decreases: circulation of liabilities!	Structure of the liabilities change within the balance but the balance sheet total will not.	T4 retained profit – C4committed reserve 30 000 M HUF
6) The prepared building is then activated, the cost is 40.000 M HUF		
until the tangible asset is not ready, it is an investment/B/A/3/- structure/B/A/3/+ Both of them are balance sheet accounts ergo, basic economic event	Structure of the assets change within the balance but the balance sheet total will not.	T1 building- C1 investment 40.000 M HUF

1	LIFO method	it supposes that stocks purchased last are used or sold first. In this case the stock existing at the balance sheet date consists only of the stocks purchased in the first place,	it supposes that stock decreases are accounted at the lowest purchase price so, the value of stocks existing at the balance sheet date is always determined at the highest purchase price.	it means, in its content, that stock decrease must always be derecognised at the value of the oldest stock i.e. purchased in the first place so, in the balance sheet the value of the stock existing at the balance sheet date will be determined by the latest purchases.	a stock decrease must always be derecognised at the value of the stock purchased at the highest price so, the value of the stock existing at the balance sheet date must be determined at the lowest purchase price in the balance sheet,
2	LOFO method	it supposes that stock decreases are accounted at the lowest purchase prices so, the value of the stocks existing at the balance sheet date is always determined at the highest purchase.	it supposes that stocks purchased last are used or sold first. In this case the stock existing at the balance sheet date consists only of the stocks purchased in the first place.	stock decrease must always be derecognised at the value of the stock purchased at the highest price so, the value of the stock existing at the balance sheet date must be determined at the lowest purchase price in the balance sheet.	it means, in its content, that stock decrease must always be derecognised at the value of the oldest stock i.e. purchased in the first place so, in the balance sheet the value of the stock existing at the balance sheet date will be determined by the latest purchase

13. SUMMARY

13.1 CONTENT SUMMARY

Let's revise the crucial points that you need to know with the help of this subject!

- Business organisations shall comply with the laws, which is essentially provided by the Accountancy Act.
- The law describes its purpose and the entities covered in its scope in very fair conceptual definitions. You also have to use the correct terms in your work.
- The Accountancy Act expects rational thinking along principles, management, and **advocacy.**
- All business entity is to determine its self-binding rules and regulations within the framework of law, and is required to apply them.
- All business entity is to put in writing in its accounting policy which rules under the UAA it considers as binding to itself.
- Accounting is an accounting and an information system at the same time; however, there are different users of the information provided by the system. The most important feature is that users can be internal and external and need different information depending on their situation.
- Accounting had to adapt to the specific situations, so **the financial accounting** was separated. It focuses on the data capturing, accounting, and reporting based on book-keeping.
- In parallel with it, strictly built on each other, **the management accounting** operates, which assists the management decision-making and with the help of which the quality of the work can be improved, the performance can be increased, the costs (expenditures) can be reduced, and the income can be maximised.
- The development and thinking green brought about the creation of the third accounting subsystem, **the environmental accounting**, which is supposed to exploit and solve of the environmental problems of an economic system, and which includes the methods and procedures to organise and deal with the economic impacts of the environmental protection.

- The business entities are to inform all those who are concerned in the subject, they are to report on their activities mandatorily. This shall be done in the statutory report. All business entity is to make an annual report, but this obligation can be modified by the scale of the indicators for the company.
- Reporting is based on a reliable book-keeping, the system of documentary and discipline. The report shall be made available to others, this is carried out by publishing and disclosing it. The auditor's responsibility is to ensure legality.
- The assets of an enterprise are the basic conditions of operation. All the assets are to be registered at the moment of the foundation, and changes in it are to be recorded continuously.
- On the basis of the appearance, all properties are assets; and on the basis of origin, they are resources. The classification of each item is regulated by the UAA.
- Accounting is responsible for the detection of the assets of the business entity. It is always important to recognise the assets when they are acquired and account for them when the balance sheet is being made.
- Law provides a framework to determine the registration value of the specific assets, the entrepreneur decides which specific procedure is to be applied. The rules for the purchase costs and for the valuation of the balance sheet items are to be determined by the entrepreneur in accordance with the interests of the entity.
- The main aim of the economic operators, the undertakings, is to acquire profit in their activities. Due to a number of other conditions, however, losses can also be generated. The income, therefore, may be positive or negative, that is to say, profit or loss.
- The relationship between income and expenditures indicates what effect the item has on the income, but you have seen that all revenue has a corresponding expenditure.
- With regard to its content, the profit and loss statement can be made in two ways: in the total cost procedure or in the costs of sales procedure.
- In the profit and loss statement, we calculate income categories by setting all revenue against their expenditure, which help in seeing the operation of the undertaking.
- In double-entry accounting, accounting accounts and journals are used for recording the economic events occurred during the year.

- The continuous, reliable book-keeping in a closed system is a basic condition for the credibility of the report.
- Accounting is based on the four-line accounting theory.
- The accounting accounts can be grouped into active and passive accounts in accordance with the accounting rules, and according to their content, they can be balance or income accounts. The asset, cost and expense accounts are active, they increase on the D side, and increase on the C side; the resource and revenue accounts are passive, we are to account for decrease on the D side, and increase on the C side.
- The accounting in these accounts begins the opening of the accounts at the beginning of the year, which is carried out on the basis of the opening balance sheet and using a technical account. During the course of the continued work, the economic events are recorded on the basis of the supporting documents following the concept of dual record, in chronological order and in account lines, and then, at end of the year, after the closing of the accounts, the profit and loss statement, balance sheet and the notes, i.e. the report is prepared.
- The Accountancy Act does not provide mandatorily applicable accounts, only a chart, that is to say it defines 10 classes of accounts and the contents thereof.

It leaves the details and the creation of the accounts to be applied to the entrepreneur, but requires that they should be drawn up in writing.

You are not likely to do accounting in the course of your work, but you may have become familiar with the use of the accounts!

I would like you to see: accounting in a properly regulated system, the effective application if which is greatly dependent on the management's needs and expectations. In this you can also help a lot on the basis of what you have learnt here!

14. SUPPLEMENTS

14.1 BIBLIOGRAPHY

14.1.1 References

Books

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14.2 MEDIA ITEMS

14.2.1 Index of figures (can be generated)