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IMPACT OF THE TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS ON COVERAGE CALCULATION

Case
Study

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Abstract

The present study focuses on the method of coverage calculation and the reasons for the different results due to the differences between the Hungarian and IFRS accounting systems. First, the accounting characteristics inherent in the content and structure of the profit and loss account are presented on which the coverage calculation is based in the Hungarian and IFRS systems. Next, the accounting items that are necessary for the calculation of coverage are described in detail and are compared according to the two accounting systems. Finally, the differences in the calculation of coverage in the Hungarian and IFRS accounting systems based on the same items are presented through an example. Based on the study, it can be clearly stated that a significantly higher coverage amount can be detected on the basis of the same items in the system of IFRS than in the Hungarian accounting environment.

INTRODUCTION

Globalization has also had an impact on the area of accounting and accounting regulation. In an accelerated world, the value of information has increased, making financial statements and the information that can be extracted from them increasingly important. It is important that this information is reliable and accurate for internal and external stakeholders of the financial statements.

Due to the international spread of companies, it has become necessary to develop a unified accounting system in the field of accounting, which makes it possible for companies anywhere in the world to be comparable and evaluable. In addition, it is important to emphasize the fact that the various calculations such as the coverage calculation, are based on financial statements prepared in accordance with the same accounting rules. This can bring a lot of advantages and disadvantages to a business.

In the present study, the similarity and difference between the accounting items underlying the coverage calculation and the profit and loss account are presented according to the two accounting systems.

The method of calculating coverage is based on the profit and loss account; more precisely on the profit and loss account prepared using the cost of sales method. The amount of coverage is calculated on the basis of the structure of revenue, cost, coverage and profit, which is the same as the structure of the profit and loss account prepared with the cost of sales method. For this reason, it is important to present the content and structure of the profit and loss account in accordance with the provisions of the Hungarian Accounting Act and the rules of IFRS, which is implemented in this chapter.

PRESENTATION OF THE FUNDAMENTAL FEATURES OF THE PROFIT AND LOSS ACCOUNT ON WHICH THE CALCULATION OF COVERAGE IS BASED

In this chapter, the income statements prepared in accordance of the Hungarian Accounting Act and IFRS are presented.

Profit and loss account according to the Hungarian Accounting Act

As a result of the change in the Accounting Act, which entered into force on 1st January 2016, the definition of the profit and loss account has changed, among others: The profit and loss account contains the derivation of the taxed profit of the entrepreneur, it presents the main factors influencing the generation and modification of the profit or loss and the components and formation of

the after-tax profit. The profit and loss account presents the income-generating ability of the business to the stakeholders using the information in the annual statement (Siklósi & Veress, 2018).

The purpose of preparing the profit and loss account is to present the factors influencing the development of the financial results and to align the components of income by dividing income and expenses by profit categories. Determination of the remuneration of stakeholders is also of great importance, such as the obligation of paying corporate tax into the state budget (Éva, 2006).

Determination of financial results can be carried out by means of two methods:

- Nature of expense method: which shows the total costs incurred during the business year (by type of cost) and compares its amount with the value of net sales revenue, other revenue and capitalized value of own performance (Siklósi & Veress, 2018). In this case, the enforcement of the principle of completeness comes to the fore.

- Cost of sales method: which takes into account the costs incurred directly or indirectly in the current period in order to sell and contrasts them with net sales revenue and other revenue (Madarasiné Szirmai, Siklósi, Sztanó, Sztanó & Veress, 2014). In this method, the principle of comparison applies.

The difference between the above methods is in the determination of the result of the business activity; the determination of the additional profit categories is the same for both methods (Róth, Adorján, Lukács & Veit, 2008). The entrepreneur is obliged to record in the accounting policy which method was selected (Sztanó, 2013).

The difference between the profit and loss accounts prepared using the above two methods is shown in the following table:

The purpose of the profit and loss account for both methods is to present the main factors and components of the formation of the after-tax profit, and the following profit categories:

- operating (business) activity results that originate from the activities of the enterprise
- profit or loss of financial operations arising from the financial investments and other financial market operations of the enterprise,
- pre-tax profit to be treated as a basis for corporate tax,
- the after-tax profit, which is the difference between the pre-tax profit and the declared corporate tax liability (Harangozóné Tóth, Bíró, Fridrich, Kresalek & Mitró, 2003).

Income statement in accordance with IFRS

In terms of its content and function, the Statement of the Comprehensive Income consists of two components:

1. Profit or Loss for the Period – P/L

2. Other Comprehensive Income - OCI) revenue (Madarasiné Szirmai et al., 2014).

The profit for the year includes all income and expenses incurred in connection with the operation, including tax expenses. The standard does not prescribe a mandatory structure and content for deriving the result, but specifies certain mandatory minimum lines to be presented, which are as follows:

- Revenue,
- Financial expenditures,
- Share of profit or loss from associates and joint ventures accounted using the equity method, profit or loss caused by these enterprises
- Tax Expenditures,
- Results from discontinued operations (profit/loss) combined with the effect of disposal
- Profit or loss for the year, which has to be broken down to the parts concerning owners and non-controlling interests
- Earnings per share (Madarasiné Szirmai, Bartha, Kovács & Mohl, 2018).

IAS 1 does not specify the categories of profit or loss that must be disclosed in the profit and loss account, but explicitly prohibits the recognition of the extraordinary profit or loss category (Rózsa, 2015).

In IFRS, the profit and loss account income statement can also be prepared using two methods:

- "Nature of Expense Method", when the types of expenditures are classified by type of expenditure (Lakatos, Kovács, Madarasiné Szirmai, Mohl & Rózsa, 2013).
- "Function of Expense Method" or "Cost of Sales Method", when expenses and prior to those the costs are classified according to their function (Lakatos et al., 2013).

The method by which a business entity prepares its profit and loss account may depend on a number of factors, such as the nature of the business activity or even the size of the entity. In practice, in the case of financial statements prepared in accordance with IFRS profit and loss accounts prepared using the cost of sales method are more common than the ones based on the nature of expense method. One reason for this may be that it is difficult to explain the derivation of profit by cost type or that it is less helpful for economic decision-making. The other reason is that IFRS are mostly used by large companies in preparing their annual financial statements, and due to the size of the company, the cost of sales based profit and loss account has a higher information content (Lakatos et al., 2013).

The breakdown of expenditures by their function, i.e. by allocating them to cost bearers, provides higher amount and more accurate information than the breakdown by cost type (Madarasiné Szirmai et al., 2018). However, if an enterprise chooses the cost of sales method-based profit and loss account, it must also present the development of expenditure

by type of costs in the notes to the annual statement, as this information helps to forecast future cash flows as well as to prepare future cash flows statements, where, for example the knowledge of the amount of depreciation is of paramount importance (Lakatos et al., 2013).

Other comprehensive income includes unrealized profit and loss that cannot be included in the profit and loss account for the current year, as they represent a change in an item of capital other than retained earnings and equity provided by owners. These items could also be shown as changes in capital, but their presentation is much more transparent through other comprehensive income (Madarasiné Szirmai et al., 2018). Other comprehensive income includes the following items:

- Changes in the value of the revaluation reserve
- Unrealized gains and losses on securities available for sale
- Differences related to the actuarial valuation of employee benefits
- Gains and losses from fair value adjustments related to the effective portion of cash flow hedges (Madarasiné Szirmai et al., 2018).

Exploration of the similarities and differences between the profit and loss accounts prepared in accordance with the requirements of the two reporting systems

A fundamental conceptual difference between the Hungarian and international regulations is that IFRS provide much more freedom in presenting the structure and content of the profit and loss account, as IAS 1 defines requirements that concern content and format only, while the Hungarian Accounting Act requires a strict, fixed structure and allows minimal expansion and merging opportunities revenue (Madarasiné Szirmai et al., 2014). Formal differences also include the fact that IFRS do not define profit or loss categories.

A significant difference in terms of the content of profit and loss accounts prepared in accordance with the requirements of the two systems is that in IFRS, the profit and loss account consists of two parts, the comprehensive income and the other comprehensive income, thus the system presents realized and unrealized items separately. There is no such distinction in Hungarian accounting, a single statement is prepared.

Another difference is that the profit and loss account prepared in accordance with IFRS shows the result of continuing and discontinuing operations separately, and after determining the profit or loss, the EPS indicator, which means earnings per share, is presented. In Hungarian accounting, earnings are not broken down in the above manner, and the indicators calculated in the annual statement prepared in accordance with Act

C of 2000 are only published in the notes (Beke, 2014).

An important similarity is that according to the rules of both accounting systems, the profit and loss account can be prepared in two ways; nature of expense method and cost of sales method. A further similarity is that according to either the domestic or the international regulation, the profit and loss account may not contain extraordinary items, and neither statement includes a dividend approved for the owners, as according to both regulations it is paid from the retained earnings. It is considered important to point out that the aforementioned similarities have been valid for Hungarian accounting since the amendment of the Accounting Act on January 1st, 2016, which proves Hungary's approximation to international standards (Beke, 2014).

CALCULATION OF COVERAGE

Coverage calculation is primarily related to the manufacturing of products, so it is mostly used by manufacturing companies. An area closely related to coverage calculation is cost calculation.

Cost calculation is a calculation activity that is always focused on determining the monetary value of the resources used for the manufactured products, regardless of whether the calculation is performed for a legal requirement or to meet the information demand of the company's management (Kardos, Sztanó & Veress, 2007).

In the course of cost calculation, the costs incurred in connection with the creation of the product are examined.

In the course of their manufacturing activities, companies face both fixed and variable costs. Fixed costs are costs that do not change with changes in production volume, such as rent or overheads. However, variable costs, are costs that will increase in parallel with the output increases, such as material costs or labour costs (Carlton & Perloff, 2003).

In the following chapters, determination of the cost of own-produced inventories, also known as manufacturing cost, is compared in accordance with the provisions of the Hungarian Accounting Act and IFRS.

Determining the cost of inventory in Hungarian accounting

The concept of inventories is defined in the Act C of 2000 as follows: "Inventories are non-permanent assets that directly or indirectly serve the business activity" (Siklósi & Veress, 2018).

Inventories are divided into two major groups:

- purchased
- and self-produced inventories (Sztanó, 2013).

The cost of inventories is determined by the Accounting Act depending on their classification. Purchased inventories include materials, goods, mediated services and deposit packaging, which may include the following items at cost:

- the purchase price
- transport, loading costs
- mediation and commission fees
- duties, taxes, customs duties, non-deductible VAT
- interest on the loan taken to purchase the inventories, administrative costs, etc. (Siklósi & Veress, 2018).

The cost of purchased inventories may not include the paid insurance fee and the discount received reduces this value (Siklósi & Veress, 2018).

Self-produced inventories include production in progress and semi-finished products, animals for breeding and fattening and other livestock and finished products. In the case of self-produced inventories, cost is the cost of production, which includes costs incurred directly during production, such as direct cost of materials, direct labour, depreciation, etc. In addition, part of production costs may be certain indirect costs that can be allocated to a given product using various calculation methods.

The Accounting Act allows an enterprise to account its costs primarily by cost items, secondarily by cost centres and cost bearers, or primarily by cost centres and cost bearers, secondarily by cost items (Róth et al., 2008).

The essence of accounting by cost centre and cost bearer is that direct and distributable indirect costs incurred during product manufacturing are continuously collected for each product during the business year, thus information is immediately available regarding the cost of inventory, satisfying the company's internal information needs.

Determination of cost in the system of IFRS

In the system of IFRS, IAS 2 Inventories defines items that are included in the cost of products manufactured in the course of production and the ones that cannot be included.

The application of the IAS 2 standard is required for the accounting of inventories under IFRS. According to IFRS, inventories are "assets that are held for sale in the ordinary course of business or that are still in the process of production but the purpose of their production is also for them to be sold and that are used in the production or provision of services" (Madarasiné Szirmai et al., 2018).

In accordance with IFRS, inventories include materials, unfinished production, finished products, commercial goods, land and other real estate for sale. However, the latter balance sheet item does not fall within the scope of the IAS 2 standard as it

is regulated by IFRS 5 Non-current Assets Held for Sale (Lakatos et al., 2013).

Inventories are presented at cost value, which includes the following:

- the amount of direct costs associated with acquiring the inventory
- in the case of self-produced products, the costs of conversion
- other costs incurred in connection with the transfer of the inventory to the given place and condition (Madarasiné Szirmai et al., 2018).

According to IAS 2, the purchase price of inventories includes:

- the purchase price,
- customs duties and other non-deductible taxes,
- transport and administrative costs,
- other costs (Madarasiné Szirmai et al., 2018).

The cost of purchased inventories is reduced by the discounts received, regardless of whether they are invoiced for quality claim reasons and are directly related to the selling price or related to the quantity purchased. The cost of self-produced inventories can be determined by determining the conversion costs. Conversion costs include, for example, the cost of purchased material, direct labour costs, wage contributions, and distributed fixed and variable operating overheads (Lakatos et al., 2013). Fixed operating overheads are costs that remain relatively constant despite changes in output, such as the amount of depreciation, maintenance costs and administrative and management costs of the factory and the production department, rental costs (Lakatos et al., 2013).

Variable operating overheads change with, but not necessarily proportionate to changes in production volume; such costs are indirect material and labour costs and overheads (Madarasiné Szirmai et al., 2018).

The IAS 2 standard also specifies the allocation of operating overheads. Fixed overheads are allocated based on the normal capacity of the means of production, and variable operating overheads are allocated based on the actual use of the means of production (Bartha, Gellért & Madarasiné Szirmai, 2013).

Other costs are included in the cost of inventories only when they are necessary to bring the inventory to its proper location and condition. Such costs may be, for example, the indirect costs of production, the cost of designing a special product, or the cost of loans, but the latter only in the case of a qualified asset (e.g. wine, cheese) (Lakatos et al., 2013).

In addition, the standard specifies the cost items that cannot be included in cost value:

- Unusual losses of materials, labour, or other operating costs
- Warehousing costs if the company is forced to store its stocks due to an error in production. In

this case, storage costs are charged to the profit for the year.

However, if due to the nature and quality of the product, storage is part of the production process, or an indispensable phase in order for the product to achieve the appropriate quality, the storage cost is included in the cost value.

- Administrative overheads that are not related to getting the inventory in the right place and condition.
- Cost of sales (Madarasiné Szirmai et al., 2018).

IAS 2 only defines the recognition and measurement rules, not the method of accounting, so in IFRS, accounting based on the cost centre and cost bearer can be applied freely.

Differences in the determination of the cost of the manufactured product in the domestic and international accounting environment

There are many differences between domestic and international accounting regulations in terms of determining the cost of inventories produced in the course of the manufacturing process.

In addition to the payable insurance fee, the Hungarian Accounting Act does not specify any items that cannot be part of the cost of the finished product while the cost has been incurred in connection with the product.

IFRS defines a number of items that cannot be included in cost value. Such costs are for example, storage costs, which can only be part of the cost value if they are necessary due to the nature of the product, otherwise they are not. In addition, it is important to highlight unusual amount of loss, such as when much more material has been used or destroyed than required, and if there is a stoppage in production due to the strike of workers and consequently higher wages are paid; none of these can be included in the cost value.

Due to the differences described above, there may be a significant difference in the determination of the cost of production and consequently, in the calculation of the coverage.

EXAMPLE OF DETERMINING THE AMOUNT OF COVERAGE ACCORDING TO THE RULES OF THE HUNGARIAN ACCOUNTING ACT AND IFRS

In this chapter, the extent of differences between domestic and IFRS regulations in terms of determining the production cost is presented with a fictitious example.

The product manufacturing and sales data of a production company are shown in *Table 1*.

Since the direct and indirect costs associated with product manufacturing are known, it is possible to determine the production cost of the product. The calculated production cost is presented separately

according to the provisions of the Hungarian Accounting Act and IFRS, thus the difference between the two accounting systems is clearly visible, which is illustrated in the *Table 2*.

It can be seen from *Table 2* that the amount of unit cost of the manufactured product shows a significant difference. It can be observed that the production cost determined according to the Hungarian Accounting Act represents a significantly higher value. This is mainly because the differences described in the previous chapters are present in this example. The difference is mainly due to the fact that IFRS strictly prohibit the inclusion of all non-standard items in the production cost of a given product, while Hungarian accounting does not require the separation of non-standard items from standard items. The determination of the production cost is followed by the calculation of the coverage amount, which is illustrated in the *Table 3*. As there were differences between the regulations of the two accounting systems when determining the production cost, another difference can be noticed in determining the coverage amount, which can be seen in *Table 3*.

CONCLUSIONS

The study dealt with the examination of the calculation of coverage according to the Hungarian Accounting Act and IFRS.

In the first chapter, the profit and loss account on which the coverage calculation is based on was presented according to the specifics of the two accounting systems. The two types of profit and loss accounts show a number of differences, of which the separate presentation of non-realized items in IFRS should be emphasized, while Hungarian accounting does not differentiate. In contrast, in terms of the preparation of the profit and loss account, it is possible to be done in both reporting systems with both nature of expense method and cost of sales method.

In the further chapters, determination of the production cost according to the rules of the two accounting systems was examined, which showed a significant difference. The main reason for the difference is that IFRS prohibits the inclusion of non-standard items in cost value, while the Hungarian Accounting Act does not require the separation of these items.

Subsequently, the differences between the accounting of the two systems were presented through a fictitious example, and finally the amount of coverage was determined. The example also illustrates well that the two reporting systems show a number of differences in several respects, which in this case meant a large difference in the

calculation of the coverage of a manufacturing company.

Based on the study, it can be clearly stated that a significantly higher coverage amount can be detected on the basis of the same items in the system of IFRS than in the Hungarian accounting environment.

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LIST OF TABLES

Table 1
Items related to the manufacturing or sales of products

Information concerning production	
Material cost	20 000 thousand HUF
- of which, unusual loss	3 000 thousand HUF
Wage costs	32 000 thousand HUF
- of which, wage increase due to strike	5 000 thousand HUF
Wage contributions	17 000 thousand HUF
Storage costs (due to a production error)	15 000 thousand HUF
Dividable operating fixed cost	10 000 thousand HUF
Normal operating capacity	90%
Manufactured amount	1000 pcs.
Sold amount	500 pcs.
Sales price of inventories	100 thousand HUF/pc.

Source: own editing

Table 2
Determination of the production cost of the manufactured product

<i>Data in thousand HUF</i>	Hungarian Accounting Act	IFRS
Material cost	20 000	17 000
Wage cost	32 000	27 000
Wage contributions	17 000	17 000
Storage cost	15 000	0
Operational fixed costs	10 000	9 000
Total	94 000	70 000
<i>Production cost (unit cost)</i>	94	70

Source: own editing

Table 3
Determination of the coverage amount in accordance with the Hungarian Accounting Act and IFRS

<i>Data in thousand HUF</i>	Hungarian Accounting Act	IFRS
Revenue from sold products	50 000	50 000
Direct cost of sales	48 000	35 000
<i>Coverage amount</i>	2 000	15 000

Source: own editing