

ANALYSIS OF THE DIFFERENCES OF FINANCIAL STATEMENTS PREPARED IN CONFORMITY WITH IFRS BY COMPANIES OPERATING IN THE HEALTH CARE SECTOR AND ANOTHER SECTOR

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Abstract: *The primary objective of present article is to compare companies operating within and outside of the health care sector that prepare their annual statements in accordance with IFRS. In present article, comparative analysis of Richter Gedeon Plc. and Telekom Plc. is realized. Richter Gedeon Plc. is a large company operating within the pharmaceutical sector and its consolidated annual statement is prepared in accordance with IFRS. Telekom Plc. is a public limited company operating in the telecommunications sector, which also prepares its consolidated annual statement in accordance with IFRS. The reason for selecting the two companies indicated above is that Richter Gedeon Plc. is one of the largest pharmaceutical companies in Hungary, while Telekom Plc. as a company operating outside the health care sector is similar to Richter in terms of its size, as their balance sheet totals are almost identical in their consolidated balance sheets. The similarity in terms of the magnitude of their balance sheet data allows for the comparison of the annual statement practices of the two companies. The examined companies are compared based on their invested assets with especial emphasis put on their intangible assets. In the course of the comparative analysis, composition of the invested assets of the investigated companies is presented, and then the proportion and composition of intangible assets and the changes in the stock of the company and its possible causes are explored. Analysis of intangible assets takes place due to the sectoral specificities of the selected large companies. In relation with the comparative analyses, specificities of relevant IFRS requirements are highlighted.*

Keywords: *IFRS; health care sector; intangible asset; consolidate annual statement.*

JEL Classification: *M4.*

Introduction

In the course of present study, the comparative analysis of a company operating in the health industry and another from a non-health sector is carried out with regard to a certain area (intangible assets). The primary consideration regarding to analysed companies was that their consolidated annual statements are prepared in accordance with International Financial Reporting Standards (IFRS). Therefore, the selection of companies listed at the stock exchange is in any case necessary, since according to the decision of the European Union, as of 2005 the consolidated annual statements of such companies must be compiled in accordance with IFRS. In the scope of the comparative analysis, the consolidated annual statements of Richter Gedeon Plc. and Telekom Plc. are examined.

1. International Financial Reporting Standards (IFRS)

This section deals with the theoretical review concerning the research topic. In the course of the technical literature overview, fundamental characteristics of annual statements prepared in accordance with IFRS are discussed together with the principles of presenting and valuating intangible assets

1.1. Origins of the International Financial Reporting Standards (IFRS)

At the end of the last century, the European Union attempted to harmonize accounting rules in its Member States by creating regulations, directives, communications and recommendations (Beke, 2014). Consequently, stock exchange listed companies of the European Union are required to apply IFRS for the preparation of their consolidated annual statements, and it is allowed for Member States to prepare consolidated and individual financial statements for non-listed companies (Madarasiné Szirmai et al., 2018). The primary objective of creating the International Financial Reporting Standards was to standardize the preparation, procedures and valuation principles of annual statements (Lakatos et al., 2018). The IFRS include standards and interpretations issued by the IASB, which comprises International Financial Reporting Standards (IFRS), International Accounting Standards (IAS), and the International Financial Reporting Interpretations Committee (IFRIC), or its predecessor, the Standard Interpretations Committee (SIC) (Madarasiné Szirmai – Bartha, 2016).

1.2. Financial Statements in the IFRS

Preparation, structure and mandatory elements of financial statements in IFRS is governed by IAS 1 standard - Presentation of Financial Statements (Lakatos, 2013). According to the standard, the purpose of the financial statement is to provide potential investors with information about the financial position, performance and cash flow of the company (Rózsa, 2015). According to the IAS 1 standard, components of financial statements are the following:

1. Statement of financial position (balance sheet)
2. Comprehensive profit and loss account
3. Statement of changes in equity
4. Statement of cash-flow
5. Notes (Rózsa, 2015).

The IAS 1 standard also includes the line items to be presented in the balance sheet; however, it does not specify the order or structure of these items, but merely lists the line items that are required to be presented. According to the standard, it is necessary to apply other comprehensive lines if they are relevant to the understanding of the financial position of the company (Madarasiné Szirmai et al., 2018).

1.3. Presentation and Valuation of Intangible Assets in IFRS

In the life of companies, accounting of intellectual capital is a major issue, however more and more intense efforts are being made to account them as accurately as possible through intangible assets (Fenyves et al., 2018). Requirements regarding the presentation, measurement of intangible assets and disclosure of their relevant information in IFRS are governed by the IAS 38 Intangible Assets standard

(Madarasiné Szirmai et al., 2018). Intangible assets are identifiable non-monetary assets without physical substance, which are controlled by the entity as a result of past events and from which future economic benefits are expected. Intangible assets are initially recognized at original cost. Acquisition of intangible assets may take place as follows:

6. By separate purchase
7. As part of a business combination
8. By self-creation (Madarasiné Szirmai – Bartha, 2016).

In the case of an individual purchase, the cost is the purchase price adjusted with increasing and decreasing items; in the case of business combination, it is always the fair value. In the case of self-created intangible assets, the cost is the direct costs incurred in the course of production. IFRS distinguishes between research and development phases, only the costs of the development phase can be capitalized as assets (Lakatos et al., 2018). Goodwill also qualifies as an intangible asset; however, it is governed by a separate standard, IFRS 3 Business Combinations (Torma, 2016).

2. Comparison of the Intangible Assets of Richter Gedeon Plc. and Telekom Plc.

The following section compares the consolidated financial statement of Richter Gedeon Plc, which operates in the health care sector and the consolidated financial statement of the Hungarian Telekom Plc, which operates in the telecommunications sector. Comparison of the invested assets, especially the introduction of intangible assets of the companies will take place in terms of the last two business years.

2.1. Introduction of the Intangible Assets of Richter Gedeon Plc. based on its Consolidated Annual Statement

Richter Gedeon Plc. is a large company, which operates in the health care sector, more exactly in the pharmaceutical industry. Fixed assets of the company are presented in its consolidated balance sheet of the years 2016 and 2017 as follows:

Table 1: Composition and distribution of the fixed assets of Richter Gedeon Plc

	m Ft	%	m Ft	%
	2017	2017	2016	2016
Land and buildings, plant machinery and equipment	196 990	43.1	191 002	37.9
Goodwill	44 377	9.7	68 632	13.6
Other intangible assets	154 958	34	192 677	38.2
Shares in affiliated undertakings	11 847	2.6	8 541	1.7
Financial investments	35 482	7.8	32 864	6.5
Deferred tax assets	10 548	2.3	5 416	1.1
Loans	2 132	0.5	4 799	1
Fixed assets total	456 334	100	503 931	100

Source: Own calculation based on the consolidated annual statement of Richter

Table 1 shows the composition and percentage distribution of the fixed assets of Richter. Based on its specific industrial activities, Richter possesses a significant amount of intangible assets, including positive goodwill. It is noticeable that goodwill and other intangible assets are shown as separate line items. The primary reason

is that these items are governed by separate standards in accordance with the provisions of IFRS. Positive business or corporate value, also known as goodwill is created through a business combination, namely the acquisition of another company. Goodwill is governed by the IFRS 3 - Business Combinations standard, while intangible assets are governed by the IAS 38 - Intangible Assets standard. Although goodwill is an intangible asset, there are still many differences between them. One of the most important differences is that, according to the regulations of IFRS, in the case of goodwill no planned depreciation can be applied, only impairment loss that corresponds to excess depreciation. Another important difference is that positive goodwill cannot be presented in an individual annual statement; it can only be recognized in consolidated financial statements. As *Table 1* demonstrates, goodwill and other intangible assets represent approximately 50% proportion within the fixed assets.

In addition, it can also be observed that from 2016 to 2017, there was a decrease in the value of goodwill and other intangible assets, thus the total of the fixed assets declined. The main reason behind this is the recognition of significant impairment loss. A significant part of the impairment loss accounted on the goodwill and other intangible assets lines was caused by the fact that one of Richter's medicinal products (Esmya) might cause serious liver damage, and therefore an investigation was initiated against the company because of the potentially harmful substance. This event resulted in a nearly 60% decrease in operational earnings. The large decrease in intangible assets is offset by a 39,929 million HUF investment, most of which is related to the acquisition of intangible assets.

The part of the purchase that is not presented amongst intangible assets is related to the purchase of instruments and equipment that serve research and development activities. Richter Gedeon Plc possesses the following intangible assets:

9. Goodwill
10. Research and development
11. Rights representing assets
12. Intellectual properties
13. Other intangible assets

Research and development is one of the most determinant activities of the company. More than 1000 people are employed in this area. Richter's most prominent pharmaceutical research and development is realized on the fields of gynecology, cardiology, and respiratory medicine. In its consolidated profit and loss account, the company presents 35,153 million HUF in 2016 and 39,903 million HUF in 2017 in research and development costs. Costs incurred in R&D activities can only be recognized as assets if they are already in the development phase. If the research and development phases cannot be separated from each other, then the costs associated with the whole activity should be treated as research costs, thus they cannot be recognized as assets at all. In the case of the Richter Group, the share of rights representing assets within intangible assets is negligible. For example, the company classifies purchased brand names as rights representing assets. Only purchased brand names can be recognized here, as IAS 38 does not allow the recognition of self-created intangible assets and the costs related to them remain as items that reduce earnings. In addition to purchased branding rights, purchased market distribution rights are also recognized here, which were acquired from an external partner. Intellectual properties primarily include products created in the course of research and development activities, pharmaceuticals, and other

medicinal products. In addition, patents and trademarks related to medicinal products are also presented here. Besides intangible assets, land and buildings, plant machinery and equipment also represent a high share of fixed assets, they amount to approximately 40% in both business years, but there is a detectable decline. As it is apparent from the annual statement of the company accounts, the total amount of these assets serve pharmaceutical production and research and development activities.

2.2. Introduction of the Intangible Assets of Telekom Plc. based on its Consolidated Annual Statement

Telekom Plc. is a company, which operates in the telecommunications and information communications sector, which prepares its individual and consolidated annual statement in conformity with the IFRS. The comparative analysis is based exclusively on the consolidated annual statement. Composition and percentage distribution of the fixed assets of the company are presented in its consolidated balance sheet of the years 2016 and 2017 as follows:

Table 2: Composition and distribution of the fixed assets of Telekom Plc.

	mFt	%	mFt	%
	2017	2017	2016	2016
Tangible assets	458 343	49.8	483 174	49.2
Intangible assets	441 458	48	478 263	48.7
Investments in affiliated undertakings	1 324	0.1	1 078	0.1
Deferred tax assets	59	0.01	73	0.01
Other long-term financial assets	19 323	2.1	18 254	1.9
Other fixed assets	127	0.01	709	0.1
Fixed assets total	920 634	100	981 551	100

Source: Own calculation based on the consolidated annual statement of Telekom

As it is demonstrated in *Table 2*, almost all of the fixed assets of Telekom Plc consist of tangible assets and intangible assets. The share of investments in affiliated undertakings, deferred task assets, other long-term financial assets and other fixed assets is not significant, their combined share is less than 3% of the fixed assets. The company possesses the following intangible assets:

14. Goodwill
15. Concessions and licences
16. Software
17. Other intangible assets.

The goodwill of Telekom is associated with its subsidiaries and acquired branches, which are treated separately as operating segments. Based on the impairment loss analysis, the company concluded that it is not justified to recognize impairment loss. The returned amounts of operating segments are determined on the basis of fair value decreased by sales costs. Concessions and licenses are considered the most significant individual intangible assets of the company. Licenses include different 2G, 3G and 4G licenses. The costs associated with the acquisition of licenses are capitalized, while the discounted value of the future annual fees for frequency usage are capitalized only if they can be estimated reliably. As the company does not have intangible assets with indefinite useful life, it uses linear depreciation for all

intangible assets except goodwill. Concessions and licenses are depreciated in 3-25 years.

As it is more difficult to determine useful lives for intangible assets, than for tangible assets, Telekom reviews useful life of its intangible assets every business year, taking into account technological developments and, if appropriate, extends them. In the case of purchased software, the costs associated with purchasing and putting into operation are capitalized, development and maintenance costs are accounted as expenses. Software items include a small amount of own development, the capitalized cost of which is negligible, so self-developed software are not presented separately, the entire stock is treated as purchased software. Software are depreciated in 2-24 years, their useful life is determined individually.

Composition and proportion of intangible assets of the Telekom Group are presented in the following table

Table 3: Composition and percentage distribution of the intangible assets of Telekom Plc

	mFt	%	mFt	%
	2017	2017	2016	2016
Goodwill	212 284	48.1	218 098	45.6
Concessions and licences	121 512	27.5	147 077	30.7
Software	95 881	21.7	101 777	21.3
Other intangible assets	11 781	2.7	11 311	2.4
Intangible assets total	441 458	100	478 263	100

Source: own calculation based on the consolidated annual statement of Telekom Plc.

Table 3 shows that most of the intangible assets, nearly half of them are represented by goodwill. In addition, it can be observed that in the business year of 2017 the amount of intangible assets decreased, due to the recognized planned depreciations and impairment losses. In the course of the impairment analysis of fixed assets, they are assigned to the smallest identifiable unit (Cash Generating Unit - CGU) that generate separate cash flows.

2.3. Comparison of the Intangible Assets of Richter Gedeon Plc. and Telekom Plc.

Intangible assets of Richter and Telekom have been introduced in the previous sections, while present section deals with the comparison of the analysed companies. The comparison only involves 2017, since this is the last closed business year of the companies.

Distribution of the intangible assets of Richter are demonstrated by the following figure:

Distribution of the intangible assets of Richter in 2017

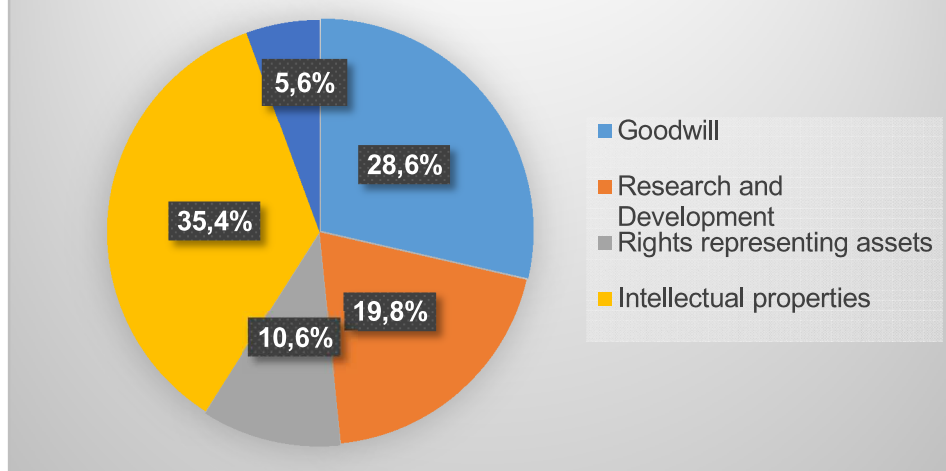


Figure 1: Distribution of the intangible assets of Richter in 2017

Source: own editing based on the consolidated statement of Richter

As illustrated by *Figure 1*, a significant part of Richter's intangible assets is comprised of intellectual properties, goodwill and research and development. The composition of Richter's intangible assets completely reflects its industrial activities, as it is a pharmaceutical company, where research and development and intellectual properties are the most commonly used assets. Conversely, Telekom presents – in addition to goodwill – concession rights and licenses and software among its intangible assets. Obviously, intangible assets are also characteristic to the industrial activity, as Telekom is a company operating in the telecommunication sector. This is the most significant difference between the intangible assets of the companies, as they operate in different industries.

Another significant difference between the two companies is that Telekom has to take into account the rapid technological development during its operations, therefore the company performs impairment loss analyses on all intangible assets in each business year, while Richter only performs these analyses in the case of goodwill generated in its subsidiaries. The largest similarity between the two companies in terms of intangible assets is that both companies have significant goodwill, which was created exclusively through the acquisition of subsidiaries. Richter has six subsidiaries that help and support production and development. In contrast, Telekom has eight subsidiaries, most of which are 100% owned. Another similarity among the companies is that none of them possesses intangible assets with indefinite useful lives, and with the exception of goodwill, planned depreciation is accounted for all assets in accordance with the investment cost model.

Distribution of the Telekom's intangible assets is demonstrated by *Figure 2*:

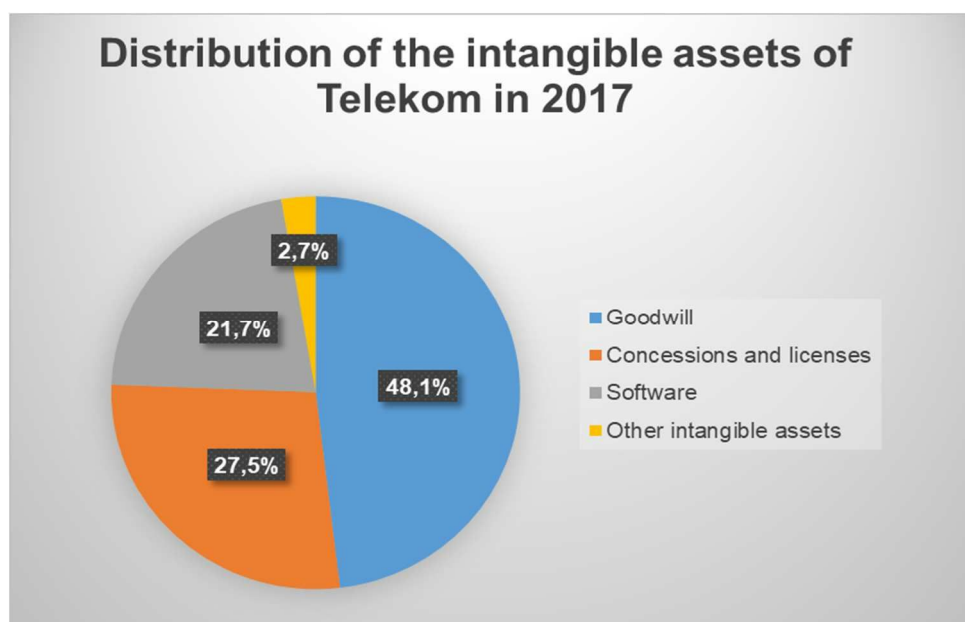


Figure 2: Distribution of the intangible assets of Telekom in 2017
Source: own editing based on the consolidated statement of Telekom

3. In Conclusion

In the course of the study, we compared the consolidated annual statements of companies (one operating within and one outside of the health care sector) that prepare their annual statements in accordance with IFRS. The comparative analysis was carried out through the corporate example of Richter Gedeon Plc. and Telekom Plc. Overall, it can be stated that since both companies prepare their statements in accordance with the requirements of IFRS, their valuation procedures, presentation and grouping principles applied are almost identical. By contrast, the industrial activities of the examined companies are different, resulting in significant differences in their statements, with particular regard to intangible assets. In the case of Richter, the vast majority of intangible assets are research and development and intellectual properties. In addition, research and development costs are presented separately in the consolidated profit and loss account, as these costs account for a large part of the costs of the industrial activities of the company. Apart from goodwill, most of the intangible assets of Telekom Plc. consist of various concession rights and licenses as well as purchased software. As the company is present in the telecommunication sector, it places great emphasis on carrying out continuous impairment loss analyses due to accelerated technological advancement, that are not typical of Richter

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