Department of Management Accounting

SUMMARY OF THESES

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To the Ph.D. thesis entitled

The role and application of fair value accounting in the Hungarian regulatory framework

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1 Research objective and background of the research

A central problem of accounting theory and accounting regulation is the accounting valuation, the value-assigning aspect of accounting as the reflection of economic phenomena. The main question of value assignment is that values with which kind of properties should be used in the accounting records and based on them in the financial statements (annual reports) as a final result of the accounting cycle that the ultimate aim of financial reporting – providing useful information for the users of financial statements to help them making decisions – could mostly prevail.

The regulation of accounting is traditionally based on the application of historical costs (past prices), however, it is not an unusual request or pursuit to apply the current market values next to or instead of historical cost. Among the trend of current market value accounting can be reckoned – as it is defined in accounting – the fair value accounting which is based on the application of fair values.

The Hungarian regulation, in accordance with international tendencies, renders fair value accounting possible in case of determined assets, although the choice of its application depends on the entity's decision – on the chosen accounting policy. The fair value accounting is a combined measurement model also from a methodological point of view, which carries in itself several decision points, therefore *the theoretical model's realisation in practice depends on several factors.*

The research focus of the present dissertation is the role and application of fair value accounting. Under the role of fair value accounting I understand the shaping character of regulation and actual accounting practice, while the application is considered to be the practical aspect of the theoretical model: to what extent the main assumptions of the model of fair value accounting prevail during the actual application.

The aim of the dissertation is, on the one hand, clarifying the role of fair value accounting in the current Hungarian regulation and in the practice of those entities which operate in the Hungarian regulatory framework; on the other hand, the study of application of fair value accounting in practice from certain aspects.

Works directly preceding the research are constituted by international studies made on fair value accounting, for instance: (Brown, Izan, & Loh, 1992), (Whittred & Chan, 1992), (Cotter & Zimmer, 1995), (Barth & Clinch, 1998), (Aboody, Barth, & Kasznik, 1999), (Lin & Peasnell, 2000), (Missonier-Piera, 2007), (Christensen & Nikolaev, 2010), (Nobes, 2011), and by studies which examine the methodology of fair valuation, for example: (Hunt & Hilton, 1997), (Danbolt & Rees, 2008), (Song, Thomas, & Yi, 2010).

Amongst the works on Hungarian accounting those ones should be mentioned which occupy with accounting policy decisions and with the links between theory and regulation, for instance: (Bosnyák, 2003), (Deák, 2006), (Lakatos, 2009), (Varga, 2009).

The dissertation is seeking to answer *the following research questions:*

- How can be defined the prevailing territory of fair value accounting in the current Hungarian regulation?
- In which cases and how often do the entities which operate in the system under Hungarian regulation use fair value accounting in their financial reports which are prepared in accordance with the Hungarian regulations?
- Which factors have an influence on and determine the application of fair value accounting in case of entities which operate in the system under Hungarian regulation?
- During the application of fair value accounting in practice with what kind of valuation techniques and based on which inputs is the fair value measured?

The *research plan* which was made in order to be able to answer the above described questions is constituted from two parts. Firstly, the regulatory, theoretical and economic background of fair value, as concept of accounting, had to be explored based on scientific sources and the valid regulations. Secondly, on the grounds of empirical research I had to create an image of the practical application, more specifically of the accounting practice of entities which operate in the Hungarian regulatory framework in connection with fair value accounting, inside this of their accounting political decisions, their methods of valuation, the assumptions and information used for the measurement of fair value.

During the research of the background knowledge about fair value accounting I had to face with the fact that although the topic has been widely discussed in the literature, the Hungarian sources are rather limited. For this reason *I could mainly use foreign sources*, still, I tried to confront them with the results of Hungarian accounting theory and the regulatory and practical experiences.

Throughout the *empirical research* I carried out an analysis with statistical methods using the annual reports made in accordance with the Hungarian regulations and the data obtained from a survey made by myself, as well as I examined the fair value models which were used at fair value accounting and in the annual reports.

During the formulation of the hypotheses, *my starting points were the research questions.* The *positive accounting theory* was chosen to be the approaching method, therefore, during the research I focused on accounting's and reality's influence on each other.

I called *multilevel embeddedness problem* the phenomenon according to which the accounting problems and research questions are inseparable from the economic and social environment, based on which I arrived to the conclusion that the research should be conducted following the triple of accounting theory-regulation-practice.

Accounting is basically a normative system, its *fundamental norms* mean the so-called underlying assumptions, qualitative characteristics, or principles: these give the interpretative and evaluation frame of the accounting models as the reflection of reality. The a*ccounting measurement and valuation* mean the value aspect of this reflection, the two basic concepts of measurement models are the applied measurement basis (elements of the value set) and the rules of assignment. In the focus of the dissertation stands a special accounting measurement basis, the fair value.

Based on the analysis of *the concept of fair value* I highlight the fair value as basis of the accounting measurement to be the chief conceptual feature of the market approach based on the hypothetical transactions. The concept's theoretical basis is the balance sheet approach, the general equilibrium theory and the comprehensive income concept. From the theoretical concepts only partially results the fair value which appears in financial reports, therefore in the operationalization of the concept, the *framework of the measurement of fair value* has a major role, according to which a hierarchical measurement model can be described which is controlled by the inputs used during the measurement. On the highest level of the hierarchy stand the quoted prices, registered on an active markets, under this stand the quoted prices of similar instruments and other market-based inputs, while on the lowest level can be found the measurements based on assumptions (models).

At the same time the measurement model *has to be placed among the fundamental norms.* Its analysis gave answer to the model, to the strength and weaknesses of its application and to the connecting opportunities and threats.

Therefore, the above mentioned theoretical considerations and the surveyed international research directions meant the starting point of answering the research questions and the formulation of hypotheses, completing the extension of fair value available in the current regulation, especially considering the Hungarian accounting regulation and practice which is the focus of the present analysis. Extension as an umbrella term includes in itself three sub-areas: the assets which can be measured at fair value, the questions of fair value as a possible alternative and the applied accounting model.

Examining the Hungarian regulation I generally found that the fair value as an authorized alternative measurement basis in case of certain assets is part of the Hungarian regulatory environment, at the same time the difference between the opportunity created by the regulation and the actual role of fair value is mainly influenced by the fact that the application of fair value depends on the entity's decision.

Among the characteristics of the Hungarian accounting regulation I highlighted the rather limited choice of fair value, the concept of value adjustment and appearing in connection to this the joint presence of the concepts of fair value and market value, and their unclear connection to each other. The demand of more specific analysis of these characteristics led directly to the formulated hypotheses.

2 Research methodology

The sources of the data used to test the hypotheses can be divided into four (3+1) groups.

Data from corporate tax returns (DB1 database)

The first group is constituted by the data of corporate tax returns of the year 2010 (tax returns of 1029) which were required to be submitted by the enterprises operating in Hungary. The reason for the choice of this period was that the data of the year 2010 are the latest ones, and this dissertation is aiming to assess the current situation. These data were provided anonymously, exclusively for research purposes by the National Tax and Customs Administration (Hungarian abbreviation: NAV). The data record contains the main data of 392,640 corporates' tax returns – except for the identification data –, this means data provision according to 268 variables for each business. The database contains the data of every enterprise which is under the Corporate Tax and Dividend Tax Act, maintains a double-entry bookkeeping system and gave in a tax return of the year 2010, without any restrictions.

Generally a rather vast scattering characterised the variables of the *DB1 database*, for this reason I opted for using those quantiles (mainly deciles) which are less sensitive to scattering from the statistic descriptions of variables. In order to refine the analyses, I stratified according to size categories, for this I used the variables of total assets and sales returns, upon creating the categories I prepared my starting point from the boundaries defined in the study of the Corvinus University of Budapest Department of Financial Accounting made in 2008.

Data from the survey of auditors (DB2 database)

My second source is constituted of data obtained from an own survey. The survey's target was the circle of auditors who are registered in Hungary and did not suspend their membership of chamber. The questions *concerned the practices of last finished audit period (2011).* The survey was sent out with the help of the Chamber of Hungarian Auditors (Hungarian abbreviation: MKVK) to every targeted auditor on the 25th June, 2012 (in August 2012 there were 3,152 not suspended members of the MKVK). The query – except for the incidental deficiencies due to data errors – was complete.

To enable the statistical analysis of the data we considered necessary a large sample composed of at least 100 elements. This goal seemed attainable even in view of the relatively low response rate (a maximum of 5%) generally experienced in similar research projects.

The number of responses received was mostly in line with this preliminary expectation as a total of 104 properly completed answers were submitted, which represents information based on 1619 audits when aggregating the number of audits conducted by the respondents in 2011.

In the survey I asked questions concerning the practice of fair valuation and value adjustment which could be noticed during the inspection of statements prepared in accordance with the Hungarian regulations. In order to facilitate the survey's completion, to get unequivocal answers and enhance the number of answers I preferred to work with closed questions in every case: concerning each and every question I made a statement which had to be rated on a frequency scale from 1 to 6.

The *DB2 database* contained data measured substantially on ordinal scale, therefore I mainly used frequency tables during the analysis. In order to obtain more applicable differences than similarities in case of every question, I rescaled the data: the original scale of the survey which went from 1 to 6 I modified to run from 0 to 5, in this way assuring that those cases in which there was no value adjustment/fair valuation would get 0. Aggregating these recoded frequencies I ordered point totals to each answer. The next step was the creation of weighted scores by applying the number of audits made by each answerer as weighted variance (number of audits × frequency), and the scores obtained in this way were summarised for each answer.

Data obtained from the financial statements of listed companies (DB3 database)

Because of research purposes a third – minor – database was created from the data of those corporates' financial statements which were made in accordance with the Hungarian regulation and the IFRS, and which corporates are listed in the Budapest Stock Exchange (Hungarian abbreviation: BÉT). Upon the creation of the database my starting data were constituted by those businesses' data whose stocks and/or bonds were listed in the BÉT in 2012. According to this 55 companies were included in the database, and upon creation of the sample it was an important criteria that the data of the statements of the year 2011 would be available according to both the Hungarian and the IFRS regulation. Consequently, the sample had to be cleared from those companies whose statements, or at least one of them, were not available.

Other sources

The supplementing data sources of the empirical research were constituted by in-depth interviews with auditors and valuation experts. The structure of these interviews was offered by the questions concerning fair valuation of the auditor-survey which constituted the basis of the DB2 database and by the joint analysis of the answers received to the survey's questions.

I was looking for answers to the following questions concerning the fair value/market value measurements which had been realised in practice: according to which methods were they made; is there a generally accepted professional guide; during the measurement of single assets which are the Hungarian specialities; is there and if yes what kind of differences there are between the measurements made according to the IFRS and those ones made for Hungarian reporting purposes; do the theoretical differences between value adjustment and revaluation according to IFRS have a significance in practice?

The survey certainly cannot be regarded representative, therefore its main purpose was to assume a supplementary role, to enhance the analysis, and to prove or disprove the data obtained from other sources. Still, at the same time the role of professional standards is relatively strong, thus the results obtained in this way perfectly reflect the generally prevailing principles.

Throughout the testing of hypotheses which can be analysed with statistical methods I prepared new variables from the variables of the databases, amongst these the most important ones are the weights of single asset groups in the balance sheet and the ratios of gearing. During the testing of the hypotheses I applied cluster analysis, distribution studies carried out with deciles, logistic regression and non-parametric tests (Kolmogorov-Smirnov, Mann-Whitney, Friedman tests, Wilcoxon signed ranks test).

3 The formulated hypotheses and results of the analysis

The formulated hypotheses were classified around the concepts of *role and application* which two concepts can be found in the title of the present dissertation.

- The hypothesis in *connection with role* was formulated upon the characteristics found in the Hungarian regulation: I wished to clarify the place of value adjustment in the system and its connection to fair valuation.
- *Role and application* are inseparable in case of those hypotheses which concern the frequency of choice of fair valuation or the assets which are measured at fair value.
- I searched for answers in connection with *application* in those hypotheses which occupied with the motivations of opting for fair valuation and in connection with the methodology of fair value measurement.

3.1 The place of value adjustment in the system of fair value accounting

Concerning value adjustment appearing as a unique feature of the Hungarian accounting regulation, the regulation does not provide an answer to the questions of measurement of market value. Given that the scope of assets concerned affected by value adjustment does not feature prices quoted in active markets, expert estimates are required in order to determine the market value. Consequently, the actual content of market value is formed not by the regulation but by the practice itself, i.e. the valuation. It was according to this that I established Hypothesis no. 1.

H1: During practical application the value adjustment laid down in the Hungarian legislation and the market value defined in case of the value adjustment are understood as being equivalent to fair valuation and fair value, respectively.

Hypothesis **H1** is unique in the sense that it was hard to examine using statistical methods. The analysis of this methodological hypothesis required its comparison versus the theoretical relationships of the Hungarian practice. To that end, I assessed the theoretical considerations underlying the Hungarian regulation of value adjustment and compared these to the provisions of the accounting act pertaining to fair value, the underlying principles of the IFRS, as well as the conclusions made following the in-depth interviews with experts.

Based on the empirical research I accepted hypothesis H1.

Hereafter, *fair valuation* as the focus of the examination is understood as recognition at the fair value defined in the Hungarian legislation and value adjustment, which is in line with the focus of international research studies that examine the fair valuation of financial instruments, tangible and intangible assets as a whole.

3.2 The choice of fair value in the Hungarian practice

The fragmentation of the Hungarian enterprise structure in and of itself determines the application environment of fair valuation as below a certain size the costs and benefits related to the fair valuation cannot balance each other. The restriction of fair valuation to certain assets carries another inherent restriction: the asset structure (the types of assets and liabilities held by an entity) has a fundamental influence on the choice of fair valuation. If an entity does not have assets (and liabilities) available for fair valuation, then fair valuation is ruled out (both in theory and in practice). In light of the above, a marginal role of fair value appeared to emerge in the Hungarian accounting practice – in line with the international trends.

Accordingly, I established Hypotheses no. 2, 3, and in part Hypothesis no. 4. Hypothesis no. 2, as well as its 2 sub-hypotheses directly relate to the actual use of fair valuation while Hypothesis no. 3 concern the implicit restriction inherent in the asset structure.

H2: Of entities operating in the Hungarian regulatory framework:

a) only a negligible portion opt for fair valuation in their financial statements prepared according to the Hungarian rules, and

b) apply fair valuation primarily for tangible assets, in particular for real estates.

H3: The asset structure of businesses operating in the Hungarian regulatory framework determines that fair valuation may only be used for a smaller portion of the businesses.

Sub-hypothesis H2/a) was tested based on the examination of the representation in the balance sheet (valuation reserve) earlier mentioned by conducting a separate examination of the reliability of data using the internal relationships of the *DB1 database* (balance sheet rows and their detailing data). The results obtained were compared to the frequency tables of the data resulting from the *DB2 database.*

For **testing Sub-hypothesis H2/b)** I examined the balance sheet weights (the ratio of the different asset groups versus total assets) calculated from the *DB1 database* using cluster analysis. Given the relatively large size of the sample, I opted for a two-stage procedure: I estimated the clusters to be established using hierarchical cluster analysis and then ran a non-hierarchical analysis (K-means method). The stability of the clusters thus established was checked using discriminant analysis and their interpretation was conducted according to their asset structure.

Subsequently, I compared the results obtained with the respective data of the *DB2 database* based on the scores described in the previous section. Although the results based on point totals are relatively easy to interpret, their statistical explanatory power is smaller. Therefore, I applied the *Friedman test* for the verification and, in cases where the examination of the ranking order was required, I applied a separate *Wilcoxon signed rank test* for the unweighted variables and for the variables weighted with the number of audits, respectively.

Hypothesis H3 was tested using the *DB1 database* in two stages: firstly, it was done for the whole population in general and, secondly, based on the layering described earlier separately for each band. The method applied involved the analysis of deciles: I examined for which part of the entities the weight of the given asset group, available for fair valuation, deviates significantly from 0. For assets subject to depreciation I extended the examination to both the net value and the gross value in order to prevent the distorting effect of the degree of depreciation. The results obtained were again compared to the data of the *DB2 database* also using the point totals calculated on the basis of the answers provided.

Based on the empirical research I accepted both of the hypotheses.

3.3 Motivations for choosing fair valuation

Upon examining the entities that opted for fair valuation the question arose as to what the motivations behind the choice of the measurement basis were. The international research findings highlight the variables of size and leverage. In case of leverage it was found that capital adequacy indicators relating to the credit application, essentially administrative barriers, also carry explanatory power. Leverage was measured as the ratio of equity versus total assets, whereby the negative equity value (and ratio) specifically appear as an extreme value, which also raises questions concerning the long-term operating ability of the business.

When examining the Hungarian accounting practice, besides the question of leverage, I consider appropriate to include in the examination the compliance with equity requirements according to the act on business entities as an explanatory variable. Its function is similar: it represents an administrative barrier. I defined the dimension of size according to the practice accepted by the European Union, using the first two constituents of the triple: net income – total assets – average statistical headcount.

Upon a comparison of the Hungarian regulation and IFRS rules I pointed out that the fair valuation of financial instruments is mandatory in the IFRS system. I also highlighted that in case of the tangible assets and intangible assets the two systems of rules permit the choice of fair valuation in the same manner. Accordingly, the harmony of valuation procedures according to different accounting systems of entities obliged to fulfil dual reporting (i.e. according to the IFRS and the Hungarian accounting act) arises as a question. In order to expose a part of the motivations behind the choice, I established Hypothesis no. 4, along with its 3 sub-hypotheses. The hypothesis is not complete in the sense that I only seek to examine the effect of the 3 factors it contains, albeit a number of other motivational factors may also play a role in choosing fair valuation.

H4: Among entities opting for fair valuation:

a) size and

b) leverage and the related compliance with requirements pertaining to the minimum volume of equity are explanatory factors for the use of fair valuation,

c) however, even in case of entities obliged to fulfil dual reporting the frequency of choosing fair valuation is not higher in the financial statements prepared according to the Hungarian rules.

The testing of **Sub-hypothesis H4/a)** was done according to the categorization of the data of the DB1 database according to size as presented earlier by comparing the distribution of the full population, those choosing and not choosing fair valuation among the different categories. The correspondence of the two sub-samples, following the Kolmogorov-Smirnov test of the examination of normality, was tested using a non-parameter procedure, the Mann-Whitney test, as well as two Kolmogorov-Smirnov tests using independent samples. Since the DB2 database also contained data relative to the entities choosing fair valuation, I again contrasted the results of the two databases (also using the point totals calculated on the basis of frequencies).

The testing of **Sub-hypothesis H4/b)** was based on the ratio of two indicators of leverage, namely equity versus total assets and equity versus registered capital. Due to the effect of fair valuation which distorts (increases) equity and balance sheet value, both indicators were established from data calculated without the valuation reserve.

Firstly, using the *DB1 database* I examined to what extent the indebtedness indicators of those choosing and not choosing fair valuation vary, again using a Mann-Whitney test and a Kolmogorov-Smirnov test, and for the purpose of exposing the relationship of cause I examined the change in the indicators upon including the valuation reserve in the analysis.

As a next step, I chose a sample out of those not opting for fair valuation with a size and asset structure similar to those opting for fair valuation and compared the indicators of those opting for fair valuation to the sample thus established. In order to assess the explanatory power of the capital situation I applied logistical regression using binary variables. The factors not included in the examination but affecting the choice of other fair valuations were examined using the *DB2 database*.

The basis of testing for the **Sub-hypothesis H4/c)** was the *DB3 database* and besides the examination of the data thus collected the fair valuation practice of entities with a foreign majority stake listed in the *DB1 database* was also examined (the separation of sub-samples were once again checked using a Mann-Whitney test and a Kolmogorov-Smirnov test), along with the answers given as the reasons for choosing fair valuation of the *DB2 database*.

Based on the empirical research I accepted the H4/a) hypothesis-section, hypothesis-section H4/b) was accepted with the restriction that inside leverage the effect of correspondence with the legal capital requirement cannot be unequivocally separated, I accepted hypothesis-section H4/c) on the basis of the sample tested, but at the same time it cannot be ignored that there was no information available on those elements of the population which could be classified into other groups.

3.4 The methodology of fair value measurement

The literature review highlighted that fair value cannot be determined based on a uniform measurement model. Mark-to-market and mark-to-model measurements can be distinguished according to their theoretical characteristics as well. Just what types of measurements dominate a given regulation environment is a key feature of the use of fair valuation in a specific regulation. I established Hypothesis no. 5 based on these methodology questions concerning the measurement of fair value.

H5: The majority of fair value measurements conducted in the Hungarian regulation environment are mark-to-model measurements.

Hypothesis H5 can be tested using statistical methods similarly in a rather restricted manner and as the *DB1 database* contained no relevant data for verification the backbone of the examination was formed by the *DB2 database* using the auditor survey and *in-depth interviews*.

Based on the empirical research I accepted hypothesis H5 with the restriction that the role of prices for similar instruments as market-based inputs are significant, still, at the same time it is generally characteristic to adjust them with other factors, which turns the measurement practically into a model-based one.

4 Conclusions

The role and application of fair value accounting stood *in the research focus of the present dissertation*. Under the role of fair value accounting I understand the shaping characteristic of the regulation and the actual accounting practice, while the application is the practical aspect of the theoretical model: to what extent the basic assumptions of the model of fair value accounting are realised throughout the actual application.

The targeted aim of the dissertation was the clarification of the role of fair value accounting in the current Hungarian regulation and in the practice of those entities which operate in the Hungarian regulatory framework; on the other hand, the study of application of fair value accounting in practice from certain aspects.

In accordance with these aims, the main results of the dissertation are summarised around the questions of role and application, and based on the drawn conclusions I formulate some suggestions which aim at the further development of the regulation.

4.1 The role of fair value accounting

In connection with *fair value accounting restricted to the area of financial instruments,* which appears in an explicit way in the Hungarian regulation, a relatively unequivocal image can be drawn: the fair value is present as an alternative measurement basis, however, it is chosen only by an insignificant proportion of entities. On a certain level this is reflected also in the regulation: the regulatory system concerning fair valuation is part of that small field of the Act on Accounting whose rules were not changed in any way in the last ten years, although the international regulation has already made further steps.

The image is taking different shapes by taking into consideration *the value adjustment* throughout the research: based on the empirical research I do not consider reasonable to divide the two concepts, as value adjustment is also a manifestation of fair value accounting. Value adjustment is significantly more frequent, especially in case of real estates, than the fair valuation of financial instruments, although the value adjustment's proportion of choice can be considered as low. Comparing the frequency of choice of fair valuation with *Varga*'s (2009) results – and taking into consideration the fact that the two studies had two different research focus – there cannot be found a fundamental change, the tendencies observed at that time prevail also today, in case of both larger and smaller entities.

Generally it can be claimed that the role of fair value is the most important one in case of real estates. This already in itself *determines the main characteristics of the application of fair value accounting in Hungary*, since in case of real estates the availability of quoted prices is restricted, therefore during the measurement at fair value inputs of lower levels are emphasized on the systematic level.

The actual *marginal role* of fair value accounting *can be conducted back to different reasons.* On the one hand, there is an external factor: the Hungarian business structure, the ownerships and the forms of financing determine that its application could be the interest of entities only in a restricted field.

On the other hand, the analysis of the structure of assets shed light to an other limiting factor: the majority of entities do not own any, or if they own, they do not have such a significant power in the balance sheet that they could be measured at fair value.

For these reasons it still can be stated of the Hungarian accounting system that it dominantly *stands on the historical cost*, and the shift to the more significant role of fair value – which can be observed in the international regulation, although it is neither a new tendency nor an undiminished one –, is not reflected in Hungarian accounting. This phenomenon – in accordance with Nobes's (2011) observations – can be partially explained with those continental roots in accounting which are based on the idea of precaution, on the other side – agreeing with the conclusions of Bosnyák (2003) –it can be also explained by the fact that due to the close interpenetration of taxation and accounting, with the extension of fair valuation (for example in case investment properties) associated not realised result items would need several legislative decisions and the reconsideration of taxation rules.

The analysis of asset structure is partially beyond fair valuation: comparing the results of the analysis differentiated according to size categories with Lakatos's (2009) study on liability side it can be noticed that there is a significant overlapping between the entities which do not have assets which could be measured at fair value and in of those businesses where the standard interest of creditors cannot be identified. On the basis of this, in regard of the asset structure of Hungarian businesses it can be concluded that the smaller enterprises show a more extreme image both in terms of asset and liability side: practically they are in possession of only those liabilities and cash whose sources mean the items (equity and liabilities) connected to owners.

4.2 The application of fair value accounting

Based on the results obtained throughout the research made on application, it has been confirmed that there is a positive connection between *the size of the entity and the choice of fair valuation*, as in case of larger enterprises the choice of fair valuation is more likely. Contrary to this, an often heard stereotype was not confirmed by the research: the motivational system of choosing fair valuation is more complex, *it cannot be merely narrowed down to the need of meeting the capital requirements described in the Corporate Act.*

The capital situation of the majority of entities which choose fair valuation is in accordance with the Corporate Acts requirements, what is more, in the survey the “owner's expectation” as motivational factor had a significant importance.

Of course the effect of the pursuit to settle the capital position cannot be underestimated, at the same time, in order to reveal the motivational system other studies and analyses are needed, which exceed the present dissertation's size. First of all, the term “owner's expectation” should be defined more precisely, and the factors which are included in it/or are beyond it should be analysed.

The thesis in connection with dual reporting highlighted the fact that, although there are available fair values based on the financial statements prepared according to IFRS, they do not appear in the Hungarian annual reports. In my own opinion, the reason for this (mainly) is that in case of those entities which are obliged to dual reporting, next to the financial statements made in accordance with IFRS the Hungarian annual report has only a subsidiary role.

The analyses *concerning the measurement of* fair value showed that in the majority of cases the measurements are model-based ones, still, for several reasons the results can be interpreted only with restrictions. On the one hand, it has to be noticed that – although my aim was only to discover the tendencies – the sample based on the survey of auditors cannot be considered representative, even though the obtained results were confirmed by the in-depth interviews as well.

The higher number of model-based measurements results from the fact that amongst the assets measured at fair value the number of real estates is dominant. Notwithstanding, it has to be mentioned that the methodology of fair value measurements, the revealing of the Hungarian characteristics of fair valuation needs further studies, which have exceeded the limits of the present research. It would be necessary to analyse the actual fair value measurements using an appropriately voluminous sample, the inputs of valuation models and the methodology in their background, however, we are facing limitations obtaining these data as the measurement reports are considered to be rather sensitive data, and they are hardly offered to third persons, even in case of researches.

4.3 Recommendations for the further development of the Hungarian regulation

The first and basic conclusion in connection with conceptual system of fair valuation was still not drawn from the theses, but from the comparison of the Hungarian and IFRS rules: the Hungarian regulation from the introduction of fair valuation in 2003 did not follow the development of international regulation, in its operational details, and more importantly, in its conceptual system it differs from the international regulation.

In my own opinion it is necessary to insert the missing unequivocal *exit price-based approach* and the conceptual system of *fair value hierarchy* in the Hungarian regulation, from merely the point of view of harmonisation as well.

The conceptual differences can be bridged, consequently, the modification would not involve the fundamental change of rules, therefore their introduction would not carry disproportionate burdens; still, the consistency of the conceptual system would be strengthened. However, it is true in the case of the definition of fair value, and in case of the hierarchical approach too.

The question in connection with the reception of hierarchy is *the regulation of the measurement of fair value.* According to my own lights, in the Hungarian regulation there would be need also for a methodological framework which is similar to the IFRS 13 and would create a unified system from the past practice. Concerning this, it cannot be left unnoticed that this would destroy the framework of Act on Accounting from the point of view of the little role of fair value and the regulatory traditions.

Examining the Hungarian characteristics of fair value measurement, I do not think that there would be need for the creation of an independent Hungarian standard which differs from the IFRS 13, contrary to this, I would consider more useful if the Hungarian regulation would include that the rules of IFRS 13, and rather than that its principles are authoritative for the Hungarian practice as well.

The test of hypothesis H1 shed light on the deeper deficiencies of the conceptual system. On the one hand, at the introduction of the concept, role and application of *value adjustment*, which was the legislative aim, contrary to the inflation accounting solution – or next to it – today in practice the individually defined revaluation at fair value of fixed assets was filled out with the appropriate content. The market value applied at value adjustment means fair value, however, this is not represented explicitly in the regulation, and following this in the financial statements made in accordance with the regulation.

According to my judgement this kind of mixture of market value and fair value is more than unfortunate, instead of market value it would be more correct to apply the fair value, and the rules of value adjustment should be separated from the impairment reversal rules.

Nevertheless, it has to be noticed that partially this is a question concerning tradition: *in the Hungarian accounting thinking fair valuation and value adjustment are sharply demarcated from each other.* If also in case of value adjustment the fair value was defined as measurement basis, it would not mean any change in rules, it would not be necessary to expand the circle of fair valuation and connect the choice of value adjustment and fair valuation of financial instruments.

Although I consider the *value adjustment of long-term investments* to be alienated from the system, and I would consider more fortunate to connect it with the fair valuation of financial instruments, still the fact cannot be unnoticed that in the Hungarian regulation's focus basically the individual statements stand, therefore the question has to be solved. In practice this means that the regulation has to give opportunity that in individual statements the long-term investments which constitute an important item could be measured at fair value separately from the other financial instruments. Nonetheless, at this point I would like to make two suggestions: firstly, also in this case instead of market value the fair value should be defined as measurement basis, secondly, it would be necessary to settle the relation of fair valuation and value adjustment: in case of choosing fair valuation it should be made obligatory that also the group of assets has to be measured at fair value.

This is not an impossible expectation from the point of view that in those cases when the fair valuation cannot be reliable measured, the actual rules of the law prescribe the application of historical cost.

The management of the events after the reporting period indirectly are in connection with value adjustment and represent a comprehensive question in the regulation: the clarification of the term “known by the balance sheet preparation date”, the clarification of the terms adjusting and non-adjusting events would be indispensable amongst others in case of the rules of value adjustment. With the precise clarification of these issues the theoretical differences between the Hungarian and IFRS rules could be solved.

I consider right *the regulation of fair valuation as suitable choice* based on the theses in connection with the role of fair value, however, I still do not consider justified the obligation of fair valuation – in this way arguing in part with the conclusions of Varga (2009) –, taking into consideration the asset structure, the size and the relevant stakeholders of entities, not even in case of larger entities.

From a theoretical point of view, if the fair value measurement's result is reliable and next to the fulfilment of the requirements of faithful presentation also the relevancy is improving, the choice of fair value is justified. Though, it cannot be left unnoticed the fact that role of general purpose financial reporting is rather restricted in Hungary, due to the lack of those shareholders whose primary sources of information are financial statements.

The studies which were also part of the background research of the present dissertation, (Bosnyák, 2003) and (Lakatos, 2009), shed light on the fact that in case of a significant proportion of entities which operate in the Hungarian regulatory framework there is no need for financial statement except for recording for tax purposes. This conclusion was supported by my analysis concerning the asset structure. The main addressees of financial statements are the (small) stock market investors, the owners of shares or bonds. The number of Hungarian listed companies is relatively low, on the other hand, according to the main rule, they are obliged to prepare financial statements according to the IFRS. In consequence, upon the decision making of investors the statements prepared in accordance with the Hungarian accounting regulation do not have a decisive importance, including also the value relations which appear in them.

The analysis conducted in connection with leverage shed light on the limits of the prevailing of *capital requirements according to the Corporate Act* and its binary nature. In connection with fair value the question arises whether it is right, it can be allowed, to what extent it is compatible with the aims of protection of creditors, if the entities manage to suit the capital requirements by revaluating the assets and presenting the non-realised capital gains.

In my own opinion, there is more than one side to a coin: if the fair value was measured reliably and the value represented in the statement truly reflects the given asset's equilibrium price, then in connection with capital adequacy the raison d'etre of remeasurement cannot be questioned. Contrary to this, if the valuation is not reliable, then a fraud is taking place, which is unacceptable for financial statements which are based on any kind of value-theoretical basis.

Howbeit, it has to be noticed that the fair value according to its definition is not a liquidation value, and in itself it does not ensure the satisfaction of creditors. In connection with the regulation of capital requirements, the question arises whether it is necessary to have a regulation which is determined in proportion with the registered capital and differentiated by forms of business. *Based on the carried out researches I could not ascertain of its raison d'etre.* The negative equity value – perhaps the registered capital which does not reach the minimal value set in the law – practically would be able to assume the same function.

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