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**The Convergence of Polish Accounting to
International Accounting Standards: A
Comparative Treatment of Fixed Assets
within a Wider European Context**

Dissertation submitted as a partial fulfilment of the requirements for

MA Finance by Research

By

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University of Greenwich May 2002

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1. INTRODUCTION

This dissertation is a comparative study of the reporting of fixed assets in Poland and in the UK. The aim is to determine the degree of convergence in financial accounting between EU countries and transitional economies such as Poland. Poland, a former socialist economy, has led the move away from a rigid centrally planned system to what is a more adaptive approach (Jaruga, 1991). Currently, Poland has an associate status of the European Union (EU) and hopes to join the EU within the next two to four years. In order to do so Poland will need to conform not only with the EU 4th, 7th and 8th Accounting Directive (European Commission, 1995) but also with the latest pronouncement by the Commission of the European Communities requiring listed companies of all member states to conform with International Accounting Standards (IASs) by 2005 (Commission of the European Communities, 2000). The problem for the Polish national standard setters is that there are considerable differences between the Accounting Directives and the IAS as identified by Craner (2000) and noted by the EC Contact Committee on the Accounting Directives (European Commission, 1996). The Polish Accountancy Act 2000 was introduced to meet the requirements of the EU Directives but in the light of the adoption of IAS by the EU further revisions to Polish accounting legislation will be necessary. Poland will therefore be required to join a game with constantly changing goal posts within a very short period of time. The pressure to conform will have far reaching implications for all member countries but especially for the standard setters and preparers in the associate EU countries who will need to adapt their current legislative framework to meet the criteria for membership. To do so it is important to establish the degree of convergence to date in terms of *de jura* compliance with supra-national laws as well as *de facto* compliance by companies, which will be subject to EU regulation. Furthermore, the

study will examine the process of implementation of IAS in Poland highlighting both the potential problems associated with the importation of accounting practices as well as benefits accruing in terms of comparability of financial statements. The convergence to IAS is extremely important from the business perspective as summarised by PWC (2000):

'Business is ahead of the European Commission (EC) and national regulators in backing for IAS. It wants clarity and comparability in financial reporting. It welcomes moves towards creating a single, high quality international financial reporting framework. Europe's CFOs know that this is a strategic business issue, not just a debate about different accounting frameworks.' (p. 5)

The UK has been chosen as a representative example of a well-developed, market economy, which has been at the cutting edge of international harmonisation. In many cases UK leads the IASC by its developments of FRSs, for example by influencing the drafting of the 4th Directive to include the notion of 'true and fair' previously unknown in the other member states. UK Financial Reporting Standards (FRSs) always refer to whether or not they are consistent with the IASs and in most cases there is a high degree of implicit compliance for UK companies. Furthermore, research using the data from the IASC comparability project showed that UK has above average level of compliance with IASs (Salter, *et al.*, 1996; Roberts, *et al.*, 1996) as compared to Germany where there has been significantly lower level of agreement. Polish financial reporting practices have been strongly influenced by Germany through its trade links and by its geographical proximity so we would expect the results of this study to show a below average level of compliance with IASs.

The study focuses on the measurement, recognition and disclosure of fixed assets in the financial statements of the two countries. Study of fixed assets has been selected for a number of reasons. Firstly, the valuation of fixed assets is particularly problematic for the transitional economies in the absence of open markets, especially markets in second hand assets (Jaruga, *et al.*, 1996; Kamela-Sowinska, 1995). At the same time it is imperative that the valuations are realistic and reasonable so that an efficient privatisation process can continue. Secondly, the relative treatment of fixed assets will have a significant effect on both the earnings of the entity and the valuation of assets. In Poland, balance sheet values are distorted by inflation rates ranging from approximately 30 per cent per annum in 1995 to 10 per cent in 2000. The cumulative impact of inflation will make the financial statements less useful unless valuations are kept up to date. Thirdly, the treatment reflects the different national attitudes in terms of the degree of the application of fundamental accounting concepts such as prudence, recognition of assets, substance over form and consistency. For example, if revaluations are disallowed this would indicate a conservative approach, whilst the treatment of finance leases will show a national preference for the recording of either the legal form or the economic substance of transactions. We would expect the national bias in Poland to be in favour of the Continental European model (Schroeder, 1996; Krzywda, 1995) and in the UK to be towards a more *laissez faire* approach (Krzywda, *et al.*, 1995). The *de jure* treatment of fixed assets in the UK is consistent with the provisions of IASs and so comparison with UK practices will act as a proxy for comparison with IAS.

The study will also explore the impact communist regime had on the underlying philosophy and approach adopted in the production of financial statements in Poland in terms of focus and objectives of financial reporting. The transition economies are unusual in the pattern of development of their accounting systems because the changes in those countries have come about suddenly and over a particularly short period of time as compared to the gradual changes that take place in well-developed market economies. The pace of change in the legislative and accounting frameworks has not been matched with the same of level of cultural and attitudinal change. In common with the other transition economies Polish attitudes are still influenced by the communist mentality characterised by a spirit of mistrust and opposition to authority resulting from a forcefully imposed political and economic system (Zaleska, 1999). The excessive communist propaganda and falsification of official data meant that centrally generated data was always viewed with suspicion and never used for decision making. In terms of the current, market orientated economy published financial statements will only become useful for decision making if the user groups accept the data as being a reliable and trustworthy source of information. It will be argued that in order to meet the objectives of financial statements as defined in the IAS 'Framework for the Preparation and Presentation of Financial Statements' (1998). Poland will have to address many wider issues such as standard setting process, professional regulation and training of both the users and preparers of financial statements in order to transform its accounting system from its current continental orientation, rooted in communism, to the Anglo-Saxon orientation of the IAS. Krzywda et. al. (1995) concludes: 'any attempt to introduce the *laissez-faire* accounting tradition into an economy in which economic development and financing of industry were characteristic of the national economic tradition, would be doomed to failure in the long run'

(p.653). Wholesale adoption of IAS will go some way towards improving the quality of corporate reporting but compliance with the spirit and the philosophy of the IAS will be much harder to achieve unless broader changes are introduced.

The Polish accounting developments must be seen in the context of greater harmonisation worldwide. Flower argues that the future convergence will be towards the Anglo-American approach and away from the European model (Flower, 1997). His analysis appears to have been confirmed by the appointment of David Tweedie who was the Chairman of UK's Accounting Standards Board as the Chairman of the International Accounting Standards Committee from January 2001.

2. ECONOMIC BACKGROUND OF POLAND

Poland is a former Soviet satellite state geographically positioned between Germany and Belarus. It is of strategic importance for the EU and for Germany in particular being the only buffer state between the European Union and the CIS. In 1989 the communist government collapsed and was replaced with the first democratically elected non-communist government in the post-war years. Despite frequent changes of government and the dominance of various coalition alliances Poland has remained politically stable during the last decade and the transformation of the socio-economic system has continued unhindered. The political reforms not only gave political freedom to the individuals, but also allowed the government to commence a programme of reforms designed to transform a centrally planned economy to a

market economy. The ultimate aim of successive Polish governments has been to achieve full European integration through membership of the EU.

Politically, the integration of Poland within EU will not only benefit Poland but will also act to protect the interests of the member states and promote peace in Europe. Economic failure in the Central and East European Countries would threaten western prosperity through mass migration, additional defence costs and loss of trading partners. Not surprisingly, Germany has fully backed the Polish request to join the EU and has vigorously supported Poland's early entry into the European Community. However, the political advantages must be balanced against the economic and financial costs of enlargement. Poland will be entitled to significant structural grants and payments under the Common Agricultural Policy designed to increase the per capita income. Nevertheless, the study by Baldwin *et. al.* (1997) attempted to quantify the effects of enlargement and estimated that the net cost of the enlargement will only be in the region of 0.01 per cent of the EU 15's budget concluding that: 'eastern enlargement will be a phenomenally good bargain for the incumbent EU 15 and also enormously beneficial to the CEEC economies.' (p 168)

As stated above, following the fall of communism in 1989 Poland embarked on a transition from a centrally planned economy to a full market economy alongside other East European countries namely: Bulgaria, The Czech Republic, Estonia, Hungary, Latvia, Romania, Slovakia and Slovenia. In the immediate years post liberalisation Poland suffered huge economic shocks characterised by a dramatic fall in output, rising unemployment and spiralling inflation. In contrast the communist era was characterised by a very well developed

welfare state and virtually no unemployment. Therefore the impact of market reforms on population was devastating given that the average Pole was ill equipped to adjust to the changes without the social protection previously offered by the state. The government was faced with the task of meeting its reform objectives and at the same time affording some social protection in order to avoid political and social unrest. The economic decline was partly cushioned through the support of the IMF and the write off of more than 50 per cent of its national debt. The decline of the early 1990's was the result of the fall of the centrally planned economy without having an efficient market economy in place. Through a programme of rapid privatisation of small and medium companies and then larger companies and utilities, a transformation has been achieved to the extent that by 2001 70 per cent of state enterprises have been privatised. (OECD 2001). By 1998 Poland has managed to embrace the market economy through structural reforms and economic stability to such an extent as to be named the 'Tiger' economy of Eastern Europe. Impressive growth in GDP was the result of two primary factors. Firstly, increased competition and the enlargement of the private sector led to a significant improvement in productivity with a greater proportion of skilled labour participating in the market place (Fischer and Sahay 2000). Secondly, capital spending has increased to 26 per cent of GDP, one of the highest in OECD (OECD 2000). The net effect of these factors was that Poland's GDP at USD150bn for 1998 was nearly 3 times greater than that for Czech Republic, the second most successful transition economy. In terms of *per capita* GDP Poland lies in fourth place after Slovenia, Czech Republic and Hungary.

with the enactment of the decree on the principles of accounting (*Rozporządzenie o Rachunkowości, 1991*) designed to converge Polish accounting practices to those accepted in the EU and contained in the International Accounting Standards (Krzywda *et. al.*, 1995).

International investors have responded very positively to the favourable market conditions and Poland has now become the main beneficiary of foreign direct investment in the region (USD 3bn. of FDI has entered the country in 1998). A study by EBRD (2000) indicated that foreign investors consider the following factors to be important for investment in a particular region (in decreasing order of importance):

Access to attractive host market

Cheap skilled labour

Proximity to home market

Favourable regulatory and tax regimes

Strong institutional link with home country

Given the criteria above it is not surprising that Poland has been successful in attracting FDI. Using the banking sector as an example it can be shown that Poland provides an attractive investment opportunity. Only 25 per cent of Poles have a bank account and total bank debt is 32 per cent of GDP as compared to 120 per cent for EU countries (Euromoney 2000a) so there is considerable potential for growth in retail banking sector. The banking sector is well regulated and there is no restriction on the remittance of profits to the parent company. The favourable business climate has resulted in over 70 per cent of the capital of the banking

sector in Poland being controlled by foreigners as compared to 10 to 20 per cent for most western European countries. Foreign ownership is, on the one hand, a major strength providing opportunities for growth and recapitalisation. However, its also a source of some political tensions. Popular unease has been voiced about the potential loss of sovereignty not only in the banking sector but in many other industries, especially those located in the previously German owned lands, as Poles fear German dominance of the economy (Euromoney 2000b). Indeed, Polish refusal to accept the EU requirement to allow purchase of land by any EU resident has been a major stumbling block in the process of meeting the conditions of accession. The business community has also had to adjust by having to adopt Western European practices when seeking finance from the banks bringing international discipline when reporting to foreign lenders. Over time it is likely that spontaneous harmonisation of business and financial practices will take place as a result of the influence of western European banks and other major overseas investors.

Foreign direct investment is also facilitated by the existence of a growing equity market, the Warsaw Stock Exchange. The WSE has operated since 1991 and was modelled on the French stock exchange. The exchange has over 200 shares listed with a market capitalisation of €33bn. It is the largest stock exchange in the region but it is one of the smallest in Europe (London €2,838bn). The stock exchange is not a major provider of corporate finance as the majority of the shares traded originate from the government privatisations. In most other cases a minority of shares in a particular company are traded whilst control is retained by the major strategic investor. Most companies are financed either internally or through bank lending and

not through public listing. This creditor orientation will have influence on the development of corporate reporting in Poland.

Forthcoming privatisation of large public enterprises coupled with the expected growth in the activities of pension funds will ensure that the exchange will continue to thrive in the future. The exchange trades equities, treasury bonds and futures. It is highly regarded by international investors for its high level of regulation and transparency.

EU is Poland's major trading partner and in particular over 70 per cent of the Polish exports are to Germany. In contrast trade with Russia is insignificant to the extent that the recent financial crisis in Russia has had minimal impact on the Polish economy. This westward focus has contributed to the overall economic, political and social stability of the country making Poland a very attractive region for overseas investors. Membership of the EU will further reduce country risk by 30 per cent leading to a substantial increase in real incomes (Baldwin *et. al.*, 1997).

In many respects Poland has proved to be an extremely successful transition economy. Nonetheless, Poland is facing some major challenges that it will have to overcome if it wishes to continue to grow at the existing rate.

Unemployment is at a record high of 18 per cent in 2002 (10 per cent in 1998). The government will have to make every effort to liberalise labour laws and to reduce the levels of taxation on labour if the economy is not to be hindered. To date the progress in this area has been slow due to objections from the Trades Unions.

Poland has a very large and inefficient agricultural sector accounting for 24 per cent of the total workforce. The industry is hugely inefficient and will demand substantial subsidies from the EU. Irrespective of the EU's contribution, Poland's agricultural sector will need to undergo major modernisation and reform if it is to compete in an open EU market. Productivity will need to be raised dramatically resulting in widespread unemployment and poverty in the rural areas. The government will need to plan for this major structural adjustment in terms of its social and economic policy and also be prepared to face potential political discord from the farmers who have a powerful representation in the government coalition.

During the last decade Poland has reaped considerable financial benefits from FDI resulting from the privatisation of large state enterprises. This source of income is likely to decrease significantly over the coming years once the privatisation process is completed, reducing the investment potential that is essential if further improvements in the infra-structure are to continue.

Since the downfall of communism in 1989 Poland has successfully transformed its economy from centrally planned system to a market economy. In the early years the priority has been to transfer property from public to private ownership and to manage the economic upheaval characterised by hyper-inflation in excess of 500 per cent in the early nineties. The focus during this decade has been to prepare the country for early entry into EU. One aspect of this preparation requires Poland to adapt its legal and accounting framework so that full compliance with the requirements of the Commission of the European Communities is

achieved. This study will go on to critically review the current Polish accounting system in its political and economic context and will then proceed to examine the process of implementation of IAS using the treatment of fixed assets to highlight the differences in the conceptual orientation of the two systems.

3. LITERATURE REVIEW

The aim of the literature review is to critically evaluate prior research that spans a number of disciplines pertinent to the study of Polish accounting in the international context. The literature relating to the classification of accounting enables this study to place Poland in the formal classification model of accounting systems. The positioning of Poland in relation to the Anglo-Saxon system would act as a powerful explanatory factor for the observed differences between Polish accounting regulation and IAS. In addition, this study also maintains that the orientation of Polish accounting has been significantly influenced by cultural factors that are rooted in the communist tradition. The cultural literature is used in this study to support the argument that accounting harmonisation with the IAS will be difficult to achieve due to persistent and deep seated cultural differences between Poland and the Anglo-Saxon countries. Finally, this study will apply the empirical models developed by Penman (1996) to assess the value relevance of Polish financial statements and compare them to UK accounts. Throughout the study will be underpinned by literature relating to the economic and accounting environment of Poland.

3.1 Classification models

The seminal work of accounting classification was first put forward by Mueller (1967) who divided accounting systems according to the objectives of accounting which in turn were based on the economic environments of the country. Mueller identified four distinct approaches in accounting development in western nations with market orientated economic systems. These are:

The macroeconomic pattern- where business accounting interrelates closely with national economic policies;

The microeconomic pattern – where accounting is viewed as a branch of business economics;

The independent discipline approach – where accounting is viewed as a service function and derived from business practice; and

The uniform accounting approach – where accounting is viewed as an efficient means of administration and control

Mueller's study is limited in two respects. Firstly, the research was carried out in 1967 and therefore does not take into account post-communist countries. Secondly, Mueller ignored the impact of external influences that are critical to the understanding of the development of Polish accounting. Although wider set of influences such as political system, legal system and cultural background are recognised in a wider sense they are not formally incorporated into the model.

Seidler (1967) introduced the idea of importing and exporting accounting rules and classified accounting systems into three systems based on spheres of influence. The three systems are:

British, including the Commonwealth
American, including Israel and Mexico
Continental led by France

Seidler's model could also be extended to communist countries under the influence of Russia.

A major limitation of this study is that it precedes the period of influence of EU which over the last twenty years has had a major impact on the accounting systems in Europe.

Krzywda, *et al.* (1995) focussed on the internal factors influencing accounting change in Poland and in the process identified two traditions of accounting development in Western Europe. These are *laissez faire* and the national economic accounting traditions. 'Implicit within the theory is the assumption that accounting is economically determined in the long run' (Krzywda *et al.* 1995:652) and therefore does not incorporate social and political factors. The classification is broadly consistent with Mueller's analysis but again ignores the influence of international pressure for change. The paper puts forward a theoretical model and one of the aims of this study will be to test whether *de jure* and *de facto* accounting practices in Poland support Krzywda's hypothesis that 'Polish financial accounting after 1989 is developing characteristics compatible with the national economic accounting traditions. (1995:653)

The validity of the distinction between the 'uniform' or national economic accounting system as typified by Germany and fair judgemental approach prevailing in the UK was tested empirically by Feige (1997). Feige analysed the accounting policies of a randomly selected

sample of six British and German chemical companies in the area of foreign currency translation and found that the *de facto* practices do not support Mueller's hypothesis of classification. He suggested that the UK's practices are more uniform than that of German companies. In reply Nobes and Mueller (1997) dismiss the findings from Feige's research arguing that the sample used was too small and addressed an atypical issue.

A much larger comparability study of compliance with IAS was undertaken by Street *et al.*, (1999) who reviewed financial statements of 49 major international companies. The findings suggest a widespread non-compliance with IAS including the following areas that are relevant to the study of fixed assets:

Failure to capitalise development costs

Failure to provide required disclosures for property, plant and equipment, particularly those associated with revaluations

Charging goodwill to reserves or amortising goodwill over a period in excess of 20 years

Although none of the companies surveyed came from the transitional economies it is reasonable to assume that Polish companies in this study will mirror these findings and also show significant non-compliance with IAS.

Considerable amount of work has been done by the major firms of accountants to identify differences between national accounting practices and IAS requirements. Typically, the studies include a large sample of companies and the data has been obtained by questioning audit partners in various countries rather than the company accountants themselves. The

studies are also limited in that they focus exclusively on accounting differences and do not attempt to explain the reasons for the differences or the qualitative factors affecting the choice of permitted treatments. The differences in practices are given the same weighting irrespective of whether they are minor or fundamental discrepancies as no attempt is made to rank them in order of importance. This study explores the treatment of fixed assets in the context of the theoretical framework and therefore only focuses on the issues that significantly affect the financial statements. It is also the case that the top five accountancy firms are the major proponents of the Anglo-Saxon orientation and therefore cannot be seen as being independent in their research having a vested interest in the outcome.

3.2 Cultural and socio-economic studies

This study maintains that the underlying socio-economic and cultural reasons for the differences are as important as the accounting differences *per se*.

The significance of culture in the development of accounting has been widely recognised and reported eg. Douppnic and Salter (1995); Grey (1988), Fetchner and Kilgore (1984), Kirsch (1994).

Hofstede (1980:25), in his seminal work on cultural differences in an organisational context defined culture as 'the collective programming of the mind which distinguishes the members of one human group from another'. Gray (1988) used the cultural differences identified by Hofstede to develop four accounting values that can be related to the wider societal values.

These are:

Professionalism versus Statutory Control – a preference for the exercise of individual judgement and the maintenance of self-regulation rather than compliance with prescriptive legal requirements.

Uniformity versus Flexibility – a preference for uniform treatment in all circumstances rather than exercise of judgement to suit individual company needs

Secrecy versus Transparency – a preference for confidentiality and the restriction of information only to those closely involved with the organisation rather than the more open and publicly accountable approach

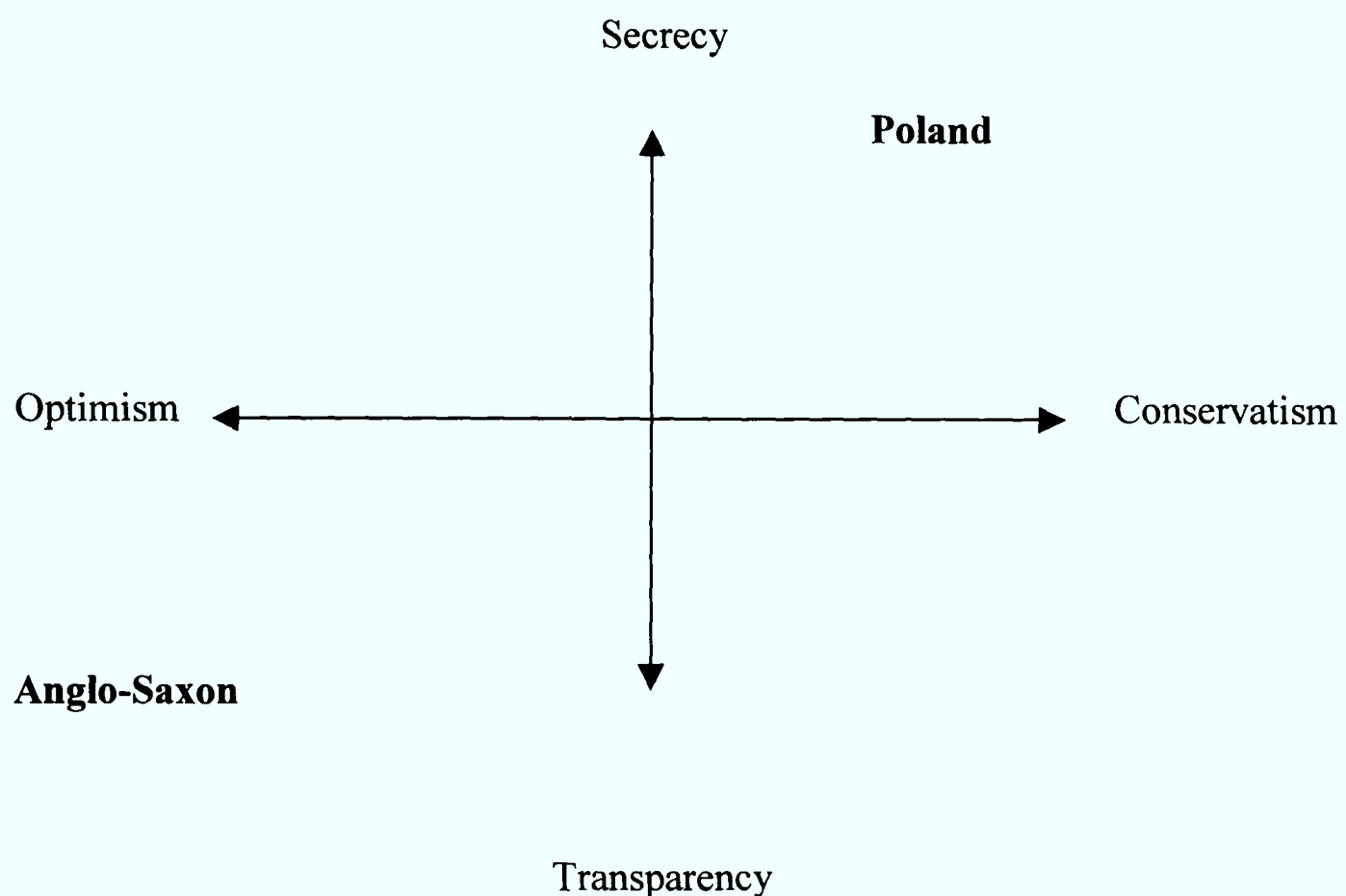
Conservatism versus Optimism – a preference for a cautious approach to measurement as compared to a more optimistic, laissez-faire, risk taking approach

Gray then ‘proposes four hypotheses on the relationship between identified cultural characteristics and the development of accounting systems, the regulation of the accounting profession and attitudes towards financial management and disclosure.

Gray’s theoretical model was empirically tested by Salter and Niswander (1994) who analysed practices in 29 countries and found that there was a significant relationship between Gray’s accounting values and Hofstede’s cultural constructs. This study will attempt to match Polish accounting practices with the accounting values identified by Gray in order to support the basic proposition that full convergence to the IAS will not be immediately achievable and

differences will persist in spite of the adoption of common standards in the EU. It is argued in this study that Polish accounting system in terms of measurement and enforcement is diametrically different to the Anglo-Saxon system upon which the IAS have been developed.

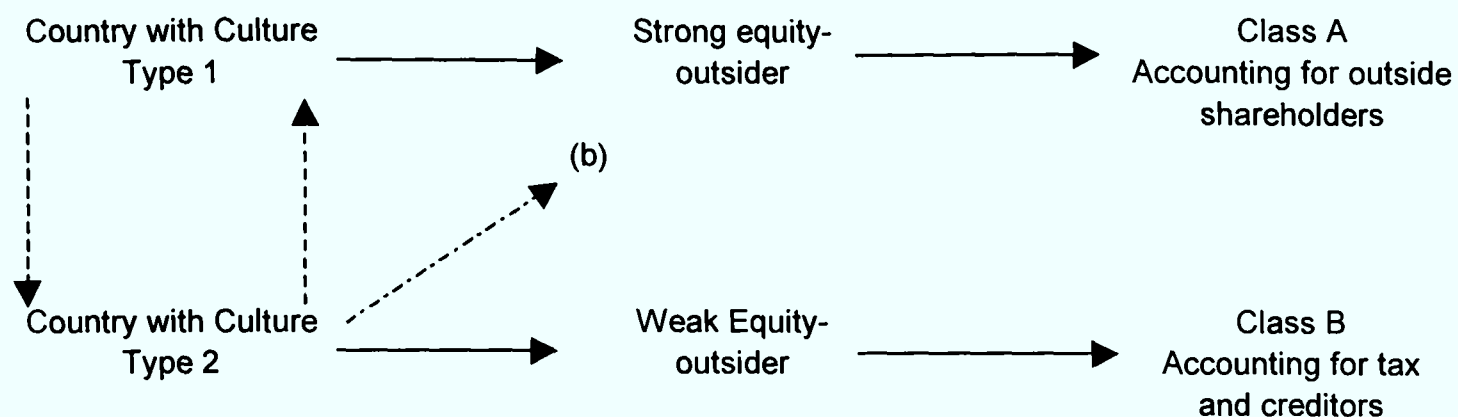
Accounting Systems: Measurement and Disclosure



Source: Adapted from Gray (1988:13)

Nobes (1998) developed a general model to explain international differences in terms of different purposes of financial reporting. He used two variables, namely the strength of the equity markets and the degree of cultural dominance to classify accounting systems.

‘A proposed model of reasons for international accounting differences’



Source: Nobes (1998:179)

According to his model Poland could be classified as a country which is culturally self-sufficient but with ‘weak equity outsider’ resulting in a creditor orientated accounting system. Imposition of shareholder focussed IAS requiring a high level of judgement may be inappropriate for a transitional economy such as Poland given its lack of indigenous financial expertise and codified legal system. However, Poland’s ambitious programme of privatisation and continual drive from a socialist to a market based economy will, eventually, make IAS more relevant and lead to a shareholder orientated accounting system. Having identified the principal differences between Polish national accounting and the IAS the study will then evaluate the impact of the transition towards the shareholder orientation by means of in-depth interviews with accountants responsible for the preparation of financial statements. It is likely that Poland will be one of the earlier adopters of IAS and the intention of this study is to provide an insight into the process of implementation of IAS, identifying both benefits and potential pitfalls of convergence to common financial reporting in the EU.

3.3 The Polish accounting system

To date, the majority of the country studies dealing with Poland have concentrated on the process of transition in a macroeconomic sense (Jaruga, 1991; Krzywda, 1995; OECD 1993). Specific accounting issues were explored in terms of *de jure* requirements without detailed reference to supra national requirements (Kamela Sowinska, 1995; Jaruga, 1996). Kwiecien (1996) carried out a general *de jure* comparison between the Polish Accountancy Act 1994, the EU Directives and the International Accounting Standards. She concluded that the first Polish Accountancy Act displays the desirable characteristics of financial reporting as set out in the 4th, 7th and 8th EU Directives but fails to conform with:

IAS 11 (Construction Contracts)

IAS 29 (Financial Reporting in Hyperinflationary Economies)

IAS 19 (Employee Benefits)

The study informs this research as to the potential area of difference between the Polish reporting requirements and the IAS in very broad terms but fails to provide an explanatory perspective for the observed differences.

The above mentioned studies dealt only with Polish accounting regulations without a comparative dimension. An exception to this approach has been a comparative study of accounting standards in the Czech Republic, Hungary and Poland (Jermankowicz and Rinke, 1996). However, 'the high level of aggregation in their comparative table failed to capture essential details' (Craner, *et al.*, 2000:357).

A very detailed, comparative study of the *de jure* determination of a group in the UK, Poland and the Czech Republic identifies ‘cross-national differences which cannot be explained fully by non-equivalencies between relevant IASs and the EC 7th Directive on consolidated accounts’. (Craner, *et al.* 2000:355). The study will be relevant to this dissertation because it is the only detailed research that has been carried out on an aspect of Polish accounting in the supra national context. This dissertation will extend Craner’s methodology by carrying out a *de facto* analysis of published financial statements as well as *de jure* comparison for fixed assets. Once the differences have been identified the study will attempt to explain the differences in terms of attitudes and orientation of the accountants responsible for the preparation of financial statements.

3.4 Fixed assets and fundamental analysis

The IAS ‘*Framework for the Preparation and Presentation of Financial Statements*’ requires that the financial statements should be prepared in such a way so as to be useful for decision making. However, until the 1990s a major weakness of financial statement analysis has been lack of a model that would link the accrual based accounting to the market values of equity as pointed out by Brennan (1991:74)

Ohlson (1995) develops a model that formally links the earnings and book values of equity derived from accrual accounting and share price. Penman (1996) goes on to apply the fundamental valuation model to examine empirically the price/book ratio. He shows that the P/B ratio represents ‘the ratio of expected future (cum-dividend) earnings given all

information relative to that given book value alone' (Penman 1996:242). His study also demonstrates that there is considerable variation in the price-book ratio across companies as shown in the table below. The table is calculated by ranking price-book value ratios by size and then grouping companies into portfolios.

Median observed Market to Book ratios for US companies over the period 1968-1985

Portfolio	Median P/B ratio	Portfolio	Median P/B ratio
1	6.2	11	1.13
2	3.66	12	1.05
3	2.82	13	0.98
4	2.33	14	0.92
5	2.00	15	0.85
6	1.76	16	0.79
7	1.58	17	0.72
8	1.43	18	0.64
9	1.31	19	0.54
10	1.22	20	0.39

Source: Penman (1996:247 table 3)

This study uses the conclusions of Ohlson's and Penman's models to measure the usefulness of financial statements by comparing the ratios of market to book values for UK and Polish companies. A high ratio indicates a wider discrepancy in the valuations that is, the company is undervalued and this is partly explained by the undervaluation of assets. The conclusion that

can be drawn from this analysis is that the accounting values are less relevant for decision making purposes.

Easton, Eddey and Harris (1993) found, in their study of 72 industrial firms, that aggregate revaluations reserves have considerable explanatory powers for the price to book ratios. They also found that including the revaluation reserve in the book value resulted in price-to-book ratios closer to one than when the revaluations reserve was excluded. The study proceeded to attempt to find an explanation for the reasons why companies would wish to revalue their fixed assets. A telephone survey of 65 Chief Financial Officers was carried out. The results indicated that the primary motivation for the revaluation of assets was to present a true and fair view followed by the desire to reduce the debt-to-assets ratio.

A closely related study by Barth and Clinch (1998) used the Price/Book ratio to investigate the relevance, reliability and timeliness of Australian asset revaluations across different types of assets. The study was more detailed than Easton, Eddey and Harris and investigated disaggregated data for the different types of assets. The study examined the accounting data of 350 publicly traded Australian firms partitioned into non-financial, financial and mining companies. Using price regression Barth and Clinch found that revalued amounts were differently associated with share price for different types of assets. In particular they found that revaluation of operating assets that is, plant and machinery is much more significantly associated with price-book value ratio than land and property. This would imply that assets more closely linked to the operation of the company have a stronger relationship with the value of the company. Furthermore, the study found that for current year revaluations there

was a strong association in cases where the revaluation adjustment affected earnings but not where the adjustment was put through the reserves.

Both of the above studies are useful for this research and form the basis for the proposition that Polish financial statements are less relevant than the UK financial statements partly because of the requirement to carry all assets at historical cost. The conclusions drawn confirm the value relevance of fair value accounting but do not consider the supra-national context. This study will consider the price-to-book ratios for both the UK and Polish companies for one sector only. The justification for using only one sector draws on the results from Barth and Clinch who found that the mean Price-Book ratio differs depending on the industry type.

This study also utilised the findings from a paper by Ali and Hwang (2000) who attempted to measure the value relevance in the context of the different country systems. Value relevance is measured in terms of earnings, accruals and the combination of earnings and book value of equity. Following Mueller's work on classification (Mueller, Gernon and Meek, 1994) 16 countries were classified as either market orientated or bank orientated using the following measures:

Debt to asset ratio

The number of publicly listed domestic companies in relation to the population

The extent to which the accounting standards are set by the government or whether private sector also participates

Accounting cluster

Financial/tax alignment

Spending on auditing services

Using the above criteria and the primary results of this study Poland may be classified as a bank orientated system due to its underdeveloped stock exchange, government involvement in the standard setting process and tax orientation.

Ali and Hwang (2000:1) studied the data of manufacturing companies from 16 countries and found that '*value relevance is lower for bank orientated systems than for market orientated systems*'. Based on the conclusions from Ali and Hwang we would expect Polish financial statements to have lower value relevance than those for UK companies. The research methodology used by Ali and Hwang is highly quantitative in nature and does not consider any qualitative data. In contrast this study goes beyond the identification of differences but also attempts to explore the attitudes that are country specific by using both qualitative and quantitative data to explore the cultural and social backgrounds.

4. RESEARCH DESIGN AND METHODOLOGY

The research methodology for this study was designed to address questions that will help to support the hypothesis that mere adoption of IAS by the listed companies in EU will not lead to true harmonisation of financial reporting in transition economies of Central Europe. The underlying research method will be a case study based on Poland as a representative of

transition economies that will be required to conform to IAS by 2005 if it becomes a member of EU in 2004 as is widely predicted. Within Poland the research was narrowed to consider the treatment of fixed assets within the IAS framework and UK GAAP. The structure of the research utilised the funnel model, whereby the research area is defined in broad terms in the first instance and then the hypothesis focuses on an increasingly narrow perspective.

The research was carried out in three main stages and each stage was supported with a different theoretical perspective and research methodology. Different research methodologies were deliberately chosen in order to triangulate the evidence 'directs the observer to combine different data sources, research methods, theoretical perspectives, and observers in the collection, inspection, and analysis of behaviour specimens' (Denzin, 1989:92). The triangulation of data by multi-method approach allows the study not only to identify the accounting differences but also to examine and explain the complex reasons for the observed differences that are rooted in the cultural context. The main advantage of using multiple methods was to increase the reliability and the validity of the results by reducing 'the personalistic biases that stem from single methodologies' (Denzin 1978:294). Similarly, Seale (1999:59) argues that 'triangulation exercises help to build plausibility for a particular account as part of a fallibilistic research strategy in which evidence is sought for central claims'. Glaser and Strauss make similar points: 'theory generated from one kind of data never fits, or works as well as a theory generated from diverse slices of data on the same category' (1967:68).

However, multiple approaches have two drawbacks in the context of this study. Firstly, the results obtained from different methodologies are not necessarily comparable. In this study

the numerical results from quantitative investigation of price/book value ratios cannot be easily aggregated with the interview findings. Nevertheless, it can be said that the combination of methods acts as a powerful explanatory tool providing deeper understanding of the observed differences. Secondly, the different methodologies may address different aspects of the research and do not necessarily confirm each other. In this case the study of the relationship between the market value and the book value of assets demonstrates the relevance of financial statements. The findings do not directly support the hypothesis that the differences in the accounting treatment of fixed assets lead to lower relevance of Polish accounting statements as compared to the UK statements prepared under UK GAAP.

The research design uses Poland as a case study to represent the transition economies of Central Europe that are expected to join the EU in the next three years. The study explores the reasons for the accounting differences between Poland and IAS that could subsequently be extended to a large-scale study of the other transition economies. Although each transition economy has its own individual identity, all the countries selected for 'fast track' accession are characterised by a common experience of Soviet domination, centrally planned economy and international isolation in the period 1945 to 1989. The common history of those countries means that they share similar challenges in the process of transition to a market economy and so the experience of Poland could be extended to the other countries.

The use of a case study approach has been advocated by Hartley (1994:212) who states that: 'a case study allows for a processual, contextual and generally longitudinal analysis of the various actions and meanings. The open-ended nature of much data gathering also allows for processes to be examined in considerable depth'. By focussing on a single country it is possible to gain a deep understanding of the cultural context of the Polish accounting system and is essential for the understanding of the attitudes and behaviour of accountants and the users of financial information. In previous studies the cultural characteristics of East Europeans, such as the inability to take risks, passivity, obedience and minimising of personal responsibility are mentioned as factors that influence the relationships with foreign enterprises (Zaleska, 1999). Although the findings present a negative cultural bias they would explain the excessive adherence to a legalistic rather than judgmental orientation when preparing accounts and the aversion to choice of accounting treatments.

Poland has been selected partly because it is a dominant economy in Eastern Europe, having the highest GDP and population in the region. Its experience of reforms will be indicative of the possible course of harmonisation for the other East European countries especially since its transformation process to the market economy has accelerated beyond the levels of some of the other countries such as Bulgaria, Rumania and Estonia. With a population of 39 million and GDP of three times that of the next largest country (Czech Republic) Poland's experience of transition and economic reform can be thought of as being highly influential and leading the transformation process for the other transition economies.

The future progress of accounting harmonisation will also be dependent on how well the stock exchanges are able to regulate and enforce the legislation introduced by the EU and national governments. Poland also has the largest stock exchange in the region The Warsaw Stock Exchange (WSE) with a market capitalisation of Euro 33,633m and 209 companies listed compared to the Budapest which is the next largest exchange with capitalisation of Euro 16,237m and 63 companies listed in May 2000. The Warsaw Stock Exchange is expected to play an important role in the design of the listing requirements and in the regulatory capacity. The trend of increasing cross border listings will mean that more foreign East European companies will be listed on the WSE and therefore Polish influence will radiate to the other transitional economies.

Fluent knowledge of the language and deep understanding of the Polish culture improved the validity and the reliability of the study. Source documents were used without the need for translation so the detail of the legal provision was not lost through inaccurate translations. Although the majority of the interviewees spoke English the ability to hold the interviews in Polish meant that the respondents were more open and able to express their opinions more honestly than would have been possible if the interviews were set in more artificial setting of the English language.

From the methodological point of view two very strong traditions, *a priori* studies and positive accounting theory dominate research in financial accounting. This study will use *a priori* approach to study *de facto* practices in Poland in the context of IAS. *A Priori* studies focus on the determination of accounting theory through inductive investigation and

observation of existing accounting standards. This methodological approach was widely used in the UK accounting research during the 1970s and 1980s at the time when the practitioner perspective was more prevalent giving rise to a framework of accounting and at the same time providing a normative context (Whittington, 1986). The purpose of *de facto* comparison of this study is to ascertain the differences in accounting treatment of fixed assets prior to carrying out further explanatory testing. The *a priori* approach was criticised by Watts and Zimmerman (1986) who argued, in the seminal text 'Positive Accounting Theory', that a general model of accounting is impossible to develop due to the political influence of the managers and the shareholders on the standard setting process. In the model the market mechanism is assumed to be efficient and to act as a benchmark in the evaluation of the regulatory framework. Using highly positivist approach grounded in empirical data they argued that scientific research should answer 'what is ' and not 'what should be' questions in the context of economic theory. Fundamental to the positivist approach is the belief in the existence of independent reality that can only be verified by observation. The observations are real and therefore not subject to interpretation, bias or the researchers cultural background. Furthermore, studies using the positivist approach can always be replicated and extended to the whole population so that the theory derived from the positivist methodology is irrefutable and therefore conceptually sound. The advantage of this approach is that it avoids the value-laden judgements prevalent in the normative studies, arguably making the research more objective and reliable. The positivist approach has been the predominant research methodology in accounting and has had a powerful impact on the research literature. Relevant to this study has been the market based research and in particular the theoretical model developed by Ohlson (1995) showing that book values and earnings determine equity

valuation. The model is logically derived from a theoretical framework and is underpinned by a series of assumptions such as the clean surplus relation, risk free discount rate and the role of dividend stream in the valuation of equity. The assumptions are logically correct but provide a rather artificial view of how investors view equities. A related shortcoming of the model is that it does not take into account the relationship between non-financial information and the firms value. It leads to some researchers to conclude that: 'we may be approaching the limit of what can be learned about fundamental analysis from large sample studies and traditional techniques' Bernard (1994:2). Nevertheless, the positivist approach has powerful explanatory power and a high level of external validity. That is the theory derived from the positivist approach will hold true in all circumstances and will not be affected by the researchers bias or personal judgement. For this reason the study will adopt a positivist approach as one of its methodologies by considering the key ratios of price to book to complement the documentary study and the interviews that were carried out with the Polish accountants. Although the calculation of ratios may point to the lower value relevance of Polish financial statements this reductionalist approach does not provide an explanation for the discrepancies in ratios and further insight into the causes for the lack of relevance is provided by using the grounded theory approach.

The critical theory takes a relativist position and recognises that it is a complex set of interrelated factors including social, political and economic contexts that shape financial accounting practices. The positivist approach cannot capture all these variables in its model and so only a very simplistic essence of the economic behaviour is considered. This is especially true when studying accounting treatment in the international context where cultural

factors are fundamental to the understanding of financial reporting methods. The main hypothesis of this study is that the adoption of International Accounting Standards in Poland will not lead to greater harmonisation of accounting practices in the short term. The attitudes and behaviour of Polish accounting profession is rooted in the communist, centrally planned system whilst the IASs are derived from the Anglo-Saxon, market driven system. The two systems view the role of accounting from a fundamentally different perspective and it is only through training and wide exposure to western influence that the Polish profession will be able to comply with the spirit of IAS provisions.

To investigate the perception of Polish accountants as to the role of accounting information and to contextualise Polish accounting practices in the international setting semi-structured interviews were carried out with financial accountants responsible for the preparation of annual financial statements. The interviews served as a powerful explanatory aid to the understanding of the observed differences. Kvale defines the qualitative research interview as: ‘an interview, whose purpose is to gather descriptions of the life world of the interviewee with respect to the meaning of the described phenomena, neither in the interview phase nor in the later analysis is the purpose primarily to obtain quantifiable responses’ (1983:174). Interviews were particularly useful in this study because they allowed the interviewer to explore the reasons for the adoption of various accounting policies and to examine the broader issues concerned with the role of accounting in the Polish context on different levels than would be possible using documentary evidence alone.

In common with other qualitative methodologies the use of qualitative interviews means that there is no scope for replication of results and so it is more difficult to measure the reliability of the results. Furthermore, the author introduces her own bias to the interviews having been trained in the UK, in the Anglo-Saxon regime and so could be thought to introduce a negative bias in relation to current Polish practices. This however, may not be a disadvantage as pointed out by King: 'Qualitative research, in seeking to describe and understand how people make sense of the world, does not require researchers to strive for objectivity and to distance themselves from research participants. Indeed to do so would make good qualitative research impossible' (1999:31)

4.1 Statutory and regulatory differences in accounting requirements

To date the studies of Polish accounting practices and their compliance with EU regulations and IASs have almost exclusively used secondary sources to highlight the major differences in the accounting requirements (Kamela Sowinska, 1995; Jermankowicz and Rinke, 1996 etc.). This study has adopted a similar approach in the first instance in order to establish *de jure* differences but the study extends previous works with detailed interviews and the consideration of value relevance of Polish accounting using ratio analysis. The use of original documents overcame the problems of inaccurate translation of detailed regulations that was a major limitation of some of the previous studies. Original sources were used that referred to:

EU Accounting Directives

International Accounting Standards

Polish Accounting Acts 1994 and 2000 and the UK Companies Acts 1985 and 1989

Financial Reporting Standards and Statements of Standard Accounting Practice

Current practices by Polish companies, listed on the WSE, were compared with the regulatory requirements of IAS compliant listed companies by reviewing the relevant published financial statements. In total a sample of thirteen listed companies in eight different industry sectors was chosen to determine the level of fixed asset disclosure in terms of both statutory and voluntary disclosure. As there are extremely few Polish companies that are fully compliant with IAS, comparison was made with two companies: Agora SA and Polski Koncert Naftowy Orlen Petroleum SA. Agora states in its 2000 financial statements (page 46) that it is fully compliant with IAS whilst Orlen complies with all IAS provisions except for IAS 29 (*Financial Reporting in Hyperinflationary Economies*).

A study by Feige (1997) has similarly compared accounting practices with the German regulatory framework but he concentrated on an extremely small sample and subsequently his methodology has been criticised by Nobes and Mueller (1997) because his sample was deemed to be unrepresentative.

Much wider in scope comparability studies have been carried out by Street *et al.* (1997) and more recently by the Institute of Chartered Accountants in England and Wales (2000). Both of those studies examined compliance with IASs for all areas of financial reporting for a very large sample of countries (in excess of 40). The comparability studies reported their results in a summary form and did not address issues of choice of policies from acceptable alternatives.

Craner *et.al* (2000) compared the criteria for the determination of a group in Poland, the Czech Republic and UK. The differences between the national and supra-national rules were reflected in terms of non-equivalencies although the study at the time of writing did not consider *de facto* practices. Using this approach Craner identified 15 non-equivalencies between the 7th Directive, the IAS and the national rules. The study concludes that:

‘the existence of non-equivalencies cross nationally and supernationally that are non-trivial and more frequent than previous research suggests. In particular, the differences exhibited by the economies in transition provide evidence of the prolonged but different nature of the accounting reforms’ (Craner, 2000:393)

The conclusion from Craner study points to the fact that differences exist between Polish and IAS requirements but is limited in that the study does not attempt to either seek an explanation of the differences or to recognise the different magnitudes of the non-equivalencies. This means that relatively minor deviations from IAS are assigned the same weighting as those that are much more fundamental differences.

4.2 Interpretation of accounting differences using ratio analysis

Further investigation using ratio analysis was undertaken to establish the extent to which book values of fixed assets, based on the financial statements, correspond to the economic values derived from the market. High values of market to book values would indicate that there is a wide discrepancy between accounting measures and the market values and that some of the values are not being reflected in the financial statements. Lev and Sarovin (1999) have shown

that for a sample of US companies the market to book ratio has increased from 0.81 in 1973 to 1.69 in 1992 which means that increasingly the financial statements fail to reflect the full value of the business. However, Ali and Hwang (2000) in their study of 16 countries have found that value relevance is lower for countries with bank orientated as opposed to market orientated financial systems. This study purports that in the UK the general accepted practice is to include at least some assets at valuation resulting in a better correlation with the market capitalisation. Poland's compulsory use of historic measurements leads to a weak relationship between book values and market capitalisation making the financial information less value relevant for the users.

In the context of intangible fixed asset capitalisation and depreciation Zarowin (1999) reports significant differences across firms, lending support to the view that cross-sectional estimates may be affected by a considerable bias. To avoid this bias the study uses the financial statements of companies in one sector only in order to eliminate the differences related to industry specific characteristics. The construction sector was chosen because the companies within this sector typically have a large fixed asset base and have not been subject to the levels of stock market volatility experienced by some of the other sectors eg. technology stocks. Previous studies (Rees, 1995) have shown that company performance is more erratic in industries that are dependent on the level of discretionary income and for this reason the service sector and other sectors for durable goods were excluded. However, it is recognised that the construction sector is particularly sensitive to the general economic cycles of the economy as a whole and care was taken to ensure that the sector in each country performed similarly. In Poland, the sector was stimulated by greater domestic demand for industrial and

commercial property in the domestic market and the sector also benefited from large scale public regeneration contracts such as road building. In the UK a combination of falling interest rates coupled with strong demand in the housing market meant that the construction sector has made significant recovery from the recession of the early 1990s.

In total a sample of 15 UK companies listed on the London Stock Exchange were compared with 14 Polish companies listed on the WSE. The sample of Polish companies represents 70 per cent of the total number of companies listed for the sector. One Polish company, Esbepepe SA, had a negative book value and was therefore excluded from the sample. Data for the book values was obtained from the annual financial statements for 1999 and 2000. Earlier years were not included because prior to 1998 the UK's treatment of intangibles was inconsistent with that of IAS. The inclusion of data for years prior to the introduction of FRS 10 *Goodwill and intangible assets* (December 1997) would have meant that the UK values for intangibles would have been distorted by the practice of writing goodwill off to the reserves. Since the introduction of FRS10 the treatment of goodwill is comparable to that required by IAS 22 with the difference that it is not possible under IAS 22 to assume an infinite life. However, a review of the accounting policies of the sample UK companies revealed that all of the companies chose to depreciate the goodwill and so the UK treatment was used as a proxy for IAS.

The market capitalisation was calculated using the year-end share prices. For the UK sample both ordinary and preference shares were included in the market value. Convertible shares

were valued at the rate at which they can be converted. Non-convertible preference shares were valued at their book value.

4.3 Interviews

The secondary research involving the review of financial statements was supported by primary research. This took the form of semi-structured interviews with a sample of finance directors or chief accountants of Polish companies including companies listed on the Warsaw Stock Exchange.

To date interview techniques in the context of international comparative accounting have not been widely used. Walinska and Urbanek (1999) used survey techniques to gain the views of accountants on the value and quality of financial statements. They surveyed 221 accountants in total, but did not carry out in depth interviews. In the investigation of revaluation practices in Australia, Easton, Edey and Harris (1993) carried out a telephone survey to find out the reasons for the decision to revalue fixed assets but again they did not carry out in-depth interviews.

In total seven accountants were interviewed from companies in different industry sectors although banking and insurance were excluded. All the respondents held the positions of Chief Accountant or above and were responsible for the preparation of financial statements in their organisations. Two of the interviewees were finance directors of listed companies and were responsible for the 'signing off' of the accounts.

The interviews were carried out over a three-day period in May 2001 during an IAS training course held for the Chief Accountants in Poland. The venue allowed the researcher access to a very elite group of respondents that would probably not be possible to gain by contacting them directly through their respective companies. The respondents were also in a relaxed, social setting, away from the work place. This meant that the interviews were carried out without interruptions and the interviewees were not so concerned with confidentiality which is a major problem when dealing with financial disclosures.

Companies represented in the sample of the accountants interviewed

Company	Number of employees	Company size T/O in 000zloty	industry	Strategic investor	Listed/non-listed on WSE
1	70	37,000	construction	USA	Non-listed
2	54	32,000	distribution	German	Non-listed
3	1000	1,100,000	manufacturing	Swiss	Listed
4	780	650,000	food industry	Belgian	Non-listed
5	170	230,000	pharmaceutical	French	Non-listed
6	1,100	1,290,000	construction	Spanish	Listed
7	400	435,000	publishing	German	Non-listed

The interview sessions lasted approximately one hour although some respondents were questioned subsequently where further clarification was necessary. All interviews were

carried out in Polish to overcome the language barrier and provide a more relaxed atmosphere in which to conduct the interview. Respondents were given considerable latitude to expand on the initial questions posed and in many cases they were happy to disclose practices that were widespread but did not conform with the accepted practice. Having just attended an IAS training course, the respondents were able to comment not only on the existing reporting practices but also on the implications of the introduction of IAS into the Polish accounting framework. It is recognised that the sample selected in this way introduced a bias in favour of the better informed and forward-looking accountants however, it was felt that the advantage of having access to this group of accountants who were aware of international developments compensated for the sampling bias.

The purpose of the interviews was to gain qualitative information, to confirm and clarify the findings from the review of the financial statements and to attempt to explain any differences. A major limitation of this study is that financial statements in their own right will not provide enough information about the accounting policies to make a useful comparison. The interviews served to explain the *de jure* differences identified through documentary research by providing detailed information about the accounting orientation of the preparers. As all accounting statements are based to a greater or lesser degree on subjective estimates and a choice of permitted treatments the cultural background of the preparers was highly relevant. This is particularly in the case of a transitional economy where many of the key personnel responsible for the preparation of financial statements have been trained under the centrally planned system and have not been exposed to any western style practices prior to 1990. Insight from the interviews support the overall premise of the study that mere introduction of

IASs will not automatically lead to greater convergence of accounting practices unless extensive training of preparers is undertaken to overcome the major cultural differences that exist between the Polish and Anglo-Saxon accountants.

4.4 Limitations of the study

A major limitation of the study lies in the use of a single country as a case study using the particular circumstances of Poland to illustrate the harmonisation process. It is possible that the study would produce different results in other transition economies. The inability to generalise the findings is a common criticism of this type of research strategy. Ryan, Scapens and Theobald (2002) argue that the purpose of case study research is to develop 'theoretical generalisations' and not 'statistical generalisations'. They go on to argue that: '*the objective of a research programme based on case studies in a particular area is to generate theories capable of explaining all the observations that have been made.*' (2002:149)

A drawback to the study is that the financial statements will be at least one year out of date whilst the rate of change in the regulatory framework is increasing. It is anticipated that in the future the study will be extended to take account of the new Accountancy Act 2000 applicable to accounting periods ending December 2002.

The scope of this work could be extended to include interviews with the audit partners from the big five accountancy firms who have a better perspective of current practice coupled and a good overview of international developments. The top five accountancy firms exert

considerable influence over the standard setting processes at national and international level and in their capacity as auditors at the company level. The review of the financial statements shows that all sample companies have been audited by a one of the top five audit firms.

From the interviews carried out it is clear that financial statements are not routinely used for making investment decisions. This is not surprising given that previous studies have shown that the communist system has left the Polish population with a profound distrust of official information and authority (Zaleska, 1999). Interviews with the major investors and financial analysts would provide useful information as to the role of financial statements in investment decision making. Harmonisation of accounting practices will only be achieved if the users are prepared to trust and rely on the data supplied by the companies. The additional dimension would triangulate the evidence further and increase the validity of the research.

The sample of interviewees was chosen judgementally from those accountants attending an international accounting training course. The sample was biased towards the respondents who either already had international input in the form of a major western investor or were forward looking and interested in the cutting edge of financial developments. However, the benefits of using this group of respondents were that they provided better insight into the direction of financial developments in Poland in the light of international harmonisation. The population of financial accountants would also include those that were less exposed to international changes and so it is likely that they would have a more legalistic approach to financial reporting and so the differences in attitudes would be exaggerated further.

A limitation of the study is that the most common accounting treatment of goodwill by UK companies prior to 1998 was to write off the goodwill directly to reserves, a practice that is not permitted under IAS. Although this practice is now prohibited, FRS10 does not require the reinstatement of previously written off goodwill so the cumulative effect is to understate both the reserves and the fixed asset values of UK companies. Review of the sample companies indicates that the amounts relating to goodwill written off can be considerable. For example Heywood William Group PLC reports in the accounts for 2000 GBP10.8m of goodwill previously written off and not reinstated on book value of GBP 144m suggesting an understatement of assets that would have a significant effect on the price/book ratios calculated. In contrast IAS 38 requires capitalisation and write off over the useful economic life with a presumption that life does not exceed twenty years.

UK firms are generally considerably larger and more diversified than the Polish companies leading to some loss comparability between the countries and a higher level of auto-correlation for the UK sample. The average book value for the Polish companies sampled was GBP 19.3m as compared to GBP 331m for the UK companies. The magnitude is very large and makes direct comparison between the two countries less reliable.

At the balance sheet dates in question ie. 1999 and 2000 the majority of the UK companies sampled adopted only the transitional requirements of FRS15 *'Tangible Fixed Assets'* (issued February 1999). The standard became mandatory only for accounting periods ending on or after 23 March 2000. The transitional arrangements permit companies to continue to carry the assets at previously revalued amounts without the requirement for a consistent revaluation

policy. Review of UK accounting policies for tangible fixed assets of the sample construction companies revealed that in majority of cases the revaluations were out of date. Many companies revalued their assets at the height of the property market and have not revalued their fixed assets since. For example Cape PLC in their 2000 accounts state that GBP 12.7m out of total land and buildings of GBP 20.9m are stated at 1988 and 1990 valuations.

The relatively high rates of inflation in Poland will have the effect of overstating the market valuations in relation to the historic costs of fixed assets in the balance sheet thus further exaggerating the discrepancy between the accounting based measures and those derived from the market.

The majority of the Polish data was obtained from the Warsaw Stock Exchange. However, the precise legal status of some of the Polish financial statements is uncertain due to the fact that they were obtained from the company web pages and may not be the same version as those filed with the Court and the Stock Exchange

The ratio analysis adopted in this study assumes that the differences in the ratio of book to market value between Polish and UK companies can be solely attributed to accounting differences. However, the relationship between the book value and the market value may be more complex arising from other factors such as greater capital investment for the UK companies as compared to the Polish companies and different stages in the respective economic cycles. The share price reflects future expectation of performance and growth

whilst the financial statements reflect both historic cost or current market values and not the future prospects of the company.

5. THE ACCOUNTING SYSTEM IN POLAND

5.1 The influence of the EU on the Polish accounting system

Over the last ten years Poland has made great strides in its efforts to move away from the communist form of accounting to western style accounting as prescribed by the International Accounting Standards. The change in the system of accounting was primarily achieved through the changes in the statutory requirements eg. Commercial Code and Accountancy Acts 1991 and 1994, and Stock Exchange regulation, Law on the Public Trading of Securities. The 1994 Accountancy Act (*Ustawa o Rachunkowosci*) was the first major attempt to adapt Polish accounting to western standards and was the cornerstone of the transformation of Polish corporate reporting. The changes brought about by this Act were based on the European 4th Directive and the IASs in existence at the time. The Act was also significant because for the first time Polish accounting regulations were separated from tax law. Further harmonisation with EU requirements will be achieved once the new Accounting Act of 2000 comes into force in January 2002. The Act attempts to meet some of the directives and regulations of the White Paper 1995 (European Commission, 1995) which sets out the measures that countries aspiring to full EU membership will have to incorporate into their legislation (Craner, 2000). The Act will also bring the Polish accounting system much more in

line with the IAS framework. For Poland membership of the EU is seen as vital for economic reasons. CEE countries are expected to receive directly from the EU in the form of structural grants and farm subsidies. Indirectly, it has been shown by Baldwin, Francois and Portes (1997) that 'the bulk of the gain from EU membership for transition economies will derive from increased investment, coming from both reduced domestic risk and increased FDI flows'. Poland will therefore, adopt all EU directives unquestionably and as quickly and fully as possible irrespective of the appropriateness or otherwise of the IAS in the national context. Poland is in a particularly difficult position in that having met the requirements of the 4th, 7th and 8th Directive through its Accountancy Act 2000 it will now have to revise the new Act in order to comply with IAS due to be implemented in 2005.

5.2 The impact of market forces on accounting reforms in Poland

Apart from the EU requirements the revision of the Act is necessary in order to meet the growing needs of the users of financial information in a fast changing Polish market economy. By 1998 Poland had become one of the most successful transition economies in terms of growth in GDP (EBRD, 2000). Growth in private enterprise has in part been achieved through the successful and ongoing privatisation programme of state owned enterprises. Large state entities have been transformed largely through capital privatisations involving strategic investors who undertake to meet social needs of the workforce as well as meeting the profit maximisation objectives. Smaller companies, that have little political significance for the government, have been privatised through initial public offering where the aim is to transfer

Within this new system the reporting requirements of the 1994 Accounting Act are no longer able to deal with new and complex accounting issues or to provide high quality financial information sought by the external stakeholders. The new Act as well as introducing better quality and more robust requirements based on the International Standards will clarify the position in cases where the law is silent on a particular accounting issue. In those cases, Article 10 of the Accountancy Act 2000 will require the adoption of national standards as set by the Accounting Standards Committee (*Komitet Standardow Rachunkowosci*) and if there is still no equivalent then those prescribed by the IASs. Theoretically, this change effectively resolves the current unsatisfactory problem where cases come to the courts for judgement because there is no law governing a particular practice. The role of the courts is asymmetric, passing judgements only in the case of disputes. The difficulty with the court based approach to resolving disputes is that it occurs on a rather ad-hoc basis, rulings are given on the basis of legal challenges, rather than attempt to reflect any coherent system of accounting. Furthermore, the accountants interviewed frequently referred to the judges' lack of technical accounting expertise resulting in rulings based on their own interpretation. Not surprisingly many inappropriate decisions, involving complex accounting issues are made, leading to confusion and uncertainty among both the preparers and users of financial statements. However, to date, *Komitet Standardow Rachunkowosci* has not been formed so that 'without the regulation many of the requirements of the Act will remain only a theory' (Lachowski, 2001).

5.3 National influences on the development of supra-national accounting frameworks

In spite of the great efforts made by the EU to achieve harmonisation of financial reporting in Europe, financial statements produced in different countries including Poland are not comparable but reflect different legal, socio-economic and cultural differences.

A good example of national differences can be observed when considering the requirements of the EU 4th Directive. The primary aim of the EC Council was to introduce a common set of basic accounting principles to all EU countries. The Directive clearly encapsulates the compromises that had to be made before the Directive could be ratified by the member states. It was first proposed in 1968 but was redrafted extensively to reflect the different philosophies of accounting of the new entrants into the EC such as Great Britain, The Netherlands and Ireland. The influence of the continental method of accounting represented by France, Germany and Italy is evident in the emphasis on the prudence and realisation concepts. For example, the 4th Directive considerably restricts the use of alternative valuation methods for assets and prohibits the inclusion of unrealised profit in the current asset valuation. The prescriptive approach which characterises continental accounting is also evident in the requirement to present financial statements in a highly standardised manner, a requirement previously unknown in the UK but common practice in say, France and Germany. In those countries uniformity is achieved through the adoption of accounting plans which specify the measurement, presentation and content of financial statements. On the other hand, Anglo-Saxon influence is apparent in the 4th Directive, which includes the overriding requirement for Financial Statements to show true and fair view of the state of the company's affairs. In cases

where there is a conflict between legal requirements and the need to show true and fair view the latter should be adopted. The true and fair view concept was first introduced in the UK in the 1947 Companies Act but was unknown in the continental model (Knorr, 1999). Compliance with this concept in countries such as France and Germany is achieved by ensuring that financial statements meet legal requirements and therefore it is argued that they must also be true and fair.

In Poland Article 4 of the Accounting Act 1994 requires the financial statements to show true and fair view but does not have the true and fair over-ride clause. The effect of this requirement mirrors the German attitude where true and fair over-ride was not adopted in the commercial code (Knorr, 1999) and results in the domination of legal form over the reporting of the substance of transaction leading to significantly different accounting practices for example in the definition of fixed assets and the treatment of leasing transactions. The Accountancy Act 1994 defines fixed assets as those assets that are owned by the enterprise, are complete and ready for use. They include buildings, machines, fittings, all forms of transport and others. In contrast tangible fixed assets are defined by the IAS as those assets with a physical form which are held by an enterprise on an ongoing basis and are expected to be used for at least one period. They will be classified as assets only if it is a probable that they will bring future economic benefits and can be measured reliably. The two definitions clearly demonstrate the different accounting systems. The Polish definition focuses on the legal, property rights and ownership whilst the International Standard attempts to represent the economic reality of the enterprise consistent with the definition in the '*Framework for the Preparation and Presentation of Financial Statements*' (1999). As stated the Polish Act does

not define the term 'asset' and so the difference in the definition will have a marked effect on the balance sheet. Lease payments are written off to the P&L account under Polish legislation because the legal title is held by the lessor but will be capitalised within the international accounting framework.

The application of the true and fair over-ride clearly highlights the deep misunderstanding of the philosophy underpinning the Anglo-Saxon accounting systems and results in the persistence of differences in accounting practices which are unlikely to be overcome simply through the introduction of IAS. The differences are highlighted by the financial statements of PKN Orlen SA, a major Polish petroleum company, that supplies a reconciliation of results between Polish accounting and IAS not normally found in Polish financial statements. PKN Orlen SA prepares detailed reconciliation of both assets and profits to IAS. The consolidation shows that on the whole Polish accounting regulations are more conservative leading to both lower profits and asset values than would be achieved if IAS was adopted.

The reconciliation shows that the difference in consolidated profit arising from the application of different regulations is material and leads to significant lack of comparability between IAS and Polish accounts.

The following reconciliation was provided in note 34 of the financial statements for 2000:

Reconciliation of profit from Polish Accounting to IAS for the year ended

31st December 2000

	Millions Zloty
Net consolidated profit per Polish regulations	805
Favourable exchange differences	79
Capitalisation of finance costs	44
Amortisation of firm CNP	(11)
Deferred tax adjustment in respect of the above differences	(27)
Other differences	12
Consolidated profit per IAS	902

The debate between rule based and principle based models of accounting continues to pose a serious barrier to global harmonisation not only between the European countries but also for the US. It is unlikely that true harmonisation can be achieved without the acceptance from the US. The US system of accounting is considerably more prescriptive and it is unlikely that the SEC would be prepared to accept financial statements prepared under IAS as a substitute for US GAAP.

Accountancy bodies and government agencies should plan for the introduction of IASs to ensure that the underlying, fundamental objectives are embraced through changes in the

national laws and training of accountants and enforcers (Lachowski, 2001). This is particularly important for a country such as Poland where the operation of the market economy is a relatively new phenomenon. Intangible and subtle changes in the orientation of financial statements and the use of judgement may be difficult to instil due to the preparers different training and experience rooted in socialist accounting.

Adoption of the 4th and the 7th Directives coupled with a greater globalisation of the capital markets has resulted in some convergence of accounting systems in Europe but the integration of the European capital markets remains very low. For example, out of approximately 7000 European companies listed on a regulated market only 500 are listed on a market other than their home market whilst only 34 per cent of individual investors hold foreign shares (Danjou 2001). The low level of integration is partly the result of different economic and fiscal policies but also arises from the lack of understanding of the financial information published by foreign companies. In terms of accounting compliance currently only 19 per cent of EU based companies comply with IAS (PWC 2000) and so comparability of financial data for companies located in different countries is not possible. According to the 'Federation of European Experts Comptables (FEE) 'a diversity in accounting principles is a major obstacle to the achievement of a unified, deep and liquid financial market in Europe' (Danjou 2001).

The pressure for change originates not only from institutions such as the EU and the various Stock Exchanges but also from the business community at large. In a recent study conducted by Pricewaterhouse Coopers (2000) 79 per cent of 700 CFOs in 14 member countries surveyed expressed support for the recommendation to make IAS mandatory for listed companies in the EU countries. The reasons given by the CFOs for the support of the IAS

were based not so much on accounting issues but rather on strategic, business considerations. Greater ability to raise capital on international markets, lower costs of reporting for group entities and easier acquisitions and mergers were all listed as advantages of adopting IAS.

6. CONCEPTUAL DIFFERENCES BETWEEN POLISH AND IAS SYSTEMS OF ACCOUNTING

6.1 Introduction

Differences in accounting practices between Poland and IAS are symptomatic of much more fundamental differences in the application of underlying concepts. Accounting is not a precise science and there may be more than one way in which financial performance can be measured and disclosed in financial statements dependent on a variety of factors such as the nature of the company, the economic background and the cultural orientation of the country.

The conceptual framework provides a basis on which robust accounting standards can be developed leading to comparable treatment of transactions. The IASB, in its foreword to the *Framework for the Preparation and Presentation of Financial Statements (1998)* states the benefits in terms of the usefulness of the framework to various user groups:

'The framework assists the IASB:

in the development of future IASs and in its review of existing standards

in promoting the harmonisation of regulations, accounting standards and procedures re presentation of financial statements by providing a basis for reducing the number of alternative accounting treatments permitted by IASs.

At an international level acceptance of IASs is more difficult to achieve due to political pressures on various nation states. The existence of a conceptual framework will enable the IASC to overcome some of the problems of legitimacy and to provide a base for authority (Hopwood, 1999) in meeting one of its main objectives:

‘The IASC is committed to narrowing (international) differences by seeking to harmonise regulation, accounting standards and procedures relating to the preparation of financial statements’ (Preface to IASC Framework for the Preparation and Presentation of Financial Statements 1998).

In order to understand Poland’s approach to financial reporting it is necessary to identify two primary theoretical models namely the balance sheet and transaction based models and to ascertain Poland’s current position in relation to the above frameworks.

6.2 The balance sheet approach

This approach gives primacy to the balance sheet and reduces the Profit and Loss account to being a residual statement. In effect, the revenue performance is measured in terms of the change in the wealth of the enterprise between the two balance sheet dates whilst the difference is allocated to profit and loss if it arises from trading or to the Statement of

Recognised Gains and Losses for all other changes in wealth. As pointed out by Ernst and Young (1996) in their highly critical response to the UK's Statement of Principles this approach can only be justified if the Balance Sheets are expressed in terms of current values. The use of current cost accounting has proved to be extremely difficult to apply in practice due to the subjectivity surrounding the valuation of assets arising from the inability of standard setting bodies to reach a consensus as to whether current replacement cost or market values would be most appropriate. Nevertheless, in terms of its usefulness for making economic decisions by investors this approach will be preferred because the valuations will be more up to date providing the investor with relevant information about shareholder values. As a result we would expect countries where corporations are predominantly financed by equity to tend towards the balance sheet system. Shareholders are primarily interested in the long term value of their holding (Chang and Most ,1979) and to a lesser extent with the profitability of the company *per se*. In the UK, value based accounting has been invoked through the wide spread use of re-valuations of fixed assets and non-depreciation of goodwill in cases where value has been maintained. A notable exception to this approach is the US where revaluations of fixed assets are generally not permitted.

The full adoption of the balance sheet approach would have far reaching consequences for accounting practices because it would be the change in the assets that would drive recognition and not the transaction. This means, for example, that leased assets should be capitalised irrespective of whether they are operating or finance leases. Also deferred costs and revenues would be excluded from financial statements unless it could be shown that they correspond to assets and liabilities.

A common criticism of the balance sheet approach is that the income statement will be subject to a far greater degree of volatility than is under the current regime. Andrew Lennard, Technical Director from the ASB (1999) rejects this as an argument for abandoning this approach by saying: ‘Engaging in business involves incurring risks, and risk taking entails volatility of outcomes. If that volatility really represents what has happened in the period, then it is quite right to reflect it as such.’

6.3 Transaction based approach

The traditional accounting system used by most countries is based upon the transaction model (Davies and Davies, 1997). That is, recognition and measurement are triggered by transactions which are allocated to the financial periods using the accruals concept and augmented by the prudence concept. Patterson (1999) argues that the role of matching is not just to smooth the results but is a legitimate accounting process. Any costs that are not allocated are deferred to the balance sheet. In effect this approach gives primacy to the profit and loss account and the balance sheet is a residual statement for the recording of deferred costs and revenues. Because financial statements are transaction driven the dominant method of valuation is historical cost basis and not current cost basis.

The main advantage of this approach is that it is an extremely reliable method of accounting based on actual costs and events (Ijiri, 1999). Subjectivity in assigning values to assets is largely eliminated through the use of historic cost basis. The transaction based model is

conservative in its outlook and has the greatest appeal to users who place emphasis on reliability and prudence rather than on relevance. Not surprisingly, in countries where the providers of capital are predominantly banks and other lenders, such as in Continental Europe (Nobes and Parker, 2000), the accounting systems are based on the transaction model). The profit and loss account is the primary statement of performance and accurately shows the profit available to meet the loan interest obligations. The balance sheet is less relevant except to show the assets available for security and as an indication of solvency. Considerable influence of tax law on the accounting orientation further reinforces the transaction system in countries such as Germany and Poland by its reluctance to recognise unrealised profits arising on revaluation.

This system also appeals to the notion that the primary role of financial statements is that of stewardship. The management is in effect the custodian of assets and is required to report on how they were safeguarded during the year. For this purpose historic cost basis will also be the most appropriate valuation basis reporting on the past performance of the management. According to Ijiri (1999) current cost information should be provided as supplementary statement so as to offer a benchmark for comparison between historic cost and fluctuating market values.

6.4 Conceptual underpinnings of the Polish accounting system

In practice financial reporting in Poland and in the UK exhibit features of both of the models although the orientation in the UK has been shifting towards the balance sheet concept whilst in Poland the transaction based approach dominates.

The choice between the two approaches is not clear cut and according to David Solomon in many areas of accounting: ‘There is no prospect of proving that one of these views is right and the other wrong, (but) it is possible to find reasons for preferring one view to the other’ David Solomon (1989).

Over the last ten years the focus of international financial reporting also has gradually shifted from the transaction towards the balance sheet model. This is evident from the publication by the IASC of an exposure draft ‘*Framework for the Preparation and Presentation of Financial Statements*’ in 1989 which sets out the underlying conceptual framework for the preparation of financial statements. The IAS framework draws heavily on the FASB six concept statements in its attempt resolve the Profit and Loss Account (P&L) vs Balance Sheet debate. Although the exposure draft does not have a status of a standard its philosophy underpins many of the standards issued subsequently For example IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IAS 38 *Intangible Assets*. It is therefore critical to the understanding of the principles of financial reporting according to IAS. This study asserts that although Poland is adopting the IAS its accounting practices are not always consistent with the underlying conceptual framework as encapsulated in the IASC exposure draft.

6.4.1 Users of financial statements

The IAS conceptual framework states that the main objective of financial statements is not an end in itself but rather to provide information that is useful for making economic decisions. It is argued that the development of the international standards has been based largely on Anglo-Saxon principles and the standards are designed to meet the needs of Anglo-Saxon users and the top five audit firms. In Poland, where there are relatively few external investors this is a new concept. The Warsaw Stock Exchange is very small in comparison to the major Western European exchanges having a market capitalisation of €33bn as compared to London's capitalisation of €2,800bn (EBRD, 2001). Most of the external capital is raised either through strategic partnerships or via bank lending. Both of these capital providers have access to management information reducing the relative importance of financial reports for decision making. The IAS framework that will be imposed on Poland as condition of joining the EU is therefore not ideal given Poland's legalistic system, lack of experienced accountants and poorly developed capital markets.

Historically, the communist system and the resulting post war isolation from the capitalist influence has had a major impact on the business organisations adversely impacting on the accountant's perceptions of the role of financial reporting. In a centrally planned-economy companies were relegated to the role of operating units where the fulfilment of political function was more important than achieving economic goals (Obloj and Kostera, 1993; Kostera 1995). In the interviews carried out all accountants employed pre 1989 emphasised the changing role of accounting in the transition period. Under the communist system the

accounting system was a method of control for the authorities, a source of statistical information for macro-economic purposes and for central planning purposes. Detailed record of transactions were kept which focussed on the outputs measured in quantities and costs incurred. The accounting information did not play any role in the decision making process because the allocation of resources was determined centrally with the aim of maximising output.

The accuracy of recording of given amounts was paramount and monthly returns were made to the Central Statistical Office (GUS). The work was time consuming but there was little benefit for the company in having the information, as they not in the position to act on the information and the plans were frequently not realised and needed amendment. The institutional falsification of data that always resulted in a favourable portrayal of the institution was met with derision and mistrust by the public and has left the nation with a deep mistrust of any official information. Financial statements are seen as official documents and will only be accepted as a useful source information if the users are able to have a greater trust in the authorities responsible for the production and regulation of the financial system.

The communist mentality in Poland is difficult to eradicate due to the existence of dual economic systems (Wilczynski, 1996). Market driven, competitive economy exists alongside of nationalised industries that have little desire to reform and wish to retain their protected status with a minimum of change. The continuing process of privatisation will in time lead to more fundamental changes in accounting orientation but this has not been achieved to date for many Polish enterprises.

The combination of the above factors means that the concept of ‘usefulness for decision making’ is irrelevant to most preparers and little thought or consideration is given to alternative accounting treatments even if they would result in more meaningful information being reported. Interviews with the Chief Accountants revealed that compliance with legal requirements and simplicity of recording transactions were the primary factors affecting accounting practices above the shareholder considerations. This was explained by one respondent in the context of the accounting treatment of leases:

‘We are not concerned with following a method that may give a more meaningful result. If the tax authorities permit the write off of a lease payment we will always do that because it is the simplest method.’ (Financial Director of a construction company).

Other factors such as effect of a change in accounting policy on key performance ratios received very little consideration and their significance was only acknowledged after prompting by the interviewer.

The IAS conceptual framework goes on to identify the users of financial statements. Some user groups such as investors, creditors and employees have a direct need for the financial information contained in the accounts whilst others use the financial statements indirectly, for example in the capacity of an advisor or a journalist. Financial statements should be prepared in such a way so as to provide useful information to all groups although the exposure draft recognises that informational needs of all groups cannot be satisfied fully by a single

corporate report. The shareholders and creditors are singled out as being the primary users for whom the information is produced. Therefore, the orientation of the accounts should be such that the shareholders receive information that will be relevant to their investment decisions. A common criticism of the current financial reporting practices has been summed up by Les Cullen, former Executive Director of Inchcape PLC (1999:57): 'Many people who have a good grasp of business and economic affairs may not be able to understand the accounts because of a lack of technical accounting knowledge, not because of financial ignorance'

To overcome this problem in the UK companies pay a great deal of attention to how financial information is presented to the shareholders. Listed companies frequently have a separate investor relations departments to organise briefings, corporate events and other functions designed to convey the information in a most attractive way. The financial statements themselves are designed to promote the company and often give extra information far in excess of the statutory requirements.

In Poland, as was previously mentioned, the investor group is far less important and relatively little attention is paid to the needs of this user group. Review of financial statements for a sample of Polish companies revealed that they are not designed to promote the company but rather to meet legal requirements. In the interviews the accountants gave an overall impression of being extremely burdened by a bureaucratic and heavy-handed system imposed by the institutions namely the tax authorities and the Stock Exchange. The respondents recognised that theoretically, different users may read financial statements as all accounts are now published in '*Polski Monitor B*'. However, they were very doubtful that any potential investor would refer to those statements because the filed documents gave little meaningful

information to the reader but aimed to meet the legal requirements. Investors would prefer to use informal hearsay or to gain information directly from the company if the proposed investment was significant. The strategic investors in those companies, who were predominantly EU or US based, received detailed management information on a regular basis. The accountants conceded that a small investor would be unable to gain relevant information from the financial statements because the accounts were focussed on the legal and tax requirements and not on the shareholder.

Any additional information provided is normally no more than a repetition of the information already contained in the primary statements. This view was confirmed by the interviews with the accountants who were asked if they provide any additional information in the financial statements over and above the minimum required. None of the companies disclosed any additional information irrespective of whether the company was listed or not. Walinska and Urbanek (1999) provide further evidence of the lack of user orientation. They surveyed 221 company accountants found that 65 per cent of accountants surveyed believed that expansion of the financial statements is unnecessary because, according to the respondents, very few users require the information contained within the accounts. When asked who, in their view, were the main users of the accounts for their company, all questioned in this study named the tax authorities (Urząd Skarbowy) as the primary recipients of published financial information. In the study by Walinska and Urbanek (1999) 63.7 per cent of the respondents prepared financial statements primarily by using tax legislation and only 30 per cent complied strictly with the requirements of the Accountancy Act 1994. The high level of compliance with fiscal regulations may be explained by the harsh enforcement regime adopted by the tax authorities

in Poland. The relationship with the tax authorities was central to the orientation of financial statements. In all cases the accountants interviewed described the tax authorities in negative terms. The relationship was characterised by mutual suspicion and lack of trust. The accountants felt that they were always perceived as tax cheats and the onus was on them to prove otherwise. This was summarised by one respondent as:

‘We are in a tax repayment position and so a tax officials spend at least two days a month at our premises. They require corroborating evidence for every allowable expense claimed. My time is largely spent dealing with these people.’ (Company Accountant)

When there are disputes with the tax authorities regarding the legality of treatment the accountants were also very dismissive of tax officials understanding of the legislation. They are perceived to be poorly informed but at the same time inflexible once a tax ruling has been passed. This mutual lack of respect means that many disputes between the company and the tax authorities end in the courts. Out of the seven respondents questioned two have had outstanding court cases at the time of the interview. The tension between the tax authorities and the companies is clearly illustrated in the published financial statements of one of the companies reviewed: ‘Tax rules were introduced in Poland relatively recently, resulting in lack of clarity and contradictions. Frequently there are differences in the opinion as to the interpretation of tax legislation both between the government departments and between the tax authorities and companies leading to uncertainty and conflicts. Settlement of tax liabilities is subject to scrutiny by officials who have the power to impose high penalties and sanctions

together with penal interest charges'. Orlen SA concludes: 'The tax risk in Poland is considerably higher than that existing in countries with a better developed tax system.'

(note 29c on page 32 of the PKN Orlen SA financial statements for the year 2000)

The company then proceeds to set out the outstanding legal actions taken by *Isba Skarbowa* (The Treasury) in respect of underpayment of tax. The company has received considerable refunds in respect of 1998 tax liability following appeals but continues to have outstanding cases in the courts. The above extract confirms the findings derived from the interviews that the relationship with the tax authorities is strained and deeply mistrustful. The focus on tax issues frequently overshadows any other economic considerations and prevents the adoption of principle based system of accounting.

From the interviews carried out it would appear that tax avoidance was also widespread. One of the accountants mentioned a scheme that overcomes the strict historic cost valuation rules and allows the company to claim higher depreciation allowances. The scheme requires the company to set up a separate subsidiary that allows assets to be transferred from the holding company at market values rather than cost. Any subsequent depreciation is based on the market value which is normally higher than cost providing a higher level of capital allowances.

The underlying reasons for the poor relationship with authorities were also explored with the respondents. The general perception of the accountants was that the bureaucracy of the communist era has remained largely intact in the government departments. The tax authorities

and the audit profession were criticized for being out of touch with the business community. Although the type of information required now as compared to pre-1989 era was different the level of detail of reporting has not diminished. The registered auditors were also dismissed as being out of touch with the current commercial environment because the majority of them have qualified during the communist era. One of the respondents who has tried to qualify as a state registered auditor in the last two years complained of a 'closed shop' mentality and a profession that is unwilling to respond to the needs of the business. Other respondents mentioned the high level of penalties levied for relatively minor defaults or late submissions. In contrast, the enforcement of the accounting law is extremely lax. The professional bodies are relatively weak and have no effective mechanism of forcing companies to change defective financial statements relying on the courts to enforce the accountancy acts. The system does not have a defined mechanism for the referral to the courts and so the majority of accounting transgressions that do not contravene tax regulations go unchallenged. The interaction of tax legislation and accounting principles is also evident in Article 32.5 Accountancy Act 1994 that permits depreciation method to be based on 'other laws' referring to tax legislation. Given that the majority of preparers use tax legislation as a primary source of authority for the preparation of financial statements this clause means that tax considerations will drive the depreciation policy in Poland and not the economic reality of transactions.

In contrast, the interviewees saw the role of the Western strategic partners very positively. The investors were seen as real agents for change and in all cases the respondents felt that

their orientation and attitudes have changed significantly when there was international influence. As one accountant stated:

‘It is no longer enough for me to know about the Polish accounting requirements, I also need to be able to apply US GAAP and operate a new IT system to comply with the holding company requirements. In addition to dealing with the tax authorities I am required to report results on a monthly basis to the parent and work closely with the group CFO’

The foreign involvement also improved the standing of the accountants in the organisation, putting them at the centre of the decision making process. All the accountants were very well rewarded, earning salaries substantially above the average pay levels. All have travelled internationally in the last year both for business and pleasure and this freedom is still mentioned with pride. In contrast the position of the accountant under the communist regime was very different. Their status was very low with earnings no higher than those of a manual workers and frequently much lower. The role of the accountant was that of a book-keeper providing information that was rarely used in any decision making process. It is the belief of the author that the foreign investor will continue to play a vital role in the transformation of Polish enterprises, demanding better quality of published financial information especially where the investor does not have a controlling interest and so is unable to gain internal, management information.

However, it is questionable whether IAS is the most suitable model of accounting for Poland. In many ways the Anglo-Saxon model does not fit the legalistic and creditor orientated

society such as Poland. A more prescriptive system of accounting would allow for the lack of experience of Polish professionals and recognise the legalistic orientation so better meet the needs of the business.

6.4.2 Desirable characteristics of financial statements

The IAS proceeds to identify the desirable characteristics that the financial statements should possess in order to make the information contained therein useful for decision making. The exposure draft identifies relevance and reliability as being the most important qualities for the users. Relevant information is seen as that which aids decision making by either helping to predict the future value of the company or confirming the current value. The value relevance of financial statements can be measured by, for example, studying the market reaction to the publication of financial results. A number of empirical studies have shown that the value relevance of financial statements has declined over the last twenty years (Rayburn, 1986; Hayn, 1995; Aboody and Lev, 1999). However, Hoegh-krohn (2000) in his comparative study of intangibles in Scandinavia argues that the value relevance of accounting information based on the continental system of accounting is actually increasing due to the change of orientation from the secretive, creditor focus to the more open, Anglo- Saxon model.

This study attempts to measure the value relevance of Polish accounts using Penman's findings. Ratio analysis was used to establish whether the accounting differences in the treatment of fixed assets give rise to financial statements that are not so well related to the market value as they would be if IAS were used. UK companies were used as a proxy for IAS

accounts although it is recognised that the practice of revaluations is more commonly adopted in the UK than it would be for many international IAS companies.

Using the financial statements for 15 Polish and UK listed companies in the construction sector for 2000 and 1999 the following ratios were observed:

Ratio	UK	UK	Poland	Poland
	2000	1999	2000	1999
Share price/Book value per share	1.10	1.22	1.07	1.12
Tangible fixed assets/Book value	0.87	0.81	0.56	0.46
Intangible fixed assets/Total fixed assets	0.007	0.052	0.09	0.02
Total fixed assets/Book value	1.07	0.97	1.12	0.95
Proportion of UK companies showing evidence of revaluations	67%	67%		N/A revaluations not permitted

The ratio of price to book value for UK companies was higher than for Poland for both years under consideration. We would expect the opposite to be the case if we assume that UK published financial statements are more value relevant than Polish accounts. However, the Polish capital market is less efficient than the London Stock Exchange so it is likely that in the absence of freely available market information the book values will closely approximate the market values. Lev and Sarovin (1999) has shown the ratio to be higher for a sample of US companies than has been obtained for either country in this study (average of 1.69). One possible explanation for the discrepancy could be linked to the fact that this study focussed on a sector that was unlikely to have a high proportion of unrecorded assets eg. brands or know

how. If industry cross section was tested we would expect to have a greater discrepancy between the price and book value as sectors with high levels of unrecorded intangibles would also be included.

Reliable information is one which is free from error or bias, is truthfully presented and is verifiable. As all financial information is based to some degree on estimates and subjective judgements there is clearly a trade off between relevance and reliability. The balance between the characteristics is dependent on a variety of factors including cultural, legal and socio-economic backgrounds. In Poland the emphasis is placed on having reliable information which discourages the use of alternative accounting policies or subjective judgements. Numerous examples of this approach may be found in the country's accounting practices. For example revaluations of fixed assets are not permitted unless decreed by the Ministry of Finance and financing costs must be capitalised in certain circumstances whereas the IAS simply allows the capitalisation of interest.

An important factor that re-enforces the avoidance of subjectivity in the accounts of Polish companies is the attitude of Polish accountants who prefer more prescriptive regulation and less choice. These were the findings of a survey of 100 company accountants and auditors by Cebrowska et.al. (1998). The study asked the respondents to evaluate the 1994 Accountancy Act. The study concluded that the majority of the preparers felt that the Act was inadequate in guiding them in the preparation of financial statements. Lack of specific rules and the generality of the principles were cited as the main criticisms of the Act. Interestingly, it was the accountants who have spent the greatest number of years in the profession that most

strongly opposed the introduction of general accounting principles. Cebrowska (1998) asserts that the attitude of this group of accountants is strongly influenced by the mentality prevalent during the communist system thus providing further support to the hypothesis of this study that the communist mentality continues to affect accounting practices in Poland. In order to identify where there is a lack of clarity in the content of Act the respondents were asked to explain the meaning of the following term:

Art. 5.2 'For the purpose of the valuation of assets and liabilities it is assumed that the entity will continue to trade in an unchanged form for the foreseeable future unless the reality or the law indicates that this is not the case.'

The above is one of the fundamental concepts underpinning the preparation of financial statements under IAS 1 as well for UK and US GAAP yet 86 per cent of those questioned in Poland were unclear as to the exact meaning of this requirement. Only 10 per cent of accountants were able to correctly identify the circumstances where the going concern assumption would not apply.

Polish accountants also found the application of prudence problematic with many of them ranking this area as the most difficult to apply. The application of the prudence concept requires a great deal of considered judgement and may leave the responsible accountant exposed to criticism if his judgement is proved to be flawed. In Poland avoidance of personal responsibility has been a cultural feature of the communist society and therefore it is not

surprising that accountants are unwilling to make judgmental decisions not supported by regulations acting as a safety net.

This study illustrates the problems encountered when a different system of accounting is introduced to a country with different accounting traditions exist. Relevant information will only be produced if the preparers are not constrained by stringent rules but rather are able to select the most appropriate treatment based on broad accounting principles. However, in countries such as Poland where there is no tradition of using judgement it will be more difficult to meet the objective of providing relevant information and in fact there is a danger that misleading information can result if inappropriate policies are adopted.

This is a problem not only for the preparers but also for the users of financial statements. Increasing complexity of standards such as IAS 38 '*Intangible Assets*' or IAS39 '*Financial Instruments: Recognition and Measurement*' requires the user to have sophisticated knowledge of accounting in order to be able to interpret fully the information contained within financial statements. Although in this study user groups were not interviewed, based on the studies of preparers it can be inferred that most users will not have the technical expertise to be able to interpret correctly the information presented to them. Furthermore, according to Davies *et al.* (1999) there is a danger that some complex provisions of IAS will not be adopted due to lack of expertise of accountants thus putting into question the whole notion of harmonisation through the adoption IAS. In their study of the Polish banking sector Skawinska and Reczek (2000) identified the following accounting areas where Polish banks that purport to apply IAS make misinterpretations and errors:

Valuation of assets and fair value determination

The meaning of 'control' and the determination of a group

Classification of leasing transactions in line with the concept of substance over form

Application of the impairment tests for asset valuation

As all of the above areas involve areas are not only prescriptive but also require the exercise of judgement it is not surprising that Polish institutions find the application of these concepts problematic.

6.4.3 Definition of assets and liabilities

The most controversial IAS concept deals with the elements of financial statements and through the definitions used prescribes the balance sheet approach as the preferred method of measuring the performance and financial status of an enterprise.

The fundamental definition is that of an asset and most of the remaining definitions are derived either from the definition of an asset or of a liability.

Assets are defined as being 'probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events' IAS (1998). Using this definition an outlay on a fixed asset is nothing more than a deferred cost which over time will bring about economic benefits in the form of additional cashflows. Liabilities are defined as 'probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities' IAS (1989). Arising from the above

definitions revenues and expenses are defined in terms of inflows or outflows of economic benefits. The framework does not define assets in terms of legal ownership but focuses on the economic resources of the business and therefore lends further support for the concept of substance over form. The ASB in its support of the conceptual framework argues that as businesses become more complex the transaction-based model is inadequate in dealing with many of the financial reporting issues such as intangibles and complex contractual arrangements. FRS 5 'Substance of a Transaction' gives guidance in the broadest terms so that the substance of transactions where there is no separate standard can be identified and reported in such a way so as to record the economic reality. The effect is to put back on the balance sheet assets that were previously dealt with 'off-balance sheet' such as factored debt and consignment stock. Although the principle of substance over form fundamentally underlies the International Accounting framework the international standards, unlike the UK standards, are deficient in that they do not contain a specific standard dealing with the substance of transactions. Issues such as recognition and de-recognition of assets are not explicitly addressed by the IAS so there is a far greater scope for creative accounting involving 'off-balance sheet transactions' than is possible in the UK.

The absence of a conceptual framework and the confusion regarding the status of the true and fair concept means that in Polish accounting legal form continues to drive the recognition of assets and liabilities. Lack of fundamental definitions also means that the tax law is highly influential in the shaping of accounting practices in Poland in the following areas:

Progress payments on long term contracts are treated as income on the issue of an invoice irrespective of the percentage of completion of the contract.

Costs associated with the raising of capital are capitalised as intangible assets even though they do not meet the IAS definition of an asset as they will not bring future economic benefits.

Capital allowances (*ulgi inwestycyjne*) given by the tax authorities are treated as costs alongside of depreciation charges derived from the accounting principles.

Recognition of income in the case of an export order is triggered by the issue of a SAD document and is not based on the economic risks and benefits passing between the seller and the customer.

Focussing on the treatment of fixed assets a major discrepancy between Polish accounting and IAS concerns the treatment of finance costs. In Poland, where there is a preference for a prescriptive approach, Art 28.2 states that the capitalised cost of construction must include interest charged on the borrowings relating to the financing of the fixed asset as well as exchange differences and any other finance costs associated with the asset. The IAS preferred method of dealing with such interest is diametrically opposite to the Polish requirement. Under IAS 23 'Borrowing costs' the benchmark treatment is to write off the interest as an expense in the period in which it is incurred regardless of how the borrowings are applied. However, the standard incorporates capitalisation as an 'allowed alternative treatment'. Under

the allowed treatment, the borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset is included in the cost. The IAS also sets out type of borrowing costs that would be included and the period of capitalisation. The standard prohibits the capitalisation of interest on assets where development is not taking place eg. holding of land.

The Polish approach is very prescriptive and forces companies to adopt a far more mechanistic approach than is required by IAS. Interest is capitalised (Art.28.2) even though there may be no future economic benefits arising from the increased fixed asset values thus increasing the risk that project costs will exceed value. As Polish law does not have a definition of an asset then this issue is not adequately addressed by the Act. Given the relatively high rate of growth and inflation in Poland the danger of asset book values exceeding the market values are low. However, if the property market falls, as was the case in the 1990s in the UK, coupled with relatively high inflation levels then it is possible that the assets will be overstated in the balance sheet. The high level of interest rates, typically above 15 per cent in the Polish economy lead to high level of finance charges boosting the asset values thus further exacerbating the problem of lack of comparability with IAS. The policy of capitalisation of finance costs irrespective of asset values is a clear departure from the concept of prudence and is one of the few cases in Polish accounting where the international approach is more cautious in its approach.

The Polish Act is also deficient in that it does not give guidance as to the period of capitalisation. The amount of interest that is capitalised may be different depending on when

completion is deemed to take place. Normally, this will be the date of the physical completion of the asset but in some sectors, such as property investment, this period may be prolonged until the asset is brought into use leading to further problems of comparability between companies. On the other hand, the international standard, by offering alternative treatments, introduces subjectivity and a lack of comparability to financial reporting in Europe. Nevertheless, finance costs are a valid and integral cost of the asset and as such should be reflected in the financial statements but with the proviso that it is probable that they will result in future economic benefits to the company and that they can be measured accurately. A review of PKN Orlen SA reconciliation statement between IAS and Polish accounting regulations revealed that the differing treatment of finance costs was a major reconciling item leading to the understatement of profit by 44 million zloty and understatement of assets by 489 million zloty as compared to the IAS method. Note 34 (b) on page 38 attributes the difference wholly to the difference between IAS 23 and the Polish Accountancy Act. The net assets of the company amount to 7086 million zloty and so comparability between company may be materially affected results

Furthermore, the Accountancy Act does not address the recognition and valuation principles for complex capital instruments. This means that within the transaction driven framework adopted by Poland risks are not fully disclosed and some transactions are treated off balance sheet and never reflected in the financial statements. Income, on the other hand, is only recognised in practice once it is certain that economic benefits will flow and not if the benefits are probable as defined in IAS 18. The Accountancy Act does not specify the point of recognition so accountants are once again largely guided by tax considerations.

Lack of definition of assets and liabilities leads to considerable loss of comparability between IAS and Polish accounting law in the treatment of intangible fixed assets. IAS 38 'Intangible Fixed Assets' defines an intangible asset as: 'an identifiable monetary asset without physical substance held for use in the production or supply of goods and services, for rental to others, or administrative purposes'. Intangible assets will be recognised if they can be separately identified and measured. The definition allows the capitalisation of a variety of homegrown intangibles provided that the above criteria are met. Lack of clear definition in Polish Accounting Act leads to the requirement to capitalise costs such as ground rent and costs associated with raising of additional capital that would fail the definition of an asset under IAS 38. Article 31 and 32 of the 1994 Accountancy Act only allows the capitalisation of acquired intangible assets, and in contrast with IAS 38, capitalisation of internally generated intangible assets is restricted exclusively to the development expenditure. In practice this is a major difference which will significantly hinder inter-company comparison especially in the sectors where the real value of the enterprise is reflected in intangible assets. For companies reporting under IAS framework we would expect a higher level of intangible assets to be shown in the balance sheet as compared to companies reporting under Polish Accounting Law.

6.4.4 Measurement

In the context of this study the measurement concept is a major source of difference between the IASs and the Polish Accountancy Act.

The IAS concept recognises that assets purchased should initially be recorded at historical cost but allows subsequent re-measurement effectively allowing the development of current cost accounting. In terms of the desirable characteristics of financial statements the use of current values will provide the user with information which is more relevant for decision making. Changes in the shareholder wealth will also be recognised immediately without the need to wait for the disposal of the assets. According to Zeff (1999) the use of current values will overcome the following serious deficiencies of the historic cost model:

Lower of cost or market

LIFO vs FIFO

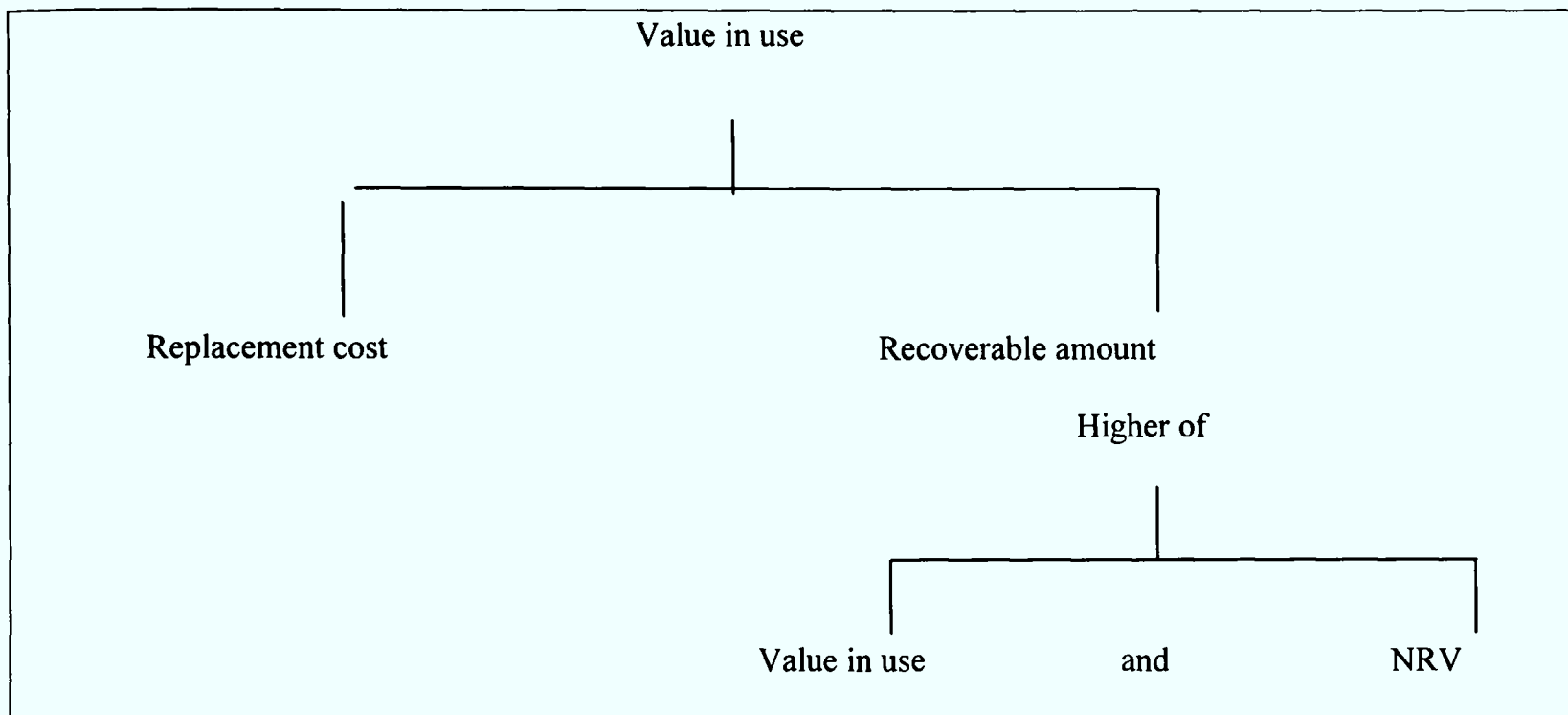
The differential recognition of profit on marketable securities

The special treatment of gains and losses on the premature extinguishment of debt

The anomalous accounting by creditors for loan impairment

The appropriate valuation model uses 'the deprival basis' as the basis for the valuation of assets. The model asserts that if an asset is worth replacing then replacement cost is the relevant value. If however, it is not worth replacing but is worth retaining in the business then the asset should be valued at its value in use or economic value. Finally, if the asset is not worth keeping then the appropriate valuation base is net realisable value.

This model is shown below:



In Poland there is there is a deep-rooted tradition for the use historic cost accounting arising from the transaction based approach and the legal framework. Valuations arising from actual transactions are perceived to be less subjective and more consistent although they are likely to result in more prudent valuations than would be achieved if an alternative valuation method was used.

Consideration of the proportion of tangible fixed assets to book value shows that in the UK tangible fixed assets account for 87 per cent of book value (1999, 80 per cent) but only 56 per cent (1999, 45 per cent) for Polish companies. The result is consistent with the argument that revaluations in the UK have the effect of increasing the overall value of fixed assets and bringing the accounts closer to a market valuation. The review of the UK financial statements shows that 67 per cent of companies have a revaluation reserve lending further support to the argument that market valuations are highly prevalent in the UK but limited to periodic purchasing power adjustments in Poland. The consideration of ratios has also revealed that the

level of investments classified under fixed assets is considerably higher for Polish companies than it is for UK companies (0.11 to 0.49 respectively). This is an unexpected result that would require a separate in-depth investigation at a later date. However, review of Polish literature dealing with group accounting suggests that non-consolidation of subsidiaries in Poland is highly prevalent leading to the classification of investments under fixed assets rather than producing group accounts. Helin (2000) identifies incorrect definition of a group as being a common problem leading to frequent non-consolidation of overseas subsidiaries and incorrect treatment of associate companies.

IAS 22 'Business Combinations' prescribes that where assets are acquired as part of a take-over they should be recorded in the consolidated financial statements at fair value.

Within the Polish accounting framework the term 'fair value' was unknown until the new Accountancy Act was introduced in 2000. The 1994 Act requires the use of market values for consolidation purposes and the notion of recoverable amount did not feature in the accounting system. This is not surprising since fair values are used so that the information in financial statements is most relevant but at the same time representational faithfulness may be sacrificed. In Poland reliability is the predominant and perceived to be the more desirable characteristic. Financial statements are prepared on the basis of information that is clearly verifiable and certain. Within this framework there is no place for estimates and subjective judgements associated with fair value accounting. The introduction of fair value accounting into the Polish accounting system is widely seen as one of the most difficult concepts to implement (Skawinska, 2000; Lachowski, 2001). The 2000 Act introduces the notion of fair

value accounting for the first time but given the predominant influence of tax legislation (Walinska, 1996) it is likely that the meaning of fair values will continue to be synonymous with market values.

Art.31 of the Polish Accounting Act 1994 requires fixed assets to be recorded at cost of purchase or cost of production for self constructed assets. Assets may only be revalued on the instruction of the Ministry of Finance. This is because Profit and Loss account forms the basis for the tax computation and depreciation charges are tax deductible expenses. Therefore, any adjustment to the historic costs will have a negative fiscal impact on the Polish tax revenues although by setting up separate subsidiaries and transferring assets at fair value companies may avoid the historic cost and gain tax advantages from higher capital allowances thus circumventing the legal requirements.

This is a fundamentally different approach to that adopted by IAS. Although some assets in Polish company accounts are stated at valuation the purpose of the valuation is to adjust partially for the price changes as decided by the Ministry of Finance and no attempt is made to present the fixed assets at market values. Since 1995 fixed assets of Polish companies have not been revalued and so the valuations are out of date in terms of purchasing power. According to the finance directors interviewed the authorities are reluctant to issue another directive for the revaluation of fixed assets in order to avoid a negative impact on the country's tax revenues. Revaluations lead to higher asset values and result in higher depreciation charges that in turn lead to lower taxable profits.

Inflation has been a major problem for the Polish economy with levels reaching over 600 per cent in 1989 and then falling to 50 and 8 per cent in 1992 and 1998 respectively (Neneman 1999). High rates of inflation cause historic cost accounts to be informationally less useful because the investors are unable to form decisions on the basis of values that are materially different from current values. In times of inflation current revenues are matched with understated depreciation charges based on historical cost asset values. As a result income is overstated leading to liquidity problems for the company if profits are fully distributed. In spite of high rates of inflation throughout the nineties Poland has not adopted the current cost accounting system as allowed under IAS 29 'Financial Reporting in Hyperinflationary Economies' but has chosen to address this problem in part through selective revaluations of assets. The Ministry of Finance issued a directive requiring all company fixed assets to be revalued on 1st January 1995 using a general price index published by GUS (Central Statistical Office) as the basis for the revaluation. The aim was to adjust the cost of assets to take account of the overall loss of purchasing power of the zloty and not to establish a market value for the assets. The purchasing power approach has been widely criticised because it does not produce values that are meaningful for the users. The restated amounts do not correspond to any readily identifiable values. They are neither cost nor market values because the indices do not take into account the varying rates of inflation for different types of assets. The experience of UK companies that have included the current purchasing power accounts as supplementary information in the 1970s has been largely negative with many including adverse comments concerning the information value of the adjusted figures (Nobes and Parker 2000).

Ernst and Young (1996) lend their support for the historical cost accounting and state:

‘we find the ASB’s proposals on valuation half baked. They appear to be based on a simplistic belief in the greater usefulness of a balance sheet stated at current values. We do not consider that financial reporting should be primarily a valuation exercise- this is the users responsibility – it is more a historical report on what has happened during the year under review.’

(Ernst and Young,1996:10)

In the context of Polish accounting it is unlikely that revaluations will ever become common practice as has been the case in the UK. Under IAS revaluations are only an alternative method and it is likely that Polish law will continue to prohibit such revaluations. The flexibility in the valuation methods favoured by the principle based IAS will continue to hinder comparability in Europe. The argument presented by Ernst and Young lies at the root of the debate and given that the US does not permit the use of market values for fixed assets it is unlikely that the conceptual argument for the full scale adoption of current cost accounting will become a reality.

7. CONCLUDING REMARKS

This study has shown that there is a widespread support for the harmonisation of accounting practices by the business community. Capital markets are becoming more international and corporations are increasingly looking beyond the national borders to raise finance. The investors need relevant information that allows them to compare financial performance for

companies dispersed internationally and are demanding information necessary for making investment decisions that is of a high quality and, more importantly comparable. The introduction of common IAS for all listed companies by the EU member states is a major step towards such harmonisation. It is expected that the adoption of IAS will have the effect of reducing the cost of capital for companies as well as giving greater credibility to the published financial statements, without having to provide extensive reconciliation of financial results.

Whether true harmonisation will be achieved in practice will depend on a number of factors associated with enforcement and political willingness by the member states to conform. Associate countries such as Poland will have additional problems of compliance with IAS arising from their relatively recent entry into the capital markets and dramatic change of economic system leaving little scope for gradual development of legal and accounting frameworks.

The documentary comparison of *de jure* accounting requirements for fixed assets in Poland as compared to the IAS has shown Polish accounting requirements are significantly different from the International Standards. The key differences concern the excessive role played by tax legislation in the shaping of accounting practices, the inability of companies to revalue fixed assets, and the legalistic treatment of leases. The introduction of the Accountancy Act 2000 will go some way towards reducing these differences but the cultural background of the accounting profession will hinder the progress towards full harmonisation. In many circumstances International Accounting Standards are not completely prescriptive but provide broad guiding principles that require high level of skill and judgement in their application.

This study has shown that Polish accountants have a preference for prescriptive rules and give little consideration to the overall truth and fairness of the financial statements. Although the 1994 Accountancy Act divorced the reporting of performance for shareholders from the tax requirements this study shows that Polish accountants continue to apply tax legislation even when this leads to inconsistencies with the accounting law. The preference for the tax orientation may be explained by the different enforcement mechanisms operating in the tax and accounting systems. The tax regime is rigorously enforced with high level of penalties levied for non-compliance. In contrast, deviations from accounting regulations are rarely challenged due to the weak accounting and audit profession. The difference in approach is also a reflection of much deeper misunderstanding. In Poland the purpose for the production of financial statements is simply to discharge legal responsibility and not to meet the needs of the users. As the recent case of the collapsed Enron Corporation has shown, strict adherence to the legal form does not guarantee that the accounts will give a complete and reliable picture of the company's affairs. The national accounting frameworks must be adequate to show the economic substance of transactions and not just their legal form. The introduction of principle based system will give greater latitude for judgmental, company orientated reporting that will require high level of expertise in application and enforcement. The difficulty for Poland lies in the fact that many accountants have been trained under the communist regime and it is only through extensive training programme and exposure to the Anglo-Saxon form of accounting that greater convergence to IAS will take place. Investors must also play a more dominant role by demanding financial information from the companies that is relevant and decision orientated. The accountancy bodies, the Warsaw Stock Exchange and the Ministry of Finance will need to play a central role in this programme. The current weak position of the

accountancy profession and lack of effective enforcement regime means that Poland will find it much more difficult to meet the IAS requirements than the UK where the accountancy profession has been at the fore-front of the IASs developments.

To ensure the success of the harmonisation process the following issues will need to be addressed:

Polish Accounting Standards Committee must be fully operationalised. This body is funded and overseen by the Commission for the Developing Capital Markets (*Rada Fundacji Rozwoju Standardow Rynku Kapitalowego*) and has been formed at the request of the Ministry of Finance and the Warsaw Stock Exchange. It is essential that the composition and legal status of the Committee is clarified as soon as possible so that it can participate fully and effectively in the standard setting process in Poland. There must be commitment from the government to devolve powers related to accounting regulation to the Committee from the Ministry of Finance.

The audit profession must become more influential and participate fully in any developments related to audit and reporting functions. Effective enforcement of the Polish accounting law is dependant on the existence of an independent and powerful audit profession. In Poland, the audit association (*Krajowa Isba Bieglych Rewidentow*) has little input in the legislative processes or in the training of the registered auditor, resulting in the profession having low status in the business community at large. Greater trust between government appointed auditors and the audit association will develop if specialist task groups from the association are invited to contribute to the legislative processes and if there is greater sharing of

information between the government and the audit association. Members of the Audit Association must also co-operate with the Accounting Standards Committee to ensure that all implications arising from the changes to the accounting requirements are transparent and fully appreciated by the profession.

A wide ranging training programme for preparers and users of financial statements must be introduced if the spirit of the IAS is to be incorporated in the financial reporting process. The new Accountancy Act 2000 together with the requirement that IASs should be adopted where there is no Polish equivalent regulation means that financial reporting in Poland has become a much more complex process than it has been in the past. This study has shown that although many of the IAS provisions have been incorporated into the Polish law the orientation of the preparers tends towards the legalistic approach. The wider requirement of the financial statements to show the true substance of a transaction is generally neglected due to tax considerations driving the preparation of the accounts. Extensive training is also necessary to update accountants with the very fast changing regulations being introduced in the run up to the membership of the EU. In the light of the weak position of the professional bodies the government together with the major firms of accountants operating in Poland must take the lead in the development of training programmes for accountants, auditors and users of financial reports.

The Ministry of Finance must introduce further amendments to the Accountancy Act 2000 in order to achieve greater convergence with IAS. Where inconsistencies between national laws and IAS are identified then the Ministry of Finance must take steps to ensure that conformity

with IAS is achieved. At present the government is sometimes reluctant to introduce accounting changes so as to avoid an adverse fiscal impact. For example, revaluations are not permitted unless decreed by the government because the effect would be to give greater capital allowances and to reduce tax receipts for the government. The Ministry should strive to dispel the notion that accounting profit is synonymous with tax profit and that it can be used to calculate tax liability. Only then companies will start to report the true financial position of the enterprises. The disclosure requirements are currently inadequate to fully appreciate the financial position and further legislation is required to ensure that the user has the necessary information to make investment decisions. Much greater and more transparent consultation process with all interested groups is required in the consultative stages prior to the passing of accounting laws to ensure that the regulations are of high quality and acceptable to the preparers.

The legislators must plan to develop an accounting framework for companies that are not listed and therefore not subject to the IAS regime. The majority of Polish companies are not listed and for those companies an alternative and less burdensome framework will need to be developed. Similarly, the position of large but not listed companies will need to be clarified. Those companies may wish to adopt the IAS regime in preparation for future listing or as a requirement of external investors. The Ministry of Finance will need to address the legal status of IAS within the Polish legislative framework and the provisions of the EU Directives.

The authorities need to introduce a robust and powerful enforcement mechanism to ensure full compliance with IAS. Currently the Polish regulatory system relies wholly on the judicial

system for the enforcement of accounting regulation. The introduction of IAS will take place without any amendment to national legislation. This means that increasingly more complex regulations are being introduced without an adequate enforcement mechanism being put in place. Polish regulators should consider the adoption of a model similar to that operating in the UK where the Review Panel scrutinises defective accounts and has the power to force the accounts to be corrected. However, greater harmonisation of accounting in Europe will only take place if IASs are fully adhered to in all member states. Currently, there are many companies which apply IAS but do not always fully comply with the standards. Without a Europe-wide enforcement mechanism this is unlikely to be corrected and deviations from the IAS will persist hindering comparability. The EU Commission with the assistance from the major European Stock Exchanges through FESCO (the Forum of European Securities Commissions) must, as a matter of urgency, develop a supra-national framework of enforcement to support the introduction of IASs. The quality of financial reporting will also improve if there is a high quality level of audit throughout the EU. Further harmonisation of audit practices in the area of auditing standards, the audit report and independence is necessary if the legitimacy of the financial reporting in the EU is to increase.

Accountants must pay more attention to the needs of the shareholders. The financial statements should convey meaningful information about the position and performance of the enterprise so that the investment potential of the company can be appreciated. Accountants should provide additional voluntary information about the company rather than repeat in the notes the information already contained in the main financial reports. The improvement will only take place if there is external pressure for information from the shareholders and their

advisors. Auditors and the strategic investors should take the lead in changing the culture from being extremely secretive to that of open and transparent reporting thus improving the conditions for cross-border business. In the long term Poland will embrace the necessary changes in the interest of becoming a full member of the EU and building an integrated capital market. However, true harmonisation in Europe will only succeed if the member countries introduce an effective and co-ordinated enforcement mechanism. Unfortunately, at this moment enforcement of accounting standards throughout Europe is weak and as a result the quality of financial reporting is variable.

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APPENDIX I
Data for a sample of 15 UK companies for 1999 based on the information supplied from 'Hydra' database

Security Name	Number Of Shares	Company M Cap (£m)	Net Assets in (£m)	Price/Book value	Total Fixed Assets (£m)	Intangible Assets (£m)	Property Plant, Equipt - NBV (£m)	Revaluation Reserve (£m)
AGGREGATE INDUSTRIES : ORD GBP0.25	1232971097	864.25	719.40	1.20	1153.10	66.60	1070.30	6.90
BOVIS HOMES GROUP : GBP0.50	112823339	348.06	228.52	1.52	7.15	0.00	7.12	0.82
CAPE : ORD 25P	54326011	38.03	55.20	0.69	46.90	0.20	45.30	11.30
CREST NICHOLSON : GBP0.10	105727252	192.32	178.50	1.08	4.10	0.00	3.80	0.00
ENNSTONE : ORD GBP0.25	92239714	41.05	48.88	0.84	62.79	5.88	53.87	0.00
HEYWOOD WILLIAMS GROUP : ORD 25P	83265156	243.74	155.90	1.56	126.40	49.50	63.80	5.70
HIGHLAND TIMBER : ORD GBP0.50	8832267	8.39	9.01	0.93	12.21	0.00	12.21	0.00
JOHNSTON GROUP : ORD GBP0.10	10753332	40.61	46.31	0.88	34.41	0.00	31.45	7.70
KELLER GROUP : ORD 10P	56770050	153.56	51.94	2.96	45.29	1.60	43.69	7.63
LAING(JOHN) : ORD GBP0.25	46489660	158.97	251.70	0.63	162.20	3.90	42.00	6.00
MARSHALLS : ORD GBP0.25	133177470	341.60	175.34	1.95	154.06	14.15	139.91	15.44
MCALPINE(ALFRED) : GBP0.25	102145533	233.51	228.81	1.02	40.13	1.54	28.69	5.77
PERSIMMON : ORD GBP0.10	180905677	435.08	363.68	1.20	11.11	0.00	11.11	1.24
RMC GROUP : ORD GBP0.25	260965820	2218.21	1854.80	1.20	2912.90	106.70	2408.80	0.00
WIMPEY(GEORGE) : ORD GBP0.25	368942839	413.22	583.00	0.71	22.10	0.00	20.70	0.00
Average		382.04	330.07	1.22	319.66	16.67	265.52	4.57

APPENDIX II

Data for a sample of 15 UK companies for 2000 based on the information supplied from 'Hydra' database

Security Name	Number Of Shares	Company Market Capitalisation (£m)	Net Assets (£m)	Price/Book value	Total Fixed Assets (£m)	Intangible Assets - Total (£m)	Property Plant & Equipt - Net Bk Value (£m)	Revaluation reserve (£m)
AGGREGATE INDUSTRIES : ORD GBP0.25	1233811363	1040.84	788.10	1.32	1318.10	90.20	1211.20	5.70
BOVIS HOMES GROUP : GBP0.50	113078466	399.73	290.05	1.38	9.25	0.00	8.58	0.82
CAPE : ORD 25P	54326011	12.22	38.90	0.31	47.80	0.00	45.70	11.30
CREST NICHOLSON : GBP0.10	107310836	211.43	203.40	1.04	9.90	0.00	3.80	0.00
ENNSTONE : ORD GBP0.25	154950655	49.58	70.84	0.70	102.98	21.41	81.57	2.35
HIGHLAND TIMBER : ORD GBP0.50	8832267	6.62	8.33	0.79	11.60	0.00	11.60	0.00
JOHNSTON GROUP : ORD GBP0.10	10828230	45.47	51.52	0.88	33.89	2.97	30.92	7.45
KELLER GROUP : ORD 10P	58815050	96.75	58.71	1.65	63.48	12.70	50.79	7.63
LAING(JOHN) : ORD GBP0.25	96725044	413.89	241.10	1.72	182.10	9.50	41.50	6.30
MARSHALLS : ORD GBP0.25	166645591	394.62	190.82	2.07	164.91	15.13	149.79	15.44
MCALPINE(ALFRED) : GBP0.25	103911042	247.13	264.71	0.93	45.31	1.17	34.11	5.51
PERSIMMON : ORD GBP0.10	182655653	444.77	418.41	1.06	15.41	3.28	12.14	1.24
RMC GROUP : ORD GBP0.25	264204646	1556.17	2083.50	0.75	3776.40	603.80	2992.20	0.00
WIMPEY(GEORGE) : ORD GBP0.25	370185649	555.28	672.60	0.83	17.40	0.00	17.40	0.00
Average		391.04	384.36	1.10	414.18	54.30	335.09	4.55

APPENDIX III
Data for a sample of 14 Polish companies for the year 1999 based on the published financial statements

Security name	No. of Shares	Share price (zloty)	Book value per share (zloty)	Price/Book ratio	Book value (000 zloty)	Tangible FA (000zloty)	Intangible FA (000zloty)	Total FA (000 zloty)	Investments (000 zloty)
Budimex SA (construction)	19790388	28.5	20.17	1.41	399185	148611	15,630	66,971	66921
Echo	3500000	80	43	1.86	151711	196353	1418	84087.86	83963
Elbudowa	4498750	36.4	22	1.65	96979	49245	2936	54640	2459
Elektroex	10665500	3.1	3.33	0.93	35542	6285	1130	56209	48794
Elmontwar	8585250	2.64	4.8	0.55	41216	21246	369	21647	32
Energopn	3717000	18	30.36	0.59	112833	57093	1806	67186	8287
Energopld	1100	26	48	0.54	52555	28335	947	29406	124
Espebepe	2150000	5.4	-22.95		-49339	24004	233	25744	1507
Exbud Skanska SA	15000000	34.5	25.02	1.37	375301	77631	8868	378241	291741
GPRD	7500000	9.9	6.8	1.45	50928	28548	1050	38975	9377
Hydrobudowa SA	2852640	20.5	18.66	1.1	53220	22852	522	26280	2806
KPBP-BICK SA	1990890	16.7	17.44	0.96	34717	12796	267	20082	7019
Mostostal - export SA	44774503	4.4	4.57	0.96	204581	1824	104	214886	212958
Mostostal - Gdansk SA	4000000	18.3	16	1.14	65181	66411	1768	93013	24834
Average				1.12	116044	52945	2428	109944	54344

APPENDIX IV
Data for a sample of 14 Polish companies for the year 2000 based on the published financial statements

Security name	No. of Shares	Share price (zloty)	Book value per share (zloty)	Price/Book ratio	Book value (000 zloty)	Tangible FA (000 zloty)	Intangible FA (000 zloty)	Total FA (000 zloty)	Investments (000zloty)
Budimex SA (construction)	25530098	19.25	21.85	0.88	557746	223601	119932	536216	66803
Echo	3500000	121	58.26	2.08	203896	47107	3251	416124	291486
Elbudowa	4244713	23.7	16.05	1.48	68131	53396	2727	53396	2459
Elektroex	11124095	2.5	2.64	0.95	29321	24378	3831	40232	11803
Elmontwar	8585250	2.11	5.06	0.42	43461	19920	259	23071	34
Energopn	3717000	14.1	31.88	0.44	118502	59340	1413	73168	9907
Energopld	1100		50		54718	26811	616	29057	1,477
Espebepe	2150000	9.95	-24.43		-52535	18230	168	24855	3513
Exbud Skanska SA	15000000	29.1	17.28	1.68	259167	385870	14195	385870	262890
GPRD	7500000	7	4.23	1.65	31741	31049	688	55180	7160
Hydrobudowa SA	2852640	22	20.66	1.06	58943	21464	291	25145	1819
KPBP-BICK SA	1990890	8.15	13.18	0.62	26243	9843	128	23478	13271
Mostostal - export SA	44774503	5	5.69	0.88	254587	1656	54	150984	149274
Mostostal - Gdansk SA	4000000	15	18.91	0.79	75645	58483	6256	100327	33985
Average				1.07	123540.43	70082.00	10986.36	138364.50	61134.36

APPENDIX V

Interview questions posed to the financial accountants

1. Company and interviewee details

- a) What is the nature of the business?
- b) What is the company turnover and how many employees do you have?
- c) Who are the main shareholders?
- d) What relevant qualification do you hold in your capacity as the company accountant?

2. Adoption of IAS

- a) Are your financial statements prepared in accordance with any other regulatory framework than Polish Law eg. US GAAP or IAS?
- b) Are the annual financial statements for your company compliant with IAS?
- c) What do you consider to be the main obstacles to the adoption of IAS?
- d) What do you consider to be the main deficiencies of IAS?
- e) What do you consider to be the main differences between Polish Accountancy Law and IAS?
- f) In your view, do you think that Polish accountants are sufficiently technically competent to prepare IAS compliant accounts?

3. The role of financial accounting

- a) Who are the main users of your financial statements?
- b) Do you provide any additional, voluntary information in the published accounts?
- c) How do you think the role of financial accountant has changed since 1989?
- d) Does the Board of Directors of your company include an accountant?

4. The role of foreign investor in the management of Polish companies?

- a) To what extent is the foreign investor actively involved in the management of the company?
- b) What influence does the foreign investor have on the reporting systems of your company?
- c) Do you think that the foreign investor has had a positive or a negative impact on the company?