2015 changes to the Act on Accounting related to the EU Directive – a summer cocktail

In this issue of our newsletter we take a look at the main amendments to Act C of 2000 on Accounting ("the Accounting Act") which serve the integration of Directive 2013/34/EU ("the EU Directive") into the Hungarian law. Act CI of 2015 amending the provisions of the Accounting Act was promulgated on 3 July 2015. The amendments shall be applied from the financial year beginning on 1 January 2016; earlier application is not permitted.

1. Reporting thresholds

Thresholds specified for preparing a simplified annual report are increased:

- assets total: HUF 1,200 million (at present HUF 500 million)
- annual net sales revenue: HUF 2,400 million (at present HUF 1,000 million)
- average number of employees: 50 persons (at present 50 persons)

Under the amendment, public interest entities may not prepare a simplified annual report.

Thresholds specified for preparing a consolidated annual report also are increased:

- assets total: HUF 6,000 million (at present HUF 5,400 million)
- annual net sales revenue: HUF 12,000 million (at present HUF 8,000 million)
- average number of employees: 250 persons (at present 250 persons)

[Sections 9 (2)-(3) and 117 (1) of the Accounting Act]

2. Definitions relating to relationships

For a company to be deemed to be an associate there is a condition that the investor should have significant ownership interest and exercise considerable influence.

As a new term, significant ownership interest is defined in the Act as follows: "a right embodied in securities or specified otherwise in the equity of other entities, the objective of which is contribution to the activities of the enterprise holding the rights, through establishing a long-term relationship with the mentioned entity; whereby the extent of the interest exceeds 20 per cent."

It is a new rule that long-term interest, interest recognised among securities, long-term loans granted, receivables recognised among current assets, subordinated, non-current and current liabilities concerning enterprises which are related through significant ownership interest as defined above have to be recognised in separate rows in the balance sheet of the annual report.

The definition of other affiliated company also changes: it is a company in which the entrepreneur has no significant ownership interest and which is not deemed to be a subsidiary, joint venture or associated company.

The definition of related company is narrowed: only parent companies, subsidiaries and joint ventures are deemed related companies. Associates are no longer deemed related companies.

[Section 3 (2) 4, 4a, 5, 7 and 9 of the Accounting Act]

3. Definition of goodwill

Unlike under the rules in force thus far, neither goodwill nor negative goodwill can be recognised separately in the standalone financial statements when the entity obtains qualified majority influence through the acquisition of interest in another company. Under the new rule, goodwill and negative goodwill can only arise in standalone financial statements, if the acquisition is realised through item-by-item recording of assets and liabilities (i.e. an asset deal). In line with this, the consideration (purchase price) paid upon purchase shall be considered the cost of the interest. As a result of the transitional provision, the opening value of the related interest in the 2016 financial year shall be adjusted for the carrying amounts of goodwill and negative goodwill recorded among the opening data of the financial year beginning in 2016 that cannot be recognised separately under the new rule.

[Sections 3 (5) 1 and 2; 49 (3); 141 (9) and 177 (46) of the Accounting Act]

4. Goodwill

According to the amendment to the Accounting Act, goodwill shall be amortised at least over 5 to 10 years, if its useful life cannot be estimated.

The amendment does not stipulate whether amortisation is required to be accounted for, and if so, according to what schedule, in the case of goodwill that arose before the amendment but may also remain in the books after the amendment. The question arises whether:

- it is necessary to start accounting for depreciation for assets that have not been depreciated so far, and

- it is necessary to modify depreciation, if the remaining useful life of an already depreciated asset, when the amendment enters into effect, is longer than 10 years.

The possibility to reverse extraordinary depreciation booked on goodwill will no longer exist.

Deferred income recognised as negative goodwill can be released against other income at least over 5 to 10 years from the acquisition. The rule effective so far specified this period as over 5 years or a longer period.

[Sections 45 (4); 52 (1), (4) and 53 (3) of the Accounting Act]

5. Types of income statement

Version "B" of the income statement (which has typically not been used by companies) is removed, and only Version "A" can be used. Entities can still choose between the methods to analyse the expenses by nature or function.

[Section 71 (2) of the Accounting Act]

6. Income statement items

The category of extraordinary profit/loss and, accordingly, profit/loss of ordinary activities will cease. The content of extraordinary profit/loss shall be recognised among other income/expenses or income from/expenses of financial transactions, in accordance with its nature and content. Another change is that, where applicable, profit or loss shall be recognised among income or expenses on a net basis.

There will be changes to items included in profit from/loss from financial transactions or to their names. Classification of, for example, the following items will change:

- Exchange loss on the sale of interest has to be recognised in a separate line of the income statement called "expenses and exchange loss on interests" instead of the line item "exchange loss on investments";
- Impairment on long-term loans less reversal of impairment booked previously has to be recognised as impairment on interests, securities, bank deposits and long-term loans. According to rules in force thus far, impairment on loans granted had to be recognised among other expenses, while reversal of impairment had to be recognised among other income.

[Sections 77; 81; 83-86 and 87 (1) of the Accounting Act)]

7. Dividends

Dividends can be paid from available retained earnings and shall be accounted for against retained earnings at the company distributing the dividend as at the date of the resolution approving the dividend. Under the rules in force thus far, a dividend was payable from profit after tax supplemented with available retained earnings and dividends were required to be accounted for in the financial year of the financial statements which formed the basis of the decision concerning the dividend. In line with this, the category of retained profit/loss for the year will be removed and the last line item in the income statement will be profit/loss after tax.

When calculating the dividend payment threshold and the owner's equity in excess of the subscribed/registered capital (in the case of repurchase of treasury shares and the increase of subscribed/registered capital from other elements of equity), the positive valuation reserve shall be taken into account as a deductible item; however, the equity cannot be adjusted for the negative valuation reserve.

Based on the amendment to the Accounting Act, it is not clear whether the entity receiving the dividend may recognise the dividend in the financial year if the resolution on the dividend is passed only between the reporting date and the balance sheet preparation date. The uncertainty is caused by a joint interpretation of the following two provisions. On the one hand, under the amendment the dividend received (due) is the amount due based on the resolution on the distribution of the profit after tax, if it is known by the balance sheet preparation date. On the other hand, when calculating the dividend threshold, a dividend received (due) accounted for by the balance sheet preparation date in the current reporting year that is not presented in the financial statements for the previous financial year can be taken into account as an item increasing equity.

[Sections 35 (7); 39 (3)-(5); 40 (1); 40/A (7) and 84 (1) of the Accounting Act]

8. Prior-year data of the balance sheet and the income statement

In accordance with the above changes the balance sheet and income statement items as well as their content are changed. In financial statements for the 2016 financial year the prior-year data of the balance sheet and the income statement have to be presented reclassified in accordance with the new requirements.

[Section 177 (45); Appendices 1-6 of the Accounting Act]

9. Content of the accounting policies, supplement and business report

The content of the accounting policies is expanded. In the case of annual reports the scope of information to be disclosed in the supplementary notes and presented in the business report is expanded, while in the case of a simplified annual report the scope of data to be disclosed in the supplementary notes generally is narrowed.

[Sections 14 (4) and 88-96 of the Accounting Act]§]

10. Other changes

- Public interest entities will not be entitled for exemption from the audit obligation based on their size as provided by Section 155 (3) of the Accounting Act. [Section 155 (5) f) of the Accounting Act]
- The content of the auditor's report is changed regarding the business report and the corporate governance statement. [Section 156 (5) h)-j) of the Accounting Act]
- An entrepreneur or an enterprise that is a parent company operating in the raw materials extraction industry or engaged in timber exploitation of natural forests has to prepare each year a standalone or a consolidated report on amounts paid to governments, if the entrepreneur is deemed a public interest entity or its ratios exceed the specified thresholds and it cannot be otherwise exempted. [Sections 134/A – 134/C of the Accounting Act]

Endnote

Unlike other issues of our newsletter, in this case we did not raise questions but summarised the amendments to the Act on Accounting we deemed substantial. To keep things brief, we did not undertake to provide a comprehensive picture of the new rules, therefore a full understanding of the new and amended rules may require familiarisation with the legal regulations and the EU Directive. If the amendments to the legal regulations gave rise to questions for you, we recommend that you contact your tax or accounting advisor, or contact us.

Contact

Judit Boros
Partner
T: +36 1 887 7196

László Kajtár
Partner
T: +36 1 887 7324

Ágnes Rakó
Director
T: +36 1 887 7438

KPMG Hungária Kft.
Váci út 31. H-1134 Budapest
E: kerdojelek@kpmg.hu