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Transformation in Hungary's Higher Education System

Within the framework of accrual-based and cash-based accounting

SUMMARY: On the basis of the goals set out in the strategy paper entitled “Gear shifting in higher education”, the Ministry of Human Resources made a decision on the structural transformation of several higher education institutions in 2015 leading to separation, separation by integration as well as merger. This paper is designed to compare how the transformation or dissolution without succession of business associations differs from the main features of the transformation of budgetary institutions with special regard to the features of the ownership structure of these economic entities. (Xantus, 2010) The structural changes are reviewed in the framework of the “double double-entry” bookkeeping method that combines accrual-based and cash-based accounting with a view also to changes in the legislative background of this transformation that occurred simultaneously with the preparations being made at the institutions. The paper highlights the cyclic nature of higher education activities that should be treated as a crucial factor in choosing the effective date of the changes.

KEYWORDS: merger, demerger, budgetary institutions, business associations, public finances accounting, accrual-based accounting, higher education

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1 January 2014 marked an important change in the accounting system of budgetary institutions when a new business administration approach appeared in addition to the old cash-based economic system that gave exclusive priority to budgetary criteria. (Pályi, 2015)

IN THE “CROSS-FIRE” OF CHANGES

The “double double-entry” bookkeeping is a big challenge even today for economic organisations operating under public finances.

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This sector finds it difficult to “get over” and change the approach based on the budgetary criteria that has been in use for years. (Simon, 2012) It can be established that even after the second financial year it is quite rare for the players in this sector to use realised profit as the basis for financial performance in line with the principle of matching, which is based on the business administration approach. The cash-flow-based financial analyses that monitor and support the financial performance of the budget continue to dominate the evaluation of the organisations’ finances. Obviously, there has been some change recently but it will definitely take more time to change the general attitude.

If the changes, required for this currently emerging new approach, are coupled with further changes in the institutions' organisational frameworks that affect their operative functions, then we can talk about a real professional challenge. On top of all that, this process is taking place in a sector within public finances, that is, in higher education, where the calendar, that is, the fiscal year – using the terminology of the accounting act (hereinafter: the Act on Accounting) the business year – is different from the temporal cyclicity that characterises this activity.

The national higher education is an area where the above challenges are concurrently present. The long-term plans that affect the future of the sector fill a basic gap in the national higher education system. (Drótos, 2010) The underlying expectations include the basic principles of both competitiveness and performance-oriented higher education systems, which pave the processes that entail numerous changes. (Barakonyi, 2014) The transformations launched on the basis of the sectoral strategy paper “Gear shifting in higher education” that was adopted in 2014 are not unique. The same tendency has been seen in the higher education of Europe in recent years. (Privot et al., 2015) The legislative frameworks for the strategic objectives are largely in place in Hungary as a result of the Act CCIV of 2011 on Higher Education (hereinafter: Act on National Higher Education) and the related government decrees that have been amended several times. Apart from the change in the governance model – which began with the appointment of chancellors in 2014 and was followed by the establishment of advisory boards on 1 January 2016 – the strategy launched a multidimensional reform in the sector by rethinking the training structure and transforming the institutional system. In the meantime, the financing model of the sector is also taking shape in line with the intention of the legisla-

tor. (Hrubos, 2015) There are different considerations behind the transformations, which have partly academic and partly governance-management-administrative aspects. Obviously, the criteria of efficiency and economy are also present. (Skodvin, 1999)

This paper intends to highlight and explain the legal, financial and accounting dimensions of the structural transformation of higher education institutions from the aspect of “the changing world.” (Ormos, et al., 2012) Additional challenges also emerge during the transformation, such as the response to organisational resistance and the need for effective communication, but this paper does not intend to address these “success factors.” (Shaw, 2012)

THE LEGAL FRAMEWORK OF THE INSTITUTIONAL-ORGANISATIONAL RESTRUCTURING

The underlying legislation of the Act on National Higher Education, which contains the sectoral rules for the transformation of higher education is Act CXCV of 2011 on Public Finances (hereinafter: Public Finances Act). Section 11 of this act regulates the different forms of transformation.¹ One way of transformation is the dissolution of a budgetary institution with or without a legal successor. An institution may be terminated with succession through the merger or demerger of several budgetary institutions, but also by the founder terminating a budgetary institution and establishing a new one. On the basis of this provision of the Act on Public Finances, Section 20 of the Act on National Higher Education stipulates that the higher education institutions shall be restructured in order to coordinate their activities. The proprietor is entitled to make a decision on this by taking into account the opinion of the Senate. The transformation may be realised

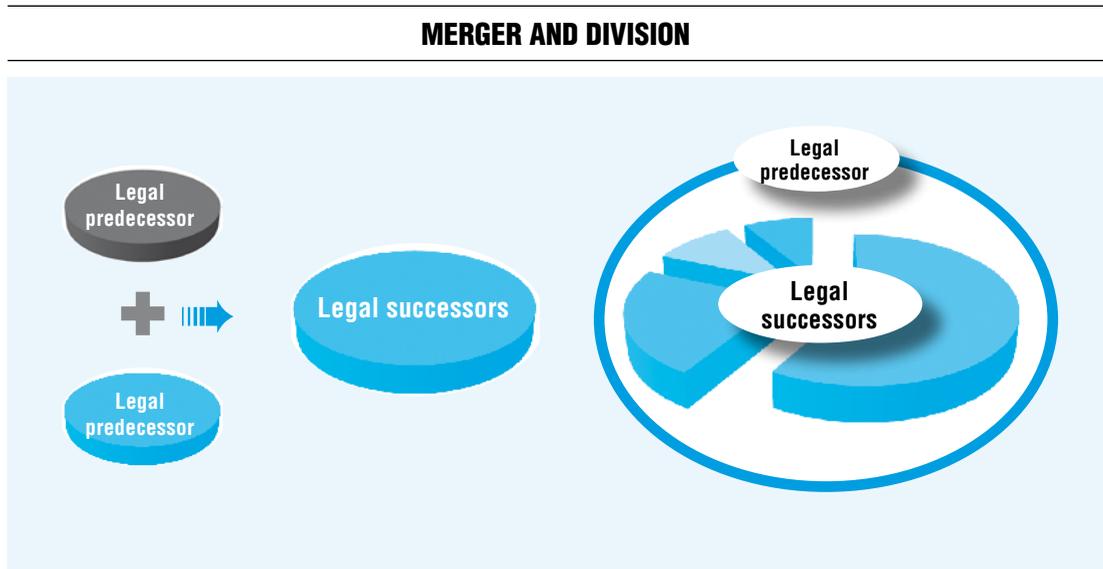
by fusion (merger, integration) or demerger (division, separation).

In the case of a merger or division, the legal predecessor institutions are dissolved and a new institution or new institutions are established as legal successors. In the first case, succession

is joint and several, while in the second case it is special. (Dobos, 2012) (See Figure 1)

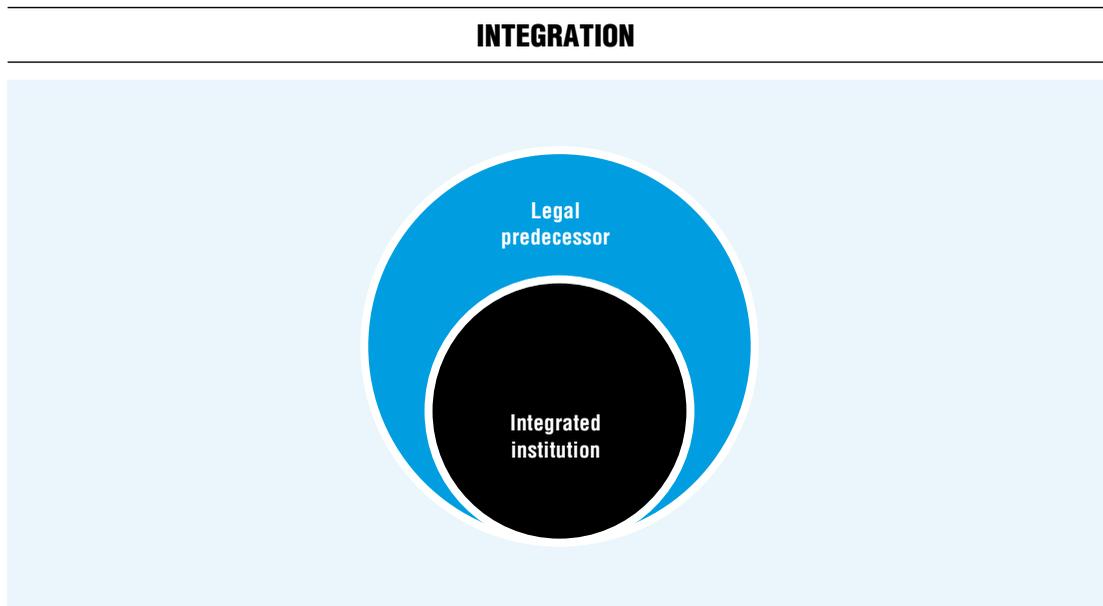
In the case of an integration the integrated budgetary institution ceases to exist and continues to operate as part of the integrating institution. (See Figure 2)

Figure 1



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Figure 2



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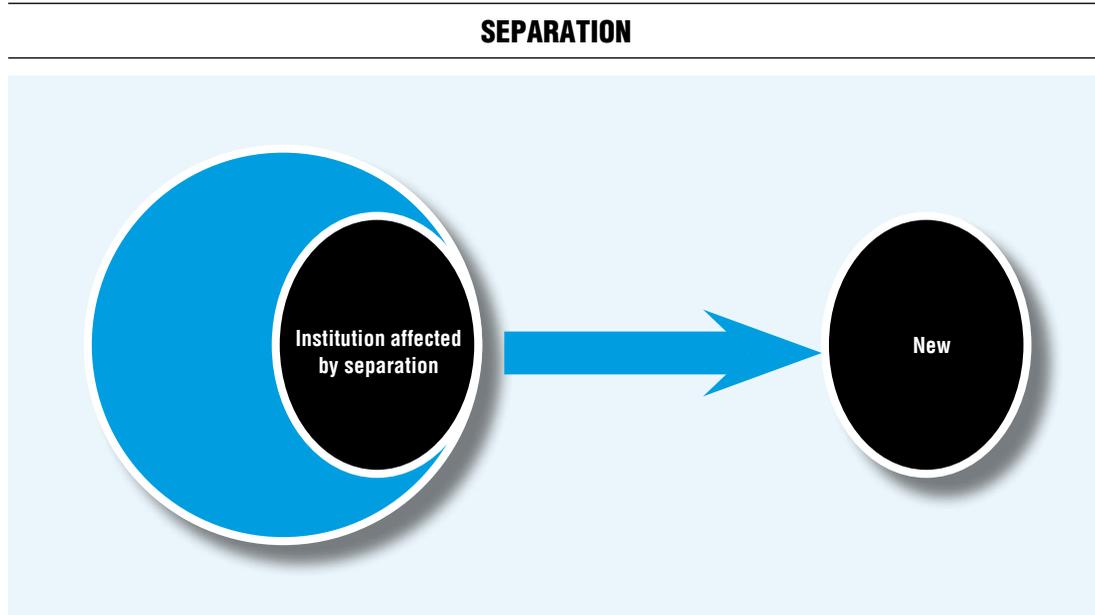
In the case of a separation, the budgetary institution affected by the separation continues to operate and a new budgetary institution is created. In this case, unlike in the previous three cases, the Act on Public Finances does not say whether the new budgetary institution is created as a legal successor with respect to the separated organisational unit. However, Section 20 (4) of the Act on National Higher Education – amended by Act CCVI of 2015 – clearly states that the legal successor institution is created as the legal successor of the original higher education institution with respect to the organisational units affected by separation. (See Figure 3)

The combination of the previous scenarios is also possible inasmuch as it can also be interpreted as demerger when the separation takes place through integration(s) (division by integration), which is also interpreted by the Act on Public Finances as legal succession. In this case it is also possible that a new organisation is created through division. (See Figure 4)

Demerger may take place through the separation of the organisational unit(s) and the simultaneous merger into another institution (separation by integration). The Act on Public Finances does not say anything either whether in these cases the budgetary institution affected by integration continues its activity as the legal successor of the original institution. (See Figure 5)

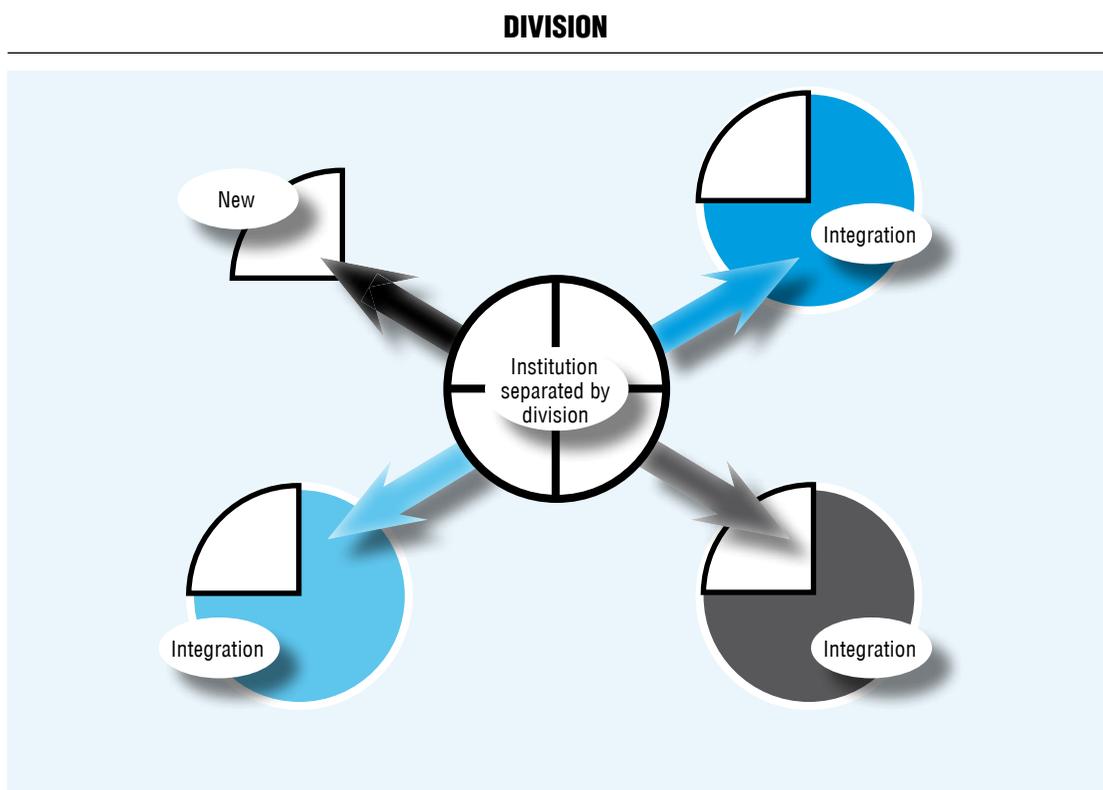
The Act on Public Finances stresses legal succession in cases when the legal predecessor is dissolved as a result of reorganisation. However, the amendment of Section 20 (4) of the Act on National Higher Education that became effective on 1 January 2016 makes it clear that “(4) in the event of separation the original higher education institution shall continue to operate and the separated organisational unit may be established as a new institution or can be merged with another higher education institution. The new higher education institution or the other higher education institution shall be the legal successor of the original higher education institution with respect to the separated organisational unit.”

Figure 3



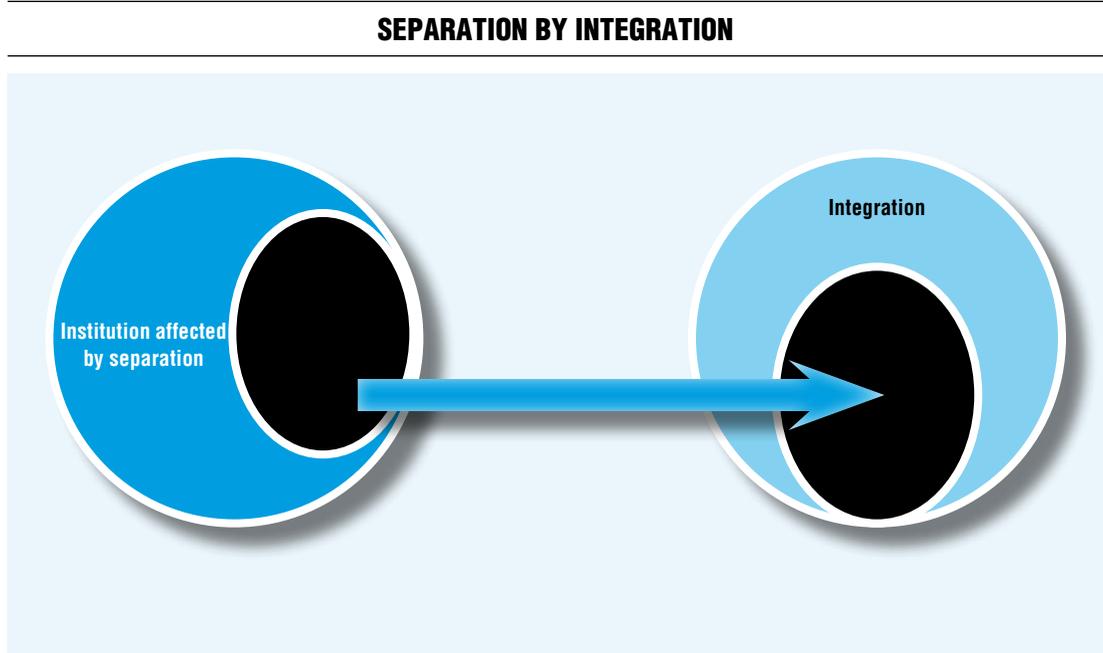
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Figure 4



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Figure 5



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This amendment of the Act on National Higher Education is extremely important. In several respects, it makes clear how institutions should be reorganised in the course of which the higher education institution affected by separation continues to operate while the new institution is established or the organisational units of the higher education institution affected by separation are integrated into an existing institution. All this is true for the settlement of obligations that are based on contracts and legal regulations in force on the effective date of reorganisation as well as for the procedures to be followed in the future operation of the institutions, one of which concerns the legal status of students. In practice, this amendment is of key importance in cases where the organisational units becoming separated from a higher education institution offer training programs and have students with student status, which requires the performance of several tasks for years to come. On the basis of the amendment of the Act on National Higher Education it can be established that the institution receiving the separated organisational units qualifies as a legal successor not only with respect to the student statuses that are effective on the effective date of separation but also for the previous student statuses at the separated organisational unit that have been closed on the effective date.

SPECIFYING THE EFFECTIVE DATE OF REORGANISATION

The effective date of reorganisation is a crucial issue for several reasons. Obviously, in an economic sense this is the day in the course of the transformations for which the final balance sheet must be prepared for the reorganisation and several other tasks must also be performed in connection with the division of property,

including both on-balance and off-balance items.

“Severing” the economic processes in itself is not a simple task, but in higher education this is coupled with the fact that the training programs are structured into academic years and semesters. Neither the academic year nor the real unit of training, that is the semester coincides with the effective calendar date of the year, that is, with 31 December, which in an economic sense would be the most optimal date for reorganisation.

Thus, it is not surprising that when asking economic experts for their opinion, they specify the effective date of the business year of economic organisations as the best date for reorganisation – if this date can be freely chosen. This can be further supported in the case of budgetary institutions by taking into account that the state subsidies are tied to the calendar year in line with the annual Act on the Budget. If reorganisation takes place during the year, the distribution of budgetary subsidy entails an extra task that can definitely be spared or at least minimised if the effective date of reorganisation is 31 December.

However, in addition to the effective date in the economic sense, it is also expedient to take into account the cyclic nature of higher education activities mentioned before according to which the autumn semester typically starts in September and ends at the end of January while the spring semester typically starts in early February and ends in June.

Accordingly, there are two time points in a year that should be selected as the effective date for transformations in higher education:

- In an economic sense, the effective date that entails the least amount of extra work is 31 December. In this case, the “only” area that requires special treatment is the period of the autumn semester that goes into January, including the effect on the student statuses and the financing processes

resulting from them in order to align the financial transactions with the accounting requirements (the principle of authenticity, the principle of matching, the principle of accruals, etc.) and to avoid the continuity being jeopardised in the training process.

- On the basis of the cyclic nature of higher education activities the most reasonable effective date seems to be 30 June with respect to the administration of student matters as in this case there are two “free” months that can be used for the implementation of the tasks related to reorganisation in a less stressful manner. However, in this case a significant amount of extra work arises in the area of economic, financial and budgetary processes in the course of which the special features of the funding of institutions need to be managed in line with the financial processes of the fiscal year when the budgets are planned and the subsequent accounts based on the reports for the effective dates of the previous fiscal year are prepared.

When the two previous dates are combined with the various forms of organisational changes presented before, we can conclude that either one or the other date is optimal for the different types of reorganisation, depending on their special features. One of the most important principles of the Act on Accounting, the going-concern principle should be borne in mind in the course of all this. In the case of reorganisation when the affected institutions continue to operate afterwards – for example in the case of separation by integration where the going-concern principle is satisfied at all the institutions affected by reorganisation even after reorganisation – the effective date that entails “the least amount of extra work” is 31 December. This is the best way to ensure that all of the minimum two institutions affected by the reorganisation can have full business/fiscal years in a financial-accounting sense

both before and after the effective date of reorganisation. In this case, there is no need for a special treatment of midyear events entailed by separation/integration that would create significant difficulties at the time of planning the budget. Obviously, one issue that has to be managed in this case is that the semester that has already started “extends” through the effective date of separation/integration by one month. In other words, if 31 December is chosen as the effective date of reorganisation, we are facing a “double” effective date as it shifts from 31 December to 1 February with respect to the student statuses.

June 30 seems to be a better date for mergers and divisions, thereby giving priority to the date that is important for student statuses and making use of the “more relaxed” summer period. On the basis of all this we can establish that these forms of reorganisation result in the establishment of one or more new institutions, while the legal predecessors cease to operate, thus their operation can be closed in a budgetary sense. In this scenario, the going-concern principle need not be satisfied at any of these actors as none of the affected institutions continues to operate after reorganisation, thus their fiscal year is not broken by reorganisation.

As for the forms of reorganisation mentioned in the previous two sections, the picture is mixed because the going-concern principle is satisfied for one of the actors affected by reorganisation, but it is not for the other actor. One example of this is separation where this basic principle is satisfied for the organisation that continues to operate while it does not for the new organisation created through separation. In these cases other criteria may dominate the choice of the effective date. One of them that needs to be highlighted is the special feature arising from the cyclic nature of the activity, on the basis of which the best choice might be the end of the spring semester.

AN ACCOUNTING APPROACH TO TRANSFORMATION

The transformation, merger and demerger of business associations – main ideas in the sense of the accounting act

The rules to be observed for transformation², merger and demerger are included in the Act on Accounting. There are many different forms of transformation, merger and demerger, which is true not only for budgetary institutions, but for business associations as well. (Bakos – Kovács, 2015) One of the biggest differences in the transformations – which manifests itself in an accounting sense too – is that while it is important to examine what happens to the invested value at the owners of business associations affected by transformation, the investors, this is not an issue to be resolved in an accounting sense in the case of budgetary institutions. In the case of budgetary institutions, the state exercises the ownership rights for which the ownership stake in the institutions is not represented as an investment. The state is not an investor in a classical sense, whose investment in an organisation affected by transformation, merger or demerger should be evaluated as in their case this issue cannot be interpreted.

It is expedient to provide a short overview of the accounting tasks related to this special situation of business associations in order to be able to identify the special features of budgetary institutions.³

If a business association ceases to operate without a legal successor, the investment ceases to exist at the owner company and it should be cancelled in the books. There is no other stake in the dissolved company to replace the stake previously owned by the investor that should be evaluated as there is no legal successor after transformation. The investor company takes over various components (assets)

of the property of the dissolved company in proportion to the nominal value of its investment, which must be entered into its books at the cost value in accordance with the proposal on the distribution of property. (Adorján, 2015)

If termination with legal succession takes place (transformation, merger, demerger), then the terminated stake in the affected business association is cancelled in part or in full at the owner⁴ and the cost value of the new investment must be determined. The cost value of the new stake is given by the value of the equity capital in proportion to the terminated stake – according to the market valuation of the legal predecessor or according to the final balance sheet of the legal successor business association created through separation. The profit results arising from the cancellation of the stake should be accounted in the financial result as a net value, taking into account the holding of the stake for investment purposes and the loss or profit-making nature of the result.

For budgetary institutions the considerations mentioned in the previous two sections cannot be interpreted either in an economic or in an accounting sense.

Another major difference between the transformation of business associations and the reorganisation of budgetary institutions is that in the case of business associations the transformation is a special situation for the company that requires the preparation of a balance sheet supported by the asset inventory in which the proper valuation of each asset item plays a cardinal role in the value of equity capital. Business associations subject to the obligation to register at the Court of Registration must prepare a balance sheet report and an asset inventory twice in this process in order to ensure that the registration process can be carried out as required by law. A draft balance sheet and a draft asset

inventory must also be prepared to support the owners' decision on transformation before the effective date and prior to the final balance sheet and asset inventory to be prepared for that date.

Budgetary institutions are not required to prepare a draft asset inventory. The balance sheet supported by the (final) asset inventory should be prepared by the effective date specified by the proprietor, which is also the effective date for the amendment of the deed of foundation of the higher education institution affected by the reorganisation. One of the main reasons for this might be that all the steps that need to be presented in the draft asset inventory and in the final asset inventory cannot be taken at a budgetary institution.

The draft asset inventories and the final asset inventories are different in structure depending on the form of transformation, merger or demerger. The balance sheets of the legal predecessor consist of one or three columns depending on whether the revaluation of the property to market value is permitted or not by law. (See Table 1)

In the case of separation, the asset components of the separated and the remaining units and in the case of division those of the divided units should be separated at the appropriate value in the balance sheet of the legal predecessor. This means the separation of the property at book value in the case of separation and at market value in the case of division, which difference is in line with the legal option of revaluation. (See Table 2)

The property is revaluated when the going-concern principle is not satisfied.

It is an important feature that the asset components cannot be revaluated during the reorganisation of budgetary institutions, thus they are transferred at book value in every form of reorganisation.

The balance sheet of companies created through transformation can have several columns depending on the special situation of the company. The default conditions are illustrated as follows. (Nagy 2014). (See Table 3)

The presentation of property at the appropriate value means that the assets of the business associations affected by transformation are entered into the balance sheet of the legal successor at book value or at a value after revaluation depending on whether the legal predecessor had the possibility to revalue the assets in its own balance sheet. All these values should be presented in separate columns next to one another for the business associations affected by transformation. In the case of separation or separation by integration, the property can be revaluated at the business association into which the integration takes place, but not at the legal predecessor, which difference resulting from revaluation should be listed in a separate column as well.

The following must be shown in the Deviations column:

- the cash and non-cash (in kind) contributions of the new owners,
- the additional cash and in-kind contri-

Table 1

THE GENERAL STRUCTURE OF THE LEGAL PREDECESSOR'S BALANCE SHEET

Name	Valuation: at book value (A)	Revaluation difference (B)	Value on the basis of property valuation (A + B = C)
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Source: author's own editing

Table 2

THE RELATIONSHIP BETWEEN THE GOING-CONCERN PRINCIPLE AND THE REVALUATION OF PROPERTY

	Name	Going-concern principle	Can the property be revaluated?
Transformation	Change in organisational form		
	Legal predecessor	Not satisfied	Yes
	Legal successor	Not satisfied	Yes
Fusion	Integration		
	Integrated institution (dissolved)	Not satisfied	Yes
	Receiving institution (continues operation)	Satisfied	No
	Merger		
	Merging institutions (dissolved)	Not satisfied	Yes
Demerger	Institution created through merger	Not satisfied	Yes
	Separation		
	Separating institution (to be created as a new one)	Not satisfied	Yes
	Transferor (continues to operate)	Satisfied	No
	Division		
	Institution separated by division (discontinues its operation)	Not satisfied	Yes
	Institution created through division	Not satisfied	Yes
Combined solutions	Separation by integration		
	Transferor	Satisfied	No
	Receiver	Satisfied	No
	Division by integration		
	Institution separated by division (discontinues its operation)	Not satisfied	Yes
	Institution created through division	Not satisfied	Yes
	Receiving institution (continues operation)	Satisfied	No

Source: author's own editing

Table 3

THE GENERAL STRUCTURE OF THE LEGAL SUCCESSOR'S BALANCE SHEET

Name	Property at appropriate value	Deviations (differences) (D)	Settlement (E)	Assets of the legal successor company (C + D + E = F)
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Source: author's own editing

- contributions to be made by the existing members (as a precondition for transformation),
- the property to be transferred to the members who withdraw capital,
- in the case of mergers, filtering out the

mutual stakes as well as the mutual claims and liabilities.⁵

It is obvious that these are less relevant for budgetary institutions. Neither the investment nor the withdrawal of capital and the fil-

tering out of mutual stakes can be interpreted in this context. However, the mutual claims and liabilities may exist on the effective date of transformation, which should be specified in the agreement on the transformation of the affected institutions and they should be filtered out as a consequence of the transformation. The solution for this is to enter these claims and liabilities into the books of the legal successor and then to cancel the claims and liabilities against one another at the legal predecessor.

The Sorting column includes the adjustments of equity capital because the equity capital of the legal successor may only contain positive capital components and it should comply with the legal requirements for the structure of equity capital in that the amount of equity capital reduced by Tied-up reserves may not be less than the Subscribed capital.

The structure of the equity capital of budgetary institutions and the requirements for them are based on very different criteria, thus there are no tasks to be performed in the Sorting column when budgetary institutions are transformed.

Some of the transformations are concluded when the legal predecessor ceases to operate. In the course of this, the business association to be terminated closes its books on the effective date of transformation and prepares the financial statements in accordance with the Act on Accounting, which is then published and deposited. In the course of transformation, the business associations that continue to operate prepare their final balance sheet without closing their books. The bookkeeping tasks related to transformation are performed under continuous bookkeeping with the inclusion of the effective date of transformation.

The key considerations summarised above suggest that the transformation of budgetary institutions should be treated in terms of the special features of their “ownership”, govern-

ance and management, which are specified by special legal regulations. This is what the Act on Accounting refers to when it says in Section 144 that “During the transformation of economic entities other than business associations, if such transformation is permitted by law, the provisions of Sections 136–143 shall apply, in observation of the regulations set out in the underlying act.” The law governing the transformation of budgetary institutions as economic entities other than business associations under the Act on Accounting is the Act on Public Finances; therefore, the provisions of this act as well as the provisions of the Government Decree on Specialities of the General Government Organisations’ Reporting and Public Accounting Rules should be observed. It is to be noted here that while the Act on Accounting stipulates auditing requirement for the transformation, merger and demerger of business associations, the transformation of budgetary institutions is not subject to this obligation.

Special features of the transformation of budgetary institutions

On-balance sheet items

Government Decree on Specialities of the General Government Organisations’ Reporting and Public Accounting Rules lays out the special rules for the accounting procedures of higher education institutions, which is complemented by Decree No. 38/2013 (IX. 19.) NGM of the Minister of National Economy on the mandatory accounting of certain economic events frequently arising in public finances (hereinafter: NGM decree). (Lilliné, 2015)

Some of the special features can be anticipated on the basis of the criteria presented for business associations, as both the content and the structure of equity capital are different.

D. Equity capital (Act on Accounting, Annex 1)	G. Equity capital (Annex 5 of the Government Decree on Specialities of the General Government Organisations' Reporting and Public Accounting Rules)
I. Share capital	I. Initial value of national property
II. <i>Share capital that has not been paid yet (-)</i>	II. Changes in national property
III. Capital reserves	III. Initial value and changes in other assets
IV. Retained earnings	IV. Accumulated profit
V. Tied up reserves	V. Source of the adjusted value of assets
VI. <i>Valuation reserves</i>	VI. Profit/loss for the year ⁷
1. <i>Valuation reserves of adjusted value</i>	
2. <i>Valuation reserves of real valuation</i>	
VII. <i>Profit after tax</i> ⁶	

Without addressing the content of each component of equity capital, we will first highlight the requirements for equity capital in accordance with the balance sheet of the business associations that are being transformed, merged or demerged. In this situation there may not be any subscribed but not yet paid capital and valuation reserve within the equity capital and the profit after tax appears in the retained earnings. The owners share the asset items that embody the equity capital in proportion to their share. In addition to the valuation of the assets items behind shares at a unique market value, it is extremely important for the owners to take into account the future capacity to generate income that also includes the synergy effects due to the transformations. The exchange ratio pertaining to the shares/stakes in the legal predecessor and a legal successor is determined on the basis of all this during mergers and demergers, which also specifies the share of the legal predecessor owners in the equity capital of the legal successor. The range of assets affected by trans-

formation is determined on the owners' side, that is, from the aspect of the equity capital, mainly on the basis of the owners' considerations regarding the future capacity of the assets to generate income.

There is no "direct" ownership based on shares, which is typical of business associations, behind the equity capital of budgetary institutions, such as higher education institutions maintained by the state, that would determine the ratio of asset distribution during the transformations. The structure of the equity capital also reflects this basic difference. Thus, the above approach cannot be used for budgetary institutions since there is no "identifiable" group of owners at the organisational units affected by transformation that can be linked to a value of equity capital in proportion to a specific share. Therefore, another approach to asset transfers is applied in respect to the asset movements during the transformation of budgetary institutions.

One of the most important features is that the asset components cannot be re-evaluated, which should be cancelled at the current value in the course of continuous bookkeeping in the transferor's books and entered into the books of the receiving organisation created through transformation or in the organisation that the entity is integrated into. Section 49/A of Government Decree on Specialities of the General Government Organisations' Reporting and Public Accounting Rules addresses the foundation of budgetary institutions where Subsection (1) concerns foundation through separation, including the accounting settlement rules for transferring assets to the organisation to be founded after separation. Section 49/B addresses the termination of budgetary institutions and also refers to integration. Section 49/B (2) specifies the rules for receiving assets by the legal successor during integration. In other words, if Sections 49/A and 49/B are "interpreted in combination" we can find the

accounting rules that should be applied in the case of separation by integration, where practically there is neither foundation nor dissolution as shown in the subtitle of Section 19/A, summarising sections 49/A and 49/B.⁸

This is also in line with the general requirements of the Act on Accounting in that the business association that continues to operate after separation must also cancel the affected asset components in its books in the course of continuous bookkeeping.

The institution created by foundation enters the asset components in its books on the day of foundation and a budgetary institution that an entity is incorporated into, which has been operating before, should follow the same procedure. All these accounts are carried out for and against the equity capital components under II. Changes in national property or III. Initial value and changes in other assets if the legal predecessor continues to operate.⁹

If during integration, merger or division the “original” budgetary institution ceases to operate, the legal successor(s) enter(s) into its/their books the assets of the terminated entity, the initial value of national property, the changes in national property, the initial value of and the changes in other assets as well as the obligations under the same ranking as in the closing financial statement of the terminated budgetary institution. The Profit/loss for the year¹⁰ and the Accumulated profit should be entered into the books under the Initial value and the change in other assets. All this is entered into the books on the day of termination in the case of an integration or on the day of foundation in the case of a merger or division.

Although it has not been stressed so far, this subsection addresses the accounting settlement of the property items (assets, obligations and the value of the equity capital arising from the difference between them) within the balance sheet. However, we have not answered the question as to how the property items af-

ected by the transformation are actually determined. Obviously, this issue is important in those cases of transformations where separation or demerger takes place since in the case of full integration and merger the legal predecessor institution(s) cease(s) to exist and the transformation affects the entire property in the same way, that is, it is transferred to the legal successor in full in accordance with the classification in the balance sheet.¹¹

However, it needs to be identified in the course of separation and demerger which group of asset items are affected by separation and which assets will remain with the budgetary institution that continues to operate and, in the case of demerger, how the assets of the legal predecessor are distributed among the legal successors. The basis for this can be created by a controlling system that reflects the organisational structure of the institution. (Szekeres, 2014)

This question can be approached differently in the case of non-monetary assets (such as intangibles, tangible assets, stocks) and monetary assets (such as funds), as opposed to liabilities.

In the case of non-monetary assets, the separation of the assets of the organisational units affected by transformation can be based on analytical records supported by the inventory if the assets were recorded separately in the controlling system that was created in accordance with the organisational structure. If this is not the case, then it may be difficult to determine the group of assets serving the operation of the affected organisational units, which may also burden the agreement on separation/demerger with conflicts. In every case, this agreement may be made with the approval of the proprietor exercising “proprietary rights.”

As for the monetary assets, that is, the amount of cash at the effective date, the “double double-entry” bookkeeping of the budg-

etary institutions provides a sufficient basis for bookkeeping since the realisation of items involving cash flow, that is, the realisation of expenditures and revenues must be constantly monitored under budgetary bookkeeping. These records – if funds assigned to organisational units have been created in the controlling system – provide a good basis for the distribution of funds on the effective date.

The claims and the (final) liabilities outstanding on the effective date should also be deferred, which are also based on a well-organised controlling system. If this is missing, the decision on distribution should be made also during the reorganisation.

Off-balance sheet items

In addition to the distribution of on-balance sheet items, the treatment of “off-balance sheet items” is equally important. The outstanding contractual claims and liabilities, that is, the previous commitments are attached special importance in the case of budgetary institutions, due to the stringent rules of funds management. Obviously, the decision on the contractual claims and obligations is indispensable for business associations as well; however, due to the requirements arising from the stringent funds management system, this should be carried out within the closed system of budgetary accounting. Public procurement contracts and PPP (*Public-Private Partnership*) contracts represent another special feature of budgetary institutions, and the business associations resolve the legal issues pertaining to transformations with respect to the off-balance sheet items of business associations. These contracts are generally made in a wide range of national higher education institutions.

It is a basic requirement for demerger – which must be concomitant of stringent funds management – that the amount of cash to be transferred during separation or division – the

residue – should be able to cover both the final and the preliminary commitments that are imposed on the available funds. It is well known however that several higher education institutions use cross financing across the different organisational units, therefore, it may turn out during the reorganisation that the funds that are necessary to cover the commitments related to their own operation are not available at (some of) the organisational units affected by separation/division. In this case, the institutions affected by reorganisation should analyse the concrete situation and make a decision together with the proprietor by taking into account this fact in the agreement.

THE EFFECT OF REORGANISATION ON GOING-CONCERN – THE TREATMENT OF THE “DUAL” EFFECTIVE DATE

Special features of the accounting of public grants

Referring back to what has been discussed before, in cases where both the legal predecessor and the legal successor institutions continue to operate after reorganisation, it is expedient to choose the effective date of the fiscal year as the effective date of reorganisation. In doing so, the violation of student interests can be mitigated by the fact that the effective date of the reorganisation does not interrupt the current semester, that is, the student statuses are transferred from the legal predecessor to the legal successor institutions as of 1 February. Thanks to this, the electronic education system documentation can be operated and the data pertaining to student statuses can be migrated in an optimal manner. The students who are just completing the last semester of their studies and are going to obtain their degree can do so at the institution where they were

admitted and where they established their student status at their own choosing.

There are some legal consequences to the fact that the student statuses “extend” beyond the effective date of the separation in an economic-legal-accounting sense, in terms of the state grants pertaining to Student appropriations and Eligibility for training grants, which should be properly managed. This should be resolved in such a manner that the “original” effective date of the separation – 31 December¹² – is not violated in the accounting sense. Since according to Section 85/A of the Act on National Higher Education the legal predecessor is entitled to the January Student appropriation and the Training grant, the proprietor plans this amount in the budget for the year following the transformation of the legal predecessor institution (hereinafter: the current year). Accordingly, the Student appropriation and the Training grant for the first month of the current year are paid to the legal predecessor institution. The grants should be settled in the financial and the budgetary accounts of the predecessor institution under the appropriate legal title as revenue (student appropriation, training grant) in the accounting settlement. The amount so received should be transferred to the legal successor institution that – since as of 1 January the personnel and material resources are transferred to the legal successor and, as a result, all the costs and expenditures incurred by the grants arise at the legal successor. This transfer should be recorded in the books of the legal predecessor and the legal successor as delivery/handover of funds within public finances.¹³ This accounting settlement ensures compliance with the principle of matching set out in Section 85/A of the Act on National Higher Education, in Government Decree on Specialities of the General Government Organisations’ Reporting and Public Accounting Rules, as well as in the Act on Accounting with respect to

revenues, costs and expenditures, and the area of cash flow.

Another important criterion is that the Student appropriations are accounted on the basis of the March and October statistical data on the students in the current year, that is, the students of the organisational units (faculties) affected by the separation no longer appear in the current year’s account to be prepared by the legal predecessor in the following year, thus there will be no actual entitlement in respect of these students. At the same time, the affected students will already be listed in the current year’s account to be prepared by the legal successor in the following year as March and October statistical data, thus the actual entitlement will belong to the legal successor. As a result, the Student appropriation paid by the proprietor in the current year that has been planned in the budget of the legal predecessor will appear as a refundable grant for the legal predecessor in the current year’s actual account to be prepared in the following year, while it will appear as a need for extra grant for the legal successor. Since the legal predecessor paid the entire January Student appropriation “in advance” in the form of transfer of funds to the legal successor, thus in the year following the current year, the legal successor should settle the necessary cash movement against the legal predecessor. This means that the legal predecessor is entitled to receive the grant to be reimbursed on the basis of its own accounts as funds accepted, which the legal successor should pay to it as funds transferred.

In accordance with the above, the legal predecessor institution must pay the students the January scholarship disbursements that it approved for the 5 months of the autumn semester within its own budget at the beginning of the semester, which also includes January. Furthermore, the proprietor plans the amount to cover the January scholarships disburse-

ments in the budget of the legal predecessor as part of the Student appropriations. However, this appropriation – as mentioned before – must be paid to the legal successor as transfer of funds, that is, the necessary funds for the scholarships are already with the legal successor. Accordingly, the legal successor must reimburse the amount of the scholarships paid by the legal predecessor for the month of January as transfer of funds. The legal predecessor will record the January stipends arising as expenditure under the legal title of scholarship since the legal predecessor received the appropriation on the basis of the current student statuses up to 31 January.¹⁴

The settlement of accounts in the case of the Training grant is somewhat different from the above. The proprietor takes into account 1/10th of the October statistical student number of the year prior to the current year in the account to be prepared in the following year for the current amount of the Training grant. As a result, the accounts of the legal predecessor will contain the students of the faculties affected by separation for the month of January, which means that both a need for extra grants and a reimbursement obligation may arise in connection with the planned monthly entitlement and the actual entitlement. If the legal predecessor has a reimbursement obligation, the legal successor must repay this amount to the legal predecessor by transfer of funds. If the legal predecessor has an entitlement for extra grants for the affected period, the legal predecessor must pay this amount to the legal successor by transfer of funds.

There are no special financial-accounting settlements for other legal titles of state subsidies that may arise from the “dual” effective date. For example, the Grants for special programmes and other grants, such as the planning of PPP grants do not entail any special features due to the reorganisation in the budget of the affected institutions.

Special accounting features of operational and accumulation revenues, costs and expenditures

The public grants appear in the same period in the cash-based and the accrual-based approach alike, thus there is no need for using the principle of accrual in this area to determine the realised profit. However, when the operational revenues, costs and expenditures are accounted for, accruals are indispensable. The operational revenues are settled for the appropriate period on the basis of the underlying performance and accruals need to be taken into account for these items affecting the results depending on whether this period is closed with respect to the effective date of the reorganisation or it extends through this date. This is typically the own revenue of the institutions coming from fee-paying students for their training, who paid their tuition fee for the autumn semester covering the period up to 31 January at the beginning of the semester, before the effective date. This revenue has been settled both in the budgetary and in the financial accounts, but deferred income should be calculated in the December 31 balance sheet for the pro rata amount of the revenue extending to the month of January, thereby reducing the realised profit. After separation /demerger, this deferred income is transferred to the relevant legal successor where it should be resolved, increasing the realised profit of the legal successor. The same procedure should be applied to costs and expenditures for the items extending beyond the effective date. The accruals and deferrals, their transfer to the legal successor and their resolution by the legal successor puts the profit and loss effects “in place” with respect to the realised profit and loss.

The distribution of cash on the effective date should obviously be treated independent-

ly of these profit and loss effects. By highlighting one example we can show that the effect of the collected tuition fees on profit/loss, that is, the revenue collected in January should be recorded, due to the principle of matching, at the legal successor, since the January costs and expenditures are settled in the profit/loss of the legal successor. However, if the legal predecessor has already used these revenues by the effective date to settle various expenditures, then these funds are no longer available on the effective date. It is very important to differentiate between the result in the business administration sense and the residual funds deriving from cash movements. Several other examples could be raised here, which make it both easier and more complicated to perform the accounting tasks of budgetary institutions

during the reorganisation process, due to the concurrent presence of business administration and cash based accounting.

The goal of this paper was to shed some light on some of the key considerations that should be borne in mind when managing and implementing the reorganisation of budgetary institutions, including higher education institutions. We have highlighted several important features of the budgetary institutions that stem from the special nature of the “ownership structure” and the special features of their accounting system, as well as the cyclicity of higher education that differs from the fiscal year. All these factors should be taken into account not only in an economic-legal-financial sense, but also with a view to social needs and the maximum protection of student interests.

NOTES

¹ Act V of 2013 on the Civil Code of Hungary and Act CLXVI of 2013 specify the transformation, merger and demerger of legal entities. Under these legal regulations transformation involves changing company form, which cannot be interpreted for a budgetary institution, thus in this case transformation is not possible in the interpretation of the Civil Code. Accordingly, we can only talk about merger and demerger in the sense of the Civil Code, in other words, when the term reorganisation is used here, it is not a synonym of transformation, but a collective term for the merger and demerger of budgetary institutions.

² As this article has suggested before, with the introduction of the new Civil Code transformation appears as an independent concept in the regulation and involves a change in company form. Merger means transforming several legal predecessors into a single legal successor, while demerger means one single legal predecessor being transformed into

several legal successors. In order to simplify the wording where it does not result in confusion in terms of content, this paper uses transformation as a collective term for the previous concepts. Where the emphasis is specifically on a change in company form, this term is used in this paper.

³ Adorján – Lukács – Róth – Veit [2015]: Számvitel speciális kérdései (Special Issues of Accounting). Magyar Könyvvizsgálói Kamara Oktatási Központ Kft, Budapest

⁴ The former share may not be cancelled because for example during the separation the share capital is not handed over to the legal successor created through separation. The stake created in the newly established company needs to be added to the previous shares in the investor’s books.

⁵ In the case of business associations, the mutual stakes are filtered out after the own capital busi-

ness shares have been settled in the accounts, that is, which means that it affects retained earnings. Any possible difference due to the different values of the mutual claims and liabilities should also be accounted against the retained earnings.

⁶ Annex 1 and Annex 2 of the Act on Accounting as amended by Act CI of 2015 specify Profit After Tax as part of the Balance Sheet Equity Capital as well as the last category of Profit and Loss Statement instead of the previous Profit/loss for the year. This means that the accounting of the dividend is not included in the balance sheet and the profit and loss statement that closes the business year, but the profit after tax is specified, which is carried over to the retained earnings and the dividend should be entered in the books as an item imposed on the retained earnings on the date the decision is made on the dividend.

⁷ At this point the amendment of Government Decree on Specialities of the General Government Organisations' Reporting and Public Accounting Rules did not follow the terms used in the Act on Accounting as Annexes 5 and 6 include the term Profit/loss for the year when the schemes of balance sheet and profit and loss statement are presented. In our view it would have been better to harmonise these concepts with the Act on Accounting. Since this issue is not in the focus of this paper, we will not present a detailed criticism on this.

⁸ 19/A. Special tasks related to foundation and dissolution

⁹ Note that in this case the value of the equity capital component under I. Initial value of national property will be zero in the equally capital of the budgetary institution newly created through transformation.

¹⁰ Pursuant to Section 49/B (4) of Government Decree on Specialities of the General Government

Organisations' Reporting and Public Accounting Rules the Profit/loss for the year shall also be entered into the books even though it is valid only "for a moment" and then its value shall be carried over to the Accumulated profit.

¹¹ Obviously, in the case of a full merger or integration we need to address the filtering out of outstanding claims and obligations against one another.

¹² Opinions vary whether the effective date should be 31 December or 1 January. In our view the effective date of reorganisation should be 31 December, by which date the balance sheet should also be prepared, and 1 January should be the "initial date" of the organisational changes that are effected during the reorganisation.

¹³ It should be settled in the agreement between the institutions whether the amount of this grant is paid by the legal predecessor to the legal successor in 12 instalments – in accordance with the payments made by the proprietor – or perhaps in a lump sum in advance. There is no legal provision for this.

¹⁴ The scholarships paid for the month of January and the Student appropriation for January should be accounted to and fro under the legal title of transfer of funds and entered into the records under the appropriate legal titles because these amounts, that is, the scholarships approved and paid out to the students for the month of January and the amount of the Student appropriation specified by the proprietor for January are necessarily different. In a financial sense, this difference should necessarily affect the legal successor, because in an economic-financial-accounting sense the effective date of separation is January 1, therefore no result can be recorded in the financial accounting nor any residue can be recorded in the budgetary accounting at the legal predecessor institution after the effective date of separation.

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