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**EVALUATION OF THE EFFECTS OF FINANCIAL  
STATEMENT CONVERSION ACCORDING  
TO THE INTERNATIONAL ACCOUNTING STANDARDS  
ON THE BASIS OF A SELECTED COMPANY**

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**A b s t r a c t**

The changes taking place both in societies as well as in the world's economy, resulting from the increase of the international business and cultural exchange, caused the necessity of harmonization in the area of broadly defined business accounting.

Financial statements are crucial in the context of making decisions on investment, development and strategies, as well as, for perception of the company by outside users of these reports. Striving at the solid presentation of information based on economic events registered by the company requires a good knowledge of the accounting rules. Accounting rules used in financial reporting play an important role in the evaluation of financial performance of a company.

The problem of converting the financial statements prepared according to the Polish accounting law into the statements based on the principles of the International Financial Reporting Standards (IFRS) is widely described in the literature. However, there is a deficiency in studies presenting the effects of converting financial reports prepared according to the Polish accounting law into the statements based on the principles of the International Accounting Standards in the context of evaluation of the company's financial resources, assets, and income.

The goal of this paper was to indicate the areas and extent of discrepancy of the financial report prepared according to the Polish balance law and that consistent with the International Financial Reporting Standards, as well as to evaluate the impact of the changes on the balance structure, income statement and basic financial ratios.

The results of the study prove that the differences between the Polish balance law and the International Accounting Standards (IAS) concerning the presentation of financial reports had a significant impact on the evaluation of financial situation of the company examined and the usefulness of financial reports for the readers as well as the quality of decisions.

**OCENA SKUTKÓW PRZEKSZTAŁCENIA SPRAWOZDANIA FINANSOWEGO  
WEDŁUG WYMOGÓW MIĘDZYNARODOWYCH STANDARDÓW RACHUNKOWOŚCI  
NA PRZYKŁADZIE WYBRANEJ SPÓŁKI**

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Słowa kluczowe: Międzynarodowe Standardy Rachunkowości, sprawozdanie finansowe.

A b s t r a k t

Zmiany zachodzące w społeczeństwach oraz gospodarce światowej, wynikające ze wzrostu międzynarodowej wymiany handlowej i kulturowej, spowodowały także konieczność harmonizacji w szeroko rozumianej sferze rachunkowości podmiotów gospodarczych.

Sprawozdania finansowe mają duże znaczenie w podejmowaniu decyzji inwestycyjnych, rozwojowych, strategicznych, a także postrzeganiu spółek przez użytkowników zewnętrznych, odbiorców tych sprawozdań. Dążenie do rzetelnej prezentacji informacji na podstawie zdarzeń gospodarczych zarejestrowanych przez spółkę wymaga dobrej znajomości przepisów rachunkowości. Stosowane przepisy podczas sporządzania sprawozdań finansowych odgrywają także istotną rolę w ocenie sytuacji finansowej stosującego je podmiotu.

W literaturze problem przekształcania sprawozdań finansowych sporządzanych według polskiego prawa bilansowego na zasady Międzynarodowych Standardów Sprawozdawczości Finansowej (MSSF) jest szeroko opisywany. Brakuje jednak opracowań prezentujących skutki przekształcenia sprawozdania finansowego sporządzonego na podstawie polskiego prawa bilansowego na zgodne z Międzynarodowymi Standardami Rachunkowości (MSR) z punktu widzenia oceny sytuacji finansowej, majątkowej i wyniku finansowego danej spółki.

Głównym celem artykułu było wskazanie obszarów i stopnia rozbieżności sprawozdania finansowego, sporządzonego według polskiego prawa bilansowego oraz sprawozdania finansowego zgodnego z Międzynarodowymi Standardami Sprawozdawczości Finansowej, a także ocena wpływu zmian na strukturę bilansu i rachunku zysków i strat.

Wyniki przeprowadzonych badań wskazują, że różnice występujące między polskim prawem bilansowym a międzynarodowymi standardami rachunkowości w zakresie prezentacji sprawozdań finansowych miały istotny wpływ na ocenę sytuacji finansowej badanego podmiotu, a w konsekwencji użyteczność dla czytelników sprawozdania finansowego i jakość podejmowanych decyzji.

## Introduction

Globalisation process occurring in various areas of economies, politics and culture has not bypassed the areas of business entities accounting either. It was started already during the 19<sup>th</sup> c. and is still characterised by the developmental trend (GMYTRASIEWICZ 2000, JARUGA 1998, WALIŃSKA 2005).

In the developed market economy characterised by existence of the capital market and free flow of capital, accounting gains major importance. Its task is to provide reliable and honest information on the results of business activities and financial standing of the individual business entities (MESSNER 2007).

Existence of differences in principles of drafting financial statements between individual countries causes that they are not compatible in the global or European markets (WALIŃSKA et al. 2006).

Financial statements are of major importance for taking investment, development, tactical and strategic decisions and as a consequence it is an important issue that they should be prepared according to the same principles by different business entities, which would allow, e.g. taking optimal decisions by the investors from different countries. On the 27<sup>th</sup> of August 2004, the Sejm [Parliament] of the Republic of Poland, amending the Act on accounting, introduced the possibility (and later a duty for some companies) to apply the International Financial Reporting Standards (IFRS). In that way, many subsidiaries of other companies – issuers of securities allowed for public trading preparing consolidated financial statements according to the International Accounting Standards (IAS) – obtained the possibility of applying the International Financial Reporting Standards (IFRS) (at least statistically in case the owners – bodies approving the financial statement – did not pass the resolution on transition to the IAS).

The problem of converting the financial statements prepared according to the Polish accounting law into the statements based on the principles of the International Financial Reporting Standards (IFRS) is widely described in the literature (HELIN 2006, JARUGA 2004, OSTASZEWICZ 2004, *Przewodnik...* 2006). However, there is a deficiency in studies presenting the effects of converting financial statements prepared according to the Polish accounting law into the statements based on the principles of the International Accounting Standards in the context of evaluation of the company's financial standing, assets and financial result.

The main objective of the paper is to define the areas of differences resulting from the Polish accounting law and the International Financial Reporting Standards and evaluation of the influence of IAS principles on the financial statements (balance sheet and profit and loss account structure), and, as a consequence, evaluation of the financial standing of the company.

Considering the extensiveness of the International Financial Reporting Standards, the paper focused only on those accounting standards that were applicable to the company studied. This resulted from the specific characteristics of the operation of the entity studied that is rental of real property to own account.

## **Research material and methodology**

The research was based on the data of a joint stock company that is a subsidiary of a company the shares of which are publicly traded. The basic

business of the company is rental of real property to own account. As a consequence of the change in regulations concerning preparation of consolidated financial statements by publicly traded companies the studied company transformed its financial statement as at 31.12.2004 for the purpose of group consolidation according to the International Financial Reporting Standards (IFRS), assuming the date of 01.01.2004 as the date of transition to the IFRS. Company financial statements, i.e. the balance sheet and profit and loss account were the main source of information used in this paper. The financial data for 2004 represents the subject of the study. The additional research material includes the financial statements as at 31.12.2003, helpful in determining the opening balance as at the date of transition to the International Financial Reporting Standards as well as other internal documents of the company influencing appropriate representation of economic transactions.

The method of analysis of comparisons concerning two consecutive years and versions of the balance sheet and profit and loss account prepared according to the different standards using tabulations was applied for processing the material collected.

## **Research result**

Transformation of the financial statement prepared according to the Polish accounting law into one that is consistent with the IAS involves several stages. During stage one the differences in booking and valuation of assets and liabilities according to the IAS and the Act on accounting must be identified. Next, the IAS accounting standards and their interpretation as at the financial statement date must be identified. The IFRS 1 require the entity to observe every IAS effective as at the date of the first financial statement made according to the IAS. The next stage involves determination of the date of transition to the IAS, the reporting date, reporting period and compatible reporting period. Next the scope of applying the optional derogations concerning retrospective application of standards must be determined. Determination of the opening balance sheet as at the transition date to the IAS is another, relatively complex, stage. It involves:

- including all the assets and liabilities as required by the IAS, which in practical terms may lead to including such items that according to the Act on accounting were not included in the records or had a zero value,
- removing the items of assets and liabilities that are not allowed by the IAS,
- changing the classification of items represented according to the earlier applied principles of accounting to different categories of assets or liabilities.

– applying the IAS to valuation and presentation of all assets and liabilities included.

Determination of the reporting items as at the date ending the compatible period (balance sheet, statement of changes in capitals, profit and loss account, cash flow) is included in the next stage. Finally, reconciliation between the previously applied principles of accounting and the IAS as at the transition date and as at the end of the period presented in the last year financial statement made according to the previously applied principles of accounting is done.

The data concerning the identified differences between the values in the financial statement (balance sheet and profit and loss account) are presented in tables 1-3.

Data presented in tables 1 and 2 indicate that there were changes in the balance sheet after application of the International Financial Reporting Standards. The balance sheet footing as at 31.12.2004 decreased by 15,7% and many changes were made in presentation of the individual balance sheet elements.

In case of the subject company the transformations on the assets side concerned fixed assets only. The differences appeared in both the intangible and legal assets value and the tangible fixed assets. The necessity to translate the land perpetual usufruct rights to the non-balance sheet records and representing operational lease according to the IAS 17 “Leasing” were the main reason for the changes. On the other hand the fixed assets as well as intangible and legal assets fully depreciated, according to the IAS 16 “Tangible fixed assets” and the IAS 38 “Intangible assets” were valued according to the fair values (buildings) and revaluated values (computer software) and included in the balance sheet. This resulted from the fact that the company was in possession of fixed assets used that according to the balance sheet had been depreciated during the earlier years. Additionally, changes in the assets caused changes in the assets for the deferred taxes.

In addition to elimination of the land perpetual usufruct rights, also the deduction updating the value of assets according to the IAS 36 “Loss of assets value”, performing the permanent loss of value test, was necessary to represent the value of assets in the balance sheet as at 01.01.2004. The IAS 36 requires that the regained value of an item of assets or cash generating centre (e.g. a set of components of assets is such a centre) should be determined as the higher of: the fair value decreased by the costs of sale or utility value. In case of the subject company the deduction updating the value of assets as at 01.01.2004 was determined at PLN 266,400 decreasing the value of assets to the level of net sale price according to the initial real property sales contracts made as at that date.

Table 1

Assets of the studied company according to the Act on accounting and the IFRS

Assets according to the Act on accounting	31 Dec. 2004		31 Dec. 2003		Assets according to the IFRS	31 Dec. 2004		31 Dec. 2003	
	K PLN		K PLN			K PLN		K PLN	
A. Fixed assets	15.936,3		25.919,5		A. Fixed assets	12.145,7		18.286,6	
I. Intangible and legal fixed assets	0,0		0,0		I. Intangible and legal fixed assets	0,0		9,4	
II. Tangible fixed assets	15.899,2		25.636,7		II. Tangible fixed assets	38,4		17.943,8	
III. Long-term receivables	0,0		0,0		III. Real property as investments	0,0		0,0	
IV. Long-term investments	37,2		37,2		IV. Fixed assets for sale	12.070,1		0,0	
V. Long-term prepayments	0,0		245,6		V. Long-term receivables	0,00		0,00	
					VI. Investments in units	37,2		37,2	
					VII. Deferred tax assets	0,00		296,2	
B. Current assets	8.243,5		11.138,2		B. Current assets	8.243,5		11.138,2	
I. Inventories	6,7		15,4		I. Inventories	6,7		15,4	
II. Short-term receivables	5.423,8		7.881,4		II. Receivables for deliveries and goods and other	5.423,8		7.881,4	
III. Short-term investments	2.808,5		3.237,4		III. Financial assets for trade	0,0		0,0	
IV. Short-term prepayments	4,5		4,0		IV. Cash and equivalent	2.808,5		3.237,4	
					V. Short-term prepayments	4,5		4,0	
Total assets	24.179,9		37.057,7		Total assets	20.389,2		29.424,8	

Source: own work based on the financial statements of the studied company.

Table 2

Liabilities of the studied company according to the Act on accounting and the IFRS

Liabilities according to the Act on accounting	31 Dec. 2004		31 Dec. 2003		Liabilities according to the IFRS		31 Dec. 2004		31 Dec. 2003	
	K PLN	(3.051,3)	K PLN	K PLN			K PLN	K PLN		
A. Equity capital, including:	18.161,5		30.574,1		A. Equity capital, including:		18.511,3		27.269,5	
VIII. Net profit (loss)			4.835,5		VI. Net profit (loss)		(863,4)		1.289,4	
B. Liabilities and provisions for liabilities	6.018,3		6.483,6		B. Liabilities and provisions for liabilities		1.877,9		2.155,3	
I. Provisions for liabilities	598,6		476,6		I. Long-term liabilities		206,4		301,8	
II. Long-term liabilities	0,0		0,0		II. Short-term liabilities		1.671,5		1.853,5	
III. Short-term liabilities	1.355,5		1.397,4							
IV. Accruals	4.064,2		4.609,5							
Total liabilities	24.179,9		37.057,7		Total liabilities and capital		20.389,2		29.424,8	

Source: own work based on the financial statements of the studied company.

Table 3

Profit and loss account of the studied company according to the Act on accounting and the IFRS

Profit and loss account according to the Act on accounting	31 Dec. 2004		31 Dec. 2003		Profit and loss account according to the IFRS	31 Dec. 2004		31 Dec. 2003	
	K PLN		K PLN			K PLN		K PLN	
A. Net sales revenues and equivalent, including:	6.050,6	10.068,9	10.068,9	10.068,9	A. Net sales revenues and equivalent, including:	6.050,7	10.069,0	10.068,9	10.068,9
B. Operating costs	6.612,4	10.717,3	10.717,3	10.717,3	B. Operating costs	6.441,4	10.574,3	10.574,3	10.574,3
C. Profit (loss) on sales (A-B)	(561,7)	(648,4)	(648,4)	(648,4)	C. Profit (loss) on sales (A-B)	(390,7)	(505,3)	(505,3)	(505,3)
D. Other operating revenue	3.013,8	12.177,9	12.177,9	12.177,9	D. Other revenues	2.125,5	9.392,4	9.392,4	9.392,4
E. Other operating costs	5.173,7	1.778,8	1.778,8	1.778,8	E. Other costs	2.071,3	1.800,6	1.800,6	1.800,6
F. Operating profit (loss) (C+D-E)	(2.721,6)	9.750,7	9.750,7	9.750,7	F. Operating profit (loss) (C+D-E)	(386,5)	7.086,5	7.086,5	7.086,5
G. Financial income	211,6	881,3	881,3	881,3	G. Financial costs	8,9	3.447,8	3.447,8	3.447,8
H. Financial costs	8,9	3.447,8	3.447,8	3.447,8	H. Gross profit (loss) (F-G)	(345,4)	3.638,7	3.638,7	3.638,7
I. Profit (loss) on economic activity (F+G-H)	(2.518,9)	7.184,2	7.184,2	7.184,2	I. Income tax	518,0	2.349,3	2.349,3	2.349,3
J. Result of extraordinary items (J.I.-J.II.)	(0,6)	13,5	13,5	13,5	J. Net profit (loss) (H-I)	(863,4)	1.289,4	1.289,4	1.289,4
K. Gross profit (loss) (I+J)	(2.519,5)	7.197,7	7.197,7	7.197,7					
L. Income tax	531,8	2.362,2	2.362,2	2.362,2					
M. Net profit (loss) (K-L)	(3.051,3)	4.835,5	4.835,5	4.835,5					

Source: financial statements of the subject company.



Additionally, the assets were adjusted by the net value of fixed assets sold and the amount of depreciation for 2003. The adjusted net value decreased the value of assets while the depreciation influenced that value in the opposite way.

As a consequence of the correlation between the IAS 36 and IFRS 5 "Fixed assets for sale and ceased activities" the order of applying those two standards is important. As at the balance sheet date, i.e. 31.12.2004, the company applied IFRS 5, which was reflected in the balance sheet while the additional assets were decreased by costs related to sale of assets.

As indicated by table 2, changes occurred in both the equity, where an increase by 1.9% occurred, and in the liabilities. The change representing the largest value occurred in the net profit (loss), which decreased by ca. 3.5 times as compared to the profit measured according to the Polish accounting law. In that item the results of assets valuation and adjustments for updating deductions were accumulated.

Increase in long-term liabilities resulted from reclassification of accruals. The perpetual usufruct rights were removed from that item and the presentation of other prepayments was changed by classifying them to liabilities.

Data presented in table 2 indicate that short-term liabilities according to the IFRS were increased by the cash received for the conditional real property sale contracts made (according to the regulations of the Act on accounting those amounts would represent prepayments).

One of the fundamental principles of IAS 18 "Revenues" is that revenues and costs concerning the same transaction should be represented in parallel. As a consequence, one cannot present revenues if we do not have the reliably defined amount of transaction costs. If the seller, then, received payment (on the base of the conditional contract) it represents the liability to the buyer until the amount of costs related to that transaction is defined in a reliable way.

As indicated by table 2, the accruals were adjusted by the following titles:

- according to the IAS 17 "Leasing" the value of land perpetual usufruct rights at PLN 3,925,800 did not satisfy the criterion of including it in the balance sheet and it was transferred to non-balance sheet records (treated as operational leasing),

- the surplus over the book value of the object of financial lease was included in the year of making the lease contract and increased the result of the past years,

- additionally, amounts received from conditional contracts made, according to IAS 18, "Revenues" were included in short-term liabilities.

Transformation of the statement influenced both the revenues and the costs of the company, which resulted in decreasing the net loss for 2004

(tab. 3). Total revenues determined according to the IAS 18 were lower than the revenues determined according to the Polish accounting law by ca. 12%. This was caused by the change in valuation of the fixed assets sold where the profit from sale of fixed assets in 2004 according to the Polish accounting law was achieved at book values, which were not subject to revaluation. Revenues according to the IFRS were adjusted (decreased) also by a part of the surplus achieved resulting from leasing. Depreciation, which reflected the period of use of assets by the company (before transformation of the statements depreciation was determined according to the tax rates) also influenced the level of costs measured according to the Polish accounting law. Additionally, as of December 2004, depreciation of fixed assets transferred to the fixed assets for sale was ceased.

The data presented in table 3 indicate that the other costs according to the IFRS were decreased by 60% as compared to the costs measured according to the Polish regulations, which resulted from reverting the deductions for permanent loss of value of fixed assets that were established according to the Polish regulations. After valuation of assets according to the IFRS the deduction decreased only the capital from valuation update. According to the IFRS the estimated costs related to disposal of fixed assets, which according to the Polish regulations decreased the capital from valuation update were included in the costs.

### **Summary and conclusions**

The progressing process of economy globalisation determines the need for harmonisation of accounting. The global trends and solutions applied in accounting in other countries are also visible in the Polish accounting law, which is exemplified by numerous amendments to the Act on accounting.

Transformation of the financial statement into one that is consistent with the international accounting standards requires a lot of work. There are still, despite implementation into the Polish accounting law of the solutions consistent with the international accounting standards, numerous areas where the IAS and Polish accounting regulations differ.

The problem of financial statements transformation is currently described extensively in the literature. This results from the fact that there are differences of opinions on interpretation and application of the International Financial Reporting Standards.

The results of the conducted studies allow formulation of the following conclusions:

1. As a result of application of the IFRS, the values of total assets and total liabilities decreased by ca. 16%. That resulted mainly from removing the land

perpetual usufruct rights from the balance sheet and valuation of assets according to the fair value.

2. After application of the principles of accounting of the IFRS the increase of the share of equity in the sources of financing the assets of the studied companies by 15% occurred. This was caused mainly by the decrease of the total liabilities. The changes in the structure of liabilities were influenced mainly by accruals, which before transformation represented 16.8% of total liabilities and after application of the IFRS their share was zero. That was the consequence of removing the land perpetual usufruct rights from the balance sheet and transformation of accruals into liabilities according to the IFRS.

3. Transformations made in the profit and loss account caused that the financial result of the company after changes of regulations according to the IFRS was improved significantly. Before the transformation the net loss amounted PLN 3,051,300 and after application of the IFRS the loss was decreased to PLN 863,400, i.e. by around 2/3 of the initial value. In case of the studied company, first of all, the profit resulting from sales of assets, deductions for permanent loss of value of assets and costs of depreciation were represented in more realistic way after applying the depreciation rates considering benefits for the company from using the individual groups of assets. As a consequence, the consequences resulting from the real value of assets were not achieved during the current year on sale of the assets, as was the case according to the Polish accounting rules, but were included in the retained profits or capital from valuation update.

Concluding, the differences between the Polish accounting law and the International Financial Reporting Standards have a significant influence on the balance sheet structure and, as a consequence, suitability of the financial statement for the users and quality of decisions taken. Nevertheless it should be noticed that there are areas where application of the IFRS did not result in appearance of differences. The current assets should be mentioned here first of all. The valuation of those components was the same according to the Polish accounting law and the IFRS.

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