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Review of practical implementation issues relating to international financial reporting standards

Case study of Poland

Note by the UNCTAD secretariat**

Executive summary

This case study presents Poland's experience with practical implementation of international financial reporting standards (IFRS). It illustrates the main provisions of the regulatory framework of Poland on financial reporting and applicable enforcement mechanisms. It discusses the main research findings on the impact of IFRS adoption on the financial statements of Polish companies. The main differences between financial statements that were prepared in accordance with Polish generally accepted accounting standards (GAAP) and IFRS pertained to (a) pension funds; (b) share-based payments; (c) financial instruments and hedging; (d) impairment of goodwill; (e) intangible assets; (f) business combinations; (g) valuation of receivables; (h) valuation of revenues and liabilities; and (i) leasing and property, plant and equipment. The findings illustrate some of the significant changes in the financial position and performance of enterprises that adopted IFRS. The study highlights the importance of effective communication of anticipated changes on financial position and performance on adoption of IFRS so that investors, analysts and other users of the financial statements are aware of what they could expect under the new reporting system. The paper notes that the transition to IFRS is expected to have a positive impact on the competitiveness of Polish companies and their integration into capital markets in the European Union.

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I. Background

1. In view of the widespread adoption of IFRS in recent years, UNCTAD's Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) has been reviewing practical issues that arise in the course of implementing IFRS, with a view to facilitating the sharing of experiences and lessons learned among member States. At its twenty-second session, ISAR deliberated on a background note (TD/B/COM.2/ISAR/28) prepared by the UNCTAD secretariat which highlighted major practical implementation issues pertaining to institutional and regulatory arrangements, enforcement mechanisms, technical issues and capacity-building. On the basis of this framework, country case studies covering Brazil, Germany, India, Jamaica and Kenya were prepared and considered at the twenty-third session of ISAR. Furthermore, country case studies of Pakistan, South Africa and Turkey were discussed at ISAR's twenty-fourth session.

2. In concluding its twenty-fourth session, ISAR requested the UNCTAD secretariat to continue conducting studies on practical implementation issues relating to IFRS, including on related topics such as implementation of international standards on auditing (ISAs). Accordingly, country case studies on practical implementation of IFRS covering Egypt, Poland, Switzerland and the United Kingdom – as well as a study on practical challenges and related considerations in implementing ISAs – were prepared for consideration by the twenty-fifth session of ISAR. The main objective of these papers is to facilitate sharing of experiences among member States.

3. This note presents findings of the case study conducted in Poland. It discusses key regulatory provisions and related enforcement mechanisms regarding accounting, financial reporting and auditing. It illustrates practical implementation of IFRS in Poland. The study also provides insights into key issues that arise in the implementation and enforcement process. Furthermore, it presents key findings of a comparative analysis of financial statements prepared under Polish accounting standards and IFRS that Polish companies prepared at the time of their transition to IFRS.

II. Introduction

4. Since 1989, Poland has undergone great political, social and economic changes. These developments have prompted important reform in the areas of accounting and reporting. This note presents Poland's experience of implementing IFRS. It also discusses the impact of IFRS on the financial statements of Polish companies immediately after adopting IFRS as their reporting basis.

5. Since 1990, Poland has attracted more than $92 billion in foreign direct investment (FDI), principally from Western Europe and the United States. In 2007, the value of FDI inflow to Poland amounted to €12.834 billion. It is estimated that, in 2007, 85.3 per cent of direct investment flows were from European Union countries, mainly from France, Germany, Austria, Italy and Sweden. The most significant investment from outside the European Union came from the United States, the Netherlands Antilles, the Republic of Korea and Japan.

6. Poland's accession to the European Union (EU) in 2004 had a positive effect on its FDI. Polish officials estimate that FDI must reach $10 billion yearly to maintain Poland's economic growth at a 5 per cent annual level. According to Polish official statistics, the United States is the fourth largest investor in Poland (a drop from third place in 2004) in terms of the volume of capital investment. Investors from Organization for Economic Cooperation and Development (OECD) countries accounted for 95.6 per cent of the cumulative value of investment in the period 1993–2005, and those from EU States

accounted for 81 per cent. Recently, companies from India, China, Hungary, the Czech Republic and Ukraine have shown interest in locating their operations in Poland.

7. Since 1997, the value of Polish investment abroad has risen 10-fold. According to data from the National Bank of Poland, through the end of 2005, Polish firms invested $6.6 billion abroad. Poland's largest foreign investments are in Lithuania, the Netherlands, Germany, France, China, Malaysia and Ukraine.

8. In 2007, the economic growth rate and profitability of enterprises remained high. The situation in the labour market (further fall of the unemployment rate, rise in employment and increase in salaries and payroll fund) reduced the risk deriving from lending to households and led to a broadening customer base for financial institutions.

9. The Polish capital market was set up in 1991, and the experiences of other countries (particularly the United States and France) were taken into account. Moreover, the legal framework concerning public trading in securities was based on appropriate standards: United States law and EU Directives. The Warsaw Stock Exchange (WSE) operates based on the Law on Public Trading in Securities of 21 August 1997 (as amended), under the supervision of the Financial Supervisory Commission. The WSE is a joint-stock company created by the State Treasury. As of 1 April 2008, there were 359 companies listed on the WSE (including 24 foreign companies). Equity market capitalization accounted for €126 billion (domestic companies) and €260 billion (all companies).

10. On 1 July 1995, Poland became a founder member of the World Trade Organization (WTO). The Europe Agreement Establishing an Association Between the European Communities and the Republic of Poland (Europe Treaty) significantly widened the bases of earlier trade agreements, trade and economic cooperation (signed in 1988 between the then-Polish People's Republic and the then-European Economic Community). The treaty established the foundations on which economic, political, scientific and cultural links between Poland and the EU could be developed.

11. On 1 January 2001, Poland – as a member of the Central European Free Trade Agreement – entered a free trade area comprising the Czech Republic, Poland, Slovakia, Hungary, Slovenia, Bulgaria and Romania. The main aim of it was removal of tariff and non-tariff trade barriers, as well as agreement on the free flow of goods: public procurement, State assistance, protection of intellectual property, rules of competition, State monopolies, etc. Since November 1996, Poland has been a formal member of OECD.

12. Poland became a member of the European Union on 1 May 2004. This membership made the Polish legal and financial framework more transparent, as it must meet EU requirements. Since Poland's accession to the EU, investors' interest and confidence in doing business in Poland has significantly increased.

A brief history of accounting in Poland

13. Four stages can be identified in the regulatory framework of Polish accounting :

(a) 1945–1991: accounting corresponding to the requirements of the central planning system and subordinated to tax purposes;

(b) 1991–1995: changes in the regulations as the result of economic restructuring, but still tax-dominated;

(c) 1995–2002: Accounting Act based on the EU Directives;

(d) From 2002: Amendment of the Accounting Act, largely incorporating provisions of EU International Accounting Standards (IAS).

14. Table 1 summarizes the major events in the international harmonization of Polish accounting regulations.

Table 1. Major events in the international harmonization of Polish accounting regulations

Year	Event
1990	• Economic changes and transformation of centrally planned economy into market economy • Beginning of the mass privatization of State-owned companies • Beginning of the harmonization process with the provisions of European law
1991	• New legislation consisted of the Audit and Publication of the Financial Statements, Statutory Auditors and their Self-Regulation Act 1991and the Decree of Ministry of Finance of 15 January 1991 on the principles of Accounting
1992	• Establishment of the National Chamber of Auditors, which issued the Polish Auditing Standards
1994	• Issuance of Act on Accounting, which suspended the provisions regarding financial reporting in the Audit Act 1991 • Issuance of the Statutory Auditors and their Self-Regulation Act 1994
2000	• Issuance of the New Accounting Act, which superseded the Accounting Act from 1994 • Issuance of the new Audit Act, which superseded the Audit Act 1994
2005	• The Regulation of the European Parliament and of the Council of 19 July 2002 on the Application the International Accounting Standards (IAS Regulation (EC) No. 1606/2002)

15. The launching of economic reform for market economic transformation in the late 1980s was accompanied by the introduction of various market-oriented regulatory actions, including new rules on accounting and auditing. The process of economic reform has been expedited by the preparations for EU accession. New legislation consisted of the Decree of Ministry of Finance of 15 January 1991 on the Principles of Accounting and the Audit and Publication of Financial Statements, Statutory Auditors and their Self-Regulation Act 1991. The introduced changes reflected an attempt to comply with many of the requirements of the Fourth Directive of the European Commission (EC), bringing Polish accounting closer to the accounting of the EC member countries. Fixed assets and intangibles were regulated solely by fiscal acts. The accounting law was strongly tax-oriented.

16. The Accounting Act 1994 and the Statutory Auditors and their Self-Regulation Act 1994 (hereafter Accounting Act 1994), in force since January 1995, superseded and expanded accounting and auditing regulations in Poland. The Accounting Act 1994 incorporated into the Polish accounting law mainly the European Union Directives but also issues from the Conceptual Framework of the International Accounting Standards Board (IASB).

17. The Accounting Act 1994 sets out the most important, fundamental accounting concepts, which have become a guideline for practice. It changed the tax-oriented accounting system into an autonomous system regulating business activity. It was a very important step in making Polish financial statements comparable. It enlarged their usefulness for investors and improved transparency of the economic transactions in Poland.

18. In the six years that have passed since the first Accounting Act was introduced, many changes have occurred in the Polish economy. Moreover, Poland was in the process of negotiations concerning joining the UE. Therefore, a broad modernization of the Polish Accounting Act was undertaken. The new act was accepted by Parliament in November 2000 and it came into force on 1 January 2002.

19. The changes to the Accounting Act generally followed two directions.[1] One was the improvement of the rules on preparation of financial statements, to align them with global standards such as IAS and to introduce regulations on new topics such as leasing, mergers and acquisitions, and financial instruments. The other direction was to simplify accounting requirements for smaller companies. The new Accounting Act appeals to fundamental definitions, methods of valuation of assets and liabilities, and qualitative characteristics of accounting information.

20. The Act on Auditing regulates the auditor profession. Based on the latest amendment ratified in September 2000, a new body of authority was established – the National Supervisory Committee – that exercises control over auditors' and auditing firms' compliance with auditing procedures.

21. Since 1998, the Polish Securities and Exchange Commission has permitted the use of IAS or United States GAAP as the basis for financial reporting of Polish companies listed on foreign capital markets. Since 2005, the Regulation of the European Parliament and of the Council of 19 July 2002 on the Application of the International Accounting Standards (IAS Regulation (EC) No. 1606/2002) requires companies whose securities are admitted to trading on regulated markets in EU member States to prepare their consolidated accounts on the basis of endorsed IAS/IFRS.

22. The regulation is directly applicable and mandatory to consolidated statements of publicly traded companies. It gives the option to extend the use of IFRS for the individual accounts of publicly traded companies, and to the accounts of non-publicly traded companies. Generally, companies that are not required to use IFRS base their accounting practices on the Polish Accounting Act and EU Directives.

23. The introduction of IAS/IFRS required major changes to the national financial reporting framework.

III. Regulatory framework

A. General rules for all non-financial entities

24. Business activities in Poland are subject to the new Commercial Companies Code, effective since January 2001, and the Law on Freedom of Economic Activity that came into force on 2 July 2004. These new laws replaced existing legislation – the 1934 Commercial Code and the 1999 Law on Economic Activity. A company registered in Poland acquires legal recognition upon being entered in the Register of Companies at the National Court Register of the Economic Court, which has jurisdiction over the seat of the company that is being formed. Under the 2000 Commercial Code (amended on 15 January 2004), companies can be established as joint-stock companies, limited liability companies, limited joint-stock partnerships, professional partnerships, registered partnerships and limited partnerships.

25. The accounting and reporting regulations are mainly covered by the accounting law of 1994 as amended in 2002, and since 2005 by IFRS. In addition, the various tax laws (including the tax ordinance) have their influence on accounting and reporting. Generally, what the law adds is that, where there is a lack of coverage of an area, then published Polish Accounting Standards (PAS) may be used. Where PAS are insufficient, then IAS can be applied.

26. The most important regulatory body of Polish accounting is the Parliament (Sejm). Accounting regulation depends primarily on legislative instruments (Act on Accounting); the accounting principles being issued by professional bodies are of secondary importance.

[1] Jaruga A, Kabalski P (2001). Znowelizowana Ustawa o rachunkowości a standardy międzynarodowe. Oddk, Gdańsk.

Accounting in Poland has also been influenced by tax regulations. The basis of the income tax calculation of companies has been the income shown in the accounts.

B. Banks and financial institutions

27. The banking sector is dominated by 12 large banks, two controlled by the Ministry of Treasury and the remaining 10 by foreign commercial institutions.

28. The National Bank of Poland is the country's central bank. Its tasks are stipulated in the Constitution of the Republic of Poland, the Act on the National Bank of Poland and the Banking Act. One of the National Bank of Poland's main objectives is to maintain price stability.

29. The General Inspectorate for Banking Supervision is an autonomous body within the structure of the National Bank of Poland. It is responsible for the supervision of banks' operations. It collaborates and exchanges information with other Polish financial regulators, such as the Polish Financial Supervision Authority, the State Agency for Insurance Supervision, the Bank Guarantee Fund, the Polish Banking Association and the National Chamber of Certified Auditors rating agencies.

30. In September 2006, the Polish Financial Supervision Authority was established, taking over the duties of the Polish Securities and Exchange Commission, the Insurance and Pension Funds Supervisory Commission and, since 2008, the Banking Supervisory Commission. The Polish Securities and Exchange Commission participated in establishing the PAS through its representation on the Polish Accounting Standards Committee. The financial reporting and disclosure requirements set by the Polish Securities and Exchange Commission for the publicly traded companies were one of steps taken in order to reduce the gap between Polish accounting regulations and IAS.

31. Banks (both listed and non-listed) are required to prepare their consolidated financial statements in conformity with endorsed IFRS, and their legal entity financial statements in conformity either with accounting regulations set by the Minister of Finance, which are based on the Banking Accounts Directive, or with endorsed IFRS.

32. Insurance companies are required to prepare their financial statements in conformity with accounting regulations set by the Minister of Finance, based on the Insurance Accounts Directive. Insurance companies prepare two sets of financial statements, one for general purpose and another for fiduciary reporting.

C. The accounting profession and auditing

33. The Accounting Standards Committee (ASC) was established in April 2002.[2] It is made up of 10 experts on accounting and auditing representing auditors' companies, the Ministry of Finance, the Polish Financial Supervision Authority, the National Chamber of Statutory Auditors, and academics. The main task of the ASC is the issuance of Polish accounting regulations independently from tasks performed by the Minister of Finance. The ASC provided a forum for exchange of views on the most problematic issues that arise during the transition process from national accounting standards to IFRS. Almost all members of the ASC actively took part in the preparation of new the Accounting Act.

34. The National Chamber of Statutory Auditors (NCSA) sets auditing standards through a process that embraces consultation with the Ministry of Finance and the Polish Financial Supervision Authority. When drafting auditing standards, effort is made to adapt internationally recognized standards to country circumstances. If particular auditing issues are not covered by the local standards, the NCSA permits use of appropriate International Standards on Auditing.

[2] For more information see the Report on the Observance of Standards and Codes (ROSC), Republic of Poland. Accounting and Auditing. 8 February 2005. World Bank.

35. In order to become a statutory auditor, it is necessary to meet many requirements. Generally, the certification of statutory auditors is largely based on the eighth EU Company Law Directive of 10 April 1984. Statutory auditors are required to undertake continuing professional education. Appropriate courses required for this purpose are defined annually by the National Council of Statutory Auditors.

36. Professional qualification and academic as well as practical training of accountants are carried out and supervised by the Accountants Association of Poland. The association certifies training programmes on international financial reporting.

D. Enforcement

37. In Poland, there are various authorities responsible for the enforcement of accounting and financial reporting requirements. These include the Polish Government, the Polish Financial Supervision Authority and the National Chamber of Statutory Auditors. However, to a large extent, enforcement mechanisms apply to large companies which, in accordance with the Accounting Act, should be audited. In all other companies where there is no duty to be audited, the enforcement comes mainly from the top management, which is responsible for financial statements.

38. The top management of the company is the first level of enforcement of accounting rules. It is responsible for the financial statements of the company. The board of directors must prepare annual financial statements that every member of the board and the accountant have to sign to indicate their agreement. Members of the board of directors must safeguard the proper application of accounting rules and principles for giving a true and fair view of the company.

39. Financial statements must be prepared within three months of the date on the balance sheet, and should be presented for approval at the annual general shareholders meeting within six months (eight months in the case of consolidated financial statements of a group). The audited financial statements, including the audit report and other information, should be filed with the registration court and published in the official gazette, *Monitor Polski B,* within 15 days of approval at the annual general shareholders' meeting.

40. For the Parliament, the governmental tools of enforcement are the commercial code, acts, and decrees that it issues.

41. The Act on Auditors, dated 13 October 1994, and its subsequent amendments regulate the audit profession in Poland. This act provides legal framework for the creation, governance and operations of the National Chamber of Statutory Auditors.

42. With respect to enforcement of tax regulations, it is important to note that failure to comply could result in corrections on tax declarations and also in severe fines and interest payments.

43. One of the basic duties of the Polish Financial Supervision Authority is constant supervision over public trading in securities. It reviews financial statements of listed companies and other participants of the securities market, and seeks to identify violations of established accounting and disclosure requirements. Publicly traded companies are required to have semi-annual financial statements reviewed by independent auditors and to submit these statements to the Polish Financial Supervision Authority.

44. To make the market fair and transparent, the Polish Financial Supervision Authority has to supervise activities of investors. The Enforcement Department searches suspicious trading and brings to the public prosecutor activities such as insider dealing and price manipulation, which are criminal offences under Polish law. Moreover, all trades in large blocks of shares (exceeding 5 or 10 per cent of votes) require notification to the Commission, to the Competition and Consumer Protection Office, and to the shareholders

of the company itself. Also, the amount of votes held by major shareholders (over 5 per cent) should be made public.

45. The Warsaw Stock Exchange Rules, Detailed Exchange Trading Rules, Rules of the Exchange Court and the Warsaw Stock Exchange Articles of Association contain sanctions concerning the accounting information presented by the companies quoted on the Polish Stock Exchange. Non-compliance with those rules is subject to a regulatory penalty.

46. The NCSA is a self-regulatory body of all Polish auditors. It plays an important role regarding the enforcement of accounting rules, and is legally authorized to set down requirements and grant the title of the statutory auditor. The main responsibilities of the NCSA also include assuring the professional development of its members. The NCSA's body of authority, the National Council of Statutory Auditors, confers on auditors the right to practice as professional auditors. The chamber, in agreement with the Minister of Finance, sets the rules of conduct. The chamber has the right to supervise whether auditors comply with the Auditing Standards and the Code of Ethics, and whether auditing firms comply with the Act on Auditors and their self-regulatory organization and other regulations concerned.

47. The National Supervisory Committee's responsibilities include ensuring that auditors and auditing firms are in compliance with auditing procedures. The amended Accounting Act has eliminated audit requirements for small-size enterprises. Statutory auditors are appointed at the general shareholders' meeting unless the articles of association provide for the supervisory board to make such appointments. Moreover, the Commercial Code provides shareholders of limited companies, who represent at least 10 per cent of the company's share capital, the right to appoint auditors to conduct an investigative audit.

48. The law sets out additional legal obligations concerning audit of insurance companies and credit institutions. It limits the tenure of audit firms to five years, after which they are required to rotate.

49. Audits of the financial statements are aimed at presenting a written opinion and report of an expert auditor, of whether or not the financial statements show a true and fair view of the financial position and financial result of the entity examined. An auditor should also indicate factors found during the audit, which may jeopardize the continuing of activities, by an entity (going concern). There are severe sanctions imposed on the auditors for non-compliance with professional rules. The NCSA may impose the following disciplinary penalties against them: admonishment, reprimand, suspension for one to three years from the auditing profession, and cancellation of auditing license.

50. Table 2 presents the main Polish accounting regulators and legal rules which are now in force.

Table 2. Polish accounting regulators and legal instruments

Regulator	Instruments
Parliament	• Act on Accounting 2000 • Act on Auditing 2000 • Decrees of the Ministry of Finance
Accounting Standards Committee of the Ministry of Finance	• A newly established body for setting Polish Accounting Standards
The Polish Securities and Exchange Commission[3]	• The Law on the Public Trading of Securities 1997 • Act on Investment Funds 1997 • Act on Bonds 1995 • Decrees

[3] Since September 2006, the duties of the Polish Securities and Exchange Commission have been taken over by the Polish Financial Supervision Authority.

Regulator	Instruments
The National Chamber of Statutory Auditors	• Auditing standards
The General Inspectorate for Banking Supervision	• Regulation for the banking system, specifying norms for banking operations, guidelines for the banks, recommendations concerning standards for risk management and sound banking practice
The Insurance and Pension Funds Supervisory Commission[4]	• Does not issue binding law, but may submit petitions to the Ministry of Finance to take appropriate actions in cases when they detect the infringement of the law by the insurance companies and pension funds

IV. The process of IFRS adoption

51. The EU, with the approval and incorporation of its Directives, has been an important agent in initiating the harmonization process. After their transposition to the national regulation, the Directives have become obligatory for companies which operate in EU member States.

52. The broader harmonization process began in 1995, when the IASB agreed with the International Organization of Securities Commissions (IOSCO) to develop a work programme with the aim to elaborate a set of "core standards" to be accepted by international financial markets. In May 2000, after the conclusion and evaluation of the set of standards (40 IAS), IOSCO decided to recommend the use of the core standards (30 IAS) by companies listed in international markets.

53. In March 2000, at Lisbon, the EU Heads of Government Council agreed that, from 2005 on, all listed companies should prepare consolidated accounts using International Accounting Standards, with a view to accelerating completion of the internal market for financial services. In this context, a measure taken by the EU was the issuance of IAS Regulation (EC) No. 1606/2002. The principal objective is to ensure a single set of rules to be used at an international level, facilitating the listing of companies in foreign markets, with the aim of improving the competitiveness in European capital markets.

54. Accounting reform in Poland has moved beyond compliance with EU Directives and towards the incorporation of IAS into domestic legislation. Recent amendments to the EU Directives have been incorporated as well (Dz.U. Nr 145, Poz. 1535, 30.04.2004). The implementation of IAS Regulation (EC) No. 1606/2002 has embraced IAS/IFRS within the Parliamentary Accounting Act (Nr 214, Poz. 2153, 27.08.2004) as follows:

(a) IAS/IFRS adopted by the EU are required in consolidated accounts (financial reports) for listed companies and banks, from 1 January 2005 (Accounting Act, article 55, p. 6a, 2004);

(b) IAS/IFRS are permitted in individual (separate) financial statements of issuers of securities admitted to public trading or trading on one of the regulated markets of the European Economic Area, as well as those of issuers of securities pending admission to public trading or trading on one of the regulated markets of the European Economic Area (Accounting Act, article 45, p. 1b);

(c) IAS/IFRS are permitted in individual (separate) financial statements of members of a capital group where a parent company prepares consolidated financial statements under IAS (Accounting Act, article 45, p. 1c);

[4] Since September 2006, the duties of IPFSC have been taken over by the Polish Financial Supervision Authority.

(d) IAS/IFRS are permitted in consolidated financial statements of issuers of securities pending admission to public trading or trading on one of the regulated markets of the European Economic Area (Accounting Act, article 55, p. 6b);

(e) IAS/IFRS are permitted in consolidated financial statements of entities that are part of a group in which a higher-level parent company prepares consolidated financial statements under IAS (Accounting Act, article 55, p. 6c);

(f) All other enterprises are required to apply the principles of the Accounting Act and other specific governmental orders. IAS/IFRS may be applied by these enterprises when a given issue is not covered in the Accounting Act or in domestic accounting standards.

55. All IAS/IFRS adopted by the European Commission have already been translated into Polish and published in the European Commission's Official Journal. The parallel translation of IAS/IFRS was coordinated and published by the National Board of Association of Accountants in Poland and has been approved by a Review Committee appointed by International Accounting Standards Committee Foundation (IASCF). However, at the time of the first adoption of IAS/IFRS, most companies used the English version of IFRS.

56. The periodical articles of auditing companies were a useful source of information and a kind of practical guideline for the implementation of IAS/IFRS.

57. Regulations concerning IAS/IFRS are in place; however, implementation will require further technical and education support, both for managers and accountants.

58. There were several important issues that the companies had to take into consideration before introducing implementation mechanisms, for example, the changes to the chart of accounts, accounting procedures, information technology systems, changes to the systems of managerial reporting and budgeting, and systems of financial information recording.

59. The implementation called for much effort, substantial work, good coordination of implementation teams, strong support from management and support from specialized outside experts. It was necessary to prepare detailed action plans. A critical challenge was recalculation of financial data for 2004, which was previously prepared in accordance with Polish Accounting Standards.

60. Usually, the whole process required changes in the organization and demanded considerable human and financial resources.

61. On the basis of research and observation,[5] the preparedness of companies in Poland may be characterized as follows: companies that were obliged or permitted to incorporate IAS/IFRS from 1 January 2005 (IAS Regulation (EC) No. 1606/2002) at the time of the first-time implementation were familiar with these requirements and were acquainted with IAS of 2000 but not with the amendments to IAS and the new IFRS published during the first quarter of 2004. IFRS 1, on first-time application of all IAS, needed a lot of effort, especially sections concerning reclassification of equity or impairment of assets. There were also challenges with the implementation of IFRS 2 and IAS 18, 27, 28, 31, 32 and 36.

V. Research findings

62. Adoption of IAS/IFRS in 2005 heralded a new era in Poland. IAS/IFRS require new measurement models in many areas. The financial statements must explain how transition

[5] Jaruga Alicja, (on behalf of the Accounting Standards Committee in Poland) in response to the questionnaire "IFRS in domestic legislation, IASB meeting with World Standard-setters". IASB. September 2004.

from previous national regulations to IAS/IFRS affected equity, and reported financial position, financial performance and cash flow. There are significant differences between what would have been reported under Polish GAAP and under IAS/IFRS.

63. Polish listed companies, in their consolidated financial statements for the first half of 2004 (at 30 June 2004), published only very basic and general information, usually only in narrative form. Most of them presented mainly impact on income.

64. According to requirements of IFRS 1, companies preparing their first financial statements under IAS/IFRS are required to present broad reconciliations of financial statements. Following that, most of the listed companies presented such reconciliations for financial data for 2004 in the form of comparative information for the 2005 figures.

65. There was no common way of communicating the differences between the IAS/IFRS numbers and those they reported using national standards. Some companies decided to present only main items changed, while others tried to prepare detailed information. The communication was often incomplete and usually only descriptive. The challenge for the companies was to avoid "surprise" changes when reporting for the first time under IAS/IFRS and to reduce the potential risk of adverse market reaction.

66. The differences between IAS/IFRS and Polish national principles concern mainly:

(a) Pension funds;

(b) Share-based payment;

(c) Financial instruments and hedging;

(d) Impairment of goodwill;

(e) Intangibles assets;

(f) Business combinations;

(g) Valuation of receivables;

(h) Valuation of revenues and liabilities;

(i) Leasing; and

(j) Property, plant and equipment.

67. An important challenge for companies was the communication and explanation of the IAS/IFRS information at a company's date of transition and for the comparative period included in the first IAS/IFRS financial statements. Analysts remained concerned that it would prove to be difficult to specifically identify changes that were the result of the transition to IFRS. Adequate explanation of the newly reported amounts was essential. Interviewed analysts (40 per cent[6]) stated that generally their knowledge of IAS/IFRS was not sufficient.

68. In order to show the impact of IAS/IFRS application on equity and net income in comparison to Polish Accounting Act rules, 2,557 financial statements were analysed (of companies which were obliged or had decided to use IFRS). The analysis revealed the following financial reporting areas in which significant changes have occurred:

(a) Property, plant and equipment: Some Polish entities had many items of property, plant and equipment still used in business activity, but fully depreciated or of very low value. With the change of accounting policies, companies faced the problem of suitable recognition and measurement of such

[6] Surveys of PriceWaterhouseCoopers, KPMG, Mazars, and Ernest and Young.

[7] Financial reports of nearly all companies listed on Warsaw Stock Exchange (including 171 consolidated financial statements).

items in financial statements under IAS/IFRS. Many companies used fair value (accepted by IFRS 1 as deemed cost) set as at 1 January 2004 (date of transition of many companies). Amounts increasing the value of property, plant and equipment or investment properties were recognized. The increase of tangible assets has impact on accounting income, as these items are required to be depreciated. On the other hand, some companies increased their accounting income as they adjusted the amount of depreciation recognized after implementing IFRS;

(b) Goodwill and negative goodwill: Many Polish companies had to derecognize negative goodwill and adjust amortization relating to goodwill and negative goodwill (previously recognized under the Accounting Act). This led to increase of goodwill and derecognition of negative goodwill and corresponding changes in equity;

(c) Recognition and measurement of revenues: Some Polish companies faced the problem of suitable recognition of revenues and receivables, especially when they sell their products or services with long deferred payment. This caused a decrease of operating revenues and a decrease of receivables or increase of financial incomes;

(d) Share-based payment: The Polish Accounting Act does not provide any rules (or requirements) relating to recognition of expenses resulting from share-based payments. Some companies after transition to IAS/IFRS had to adjust their expenses (which led to a decrease of accounting income of some companies, especially in 2005);

(e) Financial instruments and hedging: Some Polish companies faced the problem of suitable recognition and measurement of financial assets and liabilities. This especially relates to companies that were exempted from applying applicable regulations of the Ministry of Finance;

(f) Intangible assets: As in the case of property, plant and equipment, fully depreciated intangible assets had to be recognized in balance sheets of some companies;

(g) Business combinations: Some companies, in order to comply with IAS/IFRS, had to adjust their financial data (for example, in relation to reverse acquisition or pooling method used);

(h) Leasing: A lack of detailed regulation under the Accounting Act led in some companies to subjective assessment of lease agreements. Some Polish companies had previously based their accounting policies on tax law;

(i) Investment properties: The Polish Accounting Act provides specific definition of investment property, based on the objective of acquisition and not present usage. Changing accounting policies, some companies had to reclassify some properties from items of property, plant and equipment to investments. Some companies, changing their accounting policies, decided also to change measurement rules for investment properties – to apply the fair value model.

69. The research and analysis covered consolidated financial statements of companies that applied IFRS for the first time in 2004. Companies that did not disclose the necessary information or those under the process of bankruptcy were eliminated. The final sample embraced 79 companies. The analysis was mainly focused on changes in total assets, equity and income.

70. Among the 79 companies, the value of assets increased in 51 instances, decreased in 25 cases and remained the same in 3 companies. Prevailing changes were increases and they were substantial, usually more than 10 per cent. The decreases were few and were

very small. These changes indicated that the economic potential of companies was less apparent under national accounting standards, and IFRS brought the net value of the companies' assets closer to their market values. This was important information for investors, analysts and other market participants.

71. The biggest increase, by more than 63 per cent, was caused mainly by the changes in valuation of property, plant and equipment, long-term receivables, and investment properties. The decreases were caused mainly by a new method of valuation of short-term receivables.

72. Of the 102 companies analyzed, 78 showed an increase in the value of equity; only 21 companies showed decreases and 3 reported no changes. Most upward changes were substantial; 31 companies showed more than a 10 per cent increase, and 24 companies showed more than a 20 per cent increase. While analyzing decreased, it was noted that, in 50 per cent of such cases, the decrease was in the range of 0 to 1 per cent.

73. The biggest change (construction entity) was an almost 100 per cent increase in the value of equity. It was caused mainly due to reclassification of some assets of property, plant and equipment into investment proprieties and their valuation in fair value (those were often assets already mostly amortized). The biggest decrease (an information and communication technology company) accounted for -62 per cent and was attributable to accounting for business combinations.

74. The positive differences in equity valuation appeared mainly due to (a) recognition of items of property, plant and equipment fully depreciated or remeasured to fair value (deemed cost); (b) reclassification of lease agreements; (c) reclassification of real properties from property, plant and equipment to investments and their remeasurement to fair value; (d) reclassification and remeasurement of intangible assets (including goodwill); and (e) derecognition of negative goodwill.

75. The negative differences in equity valuation appeared mainly due to application of regulations of IFRS 3 (Business Combination), derecognition of intangible assets and decrease of accounting income as a result of recognition of:

(a) Expenses relating to share based payments; and

(b) Lower revenues (long-deferred payments).

76. Besides changes in equity, many companies presented changes in accounting income (after tax). Many companies showed substantial increases; however, some negative changes of net income were also observed. The decreases were generally small – more than 50 per cent of decreases were around 1 per cent – however, there were also a few big exceptions, mainly due to the recognition of additional provisions, adjustment of revenues (to requirements of IAS 18 (Revenues)) and to the recognition of expenses relating to share-based payments.

77. The positive differences appeared mainly as a result of (a) derecognition (reversal) of expenses (recognized under the Accounting Act) relating to lease agreement (impact of lease reclassification); (b) derecognition (reversal) of amortization of goodwill (recognized under the Accounting Act); (c) adjustment (decrease) of depreciation of property, plant and equipment (recognized under the Accounting Act); and (d) application of IFRS 3.

78. The research findings presented above show that transition to IAS/IFRS brought some significant changes in the financial position and performance of enterprises adopting IFRS. It is important to note that investors, analysts and other market participants could face some serious problems in understanding financial results of companies, especially when comparing financial statements prepared under IFRS with those prepared under national accounting standards.

VI. Conclusions

79. The decision of the European Union to implement IAS/IFRS for all EU-listed companies from 1 January 2005 has brought greater international convergence of financial reporting.

80. This note has highlighted main challenges relating to implementation of IAS/IFRS in Poland. The limitations of the research and conclusions presented in this paper are caused by the short period of practical implementation of new standards.

81. Characteristic features of accounting practice based on IAS/IFRS in Poland can be summarized as follows:

(a) Emphasis on the usefulness of information generated in financial reports in decision-making;

(b) Prospective approach to the presentation of the economic situation of a company;

(c) Economic content of transactions and events as the basis for their formulation;

(d) Measurement based on economic value and fair value (the new value relevant model);

(e) Application of balance sheet-based approach;

(f) Increased professional "judgement" in measurement and disclosure;

(g) Broad and interdisciplinary scope of information required for proper formulation and pricing (measurement) of transactions and events; and

(h) Broad scope of both financial and non-financial information presented in financial reports.

82. There are also several business implications of the first-time adoption of IAS/IFRS:[8]

(a) Managers need to start planning as early as possible for the process of transition to IAS/IFRS. It will take time and may require training in and changes to and training in information systems. The organizational culture may be affected, too;

(b) Accounting for certain items, such as hedges, will require decisions at or before the transition date;

(c) Understanding the effect of the adoption of IAS/IFRS on the financial statements, and the effect on contracts and agreements – such as remuneration agreements and covenants – in finance agreements is critical;

(d) Communicating to stakeholders and the financial markets about changes anticipated on financial statements is essential.

83. Implementation of IAS/IFRS will not only have a significant impact on financial reporting, but also on internal organization. It will bring harmonization of internal and external reporting, better comparability between companies, and greater reporting transparency, because the introduction of IAS/IFRS is a movement towards similarity in choices between alternative accounting treatments.

84. Polish companies that successfully overcome the practical implementation challenges of IAS/IFRS are most likely to reap the benefits of adopting globally recognized financial reporting standards. The transition is expected to have a positive impact on their competitiveness and their integration into capital markets in the European Union.

[8] IASCF (2005). *IFRS: A Briefing for Chief Executives, Audit Companies and Board Directors*.