Development of financial reporting of Polish enterprises from 1989 to 2015

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Abstract
Poland is a country where legal norms evolved from a command and control economy to market economy in a relatively short period of time. In contemporary Polish financial reporting one can notice both solutions typical for the accounting system based on the continental model and solutions typical for the Anglo-Saxon model. The research problem addressed in this paper involves investigation of changes in the structure, form and thematic scope of financial statements as well as valuation methods applied to reporting items. Specifically, the article addresses financial statements of Próchnik S.A., one of the first five companies to debut on the Warsaw Stock Exchange in 1991. The purpose of the article is to present the results of an analysis of changes in the scope of financial reporting of Polish companies taking place over a period of 25 years. The author used the method of analyzing literature and legal regulations and the method of comparisons and analogies. The research allowed the author to identify specific stages in the development of financial reporting in Poland. It was demonstrated that the turning point was the country's accession to the European Union and that changes taking place in the recent years are connected first of all with the need to implement EU regulations into the Polish legislation. In each of the said stages changes in the form and scope of financial statements and applied valuation methods were noticed.

1. Introduction

By generating information on assets and financial condition, accounting becomes one of the key "producers" and "suppliers" of financial information, and its "product" is delivered in the form of financial statements. Information contained in financial statements constitutes a basis for assessing the performance of business entities and determines economic decisions taken by financial statement users. Therefore, financial statements should fairly and faithfully present the condition of entities' assets and finances, while simultaneously constituting a collection of useful information satisfying information needs of their users [Remlein 2013, p. 9]. Financial reporting is subject to changes dictated by the needs and expectations of stakeholders.

Poland is a country where in less than two decades legal norms of accounting evolved from a command and control economy. First, the country adopted solutions typical for accounting systems based on the continental model and then moved on towards solutions typical for the Anglo-Saxon model [Śnieżek and Wiatr 2011, p. 169].

4 July 1989, the date of the first partially free parliamentary elections, is regarded as a turning point in the history of Poland. It is a symbolic date of the fall of communism and the beginning of changes that affected political and economic situation of European countries in the years to come. In just a few years legislative solutions allowing companies to operate on free-market conditions were introduced, and the Accounting Act passed in 1994 was prepared on the basis of European Union directives. In Poland, not unlike in other European countries, the development of capital markets contributed to the fact that companies used two different accounting systems: continental and Anglo-Saxon. Some companies are subject to domestic regulations (in Poland: the Accounting Act, also known as the balance-sheet law) which are

consistent with EU directives, while others prepare their financial statements in accordance with the International Financial Reporting Standards (IFRS).

The research problem addressed in this article concentrates on investigating changes in the form, structure and thematic scope of Polish financial statements, as well as valuation methods applied to reporting items.

The object of the study are financial statements prepared in accordance with the balance-sheet law in effect on the date of their completion, while the subject of the study are the companies preparing such statements.

The purpose of the paper is to present the results of an analysis of changes in financial reporting of Polish companies taking place over the last 25 years. To complete the paper, the authors used adequate research methods, such as review of literature and legislation as well as comparisons and analogies.

2. Literature review

Prior to 1989, the Polish economy was based on the command and control system, where economic soundness was of secondary importance and accounting was used mostly for statistical and auditing purposes. Accounting regulations did not provide a uniform set of solutions for all business entities; instead, they were merely a collection of regulations in the form of ministerial resolutions and decrees, determining in particular industry-specific charts of accounts. Polish literature from before 1990 emphasizes that accounting should serve the interests of entities, nearly all of which were state-owned [Skrzywan 1971, p. 13, Glinka and Kostera 2012, p. 489]. In a command and control economy, operating efficiency depended on decisions taken at central management levels, where macroeconomic criteria of efficient management were preferred over private entrepreneurship and property [Gabrusewicz, Kamela-Sowińska and Poetschke 1998, p. 15]. After 1989, a program for restoring a free market economy and developing a capital market was implemented. Enterprise privatization processes were accompanied by the formation of the structure of financial institutions that had not existed before. The Warsaw Stock Exchange was reopened in 1991, after 52 years. Today, it is the largest stock exchange in Central and Eastern Europe. The first trading day saw debuts of five companies, one of which (Próchnik S.A.) has been quoted until today. In December 2015, the number of companies quoted on the Warsaw Stock Exchange was 479.

In 1991, the first set of accounting principles based on market solutions was introduced in the form of a regulation of the Minister of Finance [Regulation of the Minister of Finance of 15 January 1991], constituting secondary legislation to the Tax Act. The regulation addressed such issues as book-keeping, stock-taking, assets and liabilities valuation, financial result calculation, preparation of financial statements, as well as safekeeping of accounting and stock-taking documents, accounting ledgers and financial statements. The regulation addressed issues of great importance for doing business in a free market economy, but suffered from a number of subjective and objective limitations.

From the legal perspective, a regulation is a normative instrument issued pursuant to an act of law, and European Union directives are implemented into the legislation of individual member states by means of top-tier legislative instruments. Therefore, the Accounting Act was passed in 1994 [Accounting Act of 29 September 1994]. Today, together with the National and International Accounting Standards, the Act constitutes the legal basis for accounting. In its original wording and by contemporary standards, the Act was a modern piece of legislation, developed *inter alia* on the basis of the Fourth Council Directive [Directive 78/660/EEC] and the Seventh Council Directive [Directive 83/349/EEC].

A number of significant changes in the Polish economy took place between 1994 and 2015. After years of isolation, Poland opened up to a free market economy and an intensive development of the capital market began. At the same time, the European Union began to search for accounting solutions of a global reach and started investigating the use of International Accounting Standards with regard to entities quoted on international stock exchanges.

Importantly, Poland submitted its EU membership application already in April 1994 [Europe Agreement 1994], which meant that all acts of law were prepared with a view to future accession of Poland to the European Union. For this very reason, the 2000 amendment to the Accounting Act contained a provision stipulating that in matters unaddressed in the Act, entities could formulate their accounting policies by applying national accounting standards issued by the Accounting Standards Committee, empowered to do so by the Act [Act of 9 November 2000]. In the absence of an applicable national standard, entities could apply International Accounting Standards. Furthermore, the Act also prescribed conditions required for commercial provision of accounting services.

Currently, two accounting systems are simultaneously operated in Poland: continental and Anglo-Saxon. In literature, classifications of accounting systems are broadly discussed [Nair and Frank 1981; Müller, German and Meek 1990; Nobes 1991], and so are the factors that determine their formation [Gray 1988, Heidhues and C. Patel 2010; Błażyńska 2015]. Business entities are subject either to domestic directives and acts (continental system) or to the IFRS (Anglo-Saxon system). The two systems are mutually complementary, since information provided by them is targeted at different groups of stakeholders.

3. Data and methodology

The period covered by this paper extends from 1989 to 2015, i.e. from the introduction of free market mechanisms in Poland until the completion of the paper in December 2015. To achieve the objective formulated in the introduction it was necessary to:

– determine the stages of changes in financial reporting (in the scope of the Polish balance-sheet law) throughout the analyzed period,
– perform a comparative analysis of financial statements of the company in the period in question.

The determination of the stages of changes in financial reporting from 1989 to 2015 was carried out first of all by analyzing 58 acts of law amending the Accounting Act of 29 September 1994 as well as Directives whose provisions were implemented to the Polish legislation.

The comparative analysis of financial statements was carried out using the purposive method. The analysis concentrated on Próchnik S.A., one of the first five companies to debut on the Warsaw Stock Exchange in 1991, quoted there ever since.

Annual reports from the following years were used in the study:

– 2002, when an important amendment to the Accounting Act took effect, introducing *inter alia* the option of fair value measurement,
– 2005, when companies were first obliged to implement the EU Regulation of 19 July 2002,
– 2014 – the last published report.

The analysis concentrated on changes in the form, structure and scope of financial statements and valuation methods.

4. Analysis and Findings

4.1. Financial reporting development stages in Poland

Stage 1: 1989 – 2001

The first attempt at regulating accounting principles was the regulation of the Minister of Finance of 1991 [Regulation of the Minister of Finance of 15 January 1991]. Eventually, accounting principles and the methodology of auditing financial statements by auditors were stipulated in the Accounting Act of 1994. The Act introduced a clear division between balance-sheet law and tax law. It prescribed that financial statements should be prepared in the Polish language and expressed in the Polish currency. The subjective scope of the balance-sheet law was specified as well.

In the first years after the introduction of the Accounting Act a number of editorial and formal amendments were introduced. At that time, Poland was adapting its legal system to the requirements of a free market economy. As new forms of organization were being introduced, the subjective scope of the Act was extended. As far as the objective scope is concerned, previously existing solutions were being fine-tuned and new ones were being introduced in order to provide investors with information necessary for assessing the financial condition of issuers of securities traded in the capital market.

Stage 2: 2002 – 2004

On 1 January 2002, an amendment to the Accounting Act of 19 November 2000 took effect. It was a response to the changing economic reality. The amendment was necessary to adapt the Polish law to the conditions of a developing market economy and to the International Accounting Standards, extended in the years 1994-1999 [Gnich 2002]. The newly implemented changes were important both for the structure and scope of financial reporting and for valuation methods. New definitions were introduced (33 new items) and names of certain items were adapted to their economic substance. Newly introduced concepts included:

– fair value measurement,
– value impairment,
– long-term contracts,
– capital investments,
– deferred tax,
– provisions on company mergers,
– a new element of financial statements – statement of changes in equity,
– division of assets and liabilities in the balance sheet into affiliated entities and other entities.

The above changes required introduction of a new financial statement model. Financial statements consist of three obligatory elements, i.e. balance sheet, profit and loss account and notes. Entities obliged to have their statements audited additionally prepare a statement of changes in equity, a cash flow statement and an activity report (equivalent to management commentary).

Stage 3: 2005 until today

Changes in financial reporting in Poland after 1989 have largely been a consequence of Poland's membership in the European Union. First of all, the following acts of EU law have been implemented: Directive 2001/65/EC, Directive 2003/38/EC, Directive 2003/51/EC. In 2002 the European Parliament and the EU Council passed a regulation obliging public EU companies (as from January 1, 2005) to prepare financial statements in accordance with the IFRS [EC Regulation of 19 July 2002]. At the same time, the Polish balance-sheet law prescribed that entities preparing financial statements in accordance with the International Accounting Standards, International Financial Reporting Standards and the related interpretations published in the form of regulations of the European Commission (collectively referred to as the "IAS") should follow the provisions of the Act and secondary legislation thereto in any matters unaddressed in the IAS [Błażyńska 2015, pp. 73-74]. Changes to the Accounting Act introduced after 2005 were first of all aimed at implementing directives of the European Parliament and of the Council into the Polish legislation and included such solutions as: relaxation of conditions required for commercial provision of accounting services [Directive 2005/36/EC; Act of 9 May 2014], regulations on micro and small entities, a new report on payments to public administration [Directive 2013/34/EU; Act of 11 March 2014; Act of 23 July 2015]. In 2009 Poland introduced the possibility to measure the value of certain assets on the basis of adjusted purchase prices and changed the definition of certain terms and regulations related to commercial provision of accounting services. Finally, after the introduction of the act on relaxation of conditions for pursuing certain regulated professions [Act of May 9, 2014], commercial accounting services can be provided by every entrepreneur enjoying full legal capacity, as long as he has not been found guilty of an offence against credibility of documents, property, economic turnover, financial turnover, securities' turnover or a tax-related offence.

To conclude, some entities in Poland prepare their financial statements in accordance with the IFRS, while others do so in accordance with the Accounting Act, which is fully consistent with the Directives. The Directives aim "at designing and delivering regulation of the highest quality whilst respecting the principles of subsidiarity and proportionality and ensuring that the administrative burdens are proportionate to the benefits they bring" [Directive 2005/36/EC]. Depending on the legal form and the size of business, entities prepare either full or simplified statements. Differences apply to valuation methods (for instance, micro and small enterprises do not need to make fair value measurements).

4.2. Research subject: Próchnik S.A.

Próchnik S.A. was founded in 1948. In 1991 it was transformed into a joint-stock company, listed on the stock exchange. The company operates in the textile industry and specializes in designing, manufacturing and marketing of men's and women's clothing.

Analyzed annual reports from 2002 and 2005 are largely similar, which is why they were analyzed in parallel. The results of the 2014 annual report were compared against the results from earlier years.

The 2002 annual report contained the following:

– opinion and report of an independent auditor,
– letter of the President of the Board to the shareholders,
– financial statements including: balance sheet, profit and loss account, notes, statement of changes in equity (prepared for the first time), cash flow statement,
– management commentary (activity report).

In 2005 the following items were added to the annual report:

– statement of the management board on the integrity of the financial statements,
– statement on the entity authorized to audit the financial statements.

The financial statements were prepared on a going concern basis. In 2002, the annual report consisted of 62 pages, and in 2005 – 79 pages.

One of the more prominent changes was the extension of the management commentary from 7 pages in 2002 to 24 pages in 2005. In the first of the analyzed reports, Próchnik S.A. chose to present merely a synthetic overview of the basic facts about the company, its governing bodies, business, economic and financial condition, operation strategy, plans and prospects. In 2005, information for shareholders was more coherent and precise. The following issues were discussed:

– key products, merchandise and services,
– changes in sales markets and sources of supply,
– agreement of significant importance for the company's business,

– changes in affiliated entities,
– factors and unusual events affecting the company's performance in 2005,
– external and internal factors of significant importance for the company's development,
– hazard and risk factors,
– changes in the composition of the company's management and supervisory bodies,
– expected development of the company.

In 2014 Próchnik S.A. prepared both separate and consolidated financial statements (since 2013). The financial statements were prepared in accordance with the IFRS and interpretations issued by the IFRS Board, approved of by the European Union by virtue of the IFRS Regulation [EC Regulation of 19 July 2002].

The structure of the separate financial statements in 2015 is the same as in earlier years. However, in accordance with the IFRS, names of individual components did change. The financial statement included: statement of financial position, statement of profit or loss and other comprehensive income, notes, statement of changes in equity, cash flow statement and additional notes and explanations. The content of the management commentary (34 pages) was divided into the following units:
– basic information,
– overview of key financial and economic figures disclosed in the annual financial statements,
– overview of significant risk factors and hazards,
– information on key products, merchandise and services together with an overview of their values and quantities,
– information on sales markets including domestic and international markets; information on sources of supply of production materials, merchandise and services together with information on dependence on one or more customers and suppliers,
– information on significant agreements concluded by the company,
– information on organizational or capital affiliations,
– information on loan and credit agreements concluded and terminated during the year, specifying at least the amount, type, interest rate, currency and maturity of such loans/credits,
– assessment of financial resources management (with a statement of grounds)
– assessment of feasibility of planned investments,
– amount of wages, awards or benefits,
– total number and nominal value of all shares,
– information on financial instruments,
– corporate governance statement by the management board of Próchnik S.A.

The analysis additionally covered changes in the approach to valuation of assets and liabilities. The results of the analysis of valuation methods used in 2002 and 2005 are presented in Table 1.

Balance-sheet item	**Balance-sheet valuation**
ASSETS	
LONG-TERM ASSETS	
Intangible assets	at purchase price or cost of production less depreciation and value impairment
Fixed assets	at purchase price or cost of production less depreciation and value impairment
Long-term investments	at purchase price adjusted by value impairment
Long-term accruals and	the company had no deferred tax assets

prepayments	
CURRENT ASSETS	
Reserves	materials, merchandise – at purchase prices, not higher than net sales prices finished products and services, semi-finished products – at cost of production, not higher than net sales prices
Short-term receivables	at an amount equal to the principal receivable, subject to impairment loss
Short-term investments	at nominal value
Short-term accruals and prepayments	at the amount of costs falling due in the following reporting periods, taking into account the precautionary principle
LIABILITIES AND EQUITY	
Equity	at nominal value
Provisions on liabilities	at reasonable and fairly measured value (on long-term liabilities to employees including retirement benefits and anniversary awards) subject to impairment loss
Long and short term liabilities	at an amount equal to the principal payable
Accruals and prepayments	at the amount of probable liabilities falling due in the current reporting period

Table 1: Assets and liabilities valuation methods used by Próchnik S.A. in 2002 and in 2005

Information presented in Table 1 indicates that in 2005 Próchnik S.A. did not use fair value measurement and did not possess any financial instruments, for instance.

In 2014, Próchnik S.A. measured the fair value of real property investments, financial assets available for sale and financial liabilities. Therefore, the notes contained references to important accounting judgments and estimates and to information on significant changes in estimated values. The financial statements also contained new items, such as goodwill and treasury shares.

Importantly, fair value measurement was introduced into the Polish legislation in 2002 and applies to:

– real property and intangible values classified as investments,
– shares in other entities,
– short-term investments,
– receivables and loans awarded, classified as financial assets,
– financial liabilities.

The annual report additionally contained a corporate governance statement, confirming Próchnik's adherence to Good Practice of Companies Quoted on the Warsaw Stock Exchange [Resolution 19/1307/2012].

5. Discussions and conclusions

Our study of the development of financial reporting of Polish companies in the period from 1989 to 2015 made it possible to notice three development stages. Stage 1 (1989 – 2001) was the time of formation of free market mechanisms and democratic structures in Poland. Accounting regulations introduced in that period drew on the experience of the European Union. Consequently, stage 2 (2002-2004) begins with the introduction of an amendment to the Accounting Act, pursuant to which the structure of financial statements changed (introduction of the statement of changes in equity) and new valuation methods were prescribed (fair value). Furthermore, a number of regulations related to capital market development and financial instrument disclosures were implemented. Stage 3 began in 2005, when Poland was already a member of the European Union and public companies prepared their financial statements in accordance with the IFRS.

In the analyzed period, the form of financial statements has not changed, unlike the objective scope, structure and valuation methods. Financial statements are prepared in the Polish language and currency. Financial information is presented in a descriptive and tabular form. As new forms of organization were being introduced, the range of entities preparing financial statements was increased. Changes in the structure of financial statements of Polish companies are illustrated in Figure 1.

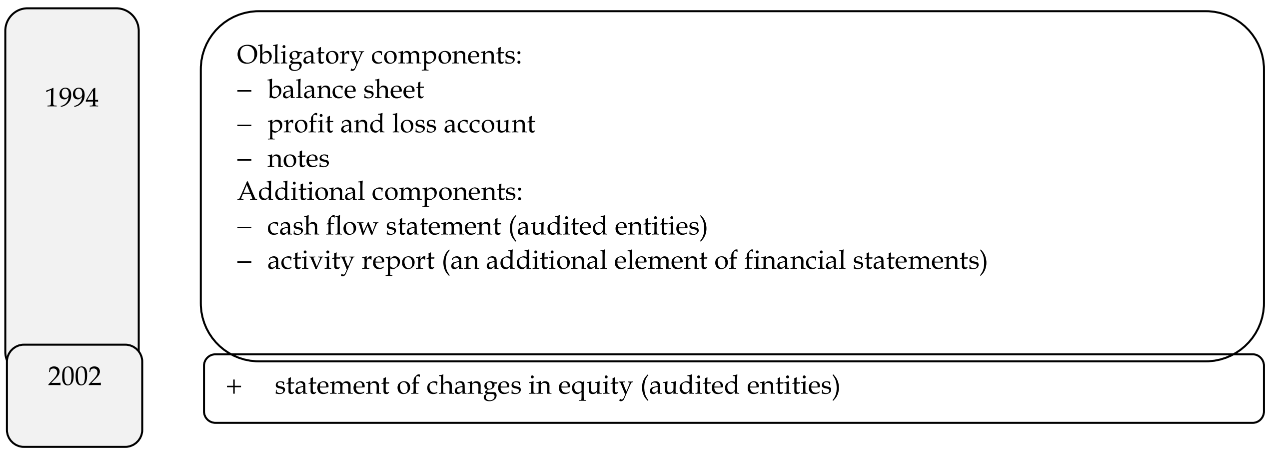

Fig 1. Changes in the structure of financial statements of Polish companies

Some entities prepare a simplified version of their financial statements. The internal structure of individual elements of financial statements changes periodically, which is caused *inter alia* by the need to disclose new assets.

An overview of changes in the methods of balance sheet items' valuation prescribed by the Polish law is presented in Figure 2.

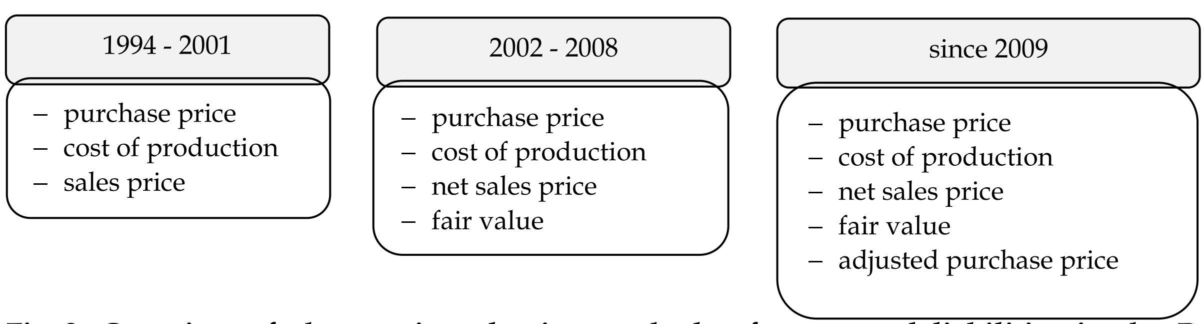

Fig 2. Overview of changes in valuation methods of assets and liabilities in the Polish balance-sheet law

The IFRS on the one hand and the Directives and national solutions on the other are based on different accounting systems (Anglo-Saxon and continental, respectively). Each of those systems addresses financial information to different stakeholders. In addition, there are differences with regard to valuation of assets and liabilities and the scope of presented financial and non-information. These differences are noticeable in the analysis of financial statements of Próchnik S.A. In the first two financial statements the company did not use fair value, unlike in the third one. The foregoing reflects both IFRS requirements and the very essence of preparing financial statements in accordance with the IFRS. Financial information is addressed to investors, lenders and other creditors and suppliers of capital to international capital markets.

Próchnik S.A. cares about good relations with stakeholders, which is why it prepares an extensive management commentary and follows the principles of corporate governance. This kind of good cooperation requires reporting of not only financial information, but non-financial information as well.

The continental system focuses on the needs of lenders and tax authorities. The same goes for internal Polish regulations. 99.8% of all entities are small and medium enterprises, 65% of which finance their investments with their own funds. Another 17% use loans, and 8% use foreign sources. All other sources are negligible [*Report on the condition of the SME sector 2015*]. Small and medium enterprises are the key beneficiary of regulations reducing the administrative burden. Similarly, regulations on financial reporting should be adequate to the size of an entity's business. Most SMEs prepare simplified financial statements and are not required to measure fair value or use adjusted purchase prices.

To conclude, the dual approach to preparing financial statement is well justified and will be sustained in the near future.

Quite importantly, Poland quickly and successfully made up for the delays in economic development. In 2009, during the economic crisis Poland was the only EU country with a positive economic growth, becoming the "green island of Europe".

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