



**Doctoral School in
Business Administration**

SUMMARY OF THESES

László Péter Lakatos

To the Ph.D. thesis entitled

**The regulation of accounting and the evaluation of the usefulness of
financial statements**

Supervisor:

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Department of Financial Accounting

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1. Research objective, background of the research

1.1. Research objective

In the early stage of the development of accounting, it became clear that the main underlying reason for the preparation of financial statements made as the final products of this work was to provide useful assistance to a certain group in decision-making. **The focus of my research has been this usefulness.** I have studied how to understand this word in the science of accounting, from whose perspective it should be interpreted, and how (near) optimal conditions can be ensured. I have designed my studies so that statements could be put forward in relation to Hungarian accounting – principally to the associated regulations –, and the results of the connected conclusions should improve usefulness. During the studies, I have conducted an analysis in connection with stakeholders: in the given economic environment (Hungary), who can be regarded to be actual stakeholders. I have reviewed whether business actors rely on financial statements, and examined what kind of data demands the existing stakeholders have. My researches have also assessed whether the differentiation provided in the currently effective regulation is adequate in terms of size.

Based on the idea taken from a U.S. research completed in 2008, I also review the relationship between data reported in financial statements and those included in tax returns, as the relative proximity or distance of the two has a meaning and consequences.

In addition, my research has another objective, which is only apparently different to the foregoing: I have also based my inquiry on accounting information system approaches. I have explored whether the difficulties of technical implementation, often referred to as obstacles to *multiple* purposes, a concept associated with usefulness at a relatively early stage, still apply with the given state of technology.

1.2. Usefulness

For the commencement of the studies, I have been to clarify the concept of **usefulness** with respect to the given topic. It has become clear that the *general concept of usefulness* applied in economics and based on the satisfaction of needs by consumption of goods *may be applied* without any restriction provided that goods are understood as financial statements and financial reporting.

Since the middle of the 1800s, there have been works of scientific approach that have been directly associated with the examination of the usefulness of financial statements. This research work has been *continued* since then, and *always* reacted to the changing social and economic environment.

Usefulness can be construed by examining *three factors*: the analysis of the stakeholders (addressees), regulation and actual contents. The first factor responds to the question *from whose perspective* usefulness should be interpreted, the second concerns *how* the desired conditions are *created and ensured*, while the third determines the desirable *qualitative characteristics* of financial statements.

1.3. Stakeholders

The **stakeholder theories** for the definition of addressees can be grouped with respect to their evolution. The so-called early stakeholder theories (sometimes also referred to as classic capital theories) shared an approach in narrowing the scope of addressees in smaller groups (partial interpretation of stakeholders). This narrowing approach led to the *failure* of these early theories. In spite of the inherent failure, these thoughts revealed a number of facets of the behavior of stakeholders, and raised questions that were then used as fundamentals by modern (multi-criteria) theories.

The following table sums up the results and weaknesses of the major partial theories.

Theory	Results of the theory	Weaknesses of the theory
Proprietary	Determines the value of the net assets distributable among the owners	No distinction is drawn between the assets of the owners and those of the entity, no stakeholders are recognized other than the owners
Entity	Clarifies the difference between the assets of the owners and those of the entity	No stakeholders are identified (the aim is to compile financial statements)
Funds	Recognizes the simultaneous existence of several stakeholders	Seeks to assign assets to funds, to which no viable solution was found in practice
Residual equity	Introduces the concept of residual equity (net assets) and demonstrates that its maximization is also in the interest of other stakeholders; its enhanced variant points out the necessity of a sharp distinction owners' equity and liabilities	Fails to provide for the satisfaction of data needs other than those of the owners
Commander	Identifies the unique position of management; Contributes to the adaptation of the agency theory to accounting	Fails to explain the needs of other stakeholders; ignores future investors

Table 1: Results and weaknesses of early stakeholder theories

The failure of the partial stakeholder theories highlighted the fact that the scope of stakeholders should be broadened, and the task to be solved was the satisfaction of the demands of *existing stakeholders* in order to arrive at the optimal degree of usefulness. Starting out from the coalition theory of companies, accounting could exceed the approach narrowing down the scope of stakeholders to a single group, and recognized: stakeholders jointly determined the scope of data to be reported, and therefore the contents of statements was dependent on the entire group of stakeholders. The key word of this theory is **conflict**. In this approach, an attempt is made to satisfy the demands of all the stakeholders in a single line of the statement, and thus in connection with the “narrowed” content negotiations are needed.

The ultimate contents is dependent on the resultant of the abilities of the individual stakeholders to promote their own interests.

As early as in 1975, Heinin worked out the multipurpose balance sheet theory far surpassing the coalition approach; I cannot interpret this theory otherwise, but as an advanced stakeholder theory. This theory excellently dissolves the restrictions embedded in the coalition theory by pointing out: there is an option to prepare not one, but “any” number of statements. According to Heinen, the question should not be raised as what a single line of the statement is to specify, but for what purposes the given statement is intended to be used. Heinen has proved: this solution is acceptable only if the correlations of the individual statements are revealed and recorded. Although the theory enjoyed nearly unanimous success, fellow researchers noted: this solution could not be implemented, because the preparation of the “system of statements” was so labour-demanding that made the proposal too expensive or simply unfeasible. *My thesis has pointed out that this attitude (in the current socio-economic and technical environment) is not valid any longer.*

These days witness the further broadening of the scope of stakeholders. The advocates of the so-called *critical accounting approach* further widen the scope of stakeholders (broader environment, social groups, etc.), concurrently change the applied techniques, thereby calling the attention to the necessity of a dialogical approach. In my opinion, this attitude is calling the attention to possible further advances but on the other hand threatens to “soften” the applied methodology.

1.4. Regulation

In any situation where more than one stakeholder interest is to be satisfied, it is necessary to settle the given conflicts of interests. The researchers of accounting regulation have succeeded in proving: it can be resolved with a *legitimate organization*, but it is also probable that adequate disclosure can be provided via certain *automatisms*. A rather striking outcome of these researches has been that it cannot be decided beyond doubts whether the regulated solution or the solution based on automatisms is the optimal one. This debate of regulation vs. non-regulation undoubtedly focuses on the content, yet in view of my own studies the most essential element of this debate may be is that data services involve considerable costs, and these costs are to be incorporated in the model, otherwise incorrect results are obtained in

connection with the established results (expectations). In addition to the correct handling of costs, the researchers have called the attention to the parallelism (common nature) of accounting data and public goods. For instance, this parallelism highlights that the regulation and certain stakeholders are inclined to generate the *overproduction* of data with their behaviour, which brings about a suboptimal situation.

The table hereunder sums up the main results of the regulation theory.

Phenomenon, problem	Pro-regulation	Anti-regulation
Information monopoly of the entity	Lack of regulation will lead to shortage of data, monopolistic pricing and socially suboptimal output.	Entities have an interest in voluntary reporting, otherwise they are placed at a disadvantage in the capital market (a consequence of signaling theory).
Managers' own interests and report manipulation	Regulation allows this to be addressed.	Through supervision, it will develop without regulation as well (application of agency theory).
Community interests	The community requires publicly accessible, comprehensive and comparable data (e.g. prevention of insider trading)	The required data can be purchased by the community members concerned, which will result in an optimal allocation of resources.
<i>EXPERIENCE</i>		
Current practice	Confirmed by current practice	<i>Not</i> confirmed by current practice

If regulated accounting as confirmed in practice is accepted, one additional question concerning contents arises: it should be answered how it is possible that all over the world regulations of non-standardized contents have evolved. The studies conducted nowadays have already explained this phenomenon. They have identified the factors that have caused the differences:

- legal environment;
- financing;
- cultural differences;
- the influence of information needs of the state.

1.5. Contents of the regulation

All over the world, regulators wish to enhance the usefulness of financial statements by selecting qualitative characteristics or accounting principles correctly. This research concerning qualitative characteristics has also pointed out that no content may be correct if the stakeholder itself and therefore the aim to be accomplished cannot be clarified appropriately. The documents of IASB and FASB being in the process of finalization have revealed: financial statements can be useful if they fulfill the expectations of *faithful presentation* and *relevance*, as well as the associated, enhancing and fundamental quality requirements. The knowledge obtained in relation to the stakeholders and regulations, as well as the outcomes of this new research have created an opportunity to analyze the Hungarian regulations from this perspective. I have concluded that the Hungarian system lacks the open communication of quite a few underlying considerations (e.g. primary addressee, purpose of financial statements, etc.), as well as an open hierarchy underlying the system. Furthermore, certain accounting principles should be explained in more details (or removed, renamed).

2. Methodology of the research

The usefulness of financial statements is hard to study empirically. This domain of accounting is difficult to quantify, or to be more precise in the course of quantification the weights of subjective elements increase, which is quite unusual in accounting studies. In spite of the foregoing, I have insisted on conducting my examinations with the use of *mathematical–statistical methods* as far as possible.

To test the hypotheses, I have employed two databases, and conducted in-depth interviews to collect data.

2.1. Database originating from the questionnaire-based queries (AB1)

To test some of the hypotheses (H1–H5), I have needed the data and opinions of Hungarian entities. To expose their opinions, obviously the method of questionnaire-based queries has been preferred. Business entities registered and properly operated in Hungary have been selected as the population of the study. Through the database used for the purpose of the analysis, I have become familiarized with the opinions of 154 companies. The sample taken from the AB1 database approximates to be a representative one.

2.2. *The database (AB2) made available by the tax authority (APEH)*

The Board of the Tax and Financial Control Authority (APEH) provided me with the corporate income tax returns (tax return statement no. '29) for the period of 2004–2007 in an itemized, but anonymous form. In the strictest sense, this database (AB2) cannot be regarded to be a sample, because apart from companies not filing their tax returns *it contains the entire examined population*.

The established databases were processed with the use of the PASWStatistic 17.0 and 18.0 suites.

2.3. *In-depth interviews as the secondary means of data collection*

In addition to the databases, data were collected with the use of in-depth interviews, as well. This approach has been necessary primarily in connection with the representatives of classic creditors' interests (banks, credit institutions), while on the other hand interviews have also been conducted with certain larger companies (mostly those listed at the stock exchange) for verification purposes. These latter in-depth interviews detailed and discussed the answers provided in response to the questionnaires more thoroughly.

I primarily used the answers received at the in-depth interviews to test and confirm the (structured) responses to the questionnaires, as well as to reveal contradictions, draw ideas. Owing to the given weight of subjective elements, I did not use these interviews directly for justification; I rather regarded them to be complementary information.

2.4. *Structuring of a data-model*

Two of my hypotheses have relied on the multipurpose balance sheet theory. I have studied those earlier statements of researchers that claimed that the efficient data structure required by the multipurpose theory could not be designed at the given state of technological development. I have intended to refute this statement at least in part by making an attempt to set up a corresponding model for the general ledger.

3. Hypotheses established and the results of the study

As I have accepted by studying former researches: usefulness can be studied via the examination of stakeholders, regulation and the actual contents of the regulation. I have set

the objective to open a way to the acceptance or refusal of such statements in connection with usefulness that are *(also) relevant in the domestic environment*.

My thesis has a priority focus on the accurate definition of stakeholders and the mapping of their goals. The literature processed and the logical conclusions have made it clear that identification of the stakeholders and the description of their relative importance are necessary to set up a properly functioning system. The experience earned in connection with the regulation has also pointed out: if it is not clarified whom the statements should be dedicated to, there will be a larger probability for the regulation to fail. As a result, it is necessary to examine how in the domestic environment entities relate to the evaluation of the essentiality of stakeholders. On the basis of my preliminary studies, I have had the following assumption:

H1: The addressees of financial statements can be ranked unequivocally with respect to the importance of the satisfaction of the data demands of the given stakeholders.

Global systems set forth and prove: usefulness is a core requirement posed against financial statements. This key quality requirements specified in the regulation are emphasized in all the possible ways (training, wording of the regulation, etc.). I think it is important to examine whether in the domestic environment *usefulness* is identified, interpreted by entities, how the “extent” of usefulness relates to the size of the enterprises. I have had the following assumption:

H2: Entities interpret the usefulness of their own general purpose financial statements; the perceived extent of usefulness is in positive correlation with the size of the opinion maker: the larger the entity is, the more useful it perceives its own general purpose financial statements.

If H2 is accepted, this line of thinking can still be expanded. If H2 is proven, it may be examined whether in terms of size there exists any difference in the evaluation of the elemental aspects representing certain usefulness and shaping usefulness. In this context, the following hypothesis has been formulated.

H3: As depending on their respective sizes, entities consider certain information to be more useful; independently from their respective sizes, they regard information pertaining to the profit (performance in the period) to be useful, yet as depending on their sizes they have a different view on information concerning items of the statement of financial position (assets, liabilities).

Among stakeholders, in certain accounting systems – as I have explained it in the thesis, creditors’ interests tend to have a key role. This stakeholder – in deviation from the owner, management and governmental stakeholders – is not necessarily present. Such a group of enterprises may be identified where “classic creditors” are not present, and therefore their demands do not need to be satisfied. In this line of thinking, the following hypothesis has been formulated.

H4: There is such a group of entities defined by their respective sizes where the classic creditor stakeholders are not existent.

Hanlon, Maydew and Shevlin’s brilliant statements and studies have offered the idea lying behind hypothesis H5. As these authors could prove earlier, the approximation of the tax base and accounting profit deteriorated the information content of the financial statements. There is no option to conduct the same study due to the few published data (stock exchange), *yet it can be examined how the tax-book conformity of the tax base and the accounting profit surfaces at Hungarian enterprises*. Thus, I have arrived at the following hypothesis:

H5: Larger enterprises are more probable to deviate their tax base from their profit before taxes with the use of such tax base adjustment factors whose application and weight is largely dependent on the decision of the given enterprise.

The first five hypotheses are connected with the interpretation and perception of usefulness. Beside the hypotheses focusing on stakeholders and usefulness from several perspectives, I have put forward statements in connection with the multipurpose accounting theory forming one of the central issues of this thesis. As it has been explained in the analysis of the associated literature, Heinen’s approach oversets the usual frameworks to respond to such accounting problems – among others – as to what evaluation principles should be applied to

prepare statements, which stakeholders should be prioritized; the establishment of the model of multipurpose orientation has resolved these issues. Although it has always been praised by the citers, this theory has been criticized widely. As I have pointed out in the discussion of the model, these “criticisms” have stressed: the proposal cannot be implemented in practice, because it is excessively complex. The following hypotheses have been worked out to confute the limitations uttered by the earlier critics of the theory (at least partly):

H6: At the current state of technology, such data structures can be designed that make the multi-criteria analysis of assets, liabilities and elements of the profit feasible.

If H6 is accepted, it is reasonable to proceed and examine whether there is more that can be justified. It is therefore studied whether the preparation of multiple financial statements – parallel ones interpreted on the basis of several different sets of rules – can be implemented with the record-keeping of multiple value relations, which are deemed to be important in themselves. This issue has led me to the H7 hypothesis.

H7: At the current state of technology, such data structures can be designed for general ledger records that make the preparation of multiple financial statements (record-keeping on the basis of several different sets of accounting rules) feasible.

All the hypotheses established have been accepted.

4. Conclusions

4.1. Recommendations concerning the approach to the regulation

The H1 hypothesis has justified: Hungarian entities establish a ranking, or to be more accurate a *clear ranking of the users of financial statements* with respect to the fact to what extent these users are important, whose data demands should be acknowledged. The Hungarian regulation primarily acknowledges creditors’ interests, and furthermore, more or less openly it strives for making financial statements creditor-oriented. In the light of my studies, this endeavor is in conflict with the attitudes and expectations of the enterprises. When examined in association with the Hungarian regulation, the H1 hypothesis is directly correlated to the H4 hypothesis, which has pointed out: for certain company sizes, the creditors’ interests

hardly convey any meaning. By examining these facts together with the earlier researches of the specialists of regulations and the documented failures of the regulation, I have arrived at the following recommendations:

I recommend for the Hungarian accounting regulation to consider the hierarchy identified by the enterprises.

I recommend for the Hungarian accounting regulation to re-consider the main addressee of financial statements, and prioritize the owner as the key user among stakeholders.

Concurrently with the establishment of the hierarchy, it should be thought over whether it is necessary to keep all the principles, or it should be clarified what we understand by principle at all: what its function is, what the level is where a principle should be regulative.

I recommend for the Hungarian accounting regulation to hierarchize the accounting principles openly, and reveal the interrelations of the individual accounting principles.

4.2. Recommendations associated with the size of the enterprise and simplification

Several hypotheses of the thesis have confirmed: smaller and larger enterprises differ from each other, they have different data demands, and judge their own financial statements differently in terms of usefulness. This fact has been posed against the current Hungarian practice, in relation to I have observed: virtually without any significant differentiation, enterprises are under the obligation to produce and publish their statutory, general purpose financial statements. The hypothesis H2, H3, H4 and H5 have formed a coherent system, and led me to the conclusion that such a low level of differentiation is rather suboptimal. The H2 hypothesis describes the relationship between the perceived extent of usefulness and the size of the enterprise, while the H3 hypothesis points out that smaller enterprises attribute less significance to data pertaining to items of the statement of financial position. If the statements of these two hypotheses have been linked up with the H4 hypothesis – which does not deem it to be too probable that creditors appear as stakeholders for smaller enterprises constituting a significant proportion of businesses –, we are arriving at the following recommendation:

I recommend for the regulation to establish new, size-based categories in connection with the preparation of financial statements.

With respect to certain size-based categories, i.e. under a given size enterprises should not be required to prepare periodically general purpose financial statements, because there is no such an external stakeholder that would be interested in obtaining such data.

In connection with the categories, on the basis of my current databases featuring limited scopes, I would have the following concrete recommendation: under the balance sheet total *and* sales revenues of HUF 100,000 thousand this simplification could be implemented due to the lack of external creditors' demands provided that the companies concerned do not face public interests in any other manner (e.g. they securities are traded publicly). These enterprises should be only required – with the preservation of double-entry book-keeping – to fulfill the data demands of the state, while in connection with the other parties concerned – in fact restricted to the circle of internal stakeholders – data services should be put in place via other automatism. It is to be added that for certain types of activities (e.g. trading) the sales revenue limit may be increased, or instead of sales revenues the price margin as an indicator might be applied.

I recommend for the regulation to accept the value worked out for the purpose of taxation (with minor adjustments at the utmost) as the basis of additional values to be calculated (e.g. limit of dividend payment, basis of data not relating to corporate income tax, etc.) in the given circle determined in view of size.

The recommendation wishes to emphasize that if the simplification is implemented, *it should be applied consistently*, i.e. the move will be reasonable only if no parallel adjustment obligations are introduced in other fields. Although in this topic more in-depth researches are still needed, it can be claimed that in the given circle the data demands of external stakeholders may as well be satisfied with the records compiled in line with the recommendation, by way of the transformation of the available data.

4.3. *Recommendations in association with the implementation of multipurpose approach*

When the H6 and H7 hypotheses were established, I noted: I have raised these very questions, because I want to present in a *formalized way* that multipurpose orientation is feasible, or to be more accurate I have succeeded in partly proving the same (in relation to the data structure of the book of prime entries).

It is a broadly known fact that certain enterprises prepare even general purpose financial statements on the basis of different accounting systems. Quite frequently, these solutions become *embodied in controversial technological solutions*, without the proper observance of some basic rules. An example to be mentioned can be adjustments through non-closed systems, or record-keeping solutions not complying with the logic of database construction. In addition to the identification of the demand, I have arrived at the conclusion: at the current level of technological and economic development, multipurpose record-keeping is feasible, and it can also be confirmed that there exist such efficient database structures with the use of which the supporting synthetic records can be shaped.

In the light of my research results and the achievements of the multipurpose balance sheet theory:

I recommend the development of such a reporting system and associated data structure scheme that implement the details of the multipurpose balance sheet theory. When this scheme is structured, the basic statement should be based on the principle of realization, and contain at least the following supplementary statements:

- 1. Statements for the valuation of certain assets at market values;**
- 2. Supplementary statements based on the tax records (tax bases);**
- 3. Supplementary statements made on the basis of value relations that occur upon the liquidation of the enterprise.**

The implementation of this recommendation undoubtedly assumes a “critical” size for the companies, as the system is feasible, but the burdens of its operation and the associated needs are considerable.

The recommendations put forward as a result of my studies are in line with the research objectives, and are suitable for the enhancement of the perceived usefulness if they are implemented.

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7. *Regulation, enforcement and development in Hungarian Accounting* (L'Association de Formations Européennes à la Comptabilité et à l'Audit, Porto 2003, Paris 2004, Göttingen 2005, Kavala 2006)
8. *Effects of the financial turmoil on accounting regulation and profession – round table presentation* (L'Association de Formations Européennes à la Comptabilité et à l'Audit, Kaunas, 2008)
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