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The Adoption of IFRS in Poland:

An Institutional Approach

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DECLARATION

I certify that this work has not been accepted in substance for any degree and is not concurrently being submitted for any degree other than that of PhD being studied at the University of Greenwich. I also declare that this work is the result of my own investigations except where otherwise identified by reference and I have not plagiarised another's work.

Signed:

Student: ………………………………….

Supervisor: ………………………………..

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ABSTRACT

The introduction of IFRS (International Financial Reporting Standards) in the EU in 2005 was perceived to be a major step towards greater global harmonisation of accounting leading to better comparability and uniformity of financial statements (Deloitte Touche Tohmatsu, 2005). However, prior literature suggests that there are significant national differences in *de facto* application of the international standards (Kvaal and Nobes, 2010; Krzywda and Schroeder, 2007).

This thesis, supported with empirical data, contributes to knowledge by rejecting the argument commonly put forward by the International Accounting Standards Board (IASB) and other policy setters that the adoption of IFRS will in itself be sufficient to achieve harmonisation of accounting practice. The research uses a case study of Poland to address three main research questions. Firstly, whether the accounting standards as promulgated by IASB (International Accounting Standards Board) have been fully adopted by Polish listed companies?

Secondly, the thesis addresses the question that if Polish companies are not compliant with IFRS what are the reasons for the non-compliance? The thesis draws on the sociological perspective of new institutional theory as put forward by Meyer and Rowan (1977) and DiMaggio and Powell (1983) to explain the reasons for the deviation in accounting practice from IFRS in Poland. The response of the Polish companies to the external demands to adopt IFRS has been evaluated using the model developed by Oliver (1991) where responses may vary from full acquiescence to defiance.

Thirdly the thesis addresses the question to what extent is new institutional theory adequate for explaining the motives driving the behaviour of various actors in the field of financial reporting?

The study contributes to knowledge by linking institutional theory to organisational behaviour and accounting practice in a transition economy in a novel and previously unexplored way in order to gain a better understanding of the role of accounting in Poland. The study of Poland provides a particularly insightful and novel approach for the study because Poland is a post-communist economy and so its national institutional orientation is significantly different to the Anglo-Saxon origins of IFRS. Poland is also a recent entrant to EU and so the interaction of communist legacy with market orientation allows better understanding of the institutional and economic factors that shape accounting.

The thesis maintains that financial reports produced by Polish companies are rationalised 'myths' due to the largely ceremonial adoption of IFRS. Furthermore, the quality of accounting is affected by various competing institutional forces.

The thesis makes a contribution to the theory by challenging the narrow perspective of mainstream new institutional theory which focuses on the homogeneity and permanency of existing practices. In contrast this research focuses on the dynamic conflict between the existing structures and new regulatory pressures that lead to the breakdown of old institutional arrangements. In particular the study addresses two aspects of institutional theory that have been neglected in prior research. Firstly, drawing on Lounsbury (2008) the notion of multiple logics and therefore different concepts of rationality have been mobilised to explain variation in accounting practice. Secondly, the role of power and conflict are used to explain the current institutional arrangements in Poland and the changing role of the accountancy profession (Lawrence, 2008). In adopting the power and multiple logics perspectives, which are not addressed in the earlier seminal works, a better insight has been gained into the heterogeneity of organisations rather than accepting the notions of order and stability.

Using institutional perspective it is argued that companies are failing to comply fully with IFRS because they face a multiplicity of expectations arising from different institutional origins. Their strategic response to these pressures is to 'compromise' to satisfy the competing demands of the accounting profession, investors and the tax authorities.

The power and resource dependency constructs were also utilised to explain how major firms of accountants attempt to penetrate the existing accounting structures in Poland and so influence the role that accounting plays in Poland. The analysis also highlights the tensions between the various bodies and the impact that has on company reporting. In particular both the state and other stakeholders utilise a common set of financial statements and the extent to which they meet the objectives of each user group is explained using the power construct.

Following call by (Suddaby, 2010) and DiMaggio (1985) for greater research focus on actions at actor level this research considers individual organisational responses to the requirement to introduce IFRS into Polish accounting framework. The thesis finds that that Polish companies will change their established practices in response to the external influences and their actions are rationally determined based on different logics and the relative influence of coercive forces which either promote or hinder change. The research has found that in Poland coercive pressure was the primary mechanism for achieving isomorphism whilst prior literature indicates that in market economies mimetic mechanism was far more important. This coercive mechanism was particularly potent due to the strong influence of the state which was a legacy of the communist system leading to weak accountancy profession. In contrast, increasing influence of the global accountancy firms and EU regulation are forcing the changes to the accounting regulation, governance structures and education of accountants in Poland. The research finds that in spite of the fact that all companies examined purport to comply with IFRS there are significant deviations in *de facto* compliance. The findings provide strong evidence of decoupling through superficial compliance. Organisations are not however decoupling in a uniform manner but appear to selectively decide on areas where they comply or not. In particular lack of compliance with disclosure requirements appear to be related to cultural characteristics of secrecy and power distance which were prevalent in the communist era. Research confirms that companies compromise by making explicit statement of compliance with IFRS whilst in many cases failing to meet the spirit of IFRS in failing to fully provide useful information for the stakeholders. Even where there is compliance the introduction of IFRS has not improved uniformity due to the use of alternative treatments permissible under IFRS.

The research utilises a mixed methodology to gain a deeper understanding of the complexity of the factors implicated in shaping of accounting. In order to identify the level of compliance with IFRS published financial data for 2005 for 40 Polish companies that are listed on the Warsaw Stock Exchange is analysed and then explained with in-depth interviews held with representatives of the institutions implicated in the study. The differences between Polish accounting regulation and IFRS were measured using comparability index first proposed by Gray (1980).

CONTENTS

FIGURES

LIST OF ABBREVIATIONS

CESR	Committee of the European Stock Exchanges
CMEA	Council for Mutual Economic Assistance
EU	European Union
FDI	Foreign Direct Investment
FESE	Federation of European Securities Exchanges
GAAP	Generally Accepted Accounting Principles
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
KIBR	National Chamber of Auditors (*Krajowa Izba Bieglych Rewidentów*)
KNF	Financial Oversight Commission (*Komisja Nadzoru Finansowego*)
PAR	Polish Accounting Regulation
SEC	Securities and Exchange Commission
WSE	Warsaw Stock Exchange

1. INTRODUCTION

1.1 Background

Globalisation of business and capital markets has created a need for a global accounting system. Over the last twenty years the leadership for the development of global accounting framework has been assumed by the International Accounting Standard Board (IASB). Sir David Tweedie, former Chairman of IASB, stated that: 'As the world's capital markets integrate, the logic of a single set of accounting standards is evident. A single set of international standards will enhance comparability of financial information and should make the allocation of capital across borders more efficient. The development and acceptance of international standards should also reduce compliance costs for corporations and improve consistency in audit quality' (Tweedie, 2005:2).

A major step towards the standardisation of accounting practice has been achieved in the EU (European Union) by the adoption of International Financial Reporting Standards (IFRS) by all listed EU companies from 2005 as part of the EU requirements (Commission of the European Communities, Regulation 1606/2002).

However, in spite of the adoption of IFRS in Europe which aimed to meet the IASB objective prior research shows that full comparability has not been achieved. Kvaal and Nobes (2010) reviewed financial statements of companies listed on the largest five stock exchanges that use IFRS and concluded that: 'IFRS practice is subject to systematic differences across countries. The continuation of national traditions seems to explain variations in IFRS policies between countries' (Kvaal and Nobes, 2010:185).

Whereas prior to the mandatory adoption of IFRS in EU only a small number of companies prepared IFRS compliant accounts the extension of the requirement to all listed companies has meant that over 8000 companies have been mandated to prepare IFRS accounts from 2005. Schipper (2005) argued that companies compelled to comply with IFRS from 2005 exhibit quite different characteristics from those companies that adopted IFRS voluntarily prior to 2005. The mandated companies are much more heterogeneous in terms of characteristics such as size, ownership structure and trading orientation (Schipper, 2005) and these factors may lead to persistent differences remaining. Prior studies from countries that have adopted IFRS demonstrate that significant differences remain between practice and IFRS pointing to a continued lack of convergence (Gray *et al.*, 2009; Tsalavoutas and Evans, 2007; Krzywda and Schroeder, 2007; Ball *et al.*, 2003).

Lack of compliance with IFRS would indicate that standards only partially explain accounting practice and other institutional factors play a significant role in shaping the reporting environment. Although the introduction of IFRS internationally is a prerequisite to the provision of relevant, consistent and reliable financial information Ball, (2006:8) doubts that this aim can be achieved in practice due to the different national characteristics: 'Despite the undoubted integration that has occurred, notably in the capital and product markets, most market and political forces are local, and will remain so for the foreseeable future. Consequently, it is unclear how much convergence in *actual financial reporting practice* will (or should) occur'. The principle based nature of IFRS means that managers have considerable latitude to use their judgement to interpret the standards (Kvaal and Nobes, 2010). Exactly what is the influence of the various factors on accounting practice is not clear as summarised by Schipper (2005:107) who states that: ‘the exact nature of the relation between incentives and standards in determining the characteristics of reported numbers is, however, not well understood. The 2005 European Union implementation of IFRS will provide a useful research setting for probing this relation further.’

Research into compliance with IFRS continues to be highly topical in the light of the recent financial crisis where some of the reporting practices by financial institutions were seen to have contributed to the crisis. At the Pittsburgh Summit, held in September 2009, the G-20 leaders stated ‘We call on our international accounting bodies to redouble their efforts to achieve a single set of high quality, global accounting standards within the context of their independent standard setting process, and complete their convergence project by June 2011’ (G-20, 2009:9, paragraph 14). The supra-national call for the globalisation of accounting then cascades to the forefront of financial policy agendas of national standard setters in jurisdictions that are still considering the adoption of IFRS such as the United States (US) and China. IFRS have been accepted for foreign issuers on US stock exchanges since 2007. However, the major challenge facing IASB at the moment is to gain acceptance from the Securities and Exchange Commission (SEC) of IFRS accounts for US listed domestic firms because US is the largest capital market in the world and therefore critical to the globalisation initiative. IASB and SEC have developed a roadmap with an aim of mandatory adoption of IFRS in US by 2015 (Gray *et al.*, 2009). However, SEC has stated that IFRS accounts will only be acceptable once the US authorities are satisfied that full convergence of IFRS and US GAAP has been achieved. Henry *et al.* (2009) found a lack of consistency in the application of IFRS by EU companies listed in US depending on the sector and the country of origin. This raises issues on the ability of IFRS to provide a framework that is sufficiently robust to be accepted in US.

The experience of the earlier adoption of IFRS in EU provides a rich source of evidence on the progress of convergence to the IFRS from national frameworks. The insight gained will inform the US GAAP versus IFRS debate mentioned above as well as being useful for other countries planning to adopt IFRS such as Canada (adopted IFRS from January 2011) or Japan where as yet there is no definitive date for the adoption of IFRS. The research is also of benefit to the regulators, auditors and preparers of financial reports in Poland being the country under investigation in this thesis.

The thesis utilises Poland as a case study of a country that has adopted IFRS as a condition of its entry into the EU in 2004. Poland is a particularly interesting state to study from the accounting classification perspective. Using the classification model put forward by Nobes (1998) Poland may be thought of as a country with strong creditor and tax orientation and weak equity-outsider and supported with a law based accounting system. It is however adapting to a diametrically opposite system of IFRS characterised by strong equity outsider and shareholder orientation with principle based accounting. In this environment the differences between the two systems are most striking and clearly demonstrate the dichotomy between national and international frameworks.

The adoption of IFRS in Poland offers a unique opportunity to study the impact of International Standards on the quality of financial reporting practice in an economy in transition from communism to becoming an EU member state. Poland joined the EU in 2004 and is the largest transition state to have done so. The country's experience of its efforts to introduce IFRS will be highly relevant to other transition economies such as Romania and Bulgaria that acceded to the EU in 2007 and are also required to comply with IFRS as mandated by EU and for Croatia who is scheduled to join EU in 2013. Evidence from other countries in the former Soviet bloc also shows that they are moving to IASB with the aim of improving their national accounting regimes as their economic progress continues (Tyrrall *et al.*, 2007). Given that all former communist countries have a common history of Soviet style accounting many of the institutional and cultural challenges facing these countries will be similar to the experiences of Poland.

1.2 Research Goals, Aims and Objectives

The primary aim of this thesis is to contribute to the understanding of institutional responses in the light of the changes taking place in the area of financial reporting by evaluating the process of implementation of International Financial Reporting Standards (IFRS) in Poland. The above aim is addressed by setting three main objectives. Firstly, to evaluate the level of compliance with IFRS by Polish listed companies. Secondly, to explain the reasons for non-compliance by utilising concepts and factors embodied in new institutional theory. Thirdly, to provide new insights into institutional theory by studying the interaction of complex relationships within the institutional field of financial reporting.

The study challenges the view presented by the IASB, the global firms of accountants and other financial institutions that the introduction of IFRS will in itself lead to greater comparability of accounting and is therefore the only method of improving financial reporting. Using evidence from a sample of consolidated financial statements from Polish listed companies the thesis provides evidence of the continual divergence and lack of comparability of financial information even when a common IFRS framework is adopted which has wide ranging policy implications for stakeholders and regulators.

IFRS requirements are designed to ensure that financial statements are useful for decision making by shareholders therefore failure to comply with IFRS leads to the fundamental question as to whether financial reporting has the same meaning and significance in Poland as it has in Anglo-Saxon countries. Using institutional lens lack of compliance with IFRS is treated in this study as a process of decoupling of actual practice from the IFRS requirements so that financial statements are rational but have no real technical value. The ‘myth’ lies in the fact that firms state that they comply with IFRS whilst actual practice often follows the established routines and set pro-formas required in the pre-IFRS period. In particular disclosure requirements are not met which suggests that provision of information to stakeholders is not the aim of Polish companies even though it is the fundamental objective of IFRS framework. By superficially complying with IFRS companies not only meet the legal obligation but are also seen to be legitimate and following best international practice.

However, the research also demonstrates that compliance is not always ceremonial but, as was found in the case of revaluation of fixed assets, accountants are prepared to undertake real changes and do not follow established institutionalised behaviour. The research finds that the revaluations in all cases results in significant improvement in the balance sheet values so the changes are deemed to be both technical and linked to resource dependency. The revaluations are presented in the accounts as neutral and objective numbers but the lack of detail of independent valuation process indicates that the in reality these numbers are highly subjective and open to manipulation.

The thesis aims to extend the new institutional theory first proposed by DiMaggio and Powell (1983) and Meyer and Rowan (1977) to recognise more fully the role of institutional factors in Poland accepting the view that ‘accounts are the quintessential rationalised myth, and it is surprising that new institutionalists have not devoted more time to studying them'(Carruthers, 1995:326). A model is developed based on the new institutional theory and evaluated using a hypothesis supported with three further propositions.

The introduction of IFRS offers the opportunity to study the dynamic process of institutional change from the perspective of an Anglo-Saxon framework being introduced to a post-communist economy where a whole range of often conflicting pressures arising from the communist era and from supra-national act on the organisations. The process of importation of IFRS into a transition economy allows the identification of the specific factors that provide explanatory variables for accounting practice. Prior research (Ernst and Young, 2006) suggests that even when a common accounting system such as IFRS is applied internationally, there are variations in the application of judgment that result in a lack of comparability between countries.

This thesis applies insights from financial reporting and institutional theory to explain the reasons for the apparent accounting differences using Poland as a case study. Drawing on institutional theory the thesis posits that it is human action that shapes practice and leads to embedded routines and that accounting cannot be seen as purely technical skill detached from the social setting in which operates (Hopwood, 2000). Within financial reporting, the IFRS regime permits alternative accounting treatments that can be differently interpreted and chosen by company accountants. Exactly what are the factors that shape the accountants' decisions will have implications for accounting practice and for the establishment of new accounting routines and institutions.

The study contributes to the body of research in the area of new institutionalism by focussing on the conflict between the existing structures arising from the state rooted in the communist system and the new influences of emerging accountancy profession and the EU regulatory demands. Whereas institutional theory is generally used to explain institutional similarities and legitimacy motives of organisations many researchers have pointed to the dynamic behaviour of firms (Greenwood *et al.*, 2002, Hopwood, 2000). This thesis aims to contribute to the development of a more comprehensive institutionalist approach by studying the process of institutionalisation as put forward by Lounsbury (2008:354) who calls for ‘an approach to logics that conceptualises institutional environments as more fragmented and contested’. In Poland the introduction of IFRS in 2005 simultaneously involved the transformation of the old accounting routines and the introduction of a new system in an institutional context that was formulated in the communist era. The research empirically measures the practice responses by companies in the very first year of the adoption of IFRS and so the focus of the study is on the initial stage of theorisation as proposed by Greenwood *et al.* (2002) and provides unique insight into how EU regulatory demands are diffused and lead to the institutionalisation of imported norms whilst the old communist rules are gradually displaced.

Through the medium of the adoption of IFRS the thesis provides an insight into the composition and action at the level of financial reporting field which has not been given sufficient attention in prior research. Lounsbury (2008:356) argues that whilst study of ‘practice has been extremely fruitful it has tended to ignore broader institutional dynamics in favour of more micro-processual studies’. The study demonstrates that the structure of the financial reporting field in Poland is shaped and influenced by a contest for power and resources which have been largely absent from the DiMaggio and Powell (1983) work. The thesis contributes to the understanding of the power dimension by showing the effect of the power struggle on the adoption of IFRS between the state and other actors in the financial reporting field. At macro-level the rise of the Big-4 firms of accountants can be seen as a dynamic struggle for influence with state organs in areas such as accounting education, regulation and oversight which the state has traditionally controlled. Power of the state comes from having control over information flows which are not shared through wider consultation and through the state's dominant position on the key decision making committees related to all aspects of auditor duties and accreditation. Conversely, the Big-4 firms superior financial resources and expert knowledge of IFRS has meant that their influence is growing as evidenced by the fact that majority of the largest listed Polish companies are now audited by the Big-4 firms of auditors.

At firm level the introduction of IFRS has meant that although the objectives of financial reports have changed from tax to shareholder orientation accountants continue to pay more attention to the demands of the state rather than the shareholders resulting in companies compromising so as to satisfy the multiple objectives. Using the power perspective the thesis demonstrates that the coercive power of the tax authorities is far more potent than the influence of IFRS requirements. The power of the state is enhanced by the lack of clarity of tax law allowing the tax authorities to be final arbitrators in tax disputes and the high level of penalties imposed for non-compliance. In contrast there is minimal coercion associated with the enforcement of compliance of IFRS and so the asymmetrical exercise of power result in the tax orientation of financial statements.

The thesis explores the motivation for compliance with IFRS which arises from three sources namely: regulation, normative pressure and resource dependency as discussed below. The study contributes to the theory of how institutionalised behaviour is established because each of the three factors offers different rationale for accounting behaviour. This thesis explores the variability in the influence of each of the factors in Poland during the period of transition and so provides better understanding of the form of institutional order that exists in Poland and how it is changing as transition progresses. Di Maggio and Powell (1983) treat the three factors as having equal influence but this research shows that the political and social context determines the strength of each factor. Therefore the institutional pressures are country specific and this fact has not been given sufficient attention in the literature.

The research also makes a contribution in terms of its integration of technical accounting findings with institutionalism thus providing a new theoretical perspective on the process of theorisation of accounting practice. In particular the research provides insight into how adoption of European norms and rules in the area of financial reporting interacts with the transformation of the accountancy profession. The adoption of IFRS requires high level of technical competence normally associated with strong professional practice (Suddaby *et al.*, 2009). In Poland, since the fall of communism, the accountancy profession has undergone profound changes in terms it purpose, status and identity. This area has not been researched adequately in the context of economic transition that has taken place in the post communist economies of Central and Eastern Europe. The study contributes to our understanding of how accountancy profession has emerged in Poland and what forces have been instrumental in defining the perceptions of the accounting profession in Poland. In doing so the thesis also explores the growth in the importance of normative factors and at the same time waning of coercive forces in a transition economy.

Further insight into the institutional theory is provided by considering the relationship between the national accountancy profession and the Big-4 firms. Whereas, institutional theory portrays the accountancy profession as being homogenous and sharing a common identity this is not the case in the Polish context where the origins of the two factions of the profession have very different social and cultural background. Through the use of interpretive research it is shown that the profession is in a process of change with the major firms attempting to gain influence and market share often by emphasising their expert knowledge of the language and application of IFRS at the expense of the local accountants.

The thesis clearly demonstrates that the relationships within the organisational field of financial reporting are highly conflictual and contested not only between the state and the companies but also between the state and the profession and within the accountancy profession itself.

Finally, the study makes a methodological contribution to institutional research. According to Scott (2008) much of the literature pertaining to institutional theory focuses on theory development and assertions of institutionalisation supported only by illustrative examples but do not provide substantive evidence. In this thesis content analysis of financial statements provides a more rigorous evidence of compliance with the general principles of IFRS which can be considered to be proxy evidence for the ability of companies to undergo change.

The overarching hypothesis of this research states that the adoption of IFRS is in itself not sufficient to ensure full compliance with IFRS and wider incentives must be taken into account when evaluating the progress of harmonisation. Furthermore, in a transition economy companies try to meet the demands of IFRS by compromising and only as they move towards a full market economy is acquiescence achieved.

Exactly which response will be adopted depends on the institutional and economic factors that shape the institutional field in which companies operate. These factors can be grouped into three main categories which lead to the following propositions:

- Strength of the accountancy profession
- The power and influence of the state institutions
- The level of resource dependency by the companies

The institutional factors noted above have been derived from the seminal work by DiMaggio and Powell (1983) and Carpenter and Feroz (2001) and applied to financial reporting where it is the particular balance between the three variables that shape the accounting function. In post communist economies the state exercises very powerful position whilst accountancy profession is weak and there is little reliance on equity funding. The dynamic nature of institutional transformation draws on the theoretical work of Oliver (1991). During the process of transition to market economy the balance of influence shifts away from the state and towards greater professionalization and greater reliance on equity funding which in turn impacts on the accounting practice. The propositions have been summarised as follows:

Proposition 1: A weak accountancy profession in Poland leads to compromising by companies with regard to IFRS. Companies continue to adhere to previously established accounting practices and do not adopt IFRS fully.

Proposition 2: Where there are competing demands arising from state agencies and from accounting regulation the companies will fully adhere to the state demands, primarily those of the tax authorities, at the expense of IFRS compliance.

Proposition 3: Compliance with IFRS will be greater where there is the greatest economic necessity to raise capital from a broad group of investors.

1.3 Institutional context for the study of IFRS in Poland

The thesis uses new institutional theory as the basis for explaining the level of compliance with IFRS in Poland. In particular the research draws on the work of Di Maggio and Powell (1983) to identify the accountancy profession and the state bodies together with resource dependency as being the main drivers that shape the practice of accounting in Poland. The new institutional framework is seen as being useful for the study of organisations where the primary influences arise from institutional pressures rather than competitive market forces. For this reason new institutional theory has been extensively used to study accounting issues in public organisations which are highly influenced by institutions but it has not been employed for the study of financial reporting practices within profit orientated companies where competitive pressures are far greater.

However, within the transition economy it is assumed that institutional forces arising from the socialist system act as a powerful influence on the companies and conversely competitive forces are weaker. The special features of transition economy provide a strong justification for the use of institutional approach. Prior research by Covalesky and Dirsmith (1988), Carpenter and Feroz (2001), Collin *et al.* (2009) all acknowledge that accounting practice has a broader social, organisational and cultural dimension. Variability in the preparation of financial statements would point to the contribution of wider social and political influences on the practice of financial reporting.

However majority of the studies including those listed above were carried out in market economies, primarily in US and Canada (Suddaby *et al*., 2009). The interaction of the IFRS framework, which originates in capitalist Anglo-Saxon countries, with the national frameworks of transition economies provides a useful setting for the study of international harmonisation of accounting. Specifically, Poland offers a unique opportunity to study the process of institutionalisation in the dynamic environment of EU enlargement, continuing transformation of the economy and the development of the accounting profession. The thesis explores the influence of institutional factors on the behaviour of Polish companies when reporting financial information and then goes on to link together institutional theories with organisational behaviour and accounting practice.

Drawing on institutional theory it is accepted that organisational behaviour is shaped by societal norms and expectations (Scott, 1995, Dillard *et al.*, 2004, Lounsbury, 2008 Scott, 2008). In Poland the underlying ideological, political and economic environment underpins a fundamental change from a command economy to market based economy and this transformation provides an opportunity to contribute to the understanding of institutions by considering the impact of political and social change on organisational behaviour. Socio-political and institutional theories recognise the political and organisational context in which managers operate and so offer a deeper and richer understanding of financial reporting in Poland.

Scott (1987) argues that over time generally accepted traditions and customs become codified in legal rules and regulations that in turn shape the institutional environment. In the context of this study the relevant institutions include legal, financial and accounting systems as well the ownership structure of businesses and the influence of the accountancy profession. These institutions, once developed, strengthen and structure the relationships between organisations so that behaviour is difficult to alter even in the light of considerable international pressure for change derived from adoption of IFRS or EU directives.

The institutional behaviour is underpinned by cultural foundations which emphasise ‘shared conceptions that constitute the nature of social reality and the frames through which meaning is made’ (Scott, 2008:57). Both cultural and institutional theories emphasise the underlying taken for granted structures so cultural characteristics as well as the institutional setting clearly shape the practice of accounting (Scott, 2008; Lounsbury, 2008). However, the impact of culture *per se* has not been treated as an independent variable in this study for three reasons. Firstly, institutional theory is typically applied to a defined field so the analysis can be more directly focussed on the actions of relevant actors whereas cultural influence is pervasive and involves all aspects of human behaviour so it is difficult to operationalise this perspective to financial harmonisation McSweeney (2002). Secondly, cultural orientation focuses on common orientation of the society and does not adequately explain issues of power and transformation (Pfeffer, 1994) which play a major part in the Polish transformation. Finally, the academic literature that underpins institutional theories does not cross over into cultural theories to any great extent and this research therefore adopts a similar approach and is restricted to the consideration of institutions. Hatch and Zilber, (2011:1) state that: *‘although the notion of the taken for granted is important to institutional theory and organizational culture theory what this means and implies is quite different for each. We also found that institutions and cultures involve meaning, the two are understood and explored methodologically in quite different ways’* However, this thesis does not reject the impact of culture but maintains that the study of institutional behaviour provides an indirect insight into cultural norms and behaviour by Polish accountants.

The position of the state in relation to the function of accounting is examined firstly as a theoretical framework and then applied to the economic systems that existed in Poland in the post-war years. DiMaggio and Powell (1983:147) identify the state and the professions as the primary agents for institutionalising behaviour in societies stating that 'they have become the great 'rationalisers' of the second half of the twentieth century'. Accounting has been portrayed by these agents as being rational, largely value neutral and objective thereby increasing their influence. However, Scott (1987) argued that the state uses its authority to increase its own power through centralisation and reduced autonomy for the organisations within its sphere of influence. Power in this context has been defined by Colignon and Covalesky, (1991) as the degree of control over human and material resources. In Poland the state, through its agencies such as the fiscal authorities, plays a far greater role in the activities of organisations than would be the case in developed market economies. This behaviour arises from the communist era when the state controlled all aspects of economic activities allowing no autonomy to local organisations. The power dimension for a transition economy presents considerable tension between interest groups rooted in the communist regime and those arising from the operation of market economy.

The relative effect of these agents has a considerable influence on the practice of accounting in Poland and their impact is explored in this thesis using a qualitative research methodology. In particular the influence of the state and the accountancy profession which contribute to institutional isomorphism is contrasted with the opposing influences of external factors arising from international regulation and power of foreign investors which act to change the behaviour of Polish listed companies.

1.4 Proposed methodology

The stated hypothesis and propositions of this research are investigated using the adoption of IFRS as an event that has significant accounting consequences and allows the impact to be studied through an institutional lens. The design of this research adopts a mixed approach utilising both qualitative and quantitative methods which are applied to institutional field of the organisations being studied namely companies, auditors, investors, accountancy profession and state agencies. Whilst the quantitative research provides factual measures of the differences between IFRS and Polish accounting regulation a qualitative approach is required to gain an in-depth understanding of the explanatory factors that lead to the persistence of differences between the two accounting frameworks. The interpretive approach, using organisational field, focuses on the totality of relevant actors and provides a deeper and broader understanding of the underlying influences on accounting in the context of a transition economy. The results from both qualitative and quantitative research are triangulated to improve the reliability and validity of the findings.

Two different research methods are utilised to measure and explain the degree of harmonisation of accounting practice in Poland. The first stage of this study provides empirical evidence on how well the transition process from national to international standards is progressing in Poland by considering the *de facto* level of compliance with IFRS by Polish listed companies that are mandated to apply IFRS from 2005. This is a unique and critical year because it allows the transition from one accounting framework to be compared with another ie. IFRS. In all future years after 2005 companies will report only on IFRS basis and so it will not be possible to measure the magnitude of differences between Polish regulation and IFRS.

In terms of institutional theory the study of compliance provides evidence of the consequences of institutionalisation. Companies that do not meet the spirit of IFRS can be considered as being institutionalised being unable to change and wedded to the old routines and habits of the communist era. Companies that fully adopt IFRS or are early adopters of these standards are considered as innovative and likely to be motivated to comply by rational competitive forces rather than institutionally determined. The thesis evaluates *de facto* compliance with IFRS of 40 Polish listed companies out of a total of 304 firms in 2005 being the first year when these companies were required to report under IFRS regime. Content analysis of published financial statements from a sample of 20 largest and 20 smaller companies is employed for this part of the research. Although in terms of the number companies the sample represents only 13 per cent of companies however the sample of the largest companies represents a far greater proportion in terms of market size forming 40 per cent of the overall market capitalisation. Furthermore many of the smaller listed companies were single companies and were not required to produce IFRS accounts and so the relevant population is far smaller than the total number of companies listed would suggest.

Content analysis of the financial statements in relation to *de facto* compliance is used to:

- Calculate Gray’s comparability index (to measure the impact of conversion to IFRS on equity, net income and Return on Equity) (sections 5.2.6 and 5.2.7)
- Evaluate compliance with IFRS 1 (First Time Adoption of IFRS) (section 5.2.4)
- Measure the level of audit qualifications (section 5.2.3)
- Evaluate the presentation of the financial statements (section 5.2.1)

The second stage of the research evaluates the role of institutional factors identified in the theoretical model that explain the variable nature of compliance by Polish companies and allow the new institutional theory to be tested in a dynamic environment.

This stage of research utilises qualitative research including content analysis of financial statements and interviews.

Content analysis provides information regarding:

- The size of the audit firm in relation to the qualifications issued to provide evidence about the strength of the audit profession (section 5.3.2)
- Qualitative disclosure in financial statements regarding the role of the state in the form of tax authorities (section 5.4.3)
- The shareholding concentration by overseas investors (section 5.5) and the state (section 5.4.4) so that the resource dependency factor can be evaluated

Interviews were held with the representatives of the organisational field which has been defined by Di Maggio and Powell (1983:148)) as: 'those organisations that, in aggregate, constitute a recognised area of institutional life'. In the context of this research this means various agencies and firms that engage with IFRS including auditors, investment analysts, Ministry of Finance officials, Polish standard setters and listed company representatives. The aim of the interviews was to ascertain the roles played by the institutions in ensuring compliance with IFRS. The analysis of the broader institutional context in relation to accounting was used to identify the factors that hinder full convergence of Polish accounting to EU norms and to assess their impact on the quality of financial reporting. Although Polish firms now operate in a market economy the cultural and institutional setting is rooted in a centrally planned system and continues to affect the behaviour of the various actors

(Krzywda *et al.*, 1996). Whether Poland is able to achieve true convergence to IFRS will depend not only on the mandated requirement being incorporated into Polish GAAP but also on the ability of the institutions, managers and auditors to adapt to changing demands to facilitate financial information flow from the entities to the investors.

1.5 Structure of the thesis

The rest of the thesis is structured as follows:

Chapter 2 provides the background to the economic, political and institutional context of Poland. The unique feature of this research is to consider accounting from a perspective of a transition economy so this chapter contextualizes the research by considering the relative impact of the command and market economies on accounting practice in Poland.

Chapter 3 reviews the literature related to two distinct areas that subsequently inform the research of this study. Firstly, literature of international accounting harmonization is reviewed with specific reference to the harmonization process in the EU and in Poland. Secondly, the body of literature related to institutional theory is surveyed and this literature informs development of the theoretical model in this study. Thereafter the theoretical model based on new institutional theory is developed.

Chapter 4 proposes and justifies the methodology for the evaluation of the theoretical model set out in the previous chapter. The chapter refers to the methodologies utilized in prior studies as appropriate and identifies the limitations and assumptions inherent in the research design of this thesis.

Chapter 5 presents the research findings and evaluates the proposed theoretical model utilizing both quantitative and qualitative techniques described in chapter 4. Data from the content analysis discussed in the first part of the chapter 5.2 is used to enhance the value the subsequent research being interviews with the various actors involved in the field of financial reporting. The chapter culminates with the summary of the findings.

Chapter 6 firstly recaps the main research objectives and then evaluates the contribution made to the methodology, theory and knowledge. Based on the findings identified in chapter 5 the thesis discusses various practical policy implications for the institutions implicated in financial reporting both in Poland and internationally. Finally the author proposes areas for future research.

2. POLAND'S HISTORICAL PERSPECTIVE

2.1 Introduction

Poland is a central European democratic country with a population of 38 million and GDP per capita of US dollars 17,294 in 2008 (OECD, 2010). Its geographic location, sandwiched between the two powerful nations of Russia and Germany, has had significant and long lasting effect on the development of its social, political and economic structures. Both Germany and Russia have also played an important role in the creation of three ideologically different systems that can be identified in Poland in the 20th century namely market economy pre Second World War, Communist era and transition era culminating in the membership of the EU . Each era has had a profound impact on contemporary Polish development and will be considered in detail below. The analysis focuses on those aspects of Polish history that have the power to explain the current orientation and practices in relation to the development of Polish accounting. Inevitably this means that some aspects of historical developments are given greater weight in this analysis when compared to others. In particular economic, monetary and legal developments are given greater predominance as they have been widely recognised in academic literature as being the main influences in the development of accounting systems (Nobes, 1998; Jaggi and Pek Yee Low 2000; Roberts *et al.*, 2005).

The historical dimension has a particular significance in the understanding of the development of Polish accounting. Colignon and Covaleski (1991), in their analysis of accounting argue that tensions between the technical, objective rationality and substantive rationality can only be understood by placing accounting in a sociological and historical context. Actions are not objective but are subjectively created based on the social interactions, meanings and norms that are shaped by the society. Hebermas (1978) quoted in

Chua (1986) also sees past actions as being important to the understanding of contemporary constructs by stating that: 'all human knowledge is a social artefact - it is a product of the constituting labour of people as they seek to produce and reproduce their existence and welfare' (Chua, 1986:603). It is the role of the social researcher to understand and try to explain human actions in the context of the societal reality which in turn has been shaped by changing historical and political events. The actions of the individuals may become typified leading to stable constructs and institutionalisation. The development of Polish accounting systems has been influenced by the wider economic and financial context. According to Roberts *et al* (2005:146) 'The accounting system is an outcome of a complex process. Governmental or political, economic, legal, tax, educational and financial systems are all important. Factors originating outside of the country can also be important, and its past trading and colonial links and current pattern of foreign investment can influence accounting.' In Poland the trade with Germany, the imposition of communism by the Soviet Union and the recent membership of the EU were events that influenced the development of accounting.

In order to understand the orientation of contemporary Polish financial reporting systems it is necessary to look at the development of institutions and the economic patterns of trade through a historical lens. Although many studies of Polish development commence with the start of the transformation in 1989 the origins of Polish legal and commercial frameworks are rooted in the early years of the twentieth century. The rest of this chapter will consider the economic and legal influence of each epoch since 1919 on the development of accounting in modern Poland.

Following First World War, the period between 1919 and 1939 marked, for the first time in the twentieth century, the establishment of an independent Polish state known as the Second Polish Republic. Although some ninety years have elapsed since Poland gained its independence, the influence of that era on the transition period post 1989 has been far more profound than would normally be expected in a country characterised by a gradual development pattern. After the fall of communism the first democratic government found that socialist structures were totally unsuited to the needs of a market economy and so the transition government reverted to many of the institutional arrangements that existed during the interwar years and so the institutional characteristics of the present day Polish institutions have been shaped by the pre-war Germanic influences. The period prior to the Second World War, German influence was particularly pervasive in the development of Polish legal and economic systems (Bien, 2007; Kaliński and Landau, 1999). In relation to this thesis the Germanic influence is reflected, among other things, in the creditor orientation of business, the nature of the business relations as embodied in the Commercial Code and the structure of the Boards of Directors.

During the post Second World War years from 1947 until 1989 Poland was a centrally planned economy known as the Polish People's Republic. Soviet communist ideology dominated every aspect of Polish life and led to the widespread nationalisation of private enterprises and membership of the Warsaw Pact. The imposition of a communist regime had led to the destruction of the pre-war capitalist structures which were not resurrected until the transition period.

With the fall of the Berlin Wall in 1989 Poland became a democracy known as the Third Polish Republic. The election of the first democratic government for fifty years marked the commencement of a transition to a market economy. The transition period culminated in May

2004 when Poland became a member of the EU. Although very few of the formal institutional structures from the command economy remained in the Third Republic the attitudes and culture of majority of the population was shaped by the communist ideology and influenced the development of Poland in recent years (Bailey, 1988).

2.2 The Second Polish Republic 1919 – 1939

At the beginning of 20th century Poland did not exist as a separate sovereign state and did not become an independent nation until the signing of the Treaty of Versailles in 1919 at the end of the First World War. In signing of the Treaty the Entente powers (Great Britain and France) anticipated that Poland would quickly develop into a modern, open and economically strong European democracy (Beksiak *et al.*, 2003). However, history has shown that this optimistic aspiration was only partly met due to the economic turmoil of the 1920s and continued hostilities with Russia.

During the period leading up to 1919 Poland was partitioned between three major European powers, namely the Austrian Empire, Russia and Prussia. The period of partition had a deep and long lasting influence on the development of the Polish economy and its institutions. The aim, in respect Poland, of each of the three occupying powers was to increase the wealth of their own countries and so the influence on Poland differed depending on the economic needs of the Russia, Prussia and Austria (Kaliński and Landau, 1999). Different economic and legal influences of each occupying country also adversely affected the accounting profession even once Poland was unified. Accountants from each region found it difficult to establish a common professional identity and so the accounting association in the interwar years displayed characteristics of a voluntary trade association rather than a strong professional self-regulated body found in Anglo-Saxon countries (Skrzywan, 1967; Bien, 2007).

Prussia had the greatest impact on the future development of the Polish state and that influence permeates to the present day. For example the Commercial Code of 1934 (*Kodeks Handlowy*) was largely based on the German model (Krzywda *et al.,* 1996). Prussia's policy during the early part of the twentieth century was to integrate the Polish economy and culture with that of Prussia to the extent that some parts of Poland, namely, Silesia were considered to be Prussian lands. The integration was achieved through two main channels. Firstly, German people were resettled in Poland bringing with them their own culture, schools and language. Secondly, all large industrial enterprises such as mining and steel were under direct control of German owners and so the administrative, banking and institutional structures were designed to meet the needs of Prussian economy (Kaliński and Landau,1999).

On gaining independence in 1919 the Polish government faced a society that was very poor, ravaged by war and ethnically divided. A large and undeveloped agricultural sector, especially in the East of Poland, masked high unemployment that contributed to the general poverty of the country (Beksiak *et al.,* 2003). In addition Poland did not have a unified legal or administrative system or a common currency. Therefore the priority of the government was to unify the three diverse areas of Poland into a single country against considerable obstacles.

To address the problems of integration the first Polish government created a new constitution that was modelled on the constitution of the 3rd French Republic giving equal rights to all Polish citizens irrespective of their background or religious beliefs. At the time there was a clear commitment to creating a liberal democracy and a framework for integration was constructed. In reality the aspirations of the newly elected National Democratic government were difficult to achieve.

In 1919 the population was culturally very diverse. Only 65 per cent of the population was ethnically Polish, 16 per cent were Ukrainians, 10 per cent were Jewish and 3 per cent were ethnic Germans (Michlic, 2007). This diversity brought its own problems. For example, Poland did not have a single currency. Both Russian roubles and German marks were commonly used until 1924 when the Polish złoty was introduced.

Apart from the problems relating to the reunification of Poland into a single state the most pressing problem was lack of capital and other resources for rebuilding of Polish infrastructure following the end of the First World War. To deal with the challenges the new Polish government assumed a highly interventionist position in relation to the business sector either directly through state ownership or indirectly through financing and regulation.
The state's use of cartels was another effective tool for rationalization and management of industrial structures. The Ministries of Trade and Finance were engaged indirectly in the creation and support of trade cartels which were legally constituted and encouraged. The cartels organised industries into monopolistic arrangements between enterprises with a view to putting a limit on competition and thereby increasing the profits of the syndicate members. With governmental support the number of such agreements in Poland rose dramatically from 53 in 1925 to 133 in 1929 and increased still further in subsequent years (Beksiak *et al.,* 2003). Through the use of cartels the state gained considerable power to control and intervene in the operation of private enterprise including the setting of prices and levels of production.

However, it is important to note that the Polish Second Republic, was ideologically committed to a free market economy and private enterprise co-existed with state owned corporations. The integration of the country was based on the principle of property rights which assumed the principle of private ownership. For example the Polish Central Bank was an independent body set up in 1924 and the Polish Stock Exchange was well established having first opened in 1817. Nevertheless, the volume of transactions was small with only 130 listings of financial instruments in 1938 (Warsaw Stock Exchange, 2008) and many of those being issued either by the government or by the banks rather than equity shares. It is also important to note that the interwar years saw the Polish economy continue to mirror Prussia in its reliance on bank funding with a limited role played by the Warsaw Stock Exchange in providing capital for industry.

The above analysis of the economic landscape of Poland during the interwar years forms the foundations of many of the present day Polish financial reporting features. The emergence of the powerful state, the weakness of the accountancy profession and the legal framework can all be traced back to the pre-war period. In order to understand the present Polish system it is important to appreciate that after the fall of communism the government drew on this period to develop current system of financial reporting. The analysis indicates that the dominant stakeholders who relied on the financial information were not shareholders but the state and the banks. The need for 'true and fair view' as the overriding attribute for financial statements was subjugated to a requirement for accurate and legally compliant accounts. The intervention of the state meant that the role of accounting was largely a means of determining the taxable profit for efficient fiscal collection and for the control of enterprises where the government either had a stake or where it was in the public interest for government to be engaged for example in the operation of cartels (Krzywda *et al.*, 2005). This is confirmed by a huge number of cases being brought by the tax authorities against businesses to the Administrative Tribunals and the high level of penalties levied on businesses that failed to comply (Skrzywan, 1967). According to Skrzywan (1967) the tax authorities also played a significant role in the formulation of Polish accounting regulation and in defining terms such as 'true' and 'correct'.

The banks, as providers of loan capital were largely concerned with the ability of the enterprises to meet the loan repayment obligations and so the accounting requirement was for prudent and consistently applied financial statements that emphasized the attributes of reliability rather than relevance for decision making by shareholders and other stakeholders.

During the interwar years regulation of limited companies was introduced for the first time in Poland through the enactment of the Act on Joint Stock Companies 1928 and the Commercial Code of 1934 that was originally based on the German Commercial Code of 1901 (Rostowski, 2007). The 1928 Act was a major step in the development of accounting regulation because for the first time the Act required the publication of balance sheet and profit and loss account together with a management report of the joint stock companies (Art.110). Furthermore, the financial statements were required to be audited and the 1928 Act for the first time established the profession of auditing where individual auditors would be appointed by the regional courts (Micherda, 2005). However, the qualifications, duties and responsibilities of the auditing profession were not actually enacted by the outbreak of the Second World War and so in practice the requirement for audited financial statements was never met during this period (Micherda, 2005). This was a serious setback for the accountancy association which promoted the audit requirement arguing that the state would have better control over the enterprises if this requirement was enacted. This view was countered by the large enterprises arguing that Polish accountants were insufficiently qualified or experienced to undertake such auditing function (Bien, 2007). The arguments point to the weakness of the accountancy profession in their inability to influence wider institutions as well as their lack of technical expertise that would give the accountants greater authority. Skrzywan (1967) assesses the quality of accounting in the pre war years to be of low quality due to the poor qualification of accountants of whom the vast majority did not have higher education.

The Commercial Code of 1934 also laid the foundations for the corporate governance structures that are still in existence in Poland today (Rostowski, 2007). The Code instituted a governance system based on a two tier principle of the executive board and the supervisory board with worker representation. The system is derived from the Germanic system and differs significantly from the Anglo-Saxon model where a single board of directors is responsible for the management of the company. The existence of a second tier supervisory board means that employees, banks, government agencies and other stakeholders are often given seats and are able to participate in the governance of the companies. This contrasts sharply with the Anglo Saxon model where the shareholders are recognised as the central stakeholders with a minimal role played by creditors or other interested parties. Following the fall of communism the participation of workers in the governance of companies proved to be invaluable in gaining acceptance for the difficult 'shock therapy' policies instituted in 1989-1992 (Rostowski, 2007).

The nature of the institutional and economic setting as outlined above suggests that the Polish Second Republic may be classified as a creditor orientated system with a strong fiscal orientation (Nobes, 1998). In the context of Poland Krzywda *et al* (1995) uses the term national economic tradition for a Polish system where there is a high level of state engagement and low shareholder participation. In the absence of market based structures at the beginning of transition in 1989 the Polish government has reverted to this pre-war model as concluded by Krzywda: 'Polish financial accounting after 1989 is developing characteristics compatible with the national economic accounting traditions. (1995:653)

2.3 The Polish People's Republic 1947-1989

The interwar years described above made a contribution to contemporary Poland by laying the foundations of a market economy and establishing many institutional structures to support this system including a central bank and the Warsaw Stock Exchange.

In contrast, during the post war years the market economy was destroyed and many of the institutions were either suspended or abolished in the name of ideological transformation to communism. Therefore at the commencement of transition in 1989 the communist structures needed to be abandoned rather than built upon. The relevance of the communist period lies in its impact on the cultural and social context on which the market economy could be established. Drawing on institutional theory it is accepted that organisational behaviour is shaped by societal norms and expectations (Scott, 1995; Dillard *et al.*, 2004). This part of the thesis explains the impact of communist ideology on Polish economy, the role of the state in society and its relationship to enterprises. The thesis interprets how this ideology shaped Polish attitudes especially in the context of accounting.

The central principle of communist ideology is that the state, on behalf of the society, owns the resources of the country and then distributes the wealth arising from these resources to the society in a fair and equitable way (Bailey, 1988). To achieve this ideological position it is necessary either to abolish or significantly reduce private ownership.

Therefore under a communist ideology it is the state and not individuals acting in a market that play the central role in the economic activities. The state manages the assets of the country and its activities through an integrated and centralized national plan constructed at the highest level by the communist party officials who not only direct production but also set prices for the products. Economic decision making has a highly political dimension and power is concentrated in the hands of the ruling party. In contrast, economic decisions in a classic market economy are driven by the profit objective where there are individual traders conducting transactions independently with a large number of buyers. In capitalist system the state plays a limited role by setting an institutional framework that regulates the behaviour of entities indirectly through legislation and fiscal policy but not through direct control, ownership and management of companies.

This fundamental difference between the systems affects all aspects of the communist society including, legal, economic and social frameworks by reducing the rights and powers of the individual whilst making the state omnipotent. In order to be able to support such a system a totally different method of organisation, financing and accounting was necessary from the one that was developed in Poland during the interwar years or the one that exists in other developed European market economies.

The next section describes the macro economic landscape of Poland in the post war years highlighting significant features of a centrally planned economy and identifying the factors that led to the eventual collapse of the system. The discussion moves to consider how accounting systems were used to support the central planning of the economy drawing a comparison with the role of accounting in a capitalist society.

Poland emerged from the Second World War having suffered the worst devastation of any European country (Davies, 2001). To compound the difficulties of reconstruction Polish borders were redrawn as part of the post war Treaty of Potsdam with the country losing eastern areas to the Soviet Union but gaining areas from Germany in the west. The redrawing of the borders involved centralized planning by the Polish government to manage large migrations of people at the same time as commencing a reconstruction of the country's infrastructure. The task of reconstruction was charged to the first communist government in 1947 under Jozef Cyrankiewicz who was deemed to be too independent for the Soviet authorities and the Stalin regime soon replaced him with a much more compliant Polish communist, Boleslaw Bierut who became the First Secretary of the Polish People's Republic in 1948 (Davies, 2001). It is at this point that it can be said that Poland fell under the absolute control of Stalin's Soviet regime. In spite of the domination of the communist party the transition to democracy in 1989 was made easier by the fact that Polish political institutions were well developed with powers of the President modelled on the French Republic (Rostowski, 2007). The existing political system allowed Poland to execute a smooth and peaceful election of Lech Walesa as a President of Poland in 1989.

Although at the end of the war there was little support from the general population for the communist ideology (Davies, 2001) given the desperate circumstances of that time the goals of the people and the communist government were largely aligned in the need for the government to adopt an interventionist position in the rebuilding of the country. However, the adoption of communist ideology had far wider and unintended consequences for the society than was required for the reconstruction of the country.

In Poland the transfer from private to state ownership was achieved in two stages. Immediately after the end of World War Two the Soviet army was able to confiscate previously German owned property which became state owned (Beksiak *et al.,* 2003). The second stage was more difficult to achieve as it involved expropriation of existing Polish owned businesses. Politically, direct intervention of the state was not acceptable and so the authorities instituted a number of measures with the aim of destroying the private sector in Poland which resulted in the majority of private businesses being liquidated by the end of the Stalin's reign in 1956. Existing enterprises were eliminated by government actions such as control of prices that a business could charge, levying high levels of taxation and excluding the enterprises from trading with government agencies (Lipton *et al.,* 1990). New businesses were prevented from starting up by the imposition of legal hurdles often impossible to overcome which included requirements for permits to operate that were often not granted or through restriction on the number of employees that a business could employ so there was no opportunity for business start-ups (Balcerowicz, 1990).

The structure of the financial sector and the concept of money also acted to stifle any business that was not state owned. Poland, in common with other communist countries, operated a state owned mono-bank, (*Narodowy Bank Polski*) which fulfilled the role of a central bank issuing money and at the same time granted credits to enterprises and acting as a saving bank. However, it is important to understand that the possession of money did not necessarily guarantee access to required materials because goods were distributed by the state and not purchased in the open market.

Chronic shortages of consumer goods, housing as well as labour, that characterized all the communist economies, were not only due to the concentration of production on heavy industrial manufacturing but also due to the resource constraint nature of the economy. Kornai (1979:801) contrasts capitalist and socialist economies in terms of the factors that limit output: 'Efforts at increasing production may hit three different upper constraints: the constraint of physical resources, demand constraints and the firm's budget constraint. The system can best be characterized according to which of these constraints is in effect. From this aspect resource-constrained and demand-constrained systems are discerned. In the former it is bottlenecks in production and not buyers' demand that limit production; in the latter case it is the reverse. A socialist economy in its 'classical' form belongs to the former type.' (Kornai, 1979:801)

In the context of resource constraint system, the accountant, who provides information for efficient allocation of resources using monetary measurements is no longer required and is replaced by engineers who can estimate production and output. The transformation of the Polish pre-war market economy to a centrally planned economy radically altered the role of accounting as was summarized by Bailey (1988:37): 'The locus of economic decision making power shifts from a multitude of micro units of economic activity to the central state agencies. There is a contraction in the scope of the accounting function and the need for accountants'.

Other business functions such as sales and marketing also had no role to play in the state owned enterprises due to the focus on production and output.

Furthermore, the granting of credit was directed by the state guided by the need of the enterprises and not the credit worthiness of the borrower. Within this environment bankruptcies were always prevented by the intervention of the bank thus encouraging inefficiencies and mismanagement of businesses. This approach to the assessment of credit worthiness in Poland was in marked contrast to the way lending decisions are made in western democracies and requires a different and lower level of engagement by the accounting profession because they are not involved in the lending process.

The role of the accountant was also diminished by the absence of financial institutions which exist in market economies and in which accountants play a central role by generating and communicating information for investors. The Warsaw Stock Exchange ceased functioning at the outbreak of the Second World War and did not recommence trading until after the fall of communism in April 1991. During the communist era all industry and commerce were nationalized so the need for a capital market became redundant. Investment was planned and financed by state organs and the Polish Bank without having to resort to private capital.

Nevertheless, even in a centrally planned economy there was a need for the audit function and the requirement for the annual audit of state enterprises was passed in 1959 (Bień, 2007). Enterprises under the communist system were required to set aside separate social funds out of annual profits for the benefit of the workers such as the payment of prizes and bonuses. These funds fell outside the direct control of the central ministries and depended on the level of profit retained. It was therefore important that the size of the funds could be confirmed but unlike in capitalist economies these activities were at the margin of the main operations. Although the auditors who undertook such duties were state registered, the nature of the audit function was very different to the accepted contemporary understanding. The audit was generally carried out by an accountant from another company on a voluntary basis. The role was neither carried out by a suitably experienced professional nor was it independent as it relied on goodwill from other enterprises.

Finally, the way state owned enterprises were governed also contributed to the denigration not only of the accountant but also of management. Pinto *et al.,* (1993:218) found that 'a serious principal agent problem existed because the managers served at the pleasure of the workers' council and there was insufficient emphasis on the long term viability of the enterprises.' The governance structure headed by the workers meant that the focus of the workers council was not profitability, cost cutting or investment but rather the improvement of employment rights, benefits and pay.

The outcome of the transition from a capitalist to a communist system was that at the height of communist rule in 1980 only 5 per cent of population was engaged in the private sector other than agriculture (Balcerowicz, 1990) whilst the remainder were employed either in state enterprises or co-operatives. Overall, 71 per cent of all workers were employed in the state or co-operative sector with a significant bias towards heavy industrial production, mining and steel working (Lipton and Sachs, 1990). In contrast to other non-communist countries the GDP derived from heavy industrial production and construction in Poland was considerably higher at 52 per cent than in non-communist countries such as Greece and Spain where the comparable contribution to GDP was 29 and 38 per cent respectively (Lipton and Sachs, 1990).

The state enterprises were highly integrated with other entities in the same sector through the compulsory formation of nine ministries which traded with each other and which were under a common control (Balcerowicz, 1990). The effect was that these highly controlled enterprises started acting as monopolies, trading with each other but without having to compete, and each receiving an allocation of input materials necessary for production. The existence of such ministries ensured that non-affiliated entities were unable to operate having been left without access to raw materials or trading opportunities. The formation of the ministries also impacted on the organisational structures. Enterprises became more institutionalized and more similar to each other in contrast to much more heterogeneous character of capitalist firms.

The aim of promoting industrial production was partly ideological but also practical, facilitating the processing of Soviet raw materials in Poland which were transformed into finished products and returned to the Soviet Union. The aims were not to maximise profit but to benefit the Soviet Union and so the activities did not lead to a general increase in economic growth and this factor in the long term contributed to the demise of the communist regime.

In contrast, light manufacturing of consumable goods and the service sector were largely undeveloped so there was little opportunity for the people to satisfy their material needs leading to an environment of permanent shortages and a thriving black market activity which aimed to remedy the excess demand. This was summarized by a Polish journalist:

> 'For the entire period of real socialism, investments were poured into a closed production circle that offered no profit: coal was necessary to produce electricity; electricity was necessary to produce steel; and steel was necessary to mine coal. All that produced statistical growth in national income, a growth which, as we now know, actually meant a decline in national income' (Lipton and Sachs, 1990:79).

Other financial institutions such as insurance and foreign exchange were also state monopolies whilst the broader financial services sector in areas such as pensions and commodity markets were, in comparison with the market economies, significantly underdeveloped or non-existent.

The inefficiencies created by central planning meant that by the 1970s popular unrest was rising as the population could see that the real standard of living was falling far behind that in western economies at the same time as the Polish government was introducing measures restricting wages and increasing working hours leading to even greater fall in real incomes (Koźminski, 2008). In December 1970 demonstrations in the Polish shipyards of Gdańsk and Szczecin led to the death of demonstrators but also gave rise to the formation of free trade unions laying foundation for the eventual overthrow of the communist regime in 1989.

In response to the unrest in 1970 Edward Gierek replaced Władysław Gomułka as the First Secretary of the Communist Party. His aim was to modernise the industry and to raise standard of living in Poland through investment and importation of know-how from the West. This aim was achieved by means of huge loans borrowed from the West which were only repaid fully in 2009. The funds received were used in the first instance to increase wages but also to raise the output of consumer goods, increase house and infrastructure building programme and to modernise the industry. However, the policy did not provide long term benefits as the communist system in which the loans were applied was deeply flawed and majority of the funds were overinvested in inefficient heavy industry and used for the import of raw materials.

The policy proved to be disastrous for Poland as the burden of debt servicing grew and Poland was faced with a deep balance of payment crisis (Lipton and Sachs, 1990). Inevitably, the high level of growth of the 1970s could not be sustained as foreign credit was withdrawn and this crisis led to long term poverty of the society. Severe shortages resulted in the introduction of food rationing creating social unrest which manifested itself in waves of strikes throughout Poland. Fearing loss of power over the nation fuelled by the activities of the trade union body, 'Solidarność' the Communist government introduced martial law in December 1981.

Contrary to the popular belief Polish economic reforms, based on decentralisation commenced in 1981-1982 and not at the time of political transition in 1989 when the first Solidarity led government took office. The economic crisis of the late 1970s revealed an urgent need for economic reforms that would restore economic efficiency and end chronic shortages (Balcerowicz, 1990). The government hoped to achieve the above objectives by introducing measures to de-centralise decision making and liberalising trade allowing businesses greater autonomy to trade freely both at home and internationally.

Enterprises no longer needed to fulfil a central plan for production and the central allocation of materials was reduced from 70 per cent to only 10 per cent in 1989 (Lipton and Sachs, 1990). In spite of the intention to reduce the role of the state in business, the structure of the command economy was such, that the government was still involved in 80 per cent of all sales. Regulation of prices was also relaxed for some products and services although for essential goods continued to be set by the state. In order to make enterprises operate independently the responsibility for raising of finance was also devolved to individual businesses. Enterprises were expected to seek loans from the single Polish national bank but lack of competition in the banking industry meant that these loans were never granted on fully commercial basis. The other consequence arising from the lifting of controls on enterprises was that the government no longer had direct access to enterprise resources and so imposed a new tax system for raising fiscal revenues. However, poor financial situation of most of the enterprises meant that the state was obliged to write off considerable proportion of the tax liabilities to prevent bankruptcies of the state enterprises.

The economic changes introduced in the 1980s did not make lead to the anticipated improvements and culminated in a 'complete collapse of financial control in the budget, the banking system and the balance of payments (Lipton and Sachs, 1990:109). The liberalisation of prices in an environment of chronic shortages led to hyperinflation and further wage demands as workers attempted to maintain their standard of living.

Balcerowicz (1990) argues that the primary reason for the economic failure of the reforms was lack of appreciation of the complexity of the economic system and so insufficiently radical reforms being undertaken. Market efficiency was introduced into an essentially centrally planned economy where majority of enterprises continued to act as monopolies so required competition between them never materialised.

2.4 Transition era 1989 to present

In 1989 the Berlin Wall was dismantled and Poland embarked on a political and economic transition from a centrally planned economy to a democracy and full market economy alongside other East European countries which subsequently became members of the European Union in 2004 namely: The Czech Republic, Estonia, Hungary, Latvia, Slovakia and Slovenia and Bulgaria and Romania in 2007.

Kornai (2006:217) contends that the transition of the East European countries from communism to capitalism has been unique in the world because the six most important characteristics of transformation shown below were present in Eastern Europe at the same time:

1 and 2: In the economic sphere the changes follow a capitalist economic system and in the

political field in the direction of democracy.

3. There was a complete transformation, parallel in all spheres: in the economy, in the political structure, in the world of political ideology, in the legal system and in the stratification of society.

4. The transformation was non-violent.

5. The process of transformation took place under peaceful circumstances. It was not preceded by war. The changes were not forced upon society as a result of foreign military occupation.

6. The transformation took place with incredible speed, within a timeframe of 10 to 15 years.

   Kornai (2006:217)

The above characteristics of transformation clearly point to a sudden and fundamental transition of all political, legal and economic structures in Poland that was unprecedented given that the changes occurred peacefully. The success of the transition could be partly attributed to institutions already in existence in 1989 which partly explain why transformation was a success in Poland but failed in the former Soviet Republics. For example, the existence of a clear legal framework meant that laws and policies could be changed quickly and easily which was a crucial consideration during the turmoil of the early years of transition. Acceptance of changes associated with transition was also made easier by the existence of workers councils (*samorząd pracowniczy*) which provided a certain level of corporate governance and helped to avoid social unrest. The powers vested in the workers councils were first sanctioned in law in 1981 and allowed the councils to participate in the decision making of the state owned enterprises. The membership of the councils was democratically elected from the employee population. This allowed many Solidarity members to gain formal representation in the state owned enterprises who were then in the position to mediate between management and workers when unpopular restructuring was taking place during the transition period. The key tasks at the start of the transition were to restore macroeconomic stability, to privatise state assets and to create laws compatible with the new system (Rostowski, 2007). Given the urgency for reform politicians set up new institutions and systems 'acting opportunistically, often following the line of least resistance so as to make pre-existing institutions 'fit for purpose' under the new circumstances' (Rostowski, 2007:11). For example, related to this study, the influence of pre-war institutions is evident in the re-enactment of Commercial Code from 1934 which underpinned the company legislation in the 1990's. The transformation was also facilitated by the existence of western capitalist models of institutions and behaviour that the transition countries could adopt quickly e.g. The Warsaw Stock exchange was modelled on the Paris Bourse.

However, the changes in the economic system also required changes in human behaviour; for example in the relationship between an individual and the state or the customer and the producer. Tomer (2002:422) argues that these behavioural structures are 'long lasting and capable of having a significant influence on human behaviour' It is therefore important to view the operation of the new systems and institutions from the historical, economic and cultural perspective.

Relevant to this study Rostowski (2007) provides evidence of imprinting from the previous system in relation to the legal system. During the early years of transition the courts had a great deal of difficulty in understanding the key provisions of the market economy. For example, under communist rule companies treated equity capital as a deposit that could not be spent. On transition the courts treated the capital of the newly formed limited companies in the same way and did not allow them to spend the money freely.

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 two decades and the transformation of the socio-economic system has continued unhindered. The political reforms not only gave political freedom to individuals, but also allowed the government to commence a programme of reforms designed to transform a centrally planned economy to a market economy (Rostowski, 2007). Economic stability had been facilitated by the independence of the National Bank of Poland, guaranteed by the Polish Constitution. The Polish Constitution also limits the level of public debt to three fifths of the annual GDP thus providing strict boundaries for all governments regarding the level of spending.

The ultimate aim of successive Polish governments has been to achieve full European integration through membership of the EU which was achieved in 2004 and entry to the Euro area is scheduled for 2015. Politically, the integration of Poland within the EU benefits not only Poland but also acts to protect the interests of the member states and promote peace in Europe. Economic failure in the Central and East European Countries would have threatened western prosperity through mass migration, additional defence costs and loss of trading partners. Not surprisingly, Germany has vigorously supported Poland's early entry into the European Union.

However, contrary to the popular belief the transition did not bring about immediate rewards. This is summarised by Kornai (2006:208): 'At that time, people felt it a hopeless daydream that within the foreseeable future their countries would become democratic market economies. Today, however, although this has become a reality, many are disappointed and bitter'. The reasons for this feeling are complex but originate in the relationship between the state and the individual. The communist era was characterised by a very well developed welfare state and virtually no visible unemployment thus providing stability and security to the population. The welfare support extended to the place of work with many enterprises owning not only social housing but also holiday accommodation, nurseries and hostels.

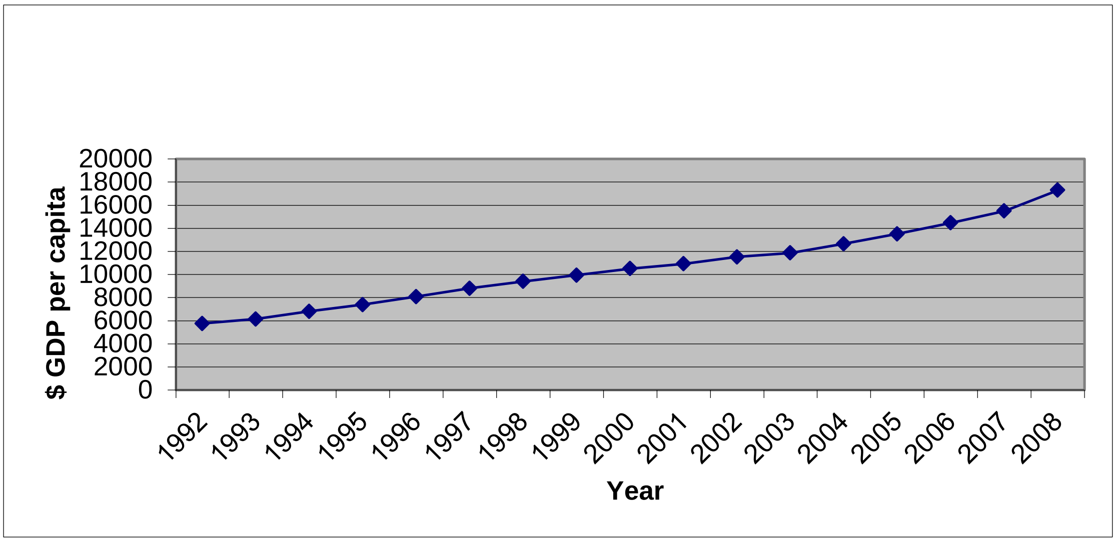
In contrast, the introduction of market reforms on population was devastating as public enterprises began to face tough competition from imports whilst at the same time losing their traditional markets centred on the Soviet Union as a result of the collapse of Council for Mutual Economic Assistance (CMEA). Loss of the trading agreement with CMEA also meant that Poland was no longer able to buy energy and other raw materials from the Soviet Union at subsidised prices but was forced to pay world rates in hard currency (Pinto *et al.*, 1993). The overall impact on the economy in the two years following the fall of communism was a dramatic fall in output coupled with spiralling inflation and high unemployment. This decline was not matched by a growth in private businesses leaving the average Pole ill equipped to adjust to the changes without the social protection previously offered by the state. The situation was exacerbated by the fact that the enterprises themselves could no longer afford to maintain worker facilities mentioned above which in most cases were sold depriving the workers of additional, highly subsidised benefits.

The government was faced with the task of meeting its reform objectives which involved the enforcement of hard budgeting, promotion of competition 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 1990s was the result of the fall of the centrally planned economy without having an efficient market economy in place. On the other hand, the sudden dismantling of central control and administration of the communist party allowed entrepreneurship to flourish as private enterprise was no longer restricted by central authorities (Kornai, 2006). 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 2007, immediately before the financial crisis, 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. In terms of its monetary policy the medium term aim was for Poland to join the Euro zone in 2012 thus fulfilling its obligation to join the Euro area as required by the Treaty of Accession although the financial crisis of 2008 has meant that the date of adoption has been postponed to 2015.

In the 3 years to 2008 the average growth rate in GDP of 6.0 per cent for Poland was more than double the EU 27 average rate of 2.2 per cent (OECD, 2010). This growth was driven largely by exports as well as increased domestic consumption and investment (Wazniewski, 2008). Structural move away from low productivity sectors such as agriculture and heavy industry to more productive service sector also contributed to the high level of GDP growth.

Figure 1: Polish GDP per capita 1991 – 2008



Source: OECD Factbook 2010

Other factors were also important for the improving prosperity of the Polish society. Firstly, in economic terms Poland has benefited enormously from EU membership allowing the standard of living to rise and providing economic and political stability. Poland has been the largest beneficiary of EU funds in recent years and over 67 billion Euros were allocated by the EU for the period 2007-2013. The majority of the funds were earmarked for improvements in infrastructure such as transport, environment and energy. Significant funds have also been set aside for human capital allowing Poland to modernise its education system and provide training opportunities for the unemployed.

Secondly, increased competition and the enlargement of the private sector have led to a significant improvement in productivity during the 1990s with a greater proportion of skilled labour participating in the market place (Fischer and Sahay, 2000) so that in terms of its competitiveness Poland's position has improved significantly being ranked in 2009 46th (2008 53rd) out of 133 countries included in the Global Competitiveness Report 2009-10 produced by the World Economic Forum (2009). It is ranked higher than Hungary, Slovakia and the Russian Federation but lags behind Estonia and the Czech Republic.

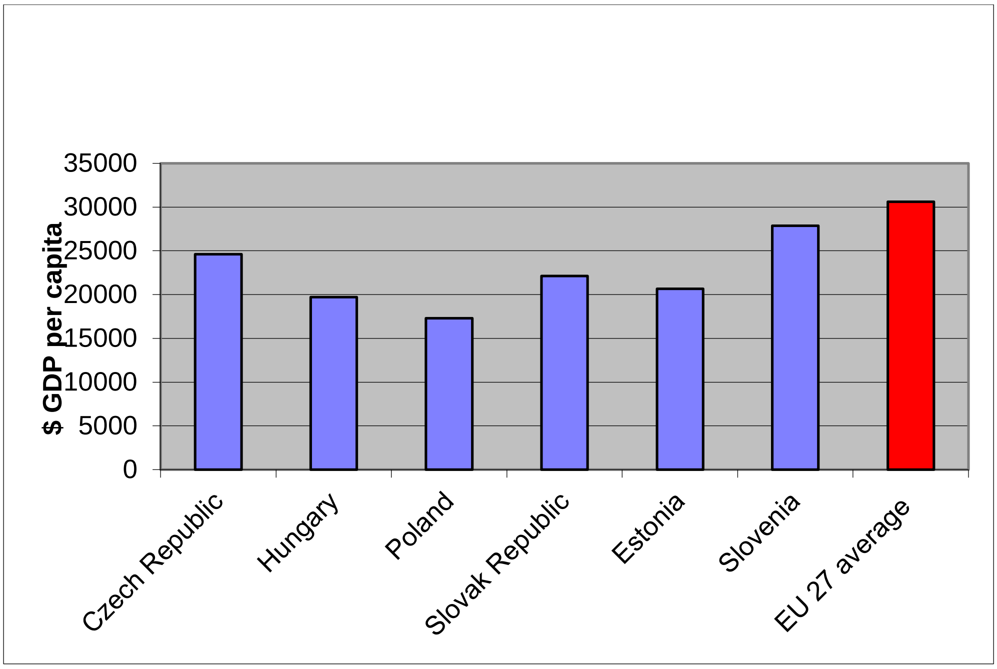
In terms of the country's weaknesses the report identifies poor tax regulation, limited access to financing, inefficient government and restrictive labour regulations as being the major hurdles for doing business in Poland. It is notable that the most problematic factors hindering Polish enterprise were primarily in the area of public regulation pointing to a much slower pace of transformation in government than in the private sector.

Nevertheless the Global Competitiveness Report (2009) has an extremely upbeat view of the Polish economy in the context of the East European region and summarises Polish economic performance as follows:

> 'Poland benefits from its strong educational system and large market size, and has seen measurable improvements in the quality of its public institutions, with greater confidence in the efficiency and honesty of the country's public servants. EU membership and buoyant growth over past years have provided an incentive and the means for conducting reforms. This, along with prudent regulation of financial markets and the large size of the domestic market, has helped Poland to weather the effects of the current global downturn and become one of the most economically stable countries in the region.'
> World Economic Forum (2009:25).

However, Polish economic progress is less impressive when viewed in terms of *per capita* GDP where the country lags behind all new EU entrant countries. Furthermore, in comparison to the EU member countries the per capita income in Poland is only approximately fifty per cent of the EU27 average income (OECD Factbook, 2010) as shown in the figure 2 below.

Figure 2: 2008 GDP per capita for new EU member states



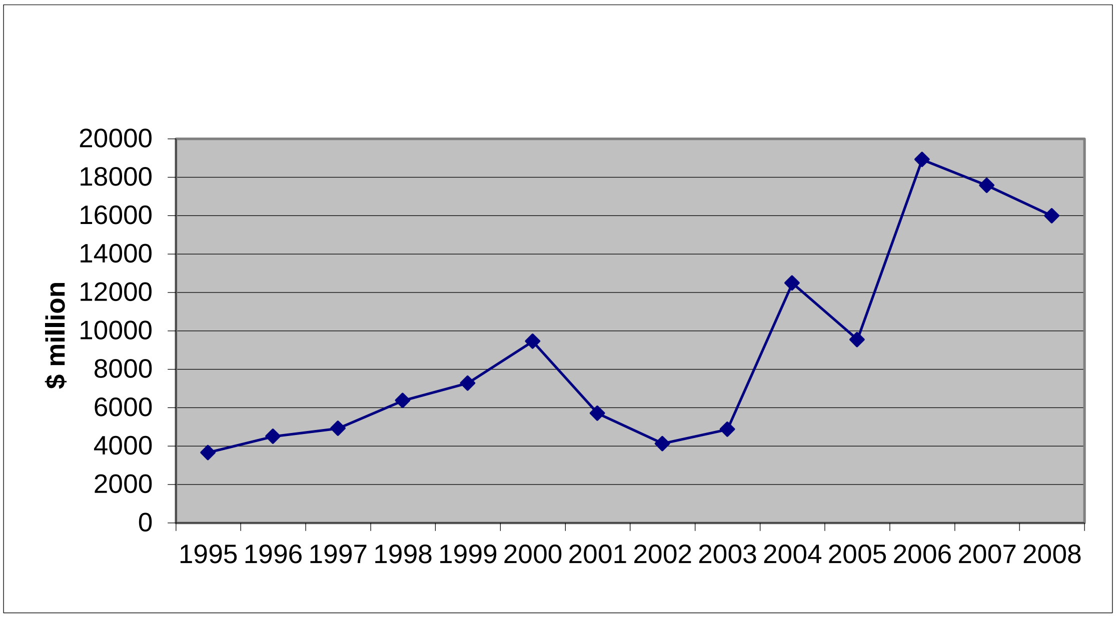
Source: OECD Factbook 2010

This low level of GDP was partly caused by the very high level of unemployment, averaging at fifteen per cent over a twenty year period, a figure not experienced by other East European member states and a worrying feature of the Polish economy. The government was called upon by OECD (2006) 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 employees and organisations such as the Trade Unions. As well as a high level of unemployment Poland also suffers from low levels of participation in the labour market arising from inappropriate social provisions that act as disincentives for work. Generous disability terms and entitlement to early retirement has the effect of reducing the GDP per capita as this group has low income and does not contribute to the economy. Poland has a very large and inefficient agricultural sector accounting for some 17 per cent of the total workforce. The industry is hugely inefficient and demands substantial subsidies from the EU. Irrespective of the EU's contribution, Poland's agricultural sector still needs to undergo major modernisation and reform if it is to compete in an open EU market. The government needs 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.

Membership of the EU led to greater expectation of improvements in the income levels and pressure for the government to continue to deliver improvements in growth rates, as well as a possible 'brain drain' to the West. From the EU perspective there is a danger of economic migration of workers from Poland to the wealthier member countries such as Austria, prompting that country to call for partial membership with limited rights. Although on joining the EU emigration from Poland tripled between 2004 and 2005 the worries of the EU15 states were largely unfounded as many of the workers have suffered as a result of the 2008 global recession and returned to Poland. This outward and inward migration has been seen by the Polish government as being beneficial for the country with workers repatriating funds to Poland whilst abroad and returning to Poland with new skills that enable them to contribute to the entrepreneurial sector (Waźniewski, 2008).

International investors have responded very positively to the favourable market conditions and Poland has now become the main beneficiary of foreign direct investment (FDI) in the region as shown in figure 3 below.

Figure 3: Polish FDI 1994 -2008

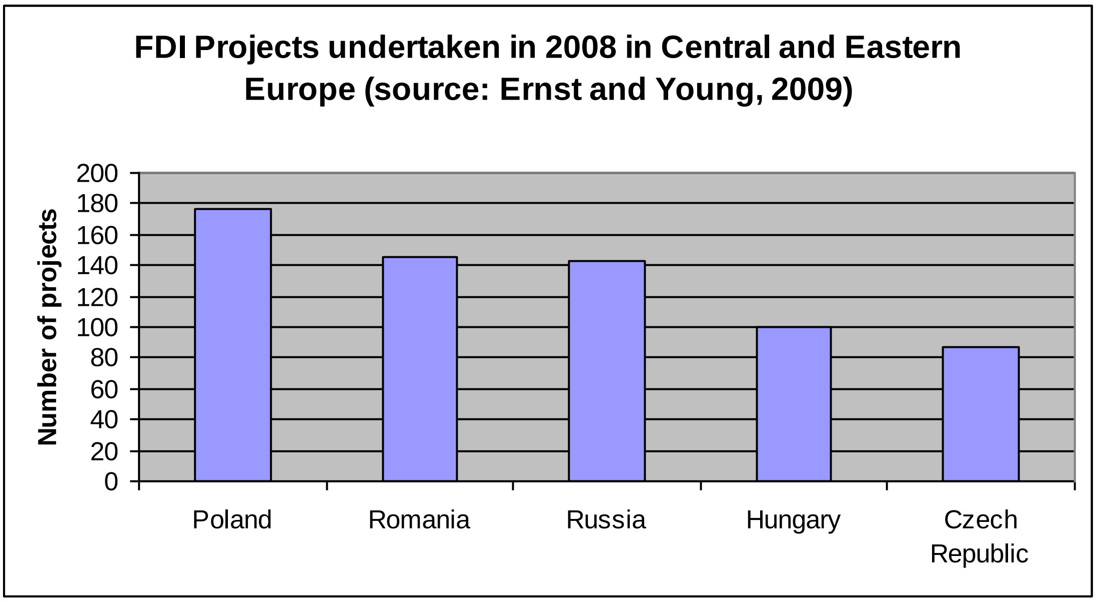


Source: OECD Factbook 2010

The fall of communism saw a steady increase in FDI in the 1990's as companies sought to exploit low cost base and a large domestic market in Poland. Thereafter the level of FDI declined significantly between 2000 and 2002 following the Russian financial crisis of 1998 where the loss of confidence affected the whole region of Eastern Europe. However, the prospect of EU membership caused the FDI to accelerate from 2003 onwards and investors exploited the removal of barriers to trade.

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 Central European region. According to OECD (2010) inward investment has increased from 4 billion dollars in 2003 to 17 billion dollars in 2007 before declining in the subsequent two years as a result of the financial crisis. The relative attractiveness of Poland for FDI in relation to the other Central European countries is shown in figure 4 below. The graph shows that Poland is able to attract a large number of projects although relative size of each economy or the size of projects has not been taken into account. For example the population of the Czech Republic is only 10 million being 25 per cent of Poland's population but it is able to attract proportionately greater number of projects.

Figure 4: FDI Projects Undertaken in Central and Eastern Europe, 2008



Source: Ernst and Young, 2009

A study of the determinants of FDI in Central and East European countries by Bevan and Estrin (2004) suggests that foreign investors consider the following factors to be important for investment in a particular region:

Low unit labour costs

Distance between source and host country

GDP of both host and source country

Prospects of quick accession to EU

Given the criteria above it is not surprising that Poland has been successful in attracting FDI. Geographically, Poland lies at the centre of Europe and so is able to exploit the whole European market. This is confirmed by actual investment in Poland where over 80 per cent of FDI came from European countries with Germany being the largest single investor. Poland joined the EU in the first tranche of post-communist countries so the sovereign risk is relatively low.

According to Ernst and Young (2009) the preference of European countries to invest in Europe reflects their aversion to risk preferring to invest in politically stable economies especially in the period following the financial crisis of 2008-09. In their survey of 809 international business leaders both Western and Eastern Europe were judged to be the most attractive regions for FDI projects ahead of China, US and the other BRIC countries.

In February 2008 Standard and Poor increased its ratings for Polish debt from stable to positive judging Poland to have made significant progress in structural reforms and improvement in the level of deficit. (Waźniewski, 2008). The added confidence of the rating agencies should further encourage inward investment although the financial crisis has impacted negatively on the level of investment by source countries as shown by figure 3. Poland itself has been largely unaffected by the financial crisis because the banking sector is relatively unsophisticated and mortgage business is much less developed than in western countries.

Wage rates are significantly lower in Poland than the average for Europe causing the relocation of businesses from high cost to low cost countries. For example in 2006 Dell has announced a 250 million dollar investment in Poland whilst at the same time announcing the closure of its Irish plant. According to Dell '"Proximity to a large base of Dell customers, the significant opportunity for growth promised by the Central and Eastern European economies, and the availability of a well-educated Polish workforce were key factors in our decision.' (Dell, 2006). Although cost factors were not mentioned in this statement it is likely that they were major deciding factors for the relocation to Poland. The wage rates in the wealthiest countries of the old EU as compared to Polish rates are approximately five times higher in the EU 15 countries than in Poland (EU 15 labour cost of 25 to 30 euro per hour, to Poland's 5 euro per hour) according to the Polish Information and Foreign Investment Agency (PAIZ, 2010).

The attractiveness of Poland for FDI is greatly enhanced by the fact that the whole of Poland qualifies for National Regional Aid for the period 2007 and 2013 under the EU rules. (European Commission, 2006). The ceiling for such aid amounts to 50 per cent of investment cost for most regions which means that investing companies can benefit from generous tax breaks such as exemptions from income tax and other subsidies. State subsidies for most regions of the EU are generally illegal under competition rules and so Poland has a clear advantage over many other EU countries by being designated a Special Enterprise Zone. The European Commission (2006) has also given permission for *ad hoc* State assistance to various companies such as Dell (to set up a manufacturing plant) and Shell Polska (to set up accountancy and human resource regional centre) which would again not be permitted for most other countries under European rules.

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 383 shares listed (Warsaw Stock Exchange, 2010) with a domestic market capitalisation of 112 billion Euros (Federation of European Securities

Exchanges, 2010). It is by far the largest stock exchange in the Central European region but it is one of the smallest in Europe (London 1,950 billion Euros). A particular feature of the Warsaw Stock Exchange is that the market is highly concentrated which limits liquidity of the market and also has negative impact on corporate governance of companies as the existence of dominant investors may lead to the abuse of shareholder rights (Kozarzewski, 2006). Concentration of ownership also affects the financial reporting role by listed companies as they are able to provide information directly to the strategic investor without needing to make available transparent and high quality information to the public reducing the quality of accounting information (Leuz et al, 2003).

Entry into the EU has significantly increased the number of foreign investors from 33 per cent in 2004 (before accession) to 41 per cent in 2005 (after accession) (*Komisja Papierów Wartościowych i Giełd*, 2006). In the longer term these foreign investors may influence the activities of the companies in which they hold investments and change the Polish orientation to a more international focus. The stock exchange is not a major provider of corporate finance as the majority of the shares traded originate from 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.

2.5 Conclusion

Since the downfall of communism in 1989 Poland has successfully transformed its economy from a centrally planned system to a stable market economy without social unrest

(Rostowski, 2007). 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 and high unemployment which peaked at twenty per cent in 2003. These goals have been achieved with both unemployment and inflation rate falling below ten per cent per annum (OECD, 2009).

In recent years Poland has benefitted from very large inflow of foreign direct investment enabling faster transition to full market economy through knowledge transfer from the international companies now operating in Poland. The EU membership has made Poland a particularly attractive host country for foreign capital and has resulted in the acceleration of the convergence process. In terms of accounting regulation membership of the EU has resulted in the adoption of IFRS as well as the implementation of the European Directives and their impact will be discussed in the following chapter.

Having joined the EU in 2004 the focus for the future is to prepare Poland for the adoption of the Euro and the membership of the Euro area. However, the Convergence Report 2008 by the European Commission has concluded that currently Poland does not meet the entry criteria due to its lack of progress in three key areas: reducing its budgetary deficit, stabilising inflation and amending its legal framework. This is clearly the key priority of the government if the membership of the Eurozone is to be achieved in the given timeframe.

A further challenge facing Poland is to ensure that the funds allocated from the EU are effectively utilised and absorbed. The amounts that flow into Poland between 2007 and 2013 are of unprecedented magnitude and Polish authorities must ensure that, through effective planning and allocation, these funds are invested so as to bring maximum benefit in the long term.

Corporation Tax was only introduced to Poland in 1992 and the system continues to be complicated and far from transparent (Piwowarski, 2005). In terms of fiscal risk Polish companies continue to operate in an uncertain environment where complex system of rules and exemptions lead to high compliance costs. In the context of this study the lack of reform of the public sector including the tax system acts as a serious barrier to improvement of the accounting framework.

The ability of the state organs to achieve greater efficiency has been a major concern (World Bank 2006). In its study of the administrative capacity of EU 8 the World Bank concludes that there is a lack of 'soundly performing systems across the whole of government which will in the future ensure that in its day to day management the public sector meets the challenges it faces in an optimal fashion.' (World Bank, 2006:iv). Specifically, the report is highly critical of the relationships between public sector staff: 'the major problem is the unwillingness of politicians to give up their traditional relationship of power and patronage over the civil service in the interests of creating a professional merit based administration.' (World Bank, 2006:vi).

From the various assessments outlined above it is notable that formal institutions such as the legal and tax systems have been much slower to adapt to the new capitalist system and this has impacted negatively on developments in accounting. The role of the state and other institutions forms an integral part of the theoretical framework developed in this thesis and the literature related to new institutional theory is critiqued in Chapter 3.4.

The economic background outlined in this chapter provides an institutional and economic context for the study of accounting developments both within EU and in Poland itself. Accounting in Poland has been fundamentally reformed to meet the need of transition from communist to market economy which also required a complete redefinition of the role of the accounting function. Furthermore, greater internationalisation of trade resulting from the accession to EU and subsequent inflow of FDI combined with the growth in capital markets has provided impetus for Polish accounting to undergo harmonisation with the international developments. The next chapter reviews the literature related to international accounting harmonisation and then more specifically consider financial reporting experience in Poland.

3. LITERATURE REVIEW

3.1 Introduction

The transition to IFRS by listed companies in a transition economy provides a unique opportunity to study the process of accounting harmonisation in a context of institutional upheaval. Therefore, the research fulfils a dual aim of addressing important policy issues relating to accounting harmonisation worldwide as well as contributing to the theoretical framework of new institutionalism. In an attempt to gain a deeper understanding of the various aspects of harmonisation this study reviews literature from two perspectives. Firstly, the research literature related to the international accounting harmonisation is reviewed in order to establish from prior studies what characteristics facilitate or hinder the harmonisation process and to ascertain the level of harmonisation that has taken place so far. This literature provides the context for the main research hypothesis as set out in section 3.5 of this chapter that adoption of IFRS is in itself not sufficient to ensure full compliance with IFRS and wider incentives must be taken into account when evaluating the progress of harmonisation. Secondly, the literature drawn from sociological and cultural theories is critiqued and used to develop an explanatory theoretical model which identifies the factors that influence the level of international convergence of accounting in transition economies focussing on Poland.

The level of compliance with IFRS is deemed to be related to firm specific, market and country factors so in the literature related to the investigation of those factors is reviewed. Thereafter the literature focuses on Polish based studies so that the wider research that is typically published in English language journals can be applied and contextualised to a Polish setting. Poland offers a unique perspective on the issues associated with accounting harmonisation because the change is taking place in the context of far wider political, social and economic transformation.

The literature related to the harmonisation of accounting comprises various strands of research that utilise different methodologies and theoretical frameworks to measure and to explain the differences between national accounting regulation and IFRS. Studies that measure *de facto* compliance with IFRS inform the hypothesis of the thesis that in practice full compliance may not be achieved even when companies make an explicit statement of compliance. The level of *de jure* compliance of national frameworks with IFRS contributes to the understanding of the influence of the state on accounting through its legislative powers. Both *de jure* and *de facto* compliance is informed by surveying international comparative studies to ascertain whether international convergence is actually taking place and if so what are the specific accounting areas where convergence is more difficult to achieve (Canibano and Mora, 2000).

To measure effectively the compliance it is important to clearly define exactly what is being measured and so an integral part of this literature review is the definition of terms by different authors. Harmonisation studies for different countries inform on the ability of individual states to converge to a common accounting system and provide a benchmark against which Polish convergence can be measured (Tsalavoutas and Evans, 2007). Specific country studies on Poland and other transition economies will be particularly useful to this thesis although no formal comparative harmonisation literature has been found in the Polish journals.

In this study the level of compliance with IFRS is also seen through the institutional lens and provides evidence of the consequences of institutionalisation. Companies that fail to comply with IFRS fully are deemed to be embedded in existing routines and are therefore unable to change whilst other companies appear to adopt the spirit of IFRS and all its provisions even before being mandated to do so.

The literature related to the factors that lead to non-compliance with the standards is reviewed to identify the explanatory variables that shape accounting practice. The literature in this area is derived from a theoretical perspective of new institutional theory (DiMaggio and Powell, 1991; Meyer and Rowan, 1977; Zucker, 1987) and resource dependency theory (Pfeffer, 1994). Both institutional theory and resource dependency theory are combined in many models (Oliver, 1991, Carpenter and Feroz, 2001) and so are considered in the same section of the review. The institutional theory forms the basis for the development of a theoretical framework that will be used in this study and is outlined in section 3.5 below.

Once the extent of differences between accounting systems has been evaluated the theoretical framework using literature on accounting classification models is employed (Krzywda,1996; Nobes, 1998) to explain the causes of the differences set out above. The classification theoretical models maintain that accounting harmonisation may be impossible to achieve due to country specific factors such as cultural, economic and political systems. The historical development of Polish accounting tradition is analysed in the context of the classification models in order to identify the specific country characteristics that shape the financial reporting and influence the accounting practice in Poland and help to locate Poland in the wider international context.

3.2 Accounting Harmonisation

3.2.1 Definition and measurement of harmonisation

The degree of international harmonisation of accounting has been measured in studies by Tay and Parker (1990); Barth *et al.* (1999) and Jaafar and McLeay, (2007). In their review of six earlier studies measuring harmonisation Tay and Parker (1990) conclude that there has been insufficient research in the area. Furthermore they concur with Nobes (1998) above and conclude that 'concepts have not been clearly defined, and this may explain the evidence of confusion in the methodology of some studies, and the inconsistent results between studies.' (Tay and Parker, 1990:85).

The term harmonisation refers to the reduction of permitted accounting alternatives so as to aid comparison of financial statements between different companies, sectors and countries. Tay and Parker (1990) distinguish between harmonisation and standardisation. The former is seen as a process that involves the 'movement away from total diversity of practice' whilst the latter is 'a movement towards uniformity (a state') (Tay and Parker, 1990:73). This distinction was used by Karel Van Hulle, Head of Financial Reporting and Company Law at the European Commission to define the convergence of EU accounting in the early 1990s and prior to the implementation of IFRS as 'Harmonisation does not necessarily mean uniformity. In the Community, we want to achieve as far as possible equivalence and comparability of financial information. Therefore the rules are often minimum rules and it is not uncommon to have options for Member States and/or for companies.'(Van Hulle, 1998:1965)

Harmonisation defined in terms of rules and regulations is known as *de jure* process whilst harmonisation that applies to the actual practice of accounting is known as *de facto* process. Therefore the adoption of IFRS in EU means that *de jure* harmonisation has taken place for the companies that are required to produce IFRS financial statements. Van Hulle (1998) uses a comparable classification of formal (*de jure*) and material (*de facto*) harmonisation. The author asserts that formal harmony would normally lead to material harmony but this may not necessarily happen. Conversely, it is possible to achieve material harmonisation without the convergence of laws and standards.

The existence of spontaneous *de facto* harmonisation is confirmed by Tarca (2004) who examined the preferred reporting regime in the UK, France, Germany, Japan and Australia. The results of the study 'show significant voluntary use of international standards in all five countries and among foreign listed and domestic only listed companies.' (Tarca, 2004:60). Tay and Parker (1990) go on to distinguish between strict regulation and less strict depending on the level of compliance required. Strict regulation would normally be associated with uniformity where high level of compliance, usually embodied in laws, is achieved. In contrast less strict regulation is associated with harmonisation where greater discretion is exercised through the application of principle based accounting standards.

The distinction between standardisation and harmonisation is important because the proponents of greater harmonisation would see the adoption of principle based IFRS as contributing towards greater convergence of *de facto* accounting, although 'the association is noisy suggesting that there are also other factors affecting practice harmony' (Rahman, Perera and Ganesh, 2002). Although the move towards greater harmonisation has been widely seen as a desirable objective (Tweedie, 2005) a market based study by Barth *et al.* (1999) found that harmonising domestic GAAP with foreign GAAP may have a negative effect on share prices and trading volumes. The study found that additional costs associated with expertise acquisition may decrease price informativeness of shares.

3.2.2 Comparative studies of international compliance of financial reporting with IFRS

De jure harmonisation with IFRS is concerned with the extent to which national accounting frameworks consisting of laws and national standards have converged to International Accounting Standards. The literature that is concerned with broad international process of harmonisation is reviewed in this section to establish the trends towards harmonisation and obstacles to the development of a common system of accounting based on IFRS.

Over the last two decades the financial reporting regime of International Accounting Standards has become increasingly influential (Roberts *et al.*, 2005; Choi, Frost and Meek, 2002) and has been able to provide a viable alternative to US GAAP. The most notable endorsement of IFRS has been the acceptance of IFRS for foreign companies listed in the US and the publication of a roadmap for the eventual adoption of IFRS for all listed companies in the US (SEC, 2007)

This is reflected in an increasing number of articles dealing with comparisons between US GAAP and IFRS. The most recent publications include Jamal *et al.* (2010) on the implications of the SEC roadmap; Haverty (2006) compared US GAAP with IFRS using Chinese companies listed on the New York Stock Exchange and Tarka (2004) on the choice between IFRS and US GAAP.

The evidence from international comparative studies suggests that *de jure* harmonisation is taking place facilitated by the widespread adoption of IFRS with over 100 countries using IFRS (Ball, 2006; Stenka *et al.*, 2008; AICPA, 2009).

The growing importance of *de jure* harmonisation has been investigated globally in numerous studies: Daske *et al.* (2008) investigated the economic consequences of the adoption of IFRS in 26 countries; Jermankowicz and Gornik- Tomaszewski (2006) and ICAEW (2007) explored the implementation of IFRS in the EU whilst Larson and Street, (2004:90) utilised data from the six largest global accounting firms which reveal that 95 per cent of the countries surveyed were committed to complete or partial convergence of their national accounting standards to IFRS.

Specific country studies consider the process of transition to IFRS. Weiβenberger *et al.* (2004) consider the adoption of IFRS in Germany; Tarka (2008) considers the Australian adoption of IFRS and Callao *et al.* (2007) considers the adoption of IFRS by Spanish companies. Although prior research points to the willingness of countries to adopt IFRS major obstacles exist. Many countries continue to operate both national and international accounting frameworks and their convergence is essential if greater global harmonisation is to be achieved (Callao *et al.*, 2007).

Exactly what is meant by compliance with accounting regulation is problematic where multiple reporting systems and different sources of regulations are present. Tay and Parker (1990) point to a varying level of compliance depending on the type of regulation and the level of application in different countries. Laws are generally more strictly enforced while standards have a lower status in terms of their authority. Measure of *de jure* harmonisation is also made more difficult by the complexity of national accounting systems and their definitions (Nobes, 1998).

Jermakowicz and Gornik Tomaszewski (2006) in their study of adoption of IFRS by listed European companies found that a third of the companies use IFRS for consolidated accounts only and by implication prepare individual accounts under a different system. This inevitably brings many problems associated with parallel running of different accounting systems notably in the areas of expertise of staff, IT systems and management reporting. The authors conclude that ‘the transition to IFRS is a complex, costly and a burdensome process’ Jermakowicz and Gornik Tomaszewski (2006:17).

Commenting on the possible problems of convergence Salter, Roberts and Kantor (1996) show that even before the enforcement of IFRS by the EU, companies that reported using UK GAAP were 70 per cent compliant with the International Standards. However, the study also revealed widespread variation between EU member countries. Germany had a compliance rate of only 57.7 per cent and Portugal of 61.1 per cent indicating that those countries would be likely to experience greater problems in achieving convergence to IFRS than countries such as the UK that was already compliant in many respects. For countries that have mandatorily complied with IFRS Al-Shammari *et al.* (2008) report on the level of compliance by firms in six Gulf States between 1996 and 2002. They found that the compliance with 14 standards examined has increased from 68 per cent in 1998 to 82 per cent in 2002 thus providing evidence of continuing convergence.

Other studies point to a continued lack of convergence due to accounting options being available within IFRS. Kvaal and Nobes (2010) hypothesised that companies chose allowable IFRS accounting policies based on the national policies that were in existence prior to the adoption of IFRS. This choice of policies meant that national differences persisted even when IFRS was uniformly adopted for all listed companies. The study utilised the largest blue chip companies from UK, Germany, France, Spain and Australia to compare the accounting options selected before and after IFRS adoption. The authors found that there were systematic differences in accounting policies that reduced comparability between companies in different countries.

The GAAP Convergence project (BDO *et al.*, 2002) surveyed accounting professionals in 59 countries worldwide to provide an indication of their countries' plans for convergence to IFRS. The study pointed to considerable obstacles to harmonisation. 51 per cent of the countries saw excessive complexity of IFRS as hindering the process of convergence. These results are consistent with the findings in the later study by Jermankowicz and Gornik Tomaszewski (2006) where majority of the firms surveyed would not undertake the conversion to IFRS if they were not required to by law.

The GAAP Convergence project (BDO *et al.,* 2002) also found that 47 per cent of respondents believed that closely aligned tax and accounting rules prevent a wholesale adoption of IFRS by member states. For example Poland, in common with many other countries, requires the majority of individual company accounts to be produced using Polish law and those financial statements then form the basis of a tax computation. Therefore, although consolidated accounts are produced using IFRS it cannot be said that the Polish accounting system has converted to IFRS for all companies.

A similar approach has been taken in other EU countries that use financial statements for fiscal purposes. In France the standard setting body, Conseil Nationale de la Comptabilite, has set out its position as follows: 'Taking into account the institutional context in France, the CNC's position is not to propose the application of the IASB's standards for the individual accounts. The CNC does not envisage at this stage, a separation of the individual accounts from the tax accounts' (Delesalle, 2002 sighted by Jermankowicz and Gornik Tomaszewski (2006).

The problem of different reporting models has another dimension when non-listed companies are also considered. In many countries parallel accounting systems operate for listed and non-listed companies and therefore convergence to IFRS may be variable even within individual countries although in the long term it may be difficult to sustain such multiple system model. Meek and Thomas (2004) exemplify the problem by posing the following question: 'What about non-listed companies and companies' non-consolidated (ie. Individual company) accounts, particularly those from European code law countries? Will they continue to reflect national accounting systems or will they shift away from them?' (Meek and Thomas, 2004:31). The concerns expressed by Meek and Thomas were supported empirically in a study of 26 listed Spanish companies by Callao *et al.* (2007) who found that comparability has actually worsened when both IFRS and Spanish GAAP are applied in Spain at the same time due to different requirements of each system and permitted variability within IFRS.

The problem of multiple reporting systems is apparent in Poland when considering the admissibility of IFRS for listed companies as set out in the revised 1994 Accounting Act. Compliance with EU Regulation for the mandatory adoption of IFRS for consolidated accounts of listed companies (Commission of the European Communities, Regulation 1606/2002) has been embodied in the 1994 Accounting Act. Although article 45 of the 1994 Act extends the admissibility of IFRS to a narrow range of companies such as banks and single entity companies of a group applying IFRS it is most important to note that the vast majority of companies continue to apply the revised 1994 Accounting Act and these companies are not subjects to the provision of IFRS. Therefore Polish accountants must have expertise in both reporting regimes and be able to apply Polish GAAP and IFRS.

Much of the information regarding the progress of *de jure* convergence has been gathered by the major accountancy firms such as Deloitte, Touche Tohmatsu (2010) through wide scale surveys Typically, the studies include a large sample of countries and the data has been obtained by questioning audit partners in various countries rather than the company accountants themselves. They have an obvious advantage in providing considerable data but Tay and Parker (1990) note 'the main difficulty involved in using surveys is the appropriateness of the data collected. Often the questions were not asked for the purposes to which researchers subsequently put them'.

Other criticisms regarding surveys relate to the fact that generally they identify the points of difference between IFRS and national GAAP but do not measure the impact of the differences. Although the studies are useful in identifying the areas of divergence from IFRS they are limited in the depth of analysis of the differences and crucially depend on the expertise of the respondents for the accuracy of the results (Larson and Street, 2004). Furthermore, the studies 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 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. Weetman *et al.* (1998:192) notes: 'analysis of differences in legislation gives no indication of how frequently such differences will be encountered in practice or how significant the differences may be in their impact on profit.'

The review of literature confirms that global *de jure* convergence of accounting from national systems to IFRS for listed companies is taking place. However, concerns remain in two main areas: firstly, the comparability between listed and non-listed companies will be lost due to the operation of both national and international systems at the same time. Secondly, convergence of legal frameworks does not guarantee that convergence of actual accounting practices will take place because the actual practice is affected by firm specific characteristics and the institutional factors of the country in question.

The next section will review literature related the relative impact of both country and firm incentives that cause divergence in accounting practice even when a common accounting regime is in place.

3.2.3 The role of incentives and other factors in financial reporting outcomes

The drive towards greater harmonisation of accounting practices by the major standard setting bodies as set out in previous section points to divergence between *de jure* and *de facto* compliance with IFRS and difficulties with the implementation of these standards. Whilst the EU Directive to adopt IFRS from 2005 has led to the imposition of a single reporting framework there is considerable evidence that full *de facto* comparability has not been achieved (Kvaal and Nobes, 2010).

The aim of this thesis is to identify the country specific impediments that hinder the harmonisation process in Poland and the studies reviewed below provide insight into the factors that explain the variation in accounting practice even when a common accounting framework is used. The research hypothesis put forward in the thesis states that in Poland country related, institutional factors arising from the role of the state, the accountancy profession and the method of financing strongly influence financial reporting practices. Krzywda (1996) classified Poland as exhibiting code law characteristics and so the accounting will be, at least in part, influenced by country specific factors.

Schipper (2005) argues that financial reporting outcomes are determined by a complex interaction of IFRS regulatory requirements, country's political systems, institutional arrangements, legal structures, level of capital market development as well as firm specific characteristics such as size, ownership structure and board composition amongst others. Drawing on the literature arising from the positive accounting theory (Watts and Zimmerman, 1979) it is argued that variation in the level of compliance with IFRS may result not only from country wide differences but also from the firms' management choosing alternative accounting policies that enhance their own benefits. Although the literature points to multiple influences this thesis assumes that in post-communist economies institutional arrangements are the dominant factors that drive accounting practice because they are significantly different from the Anglo-Saxon model (Krzywda, 1996).

Empirical support for Schipper's view of multiplicity of influences on accounting practice was provided by Barth *et al* (2008) who studied the impact of IAS on the quality of accounting as measured by degree of earnings management, timeliness of loss recognition and value relevance of earnings. Using pre and post IAS adoption accounting data for firms from 21 countries Barth *et al* (2008) show that there is an improvement in the quality of accounting as a result of adoption of IAS although the authors recognise that it is not clear that the improvement has arisen as a result of the IAS framework or from firms' incentives and/or institutional setting.

Additional insight is provided by Rahman *et al* (2002) who empirically tested the level of practice harmony for two countries, New Zealand and Australia which have similar environments and cultural background. A major difference between the two countries was the level of enforcement of accounting GAAP which was statutorily enforced in Australia but not in New Zealand. The study found that there is a strong correlation between practice harmony and regulation harmony and additionally showed that this correlation is even stronger when there is effective enforcement. The findings from Rahman's study have been considered in this research in relation to the coercive influence of accounting enforcement versus tax enforcement by the Ministry of Finance.

Ball *et al* (2003) distinguish financial reporting incentives as arising either from the markets (common law countries) or from the government (code law countries). Higher quality of publicly available information is demanded by analysts and shareholders in common law countries than in code law countries where the reporting quality is expected to be lower. This is consistent with the findings from the seminal study by La Porta *et al* (1998) who studied the effect of legal systems on country's financial systems. La Porta *et al* (1998) also point to a relationship between the level of investor protection and concentration of ownership arguing that greater concentration of shareholding overcomes the deficiencies of weak investor protection. Furthermore where there is a system of weak investor protection then the risks for minority shareholders are high making investments by small shareholders less likely.

In the context of accounting Leuz *et al* (2003) clustered countries by institutional variables and found that firms located in countries characterised by relatively concentrated ownership, weak investor protection, and less developed stock markets were likely to be engaged in higher levels of earnings management (lower accounting quality) than open countries. Although none of the post communist countries were included in the Leuz *et al* (2003) study Poland could be classified as an insider economy and therefore have lower quality of accounting. This assumes that Poland is a code based country (Krzywda, 1996) with a small stock exchange, high concentration of ownership (see section 2.4) and higher corruption index than other Western European economies (Corruption Perception Index, 2011) .

Among the various institutional arrangements the taxation system has been implicated in the quality of accounting. Haw *et al* (2004) found that high tax compliance is associated with reduced earnings management. However, Wysocki (2004) argues that the cause and effect of Haw's finding should be interpreted in the opposite way. That is improvement in standards and better investor protection reduces earnings management and so improves the level of tax compliance.

Ball *et al.* (2003) test the premise that incentives play an important part in determining accounting quality in a comparative international context. Using a sample of 2726 annual earnings from four East Asian countries (Thailand, Hong Kong, Malaysia and Singapore) the authors measure the transparency of earnings by regressing net income against economic value using change in the total shareholder value as a proxy for economic income. The results from this study show that for all four countries under consideration the transparency of reported earnings is lower than was found in common law countries such as UK and US. In particular Thailand, where tax orientation and government engagement are highest displayed the lowest timeliness of all four countries. The study concludes that strong institutional incentives act to reduce the transparency of income. This is in spite of the fact that the accounting systems in all four countries have been significantly influenced by accounting conventions derived from Anglo-Saxon traditions. The findings support the hypothesis that 'information quality is determined in large part by the underlying economic and political factors influencing managers' and auditors' incentives, and not by accounting standards *per se*' (Ball *et al.*, 2003:1).

Conclusions from Ball *et al* (2003) inform this research and allow a hypothesis to be developed that adoption of IFRS is, in itself, not sufficient to ensure high quality and consistent financial reporting practice in Poland as political and economic characteristics need to be considered. As discussed in chapter 2 Poland's economic and political history was significantly different from US and EU countries that dominate the literature so the country effects are likely to be more pervasive than in established market economies. These factors are employed in chapter 3.5 to develop explanatory propositions for the lack of compliance of listed companies with IFRS in a single, post communist country.

Daske *et al.* (2008), in their study of firms in 26 countries showed that the mandatory adoption of IFRS has a positive effect on the markets causing firms' cost of capital to fall and market liquidity and equity valuation to increase. A key finding from Daske's study that informs this research was that the results were conditional on the institutional setting of the countries in question. They conclude that: 'capital market benefits occur *only* in countries where firms have incentives to be transparent and where legal enforcement is strong'. (Daske, 2008:1). This can be contrasted with weak institutional arrangements in Poland identified by the EU and the World Bank in chapter 2.4. Specific country studies are therefore be useful for evaluating the institutional setting for the adoption of IFRS. However, Leuz and Wysocki (2008) make the point that it is impossible to identify separately the effects arising from the institutional setting from those arising from the introduction of IFRS echoing the position put forward by Schipper (2005) and Barth *et al* (2008).

Bushman and Piotroski (2006) investigate the impact of legal regime on the degree of conservatism in financial reporting. The authors find that firms where there is high level of state ownership of enterprises and a high risk of expropriation of assets by the state speed the recognition of good news and slow the recognition of bad news. This research is relevant to the post communist economies such as Poland where there is greater engagement of the state in the economy, low liquidity of the stock market and more concentrated shareholding so the quality of financial reporting would be expected to be lower than in Anglo-Saxon countries.

Country factor has been identified as an important determinant of accounting practice by Jaafar and McLeay (2007) who studied the accounting choices for policies governing goodwill, depreciation and inventory valuation by EU listed companies before the mandatory adoption of IFRS. They found that the choice of accounting policies was significantly associated with the country of domicile but less so with the industry sector and conclude that: 'any harmonization that did occur had no significant influence overall on the persistence of strong country trends in accounting policy choice' Jaafar and McLeay (2007:185).

The findings support the premise that macro-economic and other institutional factors play an important role in determining the nature of accounting. A similar study on differences in IFRS policy choice by Kvaal and Nobes (2010) carried out post EU adoption of IFRS found similar adherence to national norms thereby confirming the findings by Jaafar and McLeay. The study by Jaafar and McLeay also considered the influence of firm specific characteristics by testing the influence of size and listing but their impact was found to be weaker than the country factor.

Raonic and Isidro (2012 forthcoming) extend the previous study by integrating and measuring the relative influence of country and firm characteristics on accounting quality. The authors argue that firms have their own contracting self interest but at the same time their behaviour is modified by broader institutional characteristics such as ownership concentration and enforcement regime. Using data for firms reporting under IFRS in 26 countries for a two year period 2006 and 2007 Raonic and Isidro (2012) confirm a strong association between financial reporting quality and both country's institutional effectiveness as well as firm specific factors. Significant firm characteristics included ownership concentration, effective auditing, transparent information disclosure, analyst disclosure and capital market development and accounting quality. However, a key finding was that when combined it was found that firm characteristics play a more dominant role than country factors.

The apparent contradiction with Jaafar and McLeay (2007) could be explained by the fact that Jaafar and McLeay (2007) examined only three areas of accounting policy and used a sample data before the mandatory adoption of IFRS in EU whilst Raonic and Isidro used post 2005 data when IFRS was applicable to all consolidated listed accounts. This means that the amount of variation between countries would be less in the later study leading to lower divergence of practices resulting from country effects.

In summary, although greater comparability of accounting has been achieved through the adoption of international standards the variability in the level of practice harmonisation in different countries shows that both firm and country characteristics shape accounting practice and lead to variable level of comparability. In many of the studies reviewed country level factors appear to be dominant although most studies recognise that it is difficult to isolate the country from firm effects. The above literature does not include the study of post communist countries but it is likely that for these economies institutional and macro-economic are likely to be even more significant due to their very different political and economic background as compared to developed market economies.

Although the hypothesis developed in section 3.5 has its foundations in New Institutional Theory the explanatory variables used in the propositions are congruent with the country characteristics identified in this highly quantitative body of literature.

3.2.4 Harmonisation of Polish accounting with IFRS

Literature surveyed in the previous section showed that harmonisation can be achieved more easily when the national system of accounting is closely aligned to IFRS. This section reviews the literature related to accounting regulation specifically focussing on the Polish system of accounting. A large number of academic articles have been written by Polish academics about the adoption of IFRS but in many of the articles the aim appears to be to explain and expand on the provisions of IFRS rather than to provide an evaluation of the process of harmonisation in Poland (Frendzel and Turzyński (2004); Lachowski (2008). The literature discussed in depth in this chapter consists of the studies that provide greater insight into the process of harmonisation whilst exposition of various aspects of IFRS and the detailed comparison of IFRS and Polish accounting regulation has not been considered.

De jure harmonisation of Polish accounting system to EU requirements has been a difficult process that is still in progress. Walińska (2004) sees the evolution of accounting in Poland since the start of transition in three phases:

1991-1995 Law based and tax orientated system

1995-2001 Mixed system but evolving towards Anglo-Saxon system

2002 onwards System that has definite Anglo-Saxon characteristics

Each of the phases above is evaluated in the context of harmonisation culminating in the mandatory adoption of IFRS in 2005.

The priority at the commencement of transition was given to the establishment of a tax system in 1989 (Taxation Act of 31^{st} January 1989) and the need to collect tax revenues shaped the first Accountancy Regulation issued in 1991 and formed the basis for the determination of taxable profits. Walińska (2004) notes that at that time Polish authorities and academics had the choice of accounting models because, at the start of transition Poland was starting from ‘a clean slate’ in terms of development of an accounting system for a market economy as no such system existed at the time. In fact, the long term goal of EU membership influenced the development of the accounting framework (Walińska, 2004).

Given the EU imperative, during the 1990s Polish accounting law had to change to comply with the EU law as required by the *acquis communautaire* for the prerequisite to membership of the EU (European Commission; 1995: Annex 315-321). The scale of changes that was required by the *acquis communautaire* for the aspiring EU member countries was enormous requiring wholesale adoption of 588 directives and 311 regulations covering every aspect of the economy (Craner *et al.*, 2000). In this context accounting changes were seen as just a very small part of a major transformation of Polish legal, social and economic environment. In the early stages of transition Poland chose to align its accounting system on the compliance with EU Directives as this was a practical imperative but chose not to adopt all the IAS in existence at the time. Lack of strong accountancy bodies and no experience of self regulation coupled with the tax orientation of Polish accounting meant that the gap between IAS accounting and Polish framework in the earlier years of transition was too wide to implement all international standards in a single change (Walińska, 2004). Instead the 1994 Accountancy Act (*Ustawa o Rachunkowości*) formed the cornerstone of Polish accounting, which for the first time, separated the taxation and accountancy function and incorporated the 4th EC Directive as well as some principles from the IAS framework.

The application of the true and fair concept arising from the EC 4th Directive in Poland highlights the dilemma between continental European accounting and Anglo Saxon accounting. In Poland the true and fair construct was one of the earliest concepts to be introduced to accounting legislation following the start of transition, having been adopted in 1991 as a Regulation from the Minister of Finance. Nierzwicka (2001), in her review of the evolution of the true and fair view in Poland, argues that in the 1991 regulation primacy was given to compliance with law which, together with the lack of separation of tax law from accounting, has meant that in practice the true and fair concept was not operationalised in Poland in the way it was intended by the Directive. Major improvements to the Polish accounting regulation were implemented from 1995 once the Polish Accounting Act of 1994 was passed. The Act was extremely important because, for the first time, tax legislation was separated from accounting regulation (Nierzwicka, 2001). As the developments in Poland indicate the process of harmonisation within countries is typically evolutionary and does not necessarily take immediate effect.

At the beginning of the transition period in the 1990s further complications arose from the fact that the IAS were designed for well developed market economies whilst Poland had no private enterprise and so terms such as ‘fair value’ had no real meaning as there was no established market for assets (Craner *et al.*, 2000). As Kamela Sowińska (1995:776) concludes in her article on the treatment of goodwill: ‘Privatisation of state enterprises in Poland is a difficult, significant and completely new process both in its economic and social aspects. This process requires knowledge of law and economics which was difficult to acquire under the centrally planned economy. Unfortunately in such conditions mistakes are inevitable’

Major revisions to the 1994 Accountancy Act implemented in 2002 considerably improved and clarified the Polish accountancy framework bringing it into line with the IAS framework at the time (Walińska and Urbanek, 2001). Based on the IASC conceptual framework key terms were explicitly defined, bases for valuation were established and principles for presentation clarified. The revised Act also set out the status of the different sources of regulation giving primacy to the law but where there is insufficient guidance allowing the application of Polish Accounting Standards and finally allowing IFRS for any remaining unresolved issues. The changes to the 1994 Act were published in 2000 and implemented in 2002 giving researchers the opportunity to study the progress of accounting developments over that period.

The Accountancy Act was evaluated by Walińska and Urbanek (2001) using a longitudinal study from 1996 to 2000. Based on a survey of 550 accountants engaged in the preparation of financial statements the study found that the Act gained acceptance with time 57.7 per cent of the respondents viewing the Act positively in 1996, 56.1 per cent in 1998 and 70.9 per cent in 2000. In addition, there was a clear and growing preference for the development of local Polish Accounting Standards rather than relying on legally imposed changes from the Ministry of Finance. In 1996 only 19.7 per cent of respondents saw a role for the Polish Accounting Standards but this figure increased to 39.1 per cent in 2000. Correspondingly, the role that the Ministry of Finance should play was downgraded from 39.8 per cent in 1996 to 10.9 per cent in 2000 (Walinska and Urbanek, 2001). The findings offer a very useful insight into the changing mentality of Polish accountants regarding the balance and responsibilities of self regulation versus legislative regulation. The preference of the accountants for legally imposed regulation appears to be replaced by the desire to see greater role being given to the self-governing body of Polish Accounting Standards Committee. The results also suggest a growing professionalization of Polish accountants who are looking for greater power similar that is afforded in more mature market economies.

The findings by Walińska and Urbanek (2001) are not supported when the practice of accounting is evaluated. Borowski and Kariozen (2007) argue that the evolutionary changes to Polish law coupled with the Polish tax orientated system has meant that accounting practice has not fully accepted the changes but rather adapted marginally and just enough to meet the legal obligations without fully embracing the notion of transparency and openness in accounting.

Craner *et al.* (2000) carried out a *de jure* and *de facto* comparison of the treatment of goodwill and found that positive goodwill was treated in accordance with the options offered by the 7th EU Directive and IAS 22 (*Business Combinations*) but the treatment of negative goodwill contravened both the 7th Directive and IAS 22. The authors noted that 'the accounting treatment of positive and negative goodwill appear to favour simplicity of approach uncomplicated by a deeper consideration of the economic nature of these items'. (Craner and Schroeder 2000:20). This preference for strict application of rules is consistent with the national economic tradition used by Krzywda *et al.* (1995) to classify Poland. The preference for strict application of rules has led to persistent differences remaining hindering the progress to full harmonisation. Nevertheless, Borowski and Kariozen (2007) argue that the implementation of IFRS in 2005 has improved the quality of financial reporting in Poland through the elimination of tax orientation embodied in Polish Accounting Regulation, through reduced orientation on rule based approach and greater focus on disclosure and presentation of IFRS accounting.

Prior research suggests that the very fact of transition to IFRS has a positive effect on firms' willingness to present more user orientated financial statements. Borowski and

Kariozen (2007) studied the disclosures related to financial instruments for 23 Polish listed companies in the years 2004 and 2005 and found that the level of disclosure under IFRS improved as compared to the reporting under Polish Regulation even though the required disclosure under both frameworks was very similar. The authors do not provide an explanation for their findings, but it is likely that emphasis on better training in the run up to the implementation of IFRS meant that accountants paid more attention to the broader disclosure requirements of IFRS than they did to the requirements of Polish regulation.

Krzywda and Schroeder (2007) analysed the differences between IFRS and Polish Accounting Regulation by reviewing the disclosure notes of published financial statements of 73 Polish listed companies for 2001 and 2003. The findings show that the number of qualitative differences decreased between 2001 and 2003 and the number of reasons for the differences also decreased pointing to a *de jure* convergence between Polish Accounting Regulation and IFRS before the mandatory adoption of IFRS in 2005.

The main five causes of difference between IFRS and Polish Accounting Regulation in 2003 accounted for over 50 per cent of all differences. They were shown to be:

- No revaluation of tangible fixed assets
- No adjustment for hyperinflation in accordance with IAS 29 (*Financial Reporting in Hyperinflationary Economies*)
- Scope of disclosure less than that required by IFRS
- Presentation formats not in accordance with IFRS generally

- Capitalisation of equity issue costs not in accordance with IAS 39 (*Financial Instruments: Recognition and Measurement*)

Consistent with other studies (Kosmala, 2007) it would appear that Polish accounting does not value a high level of presentation and disclosure of information as highly as IFRS whilst the differences relating to the revaluations are inextricably linked to Polish tax orientation. It would appear that the differences identified above are those that Polish legislation was not able to eradicate and lead Krzywda and Schroeder to conclude that 'the amendments seem to have their roots in the *de facto* fiscal orientation of Polish financial reporting as well as the previous command economy system' (Krzywda and Schroeder 2007:90).

The drawback of this analysis was that the Prospectus Decree 2001 required only a descriptive disclosure of differences between IFRS and Polish regulation so quantitative evaluation was not possible until IFRS 1 (*First Time Adoption of IFRS*) came into force in 2005.

Borowski and Kariozen (2007) were able to quantify the *de jure* differences once IFRS was adopted in 2005. They showed that in 12 companies examined the average change in equity on adoption of IFRS in 2005 was an increase of 13.85 per cent as compared to equity under Polish regulation and the comparable change for net income amounted to 2.27 per cent. The authors were able to conclude that the impact of transition to IFRS from Polish Accounting Regulation was significant for equity but less so for profit.

Krzywda and Schroeder (2007) quantified the differences for 113 companies in 2004 and found that the equity under Polish regulation was understated by an average of 6 to 9 per cent whilst net profit was understated by an average of 35 per cent which is a much higher figure than obtained by Borowski and Kariozen (2007). The main reasons giving rise to the differences were identified as revaluation of fixed assets, different accounting treatment of positive and negative goodwill and exclusion of subsidiaries from consolidation. The wide discrepancy between results of Borowski and Kariozen (2007) and Krzywda and Schroeder (2007) throws some doubt as to the validity of the results but the sample for the latter was far larger and was likely to be more reliable.

Kaczmarczyk and Walińska (2007) carried out a two stage research concerning the accounting for fixed assets; firstly they carried out an in-depth *de jure* comparison between treatment under IFRS and Polish regulation and secondly, they investigated *de facto* practice of the largest listed Polish companies WIG 20 using the information from 2005 financial statements. *De jure* comparison of the accounting treatment for fixed assets under each framework led the authors to conclude that the differences were pervasive affecting fixed asset classification, recognition and amortisation. In spite of the large number of *de jure* differences identified the research found that on average each company identified only two differences related to fixed assets in their IFRS 1 *(First -time Adoption of International Financial Reporting Standards)* reconciliation in 2005 financial results. The most frequent adjustments related to the revaluation of fixed assets, treatment of finance costs and adjustment for hyperinflation. The authors concluded that firms carried out only a limited implementation of IAS 16 (*Property, Plant and Equipment)* utilising only some of the range of possible adjustments.

A deficiency in these results lies in the fact that the research was not able to distinguish between failure to comply with IAS 16 and the possibility that adjustments were simply not necessary as they did not apply to the company. For example the differences in the treatment of finance costs will only become an issue when a firm finances acquisition of fixed assets through borrowing. For companies with a low level of fixed assets say for a service company it is unlikely that they will be affected by the difference.

Other evidence of non-compliance with IFRS is available from the annual survey of listed companies produced by the Polish Commission of Financial Oversight (*Komisja Nadzoru Finansowego*). In their 2009 survey of the disclosure made in 2007 by 66 listed companies KNF (2009:9) conclude that: 'while the issuers make the required disclosures, the scope of the presented information is often incomplete or the information is not fully clear and transparent'. The KNF review is extremely limited because it simply lists some 50 areas of departure without ranking the departures by occurrence or by their materiality. Neither does the study state how many of the 66 companies were compliant. In order for the information to be useful for the stakeholders full analysis and explanation of the findings was required, but in common with many Polish disclosures, the narrative to support the factual data was extremely limited.

The difficulty in the acquisition of in-depth knowledge of IFRS is exacerbated by the considerable translation difficulties. As noted by Abd-Elsalam and Weetman (2003) a major obstacle to the adoption of IFRS by national jurisdictions concerns the technical knowledge of the IFRS and the ability to translate the standards into the home language. Abd-Elsalam and Weetman (2003) studied the compliance with IAS by listed companies in Egypt and found that compliance was lower where there was a lack of familiarity with the standard. Furthermore, compliance was also lower where there was no official Arabic translation available.

According to IASB, the official translation of IFRS into Polish language did not take place until 2004. In terms of IFRS implementation timescale this was far too late to allow users to familiarise themselves adequately for the conversion to IFRS for 2005 and comparative of 2004. Therefore it is expected that similar results, showing lower compliance with IFRS, would apply to Poland as were found for Egypt in the Abd-Elsalam and Weetman (2003) study. The issue of the quality of IFRS translation was highlighted as a serious concern in the round table discussions of the ICAEW (2007) study where participants noted: 'the possibility that errors exist in the officially adopted standards and to the use of poor and out of date translations' ICAEW (2007:46). Translation difficulties have been widely reported in the context of True and Fair construct (Aisbitt and Nobes, 2001; Kosmala-MacLullich, 2003; Alexander and Eirle, 2006). This overriding principle of true and fair underlies the preparation of financial statements, is embodied in the 4th Directive and yet has different meanings for different European countries. To ensure that accounts for companies located in different countries and using different languages are prepared on a comparable and consistent basis common understanding of the standards is essential.

In summary, the literature review has shown that in comparison to other countries Polish accounting legislation has existed for a relatively short period of time that is since the start of transition in 1991. Since that time the legislation has been influenced by the EU legislation which was incorporated gradually into Polish Accountancy Act in 1994 and 2000. Prior research shows that the changes to the Polish accounting system have been positively received by the preparers of accounts and have resulted in the convergence with IFRS. In spite of this convergence significant differences remain between IFRS and Polish Accounting Regulation and transition to IFRS have resulted in the identification of significant areas of difference which have a material impact on both the equity and earnings of companies. The next part of the literature survey will focus on the empirical studies that measure such differences on the transition from national reporting to reporting under other jurisdictions, for example US GAAP and IFRS.

3.2.5 Harmonisation of financial reporting practices using indices

The aim of this section is to review the literature related to the measurement of differences between key metrics based on national accounting regulation and IFRS. The findings from the literature point to significant differences remaining even when accounting systems are closely aligned. Those differences are rooted in the legal background, various market forces and firms' operating characteristics (Hail and Leuz, 2007). The existence of reconciliations either using F20 reconciliation to US GAAP or the reconciliation required by IFRS1 (*First Time Adoption of IFRS*) allows the differences to be measured using indices. This part of the literature reviews the studies that measure the actual differences reported by companies (Weetman *et al.*, 1998; Aisbitt, 2006; Krzywda and Schroeder, 2007; Tsalavoutas and Evans, 2007; Gray *et al*., 2009).

Tay and Parker (1990:85) in their review of six harmonisation studies suggest that: 'if harmonisation activities are the result of concern about the comparability of accounts produced by companies from different countries, then a measurement study should focus on actual reporting practices rather than regulations, that is on *de facto* rather than *de jure* harmonisation'. Prior research shows that mere adoption of an accounting framework may not lead to *de facto* harmonisation (Cairns, 2001).

Ball *et al.* (2003), in their study of four South East Asian countries sight different institutional arrangements such as the legal system and financing tradition as an explanatory factor for the differences in accounting practice even when a common IFRS system is employed. Hail and Leuz (2007) argue that accounting practice is affected by the effectiveness of enforcement mechanisms. The authors maintain that in the EU the adoption of CESR (The Committee of European Securities Regulators) Standard no.1 on Financial Information will improve the quality of compliance with IFRS by monitoring compliance and taking action when adherence is breached.

Tay and Parker (1992) describe *de facto* harmony as material harmony which 'refers to the harmony of the accounting methods actually applied in the financial reports.' (Van der Tas, 1992:70). Further distinction is made between measurement issues that affect the values in the financial statements and disclosure issues that give additional information but do not affect the performance or valuations recorded.

The seminal work by Gray (1980) utilized the 'conservatism index' to quantify the differences between the reported after tax profits and profits adjusted by financial analysts for France, Germany and UK. The index is expressed as:

$$1 - \frac{(R_A - R_D)}{R_A}$$

where R_A is the adjusted profit and R_D is the disclosed profit. Index equal to one would suggest neutrality between profits; index of more than one would indicate that disclosed profit is less conservative than adjusted profit and index of less than one indicates that the disclosed profit is more conservative than the adjusted profit. In this thesis index of less than 1 would indicate that IFRS profit is higher (less conservative) than profit calculated using PAR (Polish Accounting Regulation).

Gray (1980) found that both France and Germany were significantly more conservative in the reporting of profits than the UK. The findings support the predictions from the classification literature (Nobes, 1998) which would group France and Germany as continental European countries characterized by greater prudence required by lenders whilst the UK as an Anglo-Saxon country where external shareholders provide finance.

The use of indices, as proposed by Gray (1980) was subsequently replicated and extended in numerous studies. In a later study by Weetman *et al.* (1998) the index was renamed as the 'comparability index' so as to move the focus from the narrow concept of conservatism to a broader definition of comparability.

Tsalavoutas and Evans (2007) employ the comparability index to investigate the impact of transition to IFRS by Greek listed companies. In this research the authors consider the overall impact of transition on equity and profitability, gearing and liquidity and then extend the study to consider the impact of individual adjustment using partial indices. They found that switching to IFRS from Greek GAAP had significant impact of on reported performance. The equity mean comparability index was 0.97 and net profit comparability index was 0.88 indicating higher profit and equity under IFRS but the difference in equity was not significant. Revaluation of fixed assets was a major source of adjustments and this is consistent with findings by Haverty (2006). The liquidity ratio was shown to be 6 per cent higher under Greek GAAP than under IFRS and gearing was also higher. The negative impact of conversion to IFRS on these ratios would be expected to have an impact on the debt covenants in Greece however, the authors point to institutional features of the Greek economy where banks are closely associated with the companies and so breaches of lending criteria do not have the same implications as they would in Anglo-Saxon economies.

Haverty (2006) used the comparability index to study the differences in equity and profit for eleven Chinese companies listed on the New York Stock Exchange. These companies all produced IFRS accounts but were required to produce F20 reconciliation between IFRS and US GAAP. His study confirmed that there is a material lack of comparability between IFRS and US GAAP but between 1996 and 2002 convergence between the two systems has taken place. The findings reflect the efforts made by both US and IASB standards setters to converge their systems with the ultimate aim of the US accepting IFRS without a need for reconciliation. Haverty

(2006) found that the major source of difference between the systems was the ability to revalue fixed assets which is permitted under IFRS but not under US GAAP. As many national accounting systems, including that of Poland, do not allow revaluations this is likely to remain as the major source of difference.

More recently, Henry *et al.* (2009) used a longitudinal study of EU cross listed companies to study the differences between US GAAP and IFRS from 2004 to 2006. The study differs from Haverty (2009) by considering 75 companies from different EU countries whereas Haverty used only firms originating from China. Henry *et al.* (2009) found that the reconciling items showed significant differences depending on the legal background of the home country which lead the authors to question the consistency of application of IFRS in different sectors and countries and to suggest that country specific institutional issues impact on the application of IFRS. Overall, Henry *et al.* (2009) showed that the gap in income and equity between the two frameworks has decreased over time pointing to a convergence of the two systems. However, the net income gap remained significant with reported IFRS income being higher than US GAAP income. The major reconciling items were found to concern the treatment of pensions and goodwill. Taking the two studies together, over a period of ten years covered by Henry *et al.* (2009) and Haverty (2006) the findings point to a continual convergence of IFRS with US GAAP but significance differences persist.

Study by Gray *et al.* (2009) of European companies listed in US found that 'trends in *de jure* convergence resulting from the joint efforts of the IASB and FASB have not produced the level of *de facto* convergence anticipated by many' (Gray *et al.*, 2009:445). An interesting aspect of this study was that the sample distinguished between those that adopted IFRS voluntarily prior to 2005 and those companies that adopted IFRS for the first time in 2005. Gray *et al.* (2009) found that first time adopters reported greater divergence between IFRS income and US GAAP income whilst for voluntary users the reported income under both systems was comparable. The authors explain the findings by suggesting that voluntary adopters select policies with IFRS that would be compatible with US GAAP thus reducing the complexity and costs of reconciliation.

Gray's index of conservatism was used in the context of Polish accounting by Krzywda and Schroeder (2007). The study shows that for 2004 the book value of equity calculated using Polish accounting regulation (PAR) was understated between 6 per cent and 9 per cent as compared to IFRS. The greatest impact was however, on post tax income. Krzywda and Schroeder (2007) found that using PAR the net income was understated by an average of 35 per cent as compared to income calculated under IFRS. The study points to continued and material differences between the two accounting systems. The key adjustments that give rise to the reported differences were in the area of revaluation of fixed assets and the treatment of goodwill on consolidation. IAS16 (*Property, Plant and Equipment*) requires regular revaluations whilst under Polish accounting regulation revaluations are strictly regulated by the Ministry of Finance in Polish law and not at the discretion of individual companies.

However, a study of 26 listed companies by Callao *et al.* (2007) shows that majority of Spanish firms do not revalue fixed assets on transition to IFRS. They find significant adjustments between IFRS and Spanish GAAP but the differences arise in the area of the valuation of financial instruments, presentation of financial statements and basis of consolidation. The consequence of these adjustments is to increase liabilities but decrease equity and debtors.

3.2.6 Summary of Accounting Harmonisation

In summary the studies utilising financial statements to identify the reconciling differences between IFRS and national GAAP point to convergence taking place between IFRS and US GAAP. Other studies utilise data from a single year so the progress of harmonisation cannot be ascertained. Study by Gray *et al.* (2009) indicates sufficient flexibility within the IFRS regime for some companies to adjust their policy and therefore reduce the differences between IFRS and US GAAP. However, the studies reviewed all show significant differences between IFRS and national GAAP. Both Henry *et al.* (2009) and Tsalavoutas and Evans (2007) imply that institutional factors play a part in the application of IFRS but neither study explores in depth the nature of these factors. Other studies adopt a positivist approach to attempt to identify the incentives that lead to variable outcomes in financial reporting when a common set of standards are utilized. Jaafar and McLeay (2007) argue that whilst firm specific incentives such as ownership concentration and size influence the outcomes to a certain extent, country effects are far more important. The role of the incentives arising from political and institutional settings is considered in the next section in the literature related to accounting classification models and economic consequences literature.

3.3 Classification of the accounting systems and the role of incentives

Although the review of literature has demonstrated that there are economic benefits to investors arising from conversion to IFRS (Hail and Leuz, 2007) many studies identify other factors as being important variables in the determination of accounting practice which reduce the value of standardisation. The research on the issues of incentives arising from the legal and institutional setting is viewed either through the cultural and environmental lens grounded in historical and comparative accounting literature (Krzywda, 1995; Nobes, 1998; Alexander and Nobes, 2001) or through the economic efficiency prism (Ball *et al.*, 2003; Van Tendeloo and Vanstraelen 2005; Hail and Leuz, 2007). This section evaluates the literature related to the cultural and environmental theories and then provides evidence from the highly positive research on the role played by incentives in shaping accounting practice.

The harmonisation literature surveyed in the previous section points to the existence of international differences that persist even when a common accounting framework is adopted. The source of the differences has frequently been attributed to the different accounting systems which are commonly viewed as different groupings of countries displaying similar characteristics as exemplified by Flower (1997:281): ‘A major problem is identified as being that IASC is dominated by the Anglo-American approach to financial reporting which is fundamentally different from the continental European approach followed in the EUs directives’.

The literature relating to the classification of accounting promotes deeper understanding of the various institutional factors that lead to the development of accounting systems. The value of the classification models also lies in the fact that they have predictive qualities allowing the problems associated with the development of accounting in one country to be predicted by looking at the development paths in other countries (Alexander and Nobes, 2001). The positioning of Polish accounting in relation to the Anglo-Saxon system acts as an explanatory factor for the observed differences between Polish accounting regulation and IFRS.

The accounting systems that display similar characteristics have been classified by various researchers either by considering the cultural settings (Hofstede, 1980; Gray, 1988; Kosmala, 2007) or environmental factors (Krzywda, 1998; Nobes 1998; d'Arcy, 2001) in different countries which allow countries to be grouped according to common features. As the focus of this research is the institutional setting of Polish accounting this chapter does not undertake a comprehensive review of all the cultural theories but restricts itself to those theories where the institutional environment has significant explanatory power in the classification model. In particular cultural characteristics such as the level of individualism, power distance, masculinity and uncertainty avoidance as proposed by Hofstede (1980) and adapted for accounting by Gray (1988) have not been treated as explicit variables in this thesis. Whilst both cultures and institutions explore the taken for granted meanings Hatch and Zilber (2011:3) argue that: 'the two are understood and hence explored methodologically in quite different ways making it difficult to cross the border between organisational culture theory and institutional theory'. Institutional theory limits its analysis to the level of the operation of actors in an organisational field, normally acting in the direction from the environment to the organisation. However, organisational culture is not restricted to a defined field but acts at a broader societal level. Drawing on the position of new institutional theory, which forms the framework for this research, it has been assumed that the institutional setting has been shaped by the cultural characteristics but it is through the institutional prism, using normative and regulatory frameworks that this research is carried out. Nevertheless, a direct study of cultural influence offers rich potential for future research because as Scott (2008) maintains cultural foundations provide deeper foundations of institutional form.

The significance of culture in the development of accounting has been widely recognised and reported (Gray, 1988; Kosmala, 2007). Kosmala (2007:316) argues that: 'the richness of cultural analysis can inform the ongoing accounting and organisational research, in developing economies context, by providing a more systematic approach to studying how individuals situated in these different locations, construct notions such as auditor independence from their cultural and symbolic material'. She goes on to apply the cultural interpretive theory to explain the role of culture in the understanding of the auditor independence construct in Poland and in Czech Republic. Kosmala (2007) finds multiple meanings attached to the construct of auditor independence but does not go on to develop a framework that is capable of identifying specific influences. This is not surprising as cultural factors are so pervasive in the society and also intertwined with other national characteristics such as economic, environmental and social that it is difficult operationalise them.

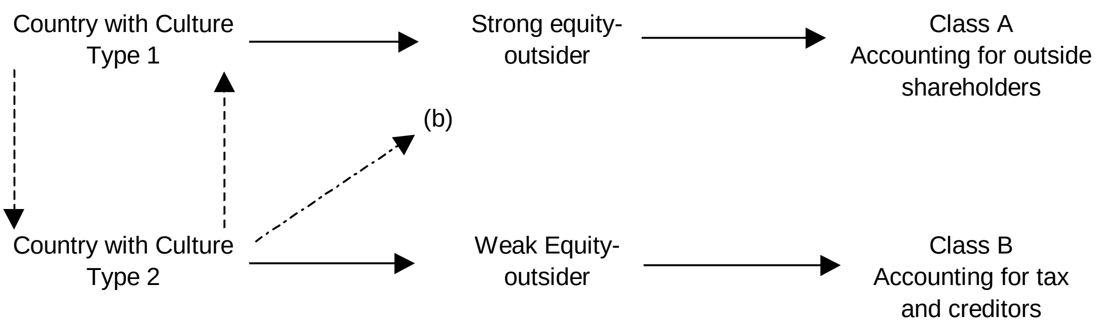
Seidler (1967) introduced the idea of importing and exporting accounting rules and classified accounting systems into three systems based on spheres of influence namely British and Commonwealth, American and Continental. The notion of importation of systems embodied in this model is particularly appropriate for the study of Polish accounting where the importation of accounting systems can be identified in each era of development, firstly, from Germany, later from Soviet Union and finally from the EU. The exact nature of the importation of accounting is discussed in the previous chapter that considers the historical analysis of Polish accounting. However, a major limitation of Saidler's model is that it precedes the period of influence of the EU and does not deal with the system of accounting during the communist regime. Both of these have had a major impact on the development of accounting in Poland.

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 paper puts forward a theoretical model that theorises 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 judgmental 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.

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.

Figure 5: A proposed model of reasons for international accounting differences



Source: Nobes (1998:179)

According to Nobes' 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. The evidence for this comes from the size of the capital market. Warsaw Stock Exchange is very small in comparison to the major Western European exchanges having a market capitalisation of 108 bn Euro as compared to London's Stock Exchange capitalisation of 1,950 bn euros (Federation of European Securities Exchanges, 2011). 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.

Tax focus pointing to Class B in Nobes' classification is supported by study by Walinska and Urbanek (1999) who surveyed 221 company accountants and found that majority of accountants produced accounts solely with the view of complying with fiscal regulations.

The Nobes' (1998) classification model would suggest that countries characterised by well developed capital markets have a greater need to reduce information asymmetry and so the earnings are more transparent than in the countries where the main source of capital is derived from lending and the main source of information is 'insider'.

Furthermore, the study suggests that the differences in transparency appear even when common accounting framework such as IFRS is adopted in both types of countries. The Ball *et al.* (2003) study supports the hypothesis that institutional factors are a major determinant of the quality of financial reporting and validates the use of multi-theoretical approach. The implication is that in order to obtain meaningful explanation for the variability in the quality of financial disclosure it is important to consider multiple influences such as regulatory frame work, capital structure and enforcement environment of the country in question.

However, findings by Van Tendeloo and Vanstraelen (2005) do not fully support the conclusions reached by Ball *et al.* (2003). In their study of 636 observations the authors compare the level of earnings management by a sample of German companies reporting under IFRS with those reporting under German GAAP. Germany has been classified as a code-law country with low level of investor protection. If the conclusions reached by Ball *et al.* are valid then IFRS companies should engage significantly less in earnings management than those companies applying German GAAP. However, the findings of this study are somewhat contradictory and do not support the study by Ball *et al.* The authors conclude: 'IFRS adopters do not present different earnings management behaviour compared to companies reporting under German GAAP' Tendeloo and Vanstraelen (2005:177). The findings in this study have a particular significance for this thesis as Polish accounting has been strongly influenced by the German system and so many of the institutional factors affecting accounting in Germany are likely to have a similar impact on Polish accounting.

Ali and Hwang (2000) also 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. 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'. The findings of this study confirm that accounting practice is affected by the method of financing. This resource dependency factor is utilised as one explanatory variable in this thesis as proposed in the theoretical model in chapter 4 of the thesis.

To summarise, this section has used classification models and empirical studies to demonstrate that wider institutional and cultural aspects play a role in the development of accounting systems. Classification models have been used to place Poland in the classification system. The accounting framework embodied in the IFRS regime and now dominating accounting developments in Poland is derived from the Anglo Saxon tradition based on ‘strong equity outsider’ (Nobes 1998). In contrast Polish socio-historic context is rooted in the socialist system that has undergone a period of transformation since the fall of communism in 1989 (Krzywda *et al.,* 1995). The transition to market economy has resulted in a complex set of forces that both help to develop accounting systems through legitimacy seeking behaviour and market demand for information but also hinder the transition progress due to institutional and other influences. The literature suggests that Polish accounting is more akin to continental European model and does not display Anglo-Saxon characteristics. The factors that point to this conclusion concern creditor orientation, relatively small capital markets and the influence of fiscal regulation. The next section will set out the literature related to institutional theory that will be used to develop the theoretical framework for this thesis.

3.4 Institutional Theory

3.4.1 Introduction

This thesis utilises the new institutional theory as developed by Meyer and Rowan (1977), DiMaggio and Powell (1983), Scott (1987) and Zucker (1987) to explain the *de facto* accounting practice in Poland. The literature reviewed in the previous sections points to the existence of different incentives in the accounting choices where companies have discretion to choose a particular accounting treatment as for example in the case of valuation of fixed assets. As a result of these incentives the adoption of IFRS does not always lead to more comparable and informative financial statements (Hail and Leuz, 2007).

The thesis uses the paradigm of new institutionalism to provide an overarching theoretical setting to answer the question of why some listed Polish companies have adopted IFRS fully whilst others continue to apply IFRS in a largely symbolic manner and what are the key drivers that instigate change. In answering this question the thesis identifies the organisational and institutional factors that influence the level of compliance with IFRS. The level of compliance with IFRS provides clear evidence of the ability and the degree of willingness of companies to abandon their existing systems and routines and to undertake change. The need for the institutional approach to financial reporting has been noted by Hopwood (2000:763) who believes that; 'our knowledge of how forms of financial accounting emerge from, sustain and modify wider institutional and social structures is modest'. Meyer and Peng (2005) contend that for theories to gain widespread acceptance in business research they need to provide novelty, continuity or scope. They go on to state that institutional theories as applied to Central and Eastern Europe do not meet the test of continuity as it is only in recent years that institutions have been treated as the main explanatory factor in business research. However, institutional theories ‘offer the highest degree of novelty in this highly unusual and novel context.’ (Meyer and Peng, 2005:601)

The research proposes that institutions play an important role in the process of transformation of accounting in the context of their transition to market economy and contribute to institutional theory by considering a unique event: the introduction of IFRS in a novel setting. The thesis extends the new institutional theory first proposed by Meyer and Rowan (1977) and DiMaggio and Powell (1983) to develop a model that combines the introduction of a new Anglo-Saxon model of financial reporting into a country that is undergoing fundamental institutional change resulting from the transition of command to market based system.

Institutional theory is a highly relevant framework for the study of accounting behaviour and has been used extensively by various authors. For example Covaleski and Dirsmith (1988) studied the budgeting process in the US university sector, Carpenter and Feroz (2001) investigated the adoption of generally accepted accounting practice in state departments whilst Elbannan and McKinley (2006) studied the introduction of new standards by the Financial Accounting Standards Board (FASB). All of the above studies note the particular features of accounting that lend themselves to analysis through institutional perspectives. Accounting is seen as always striving for the ‘best’ practice that can be accepted and adhered to but in the long term leads to resistance to change. The practice of accounting is also characterised by the pivotal role played by the professional bodies which also feature predominantly in the institutional theory (Cooper and Robson, 2006; Willmott *et al*. 1993).

The literature pertaining to new institutional theory has been structured as follows: The next section attempts to briefly locate New Institutional Sociology within much wider field of institutionalism and in so doing provides a critique of the different theoretical roots of New and Old Institutional Economics as well as New Institutional Sociology. Thereafter, literature related to the application of institutional theory to both transitional economies and to accounting is reviewed providing the justification for the use of this framework rather than the more traditional neo-classical approach.

Finally, the literature considers the role of institutional theory in the context of institutional change. This body of literature is particularly suited for explaining the behaviour of companies during the period of transition. In particular work by Oliver (1991) is evaluated and used to develop a theoretical model for this thesis.

3.4.2 Locating New Institutional Sociology within institutionalism

New institutional theory as developed by (DiMaggio and Powell, 1983) and Meyer and Rowan (1977) forms part of a much larger field of research that put institutions at the heart of explanations for the observed behaviour of organisations.

A common aim of all institutional paradigms is their attempt to explain what role is played by institutions and how these institutions shape both organisations and individuals. There are numerous distinctive areas of institutional theory, each providing a different analytical and methodological framework but this review will consider the strands that best address the issues related to accounting. Scott (1987:493) states 'the concepts of institution and institutionalization have been defined in diverse ways, with substantial variation among approaches'. The literature draws from a broad discipline of social sciences recognising considerable variation in the theories put forward but it is important to stress that that the body of knowledge does not constitute a specific theory of accounting. However, institutionalism does allow analysis to be carried out at different levels ranging from the study of behaviour at micro, organisational level to macro, societal level.

The three main theoretical paradigms of institutionalism that are particularly relevant to the study of accounting practices in Poland are New Institutional Economics, Old Institutional Economics and New Institutional Sociology. This section will briefly compare the contrast all three approaches but will go on to develop in detail the sociological New Institutional theory in the remainder of the chapter.

The New Institutional Economics (NIE) tradition is relevant to explaining accounting practice, being a theoretical framework that is most closely associated with the neo-classical theory that underpins much of the accounting research and therefore is a useful starting point for the study of 'institutionalism'. According to Moll *et al* (2006) this strand of research is not a single paradigm but rather a collection of theories and sub-theories that are included under a collective term of NIE and includes costly contracting theory and transaction cost theory amongst others. The New Institutional Economics does not reject the mainstream position but rather builds on the neo-classical model by explicitly introducing other factors such as institutions and technological change into the economic analysis (Coase, 1937). One of many definitions of institutions has been put forward by North who states that: ‘Institutions are the humanly devised constraints that structure political and social interactions. They consist of both informal constraints (sanctions, taboos, customs, traditions and codes of conduct), and formal rules (constitutions, laws, property rights). (North, 1991:97). Within new institutional economics, institutions are consciously formed in an attempt to overcome the limitations facing individuals as suggested in the above definition. The focus of NIE are institutions at macro level influencing the individuals at micro level. The new institutional perspective retains the mainstream objective that the individual is primarily interested in ‘self’, aiming to maximise his own utility Williamson (1985) and Coase (1937 and 2000).

These economists believe that individuals attempt to maximise their utility but in reality they operate in an imperfect world where information is often costly to obtain. Furthermore, monitoring and enforcement are difficult to achieve and so institutions are seen in terms of cost and benefit analysis. Williamson (1985) views institutions as governance structures geared to minimise transaction costs. They arise if the cost of the institution is lower than the benefit that the institution brings about.

The given definition point to institutions as being nothing more than corrective remedies to the limitations of transaction costs and asymmetric information posed by neo-classical theories. However, this definition is extremely limited assigning a single role to institutions without consideration of the wide ranging social and cultural roles played by institutions. Furthermore, in contrast to the Old Institutional Economics and New Institutional Sociology this approach adopts reductionist assumptions of perfect markets, utility maximisation and individualistic actions of the actors. In so doing it totally neglects the power of human agency.

The NIE framework provides a useful insight into the rise of legal and other formal institutions in a transition economy due to its explanatory power for the rise of institutions which fits with the economic theory and also classical theory of accounting. However, this thesis maintains that the NIE framework is deficient for the study financial reporting practices by listed companies in Poland for three primary reasons. Firstly, this framework totally ignores the role played by the actors in shaping and sustaining the institutions. Individuals will have different preferences and power relationships that will impact on the institutions (Lawrence, 2008) and these are not explicitly recognised in NIE.

Secondly, the neo-classical approach is predominantly concerned with the prediction of behaviour of markets and industries rather than individual companies and how they operate in their own specific cultural setting which is the focus of this research. Finally, the historical role played by institutions in post-communist countries is far more central to the understanding of organisations and their institutional setting than simply to remedy the deficiencies of the market. Drawing on classification theories it is argued that transition economies will display their own unique character that are the result of Germanic and communist history. Institutions act not only as constraints on behaviour but they can be seen as a dynamic influence on firms' behaviour so are more active rather than exhibiting the passive properties assigned to them by NIE. In post-communist countries the markets do not operate in perfect competition and so institutions impact more directly on the decisions made by organisations thereby the relative power relationships cannot be ignored. This is evidenced by factors such as small and illiquid capital markets as well high stake-holding by the state in the largest companies leading poor governance structures which offer limited rights to minority shareholders (Kozarzewski, 2006).

Unlike NIE Old Institutional Economics (OIE) was first put forward by Thorstein Veblen in direct opposition to mainstream economics (Scapens, 1994). This approach draws from the Historical School of the late 19th century (Scott, 2001). The old institutional economists view economic systems as being a sub-system of a wider societal and cultural system and so our understanding of any economic system must involve the study of the historical background and events that have created and shaped the economic system (Scapens, 1994).

OIE rejects the constraining assumptions of profit maximisation, market equilibrium and rationality to propose an interdisciplinary framework of institutions incorporating sociology, politics and law. OIE recognises that individual's preferences and desires are shaped by the other participants as well as the cultural, political and social environment (Hodgson, 1989). The benefit of this approach is that the wider social context assigned to this perspective results in a more realistic representation of the reality in which individuals and organisations operate. On the other hand OIE has been criticised because the high complexity perceived in the theory means that it is impossible to develop OIE into a generalised theory of economics in the same way that neo-classical general theory has been developed by employing reductionist assumptions. This has led some researchers to criticise the OIE for the descriptive nature of the research as summarised by Hodgson (1989:266): 'Contrary to the empiricist view of many institutionalists, the facts do not speak for themselves. There are no perceived facts without pre-existing concepts or theories'.

Within this framework economic behaviour is seen as an action by human beings who operate in the context of the wider society so the institutions are formed through complex interaction between an individual and the institution. The individual is seen as being constrained by the institutions and his preferences arise from a predetermined set of alternatives so the behaviour may be sub-obtimal. The importance of institutions has become central to economists, such as Hodgson (1989) who have focussed on the dynamic economic processes rather than accepting the neoclassical position of state of equilibrium.

They argue that individuals may not always be maximising utility as they follow established habits routines and norms which reduce uncertainty, make sense of the complex environment and provide predictable basis for future behaviour. Nelson and Winter (1982), identify rules and routines as being the blueprint for organisational identity which is transmitted over time, in most cases through an evolutionary process. OIE has been mobilised in organisational research to study the emergence, embeddness and change of management practices. In the context of accounting Scapens (1994) calls for management accounting research to focus on management accounting practice from the broader OIE perspective taking into account relative power of actors as well as social and political factors rather than attempting to fit the practice into a much narrower neo-classical framework.

New Institutional Sociology

New Institutional Sociology (NIS) rejects the rational and efficient view of the world of neo-classical school and in so doing the framework has much in common with Old Institutional Economics. Having identified striking similarities between different organisations proponents of NIS contend that the rules, habits and routines are adopted not only because they improve efficiency but because they are culturally transmitted rational ‘myths’ which enhance the legitimacy of organisations (Meyer and Rowan, 1977). The theoretical basis for NIS draws on the work of Berger and Luckmann (1967) who argue that social reality is created by human beings, who through social transmission, objectify the value of the structure to the outsiders.

The NIS framework enhances the comparative historical approach by studying the actions and motivations of actors within organisations rather than focussing on the formed institutional structures. Within this thesis rules contained in IFRS are modified by human actors and expressed in financial reports. The interpretation of the motivation for accountant’s behaviour provides additional insight into the role of institutions in shaping the accounting landscape.

The recognition of influence of broader societal factors and the rejection of neo-classical model is common to both OIE and New Institutional Sociology as exemplified in the definition of an institution in NIS: ‘Institutions consist of cognitive, normative, and regulative structures and activities that provide stability and meaning to social behaviour. Institutions are transported by various carriers –cultures, structures and routines and they operate at multiple levels of jurisdiction’. (Scott, 1995:33) From this definition it is also clear that both OIE and NIE see the role institutions as providing a way of dealing with complex reality in which organisations operate although the definition adopted by NIS is broader and clearly underlines the role of culture in institutionalism. These cultural characteristics, in the context of institutions, are rationalised by various mechanisms making them more acceptable and unquestioned.

However, there are also important differences between the two theoretical frameworks. Whereas the focus of OIE is organisational identity acquired from the operations of rules and routines developed within organisations NIS assumes that organisational form is predominantly the outcome of external factors. These factors are more influential than profit maximising objectives and result in organisations which operate in the same environment becoming similar (or isomorphic) to each other. As summarised by DiMaggio and Powell: ‘We contend that the engine of rationalization and bureaucratization has moved from the competitive marketplace to the state and the professions’ (1983:147). That is legitimacy is conferred predominantly by the actions of the state and professions although networks in organisational fields also play an important role in providing stability and permanence.

By incorporating wider societal and cultural factors sociological institutional framework is considered to be the most appropriate lens for the study of an organisational behaviour in relation to financial reporting in a transition country such as Poland. In particular the framework allows hypothesis to be developed that more fully explains why IFRS are not fully adopted in spite of a legal requirement to so. The ability to provide meaningful insight through the depth of analysis allows the thesis to explore how the accountancy profession, the state and resource dependency created rationalised conditions that explain the actions of the actors as exemplified in their adherence to IFRS.

3.4.3 The role of legitimacy in the formation of institutions

This section will outline the key features of new institutionalism namely legitimacy and different forms of isomorphism and in so doing presents a review of new institutional literature. This review will form the basis of a critique of the framework in the subsequent section.

As noted above new institutionalism adopts a sociological approach to institutions in its recognition that organisations are more concerned with stability and order than they are with economic efficiency. For example an institution has been defined as 'an established order comprising rule bounded and standardised social processes' (Dillard *et al.,* 2004:507) and more specifically for this study Oliver (1991:147) specifies institutions as: 'regulatory structures, governmental agencies, laws, courts and professions'.

According to DiMaggio and Powell (1991) new institutionalism rejects the neo-classical interpretation of firm behaviour as explained: 'new institutionalism comprises a rejection of rational – actor models, an interest in institutions as independent variables, a turn towards cognitive and cultural explanations, and an interest in properties of supra-individual units of analysis that cannot be reduced to aggregations or direct consequences of individuals' attributes or motives'.

However other researchers have argued that neo-classical explanations are not necessarily mutually exclusive with institutional theory. For example Carpenter and Feroz (2001) in their study of changes of accounting system in US government argue that institutional theory can complement economic theory in explaining organisational responses. Rodrigues and Craig (2007) combine isomorphism together with Hegelian dialectic to assess accounting harmonisation. Hegelian dialectic views the world as being in constant change arising from thesis, antithesis and synthesis. Although the perspectives are complementary the authors do not establish sufficient linkages between the perspectives to present a coherent view of the harmonisation.

Institutions have also been defined by North (1990:3) as: ‘the humanly devised constraints that structure human interaction’. The constraints arise from two sources namely formal, regulatory sources and informal sources that are imposed by the wider society and cultural norms. Other researchers focus on the notion of institutional forces as providing social stability through social reproductive routines and processes (Jepperson, 1991). As summarised by Carpenter and Feroz (2001:569): ‘Institutional theory assumes that organisations adopt structures and management practices that are considered legitimate by other organisations in their field, regardless of their actual usefulness.’ Legitimacy is the fundamental consequence of firms’ convergence and involves the acceptance of the organisation by the external environment (Deephouse, 1996; Meyer and Scott, 1992). Suchman (1995:574) offers the following definition of legitimacy: ‘Legitimacy is a generalised perception or assumption that the actions of an entity are desirable, proper or appropriate within some socially constructed system of norms, values and beliefs and definitions’. Organisations that are legitimate are approved of, respected and understood by the wider society thus bringing benefits to the entity. Scott (2008) identifies three dimensions for legitimacy namely regulative, normative and cultural-cognitive elements. These ingredients of institutional order are discussed further in the context of isomorphism and form the basis of the theoretical model utilised in this study.

The benefits of legitimacy are wide ranging and Oliver (1991) notes an ability to gain resources including human resources, increased prestige and protection from outside questioning as being some of the benefits associated with organisations that are seen by society as being legitimate.

An important premise of institutional theory is that the changes do not necessarily result in efficiency or in real economic improvement in the sense of neo-classical economic model. Rather it has been suggested by Meyer and Scott (1992) that organisations frequently engage in activities that aim to meet with the approval of the society in order to seek legitimacy externally. Exactly what form that legitimacy seeking behaviour takes is largely determined by societal norms and wider environmental expectations. Meyer and Rowan (1977:344) claim that: 'institutional techniques are not based on efficiency but are used to establish an organisation as appropriate, rational and modern. Their uses display responsibility and avoid claims of negligence'. The authors see these actions as 'myths' which, as the name suggests are not true but ensure that the company is seen to be behaving appropriately and fulfils its obligations. The actions are however rational being goal orientated and if accepted lead to formal systems in organisations. The view of rationality is revised to include different logics such as rationality arising from following rules and conventions. The distinction between technical forces that lead to real efficiency changes and institutional forces that are largely ceremonial has been criticised by Lounsbury (2008). Lounsbury contends that the distinction between the two concepts to be fundamentally flawed by not incorporating power dynamics or recognising the performance orientation of decision makers. However, Scott (2004) maintains that all organisations are subject to both institutional and technical pressures but their relative influence on organisational behaviour differs. For example Scott suggests that educational establishments are predominantly affected by institutional pressures but companies operating in the industrial sector experience the greatest impact originating from technical pressures.

Review of new institutional research literature originating from western economies such as Canada and US shows that institutional theory is predominantly utilised for the study of not for profit organisations rather than for the study of profit orientated companies. In contrast, this research contends that institutional perspective is the most suitable lens for the study of Polish companies which are still rooted in the communist past and display many characteristics of state owned enterprises. Evidence of ceremonial action that is clearly distinct from technical change can be identified in Poland. Within the current research legitimacy is afforded to Polish companies if they produce IFRS compliant financial statements but in reality, as demonstrated in section 3.2.6, many of these accounts fall far short of what could be considered as full disclosure in the spirit of IFRS. In effect little benefit has been gained by introducing IFRS as the user groups are not provided with any more useful information and so the transition to IFRS has been largely a ceremonial change.

Conversely, actions that change legitimate organisations can undermine the legitimacy of the entity and this leads to resistance by organisations to change. In describing the philosophy and culture of command economies Kozminski (2008) identifies ritualism and strong attachment to symbolic behaviour as being the characteristics of the communist system. Legitimated structures can be transmitted to organisations in a field, through tradition (organisation imprinting at founding), through imitation, by coercion and through normative pressures. Kozminski (2008) gives examples of political slogans and party conferences of the communist party in Poland as examples of substitutes for action being employed by the ruling party.

According to the above definition at the heart of institutional theory is the notion that organisations will act to gain legitimacy and their behaviour is not always driven by efficiency considerations. Deephouse (1996) tested the proposition that greater similarities between organisations increases organisational legitimacy by studying the approval by the regulators and the wider public of the strategies of commercial banks in the US. His conclusion supports the positive relationship between legitimacy and isomorphism: ‘Organisations that conform to the strategies used by other organisations are recognized by regulators and the general public as being more legitimate than those that deviate from normal behaviour’ (Deephouse, 1996:1033). One of the aims of this study is to evaluate whether the adoption of IFRS in Poland has been largely ceremonial in order to meet the regulatory requirements thereby gaining legitimacy or if the changes are more substantial and driven by the stakeholders’ needs for more relevant information. If the changes are ceremonial then the expectation is that there would be low level of compliance even when companies state that they are compliant.

3.4.4 Isomorphism

As discussed above legitimacy has been shown to be enhanced by greater isomorphism between companies. It is the fundamental premise of the institutional theory that over time firms undergo various processes that result in them becoming increasingly similar to each other (Powell and DiMaggio, 1991). DiMaggio and Powell (1983) propose that enterprises exist not in isolation but in a recognised organisational field consisting of a variety of actors including the various state organs, customers, suppliers, regulatory agents and competitors. As the organisations become more aware of each other they become 'structured' by the state, profession and competition into organisational fields. The result is that: 'Organisations may change their goals or develop new practices, and new organisations enter the field' (Di Maggio and Powell, 1983:148). The process of isomorphic change is facilitated by the actions of institutions that either compel or encourage companies to take action that will result in isomorphism.

DiMaggio and Powell (1983) hypothesise that organisations are becoming more homogenous and it is the institutional environment outside of the organisation that primarily leads to the loss of diversity. In the longer term, DiMaggio and Powell (1983) argue, the influences exerted by external institutions namely the state and professional bodies lead to 'isomorphism' of organisations with the environment. That is, firms within the same institutional environment become increasingly similar. The thesis uses draws on this work and treats the actions of the state, the accountancy profession and resource dependency as three variables that explain the level of compliance with IFRS

DiMaggio and Powell (1983) identify three mechanisms by which isomorphism is achieved namely coercive isomorphism, mimetic isomorphism and normative pressure. These mechanisms act to change organisational behaviour towards greater homogeneity but at the same time hinder change so as to maintain the similarity between entities. As noted by Mizruchi and Fein, (1999) one problem with the model is that the three mechanisms of isomorphism are shown as being separate but may be indistinguishable when two or more pressures act in concert with each other. For example in the context of Polish accounting the coercive role of foreign investors cannot be easily discerned from the mimetic influence of those foreign companies. A review of literature by Mizruchi and Fein, (1999) concerning the use of DiMaggio and Powell’s model suggests that researchers predominantly use mimetic influence in their hypothesis whilst neglecting to attribute significance to the other mechanisms. In particular they note that coercive forces are under researched whilst mimetic influence forms the basis of majority of theoretical models used in published research papers. They conclude that researchers, through their selective adoption of institutional theory, provide a limited view of the isomorphic process. As Mizruchi and Fein (1999) acknowledge, their findings are primarily based on publications in American journals that predominantly use US data.

Within transition economies coercion is a far more potent institutional agent largely because the state plays a significantly more important role in post communist countries than it plays in developed market economies (Borowski and Kariozen, 2007). This thesis addresses the above concern by studying the influence of all three mechanisms in the context of accounting in Poland with particular reference to the role of coercion exercised predominantly, but not exclusively, by the state.

3.4.5 Coercive isomorphism

Coercive isomorphism arises when external agencies impose their authority by introducing changes in entities through direct or indirectly control. Scott (1987) argues that the state agencies are far more likely to use coercion to achieve their objectives and to form set procedures to affect their aims. Within the Polish accounting context the main agent of coercion is the Ministry of Finance and specifically the fiscal authority that has an extensive system of regulations and draconian enforcement mechanisms. DiMaggio and Powell use accountancy procedures and systems as examples of such coercion 'Other legal and technical requirements of the state - vicissitudes of the budget cycle, the ubiquity of certain fiscal years, annual reports, and financial reporting requirements that ensure eligibility for the receipt of federal contracts or funds also shape organisations in a similar way'. (DiMaggio and Powell, 1983:150) The coercive pressure will be felt most strongly where there are powerful agencies demanding changes. The changes imposed may be adhered to ceremonially but they are still important for the organisations requiring resources and expertise to sustain them.

3.4.6 Mimetic isomorphism

Mimetic isomorphism involves imitation of the behaviour of other entities that may be perceived by the organisation to have greater legitimacy, expertise or better experience of the procedures being introduced. As was noted by Sahlin and Wedlin

(2009:219): ‘Ideas do not diffuse in a vacuum but are actively transferred and translated in a context of other ideas, actors, traditions and institutions’. This means that actors and interests are also important and they develop and translate the meaning of the activities being imitated. In the case of Polish accounting the requirement for the implementation of IFRS was undertaken by different companies at different times and to a different degree. However, it is not known what was the range or the degree of adoption. In the early stages firms undertake processes that enhance technical efficiency but those following often do so without reference to technical efficiency. Presumably the adopting firms are adopting the procedures because they feel that they will also benefit by reducing the effort required to search for unique solutions. By adopting the already established practice companies are able to avoid or reduce risk associated with an unknown environment and to reduce the additional costs of acquiring know how. In the economic sense this is a rational utility maximising response however, in time the goal of imitation is more likely to be associated with gaining of legitimacy than economic efficiency. This process of diffusion becomes ‘taken for granted’ and so institutionalised. (Greenwood *et al.*, 2002). Exactly which organisations could be expected mimic each other is not specified but DiMaggio and Powell (1983) give an example of US companies imitating Japanese working practices. Evidence of mimetic behaviour has been demonstrated by Haveman (1993) who studied the diversification behaviour of US lending institutions. The research found that organisations will imitate successful institutions because those already present will legitimate the actions of new potential entrants. However, as the number of organisations in the new market increases then competitive forces will lead later entrants to see the diversification as less attractive. This view is consistent with Launsbury (2008:350) who questions the simplistic notion of mimicking behaviour by stating: ‘the depiction of late adopters as passive and irrational provides an overly narrow conceptualization for institutional theory’. A notion of broader belief systems or logics that emphasise rational behaviour of actors have been developed by Launsbury (2002 and 2008) in relation to the transformation of the financial intermediary industry in the US over a forty year period. The notion that mimetic behaviour is most powerful for early followers has been demonstrated by Hail and Leuz (2007) in their study of IFRS where they proved that benefits gained in terms of reduced cost of capital by the early adoption of IFRS is far greater than for the late adopters of IFRS.

3.4.7 Normative isomorphism

Finally, according to DiMaggio and Powell (1983) normative isomorphism acts to make organisations more homogenous primarily through the actions of the professions. In their recent review of legitimacy Deephouse and Suchman propose that the term normative legitimacy as used by Scott (2008) as well as DiMaggio and Powell (1983) is replaced with professional legitimacy which better reflects the goals of professions. Professions such as the law or accountancy are characterised by being highly skilled undertaking specialised education and well organised through the activities of professional bodies (DiMaggio and Powell, 1983; Carruthers, 1995). The professions themselves become structured when members of the professional bodies come from similar backgrounds and their common characteristics are then used as entry criteria to senior posts within organisations and state regulatory organs thus diffusing the professions throughout organisational fields. They are perceived to transcend the organisations in which they operate and are seen to be experts in their field and more objective and 'untainted by social values and ideology' (Loft, 1986). This perception of neutrality and expertise give the professions a high standing and power to influence and shape their institutional environment both within and outside of the organisations thus promoting similarity between institutions.

Greenwood *et al.* (2002), in their study of the changing nature of the accountancy profession in Alberta, Canada, have showed that professional associations have three main roles in the process of institutionalisation. Firstly, they shape the common understanding within their own profession so that there is consensus regarding issues such as training, ethical behaviour and membership (Powell, 1991). For example in the professional accounting in the UK the institutes tightly control the entry qualifications of its trainees and then specify the type and level of training and post qualification experience so that the members become similar in outlook and educational standing. Secondly, professional associations interact with external agencies and develop legitimacy from the wider society Greenwood *et al.* (2002). For example the top global accountancy firms act as intermediaries between the state and private sector and are able to influence supra-national and national regulatory agencies as well as the companies that they audit or advise. Cooper and Robson (2006) have described these firms as 'multi-national business service firms' recognising their influence not only in the traditional disciplines of accounting and audit but also in the area of consultancy and broader economic activities. The global professional accountancy firms also promote change as they are closely associated with their clients operating in a competitive market environment Greenwood *et al.* (2002).

Finally, professional institutions play a role in the monitoring of prevailing institutional norms Greenwood *et al.* (2002). In summary, Burchell *et al.* (1980:6) evaluate the status of accounting as fulfilling a far broader role than just providing technical expertise: 'Accounting has gained its current organisational and social significance. No longer seen as a mere assembly of calculative routines, it now functions as a cohesive and influential for economic and social control'.

Although there are numerous studies of the accounting profession (Carpenter and Feroz, 2001; Greenwood *et al.*, 2002) in the Anglo-Saxon context Cooper and Robson (2006:417) ask: 'whether the concept of a profession is understood in the same way outside of the Anglo American world'. This study has clear implications for the research of the dynamic process of transformation of the accounting profession in Poland from low status book-keepers to professional accountants in the context of the economic transition from command to market economy as recognised by Lounsbury (2002:263): 'Little attention has been paid to processes of status mobility or how status orders themselves get restructured. Professionalization efforts provide one useful focal point for the examination of status mobility processes because they often involve the restructuring of authority and expertise in fields.'

Although DiMaggio and Powell (1983) put the actions of the state on the same footing as the actions of the professions in terms of interests and mechanisms of transmission Scott (1987) argues that professional bodies have a weaker and more decentralised administrative structures and 'are expected to rely primarily on normative and/or mimetic influences' (Scott, 1987:509) to achieve isomorphism. In the Polish context this representation of the relative power of the state acting through coercive means at the expense of the professions is highly likely and will be explored further.

3.4.8 Critique of the new institutional theory as put forward in Di Maggio and Powell's (1983) and Mayer and Rowan (1977) frameworks

New institutional theory as expounded in sections 3.4.2 to 3.4.6 above has become the dominant perspective on how institutions influence organisational behaviour and structure. The purpose of this section is to critique the two seminal studies by Di Maggio and Powell's (1983) and Mayer and Rowan (1977) which formed the conceptual foundation of new institutional framework and in so doing to provide an overview of the direction of subsequent work and to identify opportunities for further research.

The founding theories put forward by Meyer and Rowan (1977) and DiMaggio and Powell (1983) have had a profound influence on our understanding of how organisations are impacted upon by their institutional context. Prior to the publication of this work technological change and resource dependency were considered to be the main drivers of organisational behaviour. The seminal works on New Institutional Theory for the first time explicitly recognised the role of institutions in providing legitimacy, stability and continuity in organisations whilst reducing the significance of technical imperative. The definition of institutions in this sociological framework is far broader than has been used in the economic theories and includes the influence not only of regulatory and normative forces but also social and cultural-cognitive elements.

New institutional theory has been researched extensively over the period of thirty years either through conceptual development or through the application of the theory to a variety of organisations and institutional contexts. The studies generally indicate that the fundamental premise in respect of the role of the institutions still holds although the concepts have been refined and new insights provided. This section provides a critique of the main tenets of institutional theory as outlined in the previous section.

The earliest work on institutionalism recognised the social aspect of institutional behaviour but the focus has been to portray the ‘myths’ as formal rules that are imposed from above but are then diffused through the society by the most powerful organisations. For example Meyer and Rowan (1977) tend to focus on professions, policies and programs as an expression of legitimate behaviour which leads to the homogeneity of organisations in all sections of society ranging from highly institutionalised organisations such as schools to efficiency driven companies in the manufacturing and service sector. This premise, although groundbreaking in their recognition of institutions as agents of rationalisation also suffers from the limitations associated in part with simplification and also from the neglect of the social elements of institutions (Phillips and Malhotra, 2008).

One of the major deficiencies of the early work lies in the limited recognition of the key influences of institutionalisation. For DiMaggio and Powell (1983) rules, laws and procedures are generally the main agents of institutionalisation and are mostly imposed from above by regulatory bodies and the professions. It is assumed that the adoption of these rules is a conscious decision because an organisation has to implement the plan or rule. However, the role of cultural unconscious and taken for granted habits and behaviour are not explicitly dealt in the earlier works.

This criticism was remedied by Scott (2001) who made an important theoretical contribution to institutionalism by explicitly recognising three pillars that together shape the institutional context. Whilst the first two pillars (coercive and normative) are drawn from the earlier work he also added cultural-cognitive pillar. Scott urges the three pillars to be treated separately and for the researchers to specify which pillar they are mobilising. However, other studies namely Rostova and Roth (2002) combine the different pillars to form 'an institutional profile' which, they argue, better represents the institutional context.

Scott (2008) argues that although regulatory and normative forces are more visible they can be superficial whilst cultural cognitive frameworks provide deeper foundations for institutional context. Greenwood *et al* (2008:12) goes further and argues that it is imperative to incorporate the cultural element into the regulatory model as explained: 'For us, inclusion of regulatory frameworks as 'institutions' is appropriate *only if* it is made clear that those institutions embody taken for granted societal norms and values and if these values are explicitly identified.'

Phillips and Malhotra (2008) extend this argument and challenge Scott's three pillars as a workable typology for institutionalisation for three reasons. Firstly, the origins of each pillar have very different philosophical underpinnings in how social reality is perceived so the ontological perspectives are difficult to reconcile. Secondly, the motivations for compliance for the cognitive pillar are very different from the other two pillars and so the theoretical framework that addresses these factors also needs to be different. Cultural pillar assumes unquestioning and unconscious compliance whilst the regulatory and normative pillars originate from legal rules and professional morals imposed from above so other theoretical perspectives may be more suitable for their study. Zucker (1987) concurs with this view and points out that some indicators of institutionalisation such as power and authority are difficult to distinguish from resource dependency. For example the failure to comply with laws may expose the organisation to financial or other sanctions which are directly related to resources but also relate to external norms espoused by institutional theory.

Phillips and Malhotra (2008) support Zucker's (1991) argument that there is no need for normative and coercive explanations on the grounds that compliance with routines to take place, external motivations are not necessary because the actors have internalised the accepted norms so will comply with them in any case without the need for direct control.

This leads Phillips and Malhotra (2008:711) to conclude that: 'institutions are best thought of as fundamentally cognitive and that these other two pillars not be combined in a theory of institutions'. The authors therefore narrow the reasons for institutionalisation to a single factor and call for the mobilisation of the discursive analysis based on the earlier work of Berger and Luckmann (1967) where institutions are seen as essentially social structures that are built on and created from shared meanings and knowledge. The shared understandings are called 'discourses' and consists of 'spoken, written, performative and spatial texts, grounded in specific contexts and power relationships' (Zilber, 2012:89). Sahlin and Wedlin (2008) contend that ideas and practices do not remain intact and unchanged as they adopted by one actor from another but the ideas are translated and through translation the meanings may be altered or adapted. As ideas are circulated they evolve and result not only in homogeneity as is assumed in institutional theory but also in variation and stratification. The focus of this strand of institutionalism is clearly on an individual actor who is embedded in cultural setting (Sahlin and Wedlin (2008) but exactly how such actor interprets rules and actions is not well understood (Powell and Colyvas, 2008).

Zilber (2012) argues that the cognitive and other aspects of institutional theory allow this framework to integrate with and enhance the organisational cultural theories to provide a much deeper understanding of the influences that act on organisations in the following ways. Firstly, cultural theories do not typically deal with cultural changes over time whilst institutional theories better address the dynamic issues of the institutional process. Secondly, cultural theories focus on the deep understanding of organisations and do not concern themselves with the culture external to the organisation. In contrast institutional theory puts the organisational field, with its many actors and multiple motivations thus presenting a research opportunity to study the impact of different field players on the organisational culture.

Nevertheless, according to Suddaby (2010) the research agenda still does not adequately address exploration of meanings, symbols and myths. He argues that methodological difficulties have constrained researchers to more positivist approaches which are not suitable for the study of the softer, behavioural aspects of institutionalisation. Suddaby (2010) offers both methodological and analytical remedies to address the gaps in research. Firstly, he suggests that far greater use should be made of interpretive methodologies to allow a deeper interpretation of the relationship between actors and institutions. This should be done at organisational level to enable better appreciation of how institutional pressures are interpreted by actors. Secondly, he points to four areas of research where the social issues can be investigated and to date have been neglected in academic literature. These are institutionally defined categories, the role of language in institutional maintenance and change, the study of non-economically useful activities such as aesthetics and the study of individual's role in institutionalism.

The definition of categories is important because individuals are afforded legitimacy by conforming to expected norms. Failure to conform leads to actors or objects being unclassified and this can lead to social or real economic penalties (Zuckerman, 1999). Identification of boundaries in organisational fields allows better specification of research questions and opportunity to study relationships and behaviour at inter-category level. This research recognises that in transition economies these boundaries are changing and so the study explores the changing boundaries of accountancy profession and the state. In particular of the accountancy firms wish to extend their influence from simply acting in the capacity of accountants on behalf of the firms to being seen as experts influencing financial reporting regulation at national level. This means that the relationship between the state that has previously imposed all regulations and the profession is being redefined in a new way.

The omission of the role of individual has been sighted in many other studies as traditionally institutional theory focussed predominantly on the source of acceptance by the actor of imposed rules, stability and resistance to change. However, within this framework the actor does not have any influence on the institutions rather the direction of action is always for the institution to constrain the individual's actions (Zucker, 1991). Therefore, the majority of research in this area concerns the study of institutions in a macro context focussing at the level of fields and organisations but not on individuals who are not important because they are shaped by the institutions.

In a later paper DiMaggio (1988:5) argued that institutional theory needed to also address 'the reality of purposive, interest driven and conflictual behaviour'. This brings into play the paradox of stability arising from institutions and change which DiMaggio suggests should be studied by focussing on agency or institutional entrepreneurship. The behaviour of individuals in their dealings with organisations and institutions has been largely under-researched as many researchers assume a naive view of passive compliance which may not be rational.

An interesting experiment by Zucker (1991) involving the study of individual actor's behaviour in different institutional settings showed that cultural persistence was highly dependent on the level of institutionalisation. In this study Zucker demonstrated that any act carried out by an individual acting purely in a personal capacity was low in terms of institutional impact whilst acts performed by an occupant of an office had a much higher institutional influence.

Accepting that actors are the main agents for the formation of institutions language is clearly an important medium for developing an understanding of shared meanings that are central to institutional theory. The use of language concerns the individual's capacity to influence institutions and connect actors with each other. Powell and Colyvas (2008) argue that the study of the use of language in organisational archives and correspondence can provide insight into how everyday communication leads to social reproduction. More specifically, Suddaby (2010:17) suggests that researchers should attend more to the instrumental use of words that aim to procure resources for the organisation. In particular he calls for a greater: 'focus on the *deliberate* use of persuasive language to influence the creation and maintenance of cognitive categories'. The differences in the use of language have also been used to demonstrate the degree of institutionalisation. For example, in the study by Tolbert and Zucker (1983): 'the justification of civil service reform changed from reforming city governments plagued by bossism and corruption to a required aspect of modern, efficient government structures' (Zucker, 1987:447). In this example criticism and negativity surrounding individuals changes to the approval of modern institution.

Particularly salient to this study is the sense making approach, most commonly evident in changing environment when actors are uncertain of the meaning of new situations or conditions. In Poland the introduction of market economy involved the interpretation of totally alien terminology associated with business. Unlike in Anglo-Saxon countries where there is a common understanding of the business language, in Poland various versions of meanings arise depending on the source of authority. One of the consequences of this uncertainty has been to allow the Big-4 firms of accountants to extend their influence by portraying themselves as experts in IFRS who can facilitate common understanding of the standards for organisations.

Focus on language implicitly assumed the role of individuals but recent studies have taken a more explicit ontological position by putting the actors and their practices at the centre of institutional research. For example, Lawrence *et al* (2011:55) suggests the employment of 'institutional biography- the exploration of specific individuals in relation to the institutions that structured their lives and that they worked to create, maintain or disrupt'. In recent years this academic debate has culminated in the development of a new branch of research known as institutional logics (Thornton and Ocasio, 2008; Lounsbury, 2008) which has been defined by Thornton (2004:69) as: the socially constructed, historical pattern of material practices, assumptions, values, beliefs and rules by which individuals produce and reproduce their material subsistence, organise time and space, and provide meaning to their social reality'

Institutional logics moves away from the role of institutions as being a process of homogeneity and isomorphism which are the defining features of new institutionalism as described in previous section to exploration of the reasons for heterogeneity and practice variation. Lounsbury (2008:350) critiques the earlier neo-institutional formulations as follows: 'this narrow conceptualisation of institutional dynamics was fundamentally flawed in that it maintained a distinction between technical forces and rational decision making on the one hand, and institutional forces and 'irrationality' on the other.' To remedy this view institutional logic argues that actors often operate in multiple, fragmented and conflicting fields and so they develop their specific form of institutional rationality which is context dependent. Therefore the research in this area concerns the understanding of the different motivations of actors which can then explain variation in practice. The notion of conflict and variation in practice has been applied in this study in the context of compliance with accounting standards and the study provides evidence of complex interaction of different actors that influence the financial reporting outcomes.

Similarly, in relation to the notion of ‘conformity’ to institutional rules Oliver (1991) challenges the simplified response portrayed in the earlier papers that organisations passively absorb and accept institutional rules which are imposed from above. However, she is not concerned with the creation of institutional meanings which is a concern of institutional logics research but rather deals with individual responses to these pressures. She puts forward a framework where organisations can undertake variety of strategic responses to the imposed rules which may vary from full acceptance to defiance. In another study Westphal and Zajac (1994) showed that early adopters of executive compensation plans were more likely to implement the programme than the later adopters. In this case it is not clear whether the variable adoption of executive compensation plans was an institutional response with firms mimicking or a learning process. Greenwood *et al* (2008) calls for future research into the role of institutional learning be undertaken area. Mizruchi and Fein (1999) point to the fact that most researchers identify mimetic form of isomorphism as acting on organisations but in most cases normative and coercive forces could be equally applicable. In order to establish whether a process is technical or institutional Suddaby (2010) calls research to focus on the motivations of organisations and not just focus on the outcomes of a process because the outcomes will not provide an indication of the reasons for the observations. This, according to Suddaby (2010) should be done by mobilising interpretive methodology rather than pursuing ever more positivist evidence which in many cases misses the intended explanations.

The focus by early neo-institutional researchers on the mimetic means of institutionalisation has neglected the role of power and influence in the formation and maintenance of institutions. Although the role of power and control is implicit in the identification of coercive forces put forward by DiMaggio and Powell (1983) and in the discussion of 'powerful myths' in Meyer and Rowan (1977) work it has not been explicitly dealt with in the earlier studies. Power plays an important role in this framework because isomorphism is achieved through the application of rules, controls and sanctions that prevent deviation from the accepted norms. Yet Greenwood *et al* (2008:25) suggest that there is: 'limited understanding of how power conflict and fundamental social interests affect and are affected by institutional processes. Although Lawrence (2008) puts forward a framework for understanding the relationship between power and institutions there is limited empirical research in this field. Lawrence calls for the power to be treated as an explicit element in future studies so that a more generalisable framework of institutional theory can be developed.

Meyer and Rowan (1977) see the impact of the rules as being comparable for all organisations but in reality the impact may be affect different organisations in different ways and these organisations may respond differently. In a later paper DiMaggio and Powell (1983), refine the institutional impact as acting on an organisational field because: 'organisations are rewarded by being similar to other organisations in their field'. In further studies institutional fields themselves were in fact shown to be conflicting with competing demands which lead to reduced legitimacy and increased complexity (D'Aunno *et al*, 1991), Greenwood *et al* (2002). Scott, (2008) argued that the rules and imposed laws can in themselves be modified by the cultural and cognitive influences so that the nature of the regulation itself is altered and not just the response to the regulation. This is clearly demonstrated by Greenwood *et al*, (2002) who focussed on the role of the accountancy profession which they considered to be a major source of normative pressure. The authors studied the deinstitutionalisation and reinstitutionalisation of Canadian accountancy firms into business services firms over a 20 year period. They concluded that the notion of existing practices as being static is an oversimplification as institutional pressures act unevenly on organisations. Subsequent to the original publications a great deal of research has been carried out on the extent of organisational embeddeness and the process of change in organisations. Whilst at the crux of Institutional theory is the notion of stability and isomorphism later research addressed the question of what factors lead to observed changes in organisational behaviour. For example Seo and Creed (2002) put forward a theory that it is contradictions that lead to tensions and result in change taking place. In other studies the role of power is emphasised as being the main driver of institutional change (Covaleski and Dirsmith, 1988),The dynamic aspects of institutional theory are particularly important in the Polish context and this area is fully discussed in section 3.4.10

A further area of refinement of the original Meyer and Rowan (1977) paper concerned the relationship between institutional rules and technical efficiency. Meyer and Rowan (1977:355) argued that the two concepts conflict with each other stating that: 'Organisations face the dilemma that activities celebrating institutionalised rules, although they count as virtuous ceremonial expenditures, are pure costs from the point of view of technical efficiency'. Decoupling of institutional activities allows the technical efficiency to be maintained. The relationship between institutionalism and efficiency was subjected to further studies and refined in a number of studies including Powell (1991) who showed that the technical context itself is subject to institutionalisation. Furthermore, as discussed above the institutional behaviour should not be seen as irrational but rationally determined from different competing firms. Lounsbury (2008) sees a gap between the actors and institutions and calls for more research in the interface of the two. This thesis attempts to bridge this gap by studying the action of accountants at micro-level in their adoption of IFRS and at the same time how accountants satisfy the competing demands of the institutions that provide the normative and regulatory requirements.

To conclude, the research agenda of institutionalism has developed in diverse ways giving more recognition to the complexity of institutions. From the original notion of institutional compliance to obtain legitimacy far deeper insights have been gained into various aspects of this framework including the role of culture and power relationships, the dynamic nature of institutional change and the relationship between individuals and the institutions. Lounsbury (2008) argues that this research can find new directions and be enhanced by taking a more multi-disciplinary approach using actor network theory or practice variation.

3.4.9 Application of institutional theory to transition economies

Institutional theory has considerable explanatory powers for explaining post communist accounting developments by recognising wider social structures that affect human behaviour (Dillard, *et al.*, 2004, Scott, 1995). Therefore the conceptual basis for the analysis must be grounded in a broader sociological framework which is more meaningful than the approach taken by neo-classical models. In transition countries the political and economic contexts of the communist era are crucial for the understanding of the dynamic process of institutional transformation.

The analysis of the institutionalisation process in Poland draws on the historical context so that better understanding of accounting change can be gained. The historical dimension is given prominence by Berger and Luckmann (1967:54-55): 'Institutions always have a history, of which they are the products. It is impossible to understand an institution adequately without an understanding of the historical process in which it was produced'.

In considering the alternative theoretical frameworks for this thesis new institutional theory was selected in preference to the neo-classical economic theory which has lower explanatory powers for transition economies. The neo-classical model assumes perfect markets and that competitive pressures always drive company behaviour whilst ignoring considerable influences stemming from the communist era not found in other mature capitalist economies such as far reaching influence of the state that leads to greater bureaucratisation and lower efficiency.

The different characteristics of the transition countries has meant that these countries are seen as being significantly different from the other groupings used in the classification models (Parker and Nobes, 2004). Therefore, a study of the accounting system in transition economies must adopt a theoretical perspective that is capable of recognising the influence of political and economic change on accounting practice. These political, social and institutional influences are far more significant than are found in stable well developed market economies (Krzywda *et al.*, 1996). This approach places institutions at the forefront of the debate on the evolution of organisations and at the same time downgrades the role of an individual acting to maximise own utility in the neo-classical sense.

Furthermore, unlike the mainstream theories such as agency theory (Jensen and Mecking, 1976) or positive accounting theory (Watts and Zimmerman, 1979) institutional theory recognises the state as being one of the principal agents that acts on organisations and brings about homogeneity to entities (Carroll *et al.*, 1988). Where there is a strong state, as would be found in transition economies, 'states are more likely to be able to resist private pressures, to change private behaviour, and to change a nation's social structure'. (Carroll *et al.*, 1988:233). Scott (1987) argues that institutions created with a significant involvement of the state will exhibit more bureaucratic features that lead to centralised structures.

The breakdown of command led system led to the fundamental breakdown of all institutions (Peng, 2003). Hosskinson *et al.* (2000) speculated that during the communist era and the early stages of transition majority of organisations focussed on institutional, external mechanisms whilst competitive effects within organisations only became evident in Poland in the latter stages of transition when the market forces began to dominate the economy. The institutional factors that dominate the transition economies and differentiate them from competitive forces of market economies arise from the social, political and economic conditions prevalent in the communist era. Those variables include the high involvement of government agencies, poor standing of professional bodies and limited access to resources (Kornai, 2000).

Another legacy of the command economy that is relevant to the structuring of entities as proposed by institutional theory, and described in chapter 2.3, was the existence of inter-related enterprises structured into a number of ministries. These enterprises formed a cartel that traded primarily with each other and were prevented from developing their own trading patterns with private companies or foreign contacts. The existence of highly integrated organisations prevented enterprises from evolving either through diversification or through the entry of new players (Balcerowicz, 1990). These cartels were so highly structured that they continued to operate in this structured environment even following the removal of central control once the communist system had fallen.

The contextual importance for the understanding of transition economies was tested by Roth and Kostova (2003) who hypothesised that the ability of firms in transition to change is dependent on the embeddedness of the firm in the past and current institutional system. The study concluded that the greater the gap between the established routines and the new system the more difficult it will be for companies to transform. For Polish companies the gap between market and communist structures was considerable, particularly at the start of transition. Under the communist system conformity with the national plan and maximisation of output was considered as legitimising objectives (Bailey, 1988). In contrast, once the communist regime fell and Poland transformed into a market economy, efficiency and profit maximisation became the key objectives that companies would want to either adopt or be seen as adopting.

The research in the area of institutional theory to date does not adequately deal with the issue of deinstitutionalisation or with the rebuilding of new institutions

(Greenwood *et al.,* 2002; Peng, 2003). Whereas the institutional theory's primary focus is to explain organisational behaviour in terms of conformity and adherence to existing rules there is a gap in the theory where the impact of dynamic change on organisations is not addressed. In the context of this study the destruction of old communist structures is one such change which has left a vacuum in the intervening period before new market orientated institutions were developed. The process of how accounting practice is changing in the light of institutional upheaval has not been adequately addressed in the research literature (Peng, 2003). According to Peng (2003) this period was characterised by uncertainty and consequently informal constraints played a dominant role in the economy.

North (1990) argues that mere introduction of market reforms does not necessarily lead to real change: 'although formal rules may change overnight as the result of political and judicial decisions, informal constraints embodied in customs, traditions, and codes of conduct are far more impervious to deliberate policies.' (North, 1990:6). Within the Polish accounting context examples of such customs and traditions followed by Polish accountants could be excessive adherence to accounting rules, the close relationship between tax and accounting regulation and the relative secrecy regarding the disclosure of financial information. In the process of transformation the institutions that support the above characteristics become obsolete and so need to be dismantled and replaced with new institutions that suit the market economy (Greenwood *et al.,* 2002). The more deep seated and established these characteristics are the more difficult it is for the Polish companies to comply with new rules such as IFRS which originate in a market based economy.

3.4.10 The application of institutional theory in accounting research

Institutional theory has been used to explain accounting behaviour by a number of researchers (Covaleski and Dirsmith, 1988; Carpenter and Feroz, 2001; Collin *et al.*, 2009). A particularly relevant insight is provided by Carpenter and Feroz (2001) who use institutional theory to explain the adoption of Generally Accepted Accounting Principles (GAAP) into local governments in the US where previously a completely different cash model of accounting was used. The research by Carpenter and Feroz (2001) has many parallels with this thesis as both studies consider the introduction of very different external models of accounting (IFRS in this case) into organisations with a long history of public financing. The US local government authorities studied by Carpenter and Feroz (2001) may be compared to the Polish entities that were previously state owned and continue to have the Treasury as the strategic shareholder.

In their findings Carpenter and Feroz (2001) identify resource dependency as the key source of coercive institutional pressure but power relationships and weak professional associations provide resistance to change. They conclude that: 'strategic responses to resist institutional pressures for GAAP adoption will ultimately fail because of the potency of the institutional pressures that result from the well organised accounting and governmental institutional fields.' (Carpenter and Feroz, 2001:565). Whereas institutional theory promotes the notion of conformity and adherence to existing routines without questioning, resource dependence theory emphasises the ability of organisations to adapt in the light of changing external economic pressures (Oliver, 1991).

The literature also points to other factors being significant in understanding accounting practice as stated by Dacin (1997:47) although institutional theory provides the 'best fit' for this environment: 'Institutional pressures operate in concert with other forces, such as competitive or market pressures, to influence dynamics of organisations. In fact, a more complete view of organisational action reinforces the notion that organisations are inextricably embedded in a dynamic system of interrelated economic, institutional and ecological processes'. For example, resource dependency has been found to be a significant agent for the introduction of Generally Accepted Accounting Practice in the US government accounting in a study by Carpenter and Feroz (2001). The inter-related forces acting on companies has been incorporated into a theoretical model by Oliver (1991) but there exists a gap in the understanding of how the historic, economic and institutional variables impact on company behaviour.

According to the institutional theory the transformation of the political and economic system should eventually lead to change in the behaviour of companies. However, findings by most authors in this field including (Covalesky and Dirsmith, 1988; Carpenter and Feroz, 2001 and Elbannan and McKinley, 2006) point to a significant resistance to change in the field of accounting. Institutional theory addresses this issue by recognising that individual actors within organisations may adhere to the existing and known patterns of behaviour. Scott (2008:158) introduces the concept of imprinting where 'strong influences of social conditions present at the time of its founding on the structural forms of organisations'.

Resistance to change is also one mechanism that organisations will employ to deal with uncertainty (Elbannan and McKinley, 2006). Other reasons that have been identified to explain resistance to change were greater administrative burden or resource dependency implications (Elbannan and McKinley, 2006).

Within Poland the above influences can clearly seen to be hindering the transformation of the accounting framework. The imprinting influence of the communist era which preserves the power of the state together with the uncertainty resulting from the market economy reforms acts to resist changes at the same time as the institutional and market mechanisms introduce changes (Newman, 2000). In relation to financial reporting in Poland the impact on the organisations arising from the opposing market forces for disclosure of financial information versus the lack of expertise and conformity to existing rules exerted by the state is not well understood and will be explored in Chapter 5 of this thesis.

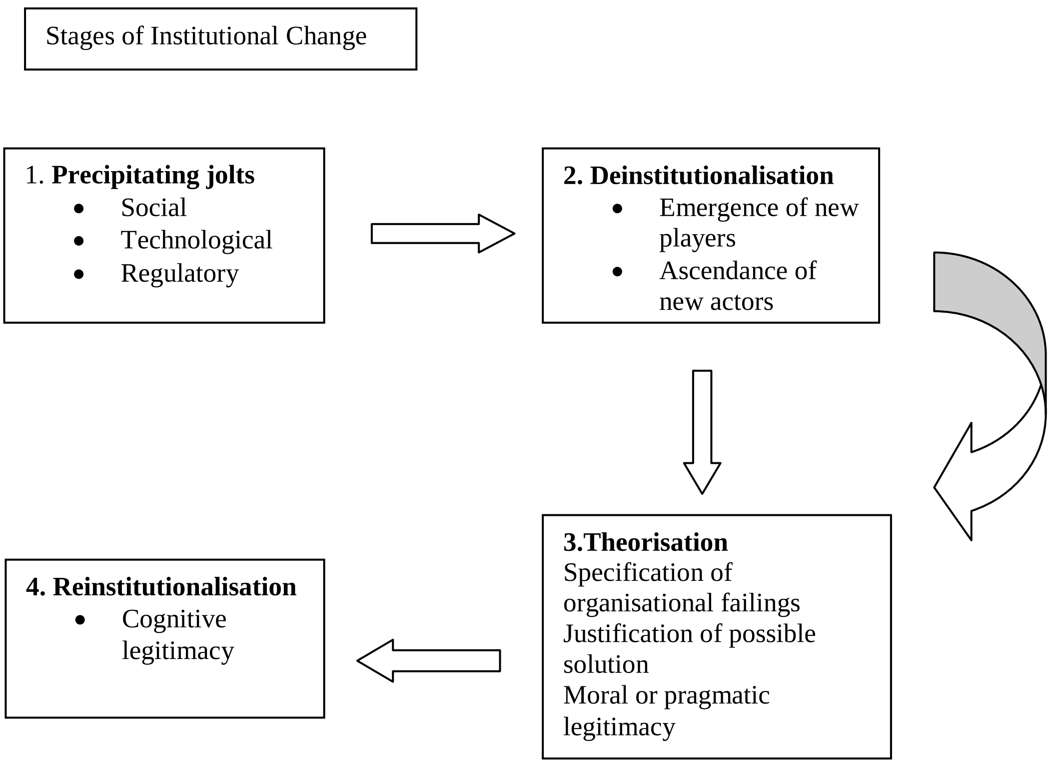
3.4.11 Dynamic dimension of institutions

At the crux of the institutional theory is this paradox between change that is known to take place and conformity resulting from the adherence to established norms and templates that act to reduce transformation of institutions. On one level companies gain legitimacy as a result of conformity with other organisations which is a desirable quality but on another level they become structured and that process has a negative impact on the company. In the long run, 'organisational actors making rational decisions construct around themselves an environment that constrains their ability to change further in later years.' (DiMaggio and Powell 1983:148). This assertion has wide reaching implications for the organisations in transition because, whilst it suggests that the political and economic environment may have altered, the enterprises will continue to operate within their structured organisational field and resist pressure for change. Under the command economy enterprises were highly concentrated into industry sectors creating structured organisational fields that hindered any change but had the advantage of being easily controlled by the central authorities.

Institutional theory has been criticised for its emphasis on passive behaviour and compliance with external institutions as methods employed by organisations to guarantee stability, legitimacy and acceptance in the wider social context. Critics of the theory argue that organisations employ a variety of strategic responses that range from compliance to defiance when faced with external changes and demands (Perrow, 1985; Oliver 1991). Institutional theory does not deny that change takes place but the changes are associated with the convergence towards uniformity in organisational fields. Greenwood *et al.* (2002) in their study of the Canadian accountancy bodies argues that the notion of isomorphic stability is an illusion and that organisational fields are in fact in a continual state of evolving. In relation to financial accounting in Hopwood (2000:765) states that: ‘rather than looking for theories of stability and permanence, we need insight into the means by which at least certain accounting practices can respond rapidly to contextual change’. In a similar vein Greenwood *et al.* (2002) contend that the current institutional research focuses on the effect of the institutional process rather than on the factors that bring about the perceived effects.

Greenwood *et al.* (2002) depict the process of institutional change as shown below, in contrast to isomorphic change, in a number of stages starting from the initial trigger acting on the existing institutions which cause new entrants to participate and disturb the existing institutional fields. The new entrants will independently find viable solutions to the changed environment which become theorised. Greenwood identifies the theorisation stage three as being critical to the institutionalisation process. 'In effect, theorisation is the process whereby localised deviations from prevailing conventions become abstracted and thus made available in simplified form for a wider adoption. Eventual diffusion and reinstitutionalisation will only take place if the new solution is perceived to be superior to the existing practices.

The process of institutional change has been depicted diagrammatically as follows:



Source: Adapted from Greenwood, Suddaby and Higgins (2002:60)

The model is highly relevant to the Polish accounting context because precipitating jolts arising from the fall of communism allow us to study the impact of the changes on the institutionalised behaviour in a dynamic context by undertaking interviews with actors who were familiar with the accounting environment in both communist and market economy. Deinstitutionalisation took place when the existing accounting institutions under centrally planned system became irrelevant and new system was required. Technical need for financial information has led to the theorisation of the accountancy profession leading to the establishment of new institution of the accountancy as a separate discipline with its own identity. Suddaby *et al.*, (2009) studied the impact on professional work, in the context of Canadian chartered accountants, when accountants change the context, content or position from their traditional position of working in public practice to industry and commerce.

In Poland the shift has been in the opposite direction from that studied by Suddaby *et al.,* (2009) as accountants move from the industry into practice and the content of their work changes. There has not been any empirical studies that examine the impact of professionalization on the ability to meet the accounting obligations posed by IFRS framework in a post communist context. This thesis contributes to the understanding of how a new profession emerges by looking at the forces that either promote change as would be the case with competitive forces for financial information or hinder change for example through the actions of the state.

Seo and Creed (2002) also extend the new institutional theory as originally proposed by DiMaggio and Powell (1983) to address the dilemma of how new institutions develop and change given that institutional theory is based on the notion that institutions are static in nature. Seo and Creed (2002:223) develop a new model to identify ‘the key mechanisms linking institutional embeddedness and institutional change’. They propose that organisations will only change if there are ‘contradictions’ within the system that make the existing institutional arrangement unsustainable and human agency known as ‘praxis’ that act to force change.

Praxis is defined as ‘the essential mediating mechanism that links institutional embeddedness, contradiction and change’ (Seo and Creed, 2002:240). Within this model authors identify four sources of contradiction: Firstly, the symbolic institutional arrangements that are decoupled from technical performance over a long period of time may actually undermine efficiency to such an extent that they threaten the survival of an organisation. Secondly, organisations become so structured in the process of adaptation that they are no longer able to change and so contradictions emerge. Thirdly, new stakeholders with vested interests may engage with an organisation in a way that contradicts established institutional arrangements which were the outcome of political power and interest of a different group (Covalesky and Dirsmith, 1988). Fourthly, particular institutional arrangements that exist may conflict with different priorities in different sectors.

Seo and Creed (2002) combine the notions of contradiction and praxis to hypothesise that the severity of contradictions will affect the nature of praxis so that the stronger the contradictions the greater the praxis response. Burns and Baldvinsdottir (2005) tested Seo and Creed’s (2002) model in the context of the changing role of management accountants and their findings support the notion that where there are strong contradictions institutional resistance to change will be broken down.

The findings by Burns and Baldvinsdottir (2005) support the hypothesis of this study that in the long run the contradictions in accounting practice and in the accounting profession arising from severe socio-economic changes in Poland will result in praxis that will lead to change in the accounting framework.

Prior research by Scott (1987) and Oliver (1991) would suggest that power, self interest and resource dependencies act as important agents for change and determine how the organisation will respond to external pressures. Power has been defined by Pfeffer (1992) as being able to influence outcomes by overcoming resistance and ensuring compliance even when there is reluctance to do so. Power and resource dependencies have been shown to be inextricably inter-related. In their study of organisational decision making Salancik and Pfeffer (1974) argue that power is positively related to the ability of a subunits to provide resources to the organisation. In other words, the scarcer the resources are the more power will accrue to the providers of these resources as the contest for them intensifies. This hypothesis has been supported in a study by Covaleski and Dirsmith (1988) who researched the relationship between the State and management of the University during the budget setting process at Wisconsin University at the time of significant financial cutbacks. In this case study the University did not passively accept externally set budgets as would be predicted by institutional theory but actively challenged the basis of the budgeting process and rejected the status quo. The study found that 'the process of institutionalization appears to be infused with power and self interest both within organisation and in extra organisational relations, with extra organisational relations appearing to play a dominant role in periods of organisational decline' (Covaleski and Dirsmith,1988:562).

Oliver (1991) focuses on the strategic responses made by organisations to institutional transition by firstly setting out the range of responses that an organisation can make from acceptance (acquiescence) of the change to compromise, avoidance, defiance and finally manipulation. The study is particularly relevant to this research as the level of compliance of Polish companies with IFRS can be evaluated using the strategic responses proposed by Oliver. Exactly, which response an organisation will choose will depend on a number of institutional factors and how they are perceived by the stakeholders. These institutional factors relate to the reasons for the change, who instigates the change, the ability to enforce the change and the context within which the change is taking place. In the Polish financial reporting setting the role of the accounting profession, enforcement agencies and other stakeholders such as overseas investors are considered to be the primary agents that determine the level of compliance with IFRS.

Oliver (1991) then goes on to hypothesise that:

Hypothesis 1:'The lower the degree of social legitimacy perceived to be attainable from conformity to institutional pressures, the greater the likelihood of organisational resistance to institutional pressures.'

Hypothesis 2: 'The lower the degree of economic gain perceived to be attainable from conformity to institutional pressures, the greater the likelihood of organisational resistance to institutional pressures'

Hypothesis 3: 'The greater the degree of constituent multiplicity (that is the greater the number of competing demands), the greater the likelihood of organisational resistance to institutional pressures

Hypothesis 4: 'The lower the degree of external dependence on pressuring constituents the greater the likelihood of organisational resistance'
(Oliver; 1991:160-162).

In the context of this thesis the external institutional pressures take the form of greater the requirements to disclose high quality financial information by companies in Poland. The companies will only comply fully if they feel that they will gain either a greater level of social legitimacy or if there are economic gains (resource dependency) that can be derived from compliance. Furthermore, companies are likely to disclose high quality financial information if they have clear requirements that do not conflict with requirements from other bodies such as fiscal authorities.

Prior studies by Oliver (1991); Greenwood *et al.* (2002) or Seo and Creed (2002) do not consider specific types of change such as the fundamental upheaval affecting transition economies (Lounsbury, 2008; Peng, 2003). The issue of exactly how institutions are shaped is important in the Polish context where there has been a sudden and fundamental change in the political and economic environment (Newman, 2000). In this respect institutional theory does not fully explain the process of transformation from command to market based economy or how various actors are able to adapt to the market economy.

Peng (2003) used relative cost of transactions in emerging economies to show that in the early phase of transition personalised relationships played a far more important role in strategic decision making and only during the later phase of transition the rule based, competitive and impersonal mechanisms that underpin the market economy became the norm. In the early years of transition the rules were not clearly defined and so choices were made based on mimicry or past historical experiences. In his analysis Peng (2003) distinguished between incumbent firms, entrepreneurial start up firms and foreign entrants to predict the relative adherence to informal networks as compared to regulative and competitive pressures. He hypothesised that incumbent firms do not have the accepted beliefs or norms of market economy and so are far more likely to rely on informal relationships to carry our business than either the new start up companies or the foreign entrants.

This model suggests that adherence to rules such as IFRS in Poland is likely to be variable depending on the nature of the firm. It is expected that adherence will be lower for the state entities that existed prior to the start of the transition and higher for the new entrants and foreign owned companies.

Newman (2000) uses the fall of communism in Central and Eastern Europe to develop a framework to explain organisational transformation during a period of period of extreme economic and political upheaval. The conceptual framework developed in this study integrates the institutional theory and organisational learning to propose that first order institutional change encourages learning up to a point but in period of fundamental upheaval the ability of organisations to learn and transform is inhibited because the experience gained under the previous system was not relevant to the newly transformed environment.

Newman draws on Meyer *et al.* (1993) to distinguish between first order and second order change. The former change is ‘incremental and convergent’ and is likely to take place over a long period of time. The latter change is 'transformational, radical and fundamentally alters the organisation at its core. It takes organisations outside their familiar domains and alters bases of power' (Newman, 2000:604). The changes taking place in Poland can be considered to be of second order change and so the model can be used to predict that Polish accountants will find it difficult to interpret fully the provisions of IFRS due to their adherence and preference for the 'old' accounting orientation.

3.4.12 Summary of institutional theory

The above analysis has set out and justified the use of the new institutional framework for the study of the adoption of IFRS in Poland. The research literature related the new institutional theory was used in a variety of ways to support this thesis. Firstly, the main hypothesis and features of original framework as proposed in the seminal work by DiMaggio and Powell (1983) was evaluated and in doing so, the benefits of using the institutional theory rather than other theoretical models were clearly identified. The application of institutional theory was investigated by a review of past empirical studies that tested the framework. The review of the empirical work revealed that most past research involved entities operating in a relatively stable Anglo-Saxon context. Secondly, the literature relating to the specific features of transition economies was analysed to ensure the appropriateness of using this model for the study of change in post-communist countries. Thirdly, the theoretical developments subsequent to DiMaggio and Powell's (1983) original work that incorporate the notion of institutional change were critically evaluated in the context of dynamic change.

3.5 Theoretical Model

This section sets out the theoretical framework that aims to explain the empirical evidence of the level of compliance with IFRS by Polish listed companies that are legally required to apply IFRS framework and to explain more fully the factors that influence the level of conformity with IFRS by listed companies in Poland. To do so a theoretical model is derived drawing on the various strands of institutional theory (DiMaggio and Powell, 1983; Scott, 2008; Oliver 1991; Carpenter and Feroz, 2001) reviewed in the previous section. Support for this type of research is provided by Scott (2008:429) who states that: ‘An important task of the institutional scholar is to ascertain what *elements* are at play in a given *context* and the *extent* to which they work to reinforce or undercut one another’. In this study the context is provided by financial reporting in respect of the adoption of IFRS in Poland and the specific elements are derived from DiMaggio and Powell (1983) and are identified as being the state, the accountancy profession and resource dependency. These elements are investigated using three propositions set out below.

Utilizing various actors in the financial reporting field namely Polish companies, government authorities, investment analysts and accounting profession the thesis investigates how each of the three elements shown above impact on the on the development of financial reporting in Poland and specifically on the adoption of IFRS compliant financial statements and in 2005.

The adoption of IFRS in Poland in 2005 represents the imposition of an Anglo-Saxon shareholder model of accounting into an economy that is undergoing a transition from communism to a market economy. The transition to capitalist society typically involves the dominance of the state which is replaced with market driven coordination (Kornai, 2000). In a transition economy accounting largely met the needs of the state and was unsuited to the needs of divergent interests of stakeholder groups that characterise a market economy. The transformation of Polish economy leads to contradictions between systems that support the old command style practices and new systems that are required in the new market economy Seo and Creed (2002). These contradictions act as agents for change but it is not clear what are the relative influences that either promote or hinder the adoption of IFRS.

The responses that the companies are able to make are either to comply fully (acquiescence) or to compromise (Oliver, 1991) with the new accounting standards. The other strategic responses proposed by Oliver are not available to companies as the requirement for IFRS accounts is a legal obligation that cannot be avoided. Therefore, although companies could in theory respond by defying or avoiding these options are not available in practice.

Acquiescence in the context of accounting means compliance not only with the specific rules of IFRS but also with the spirit of openness in terms of disclosure. Given that IFRS is a new framework the response requires conscious change of accounting practice by organisations which, in most cases, cannot be achieved through habit or imitation Oliver (1991).

The alternative response that Polish companies could employ would be to compromise and superficially adopt IFRS by making an explicit statement of compliance whilst at the same time not meeting many of the specific measurement and disclosure requirements. Compromise is achieved by either accommodating the various needs of stakeholders groups or by pacifying them but in any case the compliance is only partial. In this study the regulators would be pacified by companies being compliant with the less problematic IFRSs whilst lower level of compliance would be achieved for those which are more complex or require a higher level of judgment.

The responses made are dependent on the relative strength of the explanatory variables are depicted on the diagram shown below:

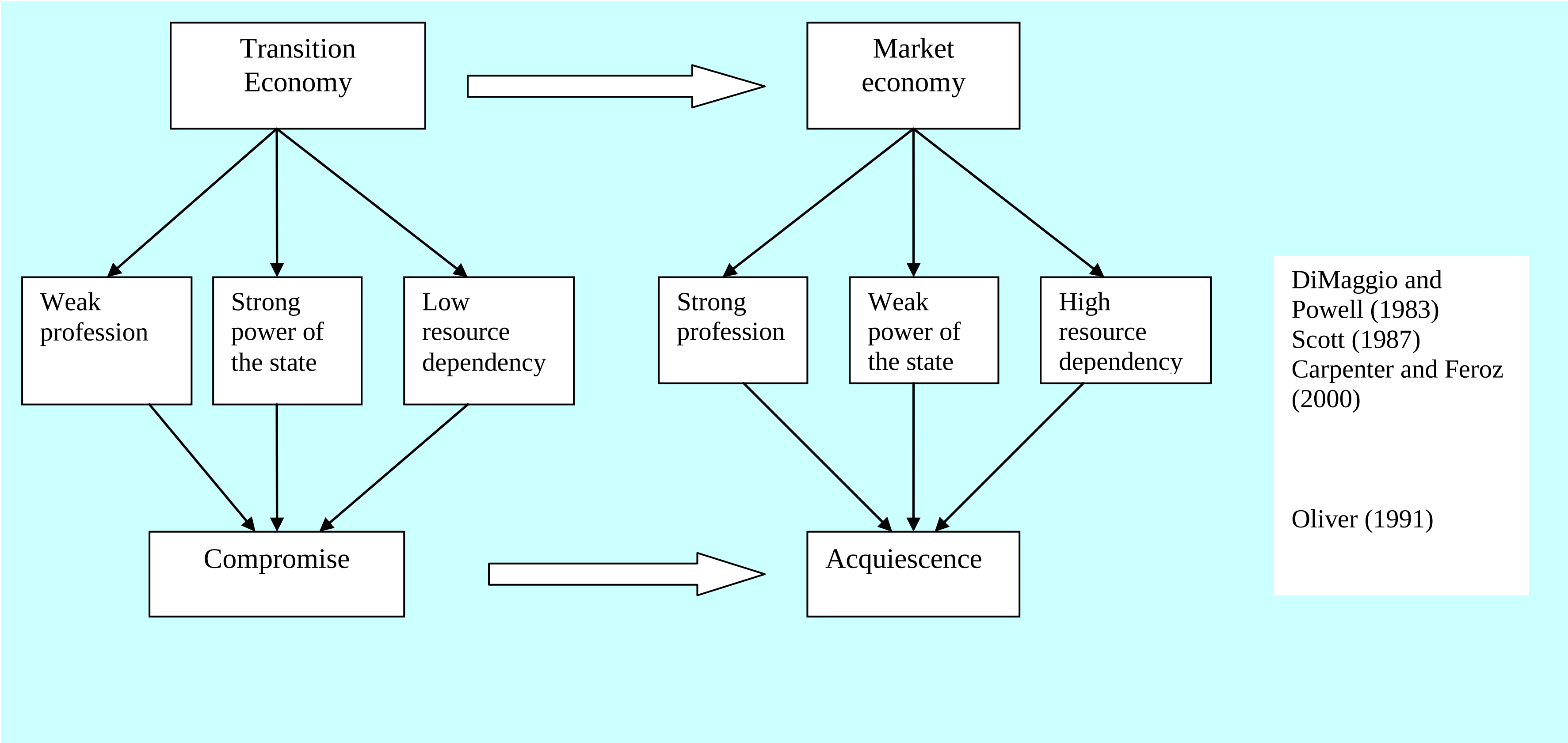


Figure 6: Accounting in a transition state: a theoretical model

Source: Iwona Vellam, 2010

From the above model the following hypothesis has been developed:

Hypothesis: In a transition economy companies try to meet the demands of IFRS by compromising and only as they move towards a full market economy is acquiescence achieved. Polish accounting practice is significantly different from IFRS and this hinders companies from full compliance with IFRS and reduces comparability between accounts of single listed companies and group companies.

Following from this hypothesis three propositions are developed, based on institutional theory, to explain the reasons for the responses identified in the hypothesis. Exactly which response will be adopted depends on the institutional and economic factors that shape the institutional field in which companies operate. These factors can be grouped into three main categories:

- Strength of the profession
- The power and influence of the state institutions
- The level of resource dependency

Each of the factors above arise from transition political and economic contexts in which Polish companies operate in as compared to the market orientated environment for which IFRS were designed.

The strength of the profession corresponds to DiMaggio and Powell's (1983) notion of normative influence. Full adoption of IFRS will only take place when the accountants have the necessary skills and knowledge to fully appreciate the impact of the international standards and are able to exercise informed judgment in their application of principle based accounting embodied in IFRS. Companies' accounting practices will converge and become more similar through the actions of professional accounting bodies that, through the operation of their professional institutes, are able to transcend the organisational diversity and introduce common practices and routines. They play an active role in training and in maintaining high ethical standards of its members. Unlike in the Anglo-Saxon countries where accountancy profession has its roots dating back to the late 19th century, accountancy profession in Poland became fully recognised only after the fall of communism in 1989 and therefore its participation in shaping of accounting practice is much lower than in market economies. In contrast, the global accountancy firms have the ability to enhance the quality of accounting through direct audit function of companies and indirectly through their influence on the operation of the profession.

Proposition 1: A weak accountancy profession in Poland leads to compromising by companies with regard to IFRS. Companies continue to adhere to previously established accounting practices and do not adopt IFRS fully. Where the auditor is a global firm of accountants the compliance with IFRS is greater.

The relative power of the state organs to coerce companies to comply is a potent isomorphic force (DiMaggio and Powell, 1983). This is particularly the case in transition economies where the state retains considerable control over all economic activities through penal enforcement mechanisms. The dominance of the state has been shown by Kornai (2000) to be a specific attribute that defines the socialist system and so during transition to capitalist system the role of the state is an important explanatory variable. The multiple objectives set for companies by different agencies mean that the companies will comply with IFRS in a ceremonial way, compromising rather than achieving full compliance.

In order to move fully towards IFRS it is also important that the Polish accounting law is also aligned as much as possible with IFRS. The further Polish accounting Regulation is from IFRS the more difficult it will be for companies to fully convert to IFRS.

Proposition 2: Where there are competing demands arising from state agencies and from accounting regulation the companies will fully adhere to the state demands, primarily the tax authorities, at the expense of IFRS compliance.

Finally, resource dependency has been identified by various researchers to be a significant factor in explaining firms' behaviour (Oliver, 1991; Carpenter and Feroz, 2000). Dependency on various agencies for resources has a powerful coercive effect on the behaviour of the firms. Unlike, the power construct which tends to inhibit change the resource dependency theory points to the resource providers acting as significant influence for change.

Proposition 3: Compliance with IFRS will be greater where there is the greatest economic necessity to raise funds.

The following chapter will set out the research design and methodology that addresses the hypothesis and propositions derived from the theoretical model.

3.6 Literature review chapter summary

The aim of this chapter has been to inform the research that enabled the main hypothesis to be posed. That is, that the adoption of IFRS is in itself not sufficient to ensure full compliance with IFRS and wider incentives must be taken into account when evaluating the progress of harmonisation. Thereafter, using the theoretical framework of new institutionalism, three propositions were developed to explain the reasons for non-compliance with IFRS.

In the first instance literature was reviewed to determine whether accounting harmonisation has taken place as a result of the introduction of IFRS. Prior research shows that convergence of national frameworks is taking place for listed companies. In relation to Poland the literature assessed the changes to the legal accounting framework as being evolutionary over a period of 15 years culminating in the adoption of IFRS in 2005.

The acceptance of IFRS is facilitated by the fact that IFRS financial statements have been shown to be of higher quality than national frameworks. The effect of this higher quality is to lower cost of capital by reducing informational asymmetry. However, the endorsement of IFRS has been hampered by the private constitution of the standard setting body, the IASB, lack of participation by smaller countries and lobbying activities of interested bodies. This has led to selective carve outs from individual standards which weaken the harmonisation process. Literature also points to complexity of the standards and high cost of implementation together with delays in translation as obstacles to greater convergence.

Lack of convergence becomes apparent when both listed and unlisted companies are considered because unlisted companies continue to apply national accounting rules whilst listed companies apply IFRS. In the long run, literature suggests that the operation of such dual accounting systems is unsustainable.

In terms of *de facto* convergence various country studies such as for Greece, Spain, US and China show that there are significant differences between accounts prepared under IFRS and those prepared under national accounting frameworks. The major sources of difference arise from the different valuation methods of fixed assets for US, Greece and Poland. However, the Spanish study by Callao *et al.* (2007) points to differences arising from the valuation of financial instruments and presentation of information. For Polish companies adjustment for hyperinflation and finance costs were also shown to be significant (Kaczmarczyk and Walińska, 2007).

The studies that use comparability indices generally show profit and equity to be higher under IFRS than under national GAAP. In particular, research by Krzywda and Schroeder (2007) involving Polish companies show that equity under Polish regulation was understated by 6 to 9 per cent while net profit was understated by 35 per cent. This would suggest that the differences arise from a more conservative orientation of the national accounting systems.

Typical characteristics of a national accounting system can be predicted by locating the country in a particular classification model. Using Nobes (1998) method of classification Poland could be classified as a country that is culturally self sufficient but with ‘weak equity outsider’ resulting in a creditor orientated accounting system. This finding would be consistent with greater conservatism that was shown in the profit and equity by Krzywda and Schroeder (2007)

Numerous studies including Ball *et al.* (2003) refer to the institutional factors as being the key determinants of harmonisation which lead to the conclusion that the introduction of IFRS on its own is not sufficient to ensure full convergence of accounting.

The second part of the research uses three propositions that identify various institutional factors that play a role in the determination of accounting practice. The thesis utilises new institutional theory (Di Maggio and Powell, 1983) to develop a conceptual framework that explains the lack of full convergence by Polish companies demonstrated by Krzywda and Schroeder (2007). Underpinning the new institutional theory is the notion that companies routinely undertake behaviour that is ceremonial rather than real in order to gain wider acceptance and legitimacy from the society at large (DiMaggio and Powell, 1991; Scott, 2008). Over time organisations become similar to each other either because they are coerced to conform or because they undertake similar (mimetic) behaviour to other organisations. The focus of the earlier literature was on permanency and continuity of organisations in a stable and ordered environment. Another source of new institutional research concerns the reasons for the different responses taken by the companies. Launsbury (2008) argues that actions that are taken by organisations are in most cases institutionally rational and cannot be simplistically divided into either ceremonial and therefore irrational, or technical and so rational. This research draws on Launsbury's approach to provide a rationale for the behaviour of the companies studied.

In transition economies organisations exist in a fundamentally transformational environment that provides a novel context for this research. To date the research using institutional framework to explain issues in financial reporting have been largely limited to Anglo-Saxon countries. Survey of literature suggests that new institutional theory has not been adequately tested in an environment of fundamental transformation as was experienced by Central and

East European countries since the start of transition in 1989. This thesis offers a new way of using institutional perspective where responses by companies to external pressures can be investigated in a dynamic context. The responses that can be made have been theorised by Oliver (1991) and vary from full acceptance to outright resistance to change and these responses have been applied to the level of compliance with IFRS in Poland. Transition economies offer a rich source of research as to how different companies react to externally imposed regulation in an environment that has been shaped by communist institutions.

4. RESEARCH METHODOLOGY AND DESIGN

4.1 Theoretical foundations

The research methodology for this study was designed to address the hypothesis that the adoption of IFRS by listed companies in Poland will not necessarily lead to full compliance with the provisions of IFRS. The explanatory factors for the non-compliance are associated with the specific features related to the transition economies. In order to provide fuller and more rigorous explanations for the observed findings a sociologically derived theoretical model was utilized and subsequently tested. Unlike in natural sciences, the aim of theorising in this context was not to generalise to a population but rather to generalise to a theoretical framework by studying a unique event of transition from command to market economy and thereby to gain a real insight into its impact on accounting. The advantage of theorising in the thesis is to provide a rational and practical framework for explaining the meaning and significance of observed behaviour without attempting to generalise or to predict future events in a scientific manner (Schwandt, 1994).

Conceptual framing has been employed in a variety of research settings and Llewelyn (2003:663) identifies five levels of theorising for qualitative research:

Level 1: Metaphor

Level 2: Differentiation

Level 3: Concepualisation

Level 4: Context-bound theorising of settings; and

Level 5: Context-free ‘grand’ theorising

The typology identified above provides a framework for the type of empirical issues that are studied. At the lower levels theories are created to further understanding at individual or unit level and at higher levels the theories increasingly deal with more complex settings at macro level. The highest level of theory identified as grand theorising reflects abstract view of the social world at macro level. This generalised view of the world is only loosely related to practice and so is difficult to test.

Within the framework developed by Llewelyn (2003) this thesis combines level 2 theory of differentiation with level 4 context-bound theorising of settings. Meaning and significance are created by using level 2 theory of differentiation which contrasts the phenomena found in command economies with those of market economy at macro- economic level. It is the unique change in the systems that highlight the differences in the role of accounting in the transformation process. Specifically in relation to accounting, differentiation and contrast are also employed in the comparison of national and international accounting systems allowing Polish accounting to be placed in the accounting classification models. The theorising at level 2 interacts with level 4 theorising of settings in its aim to provide explanatory factors for the observed accounting practice. Theorising of settings is primarily concerned with the explanation of the role of organisations in the wider social contexts.

Utilising Hopwood (1983) this thesis assumes that accounting is not simply a technical craft but plays a wider role in the broader societal context and is also influenced by the society and not only by the technical requirements. Therefore, the theoretical model developed in this research utilises new institutional theory as its foundation, drawn from the sociological research, and not the positivist approaches that are normally employed in accounting research. Positivist research in financial accounting typically investigates the relationships between accounting numbers and other variables such as market reaction. In transition economies issues identified by Hopwood (1983) are even more relevant because the organisations, institutions and the wider social environment are in the state of flux and so the application of positivist approach was deemed to be inadequate.

4.2 Evaluation of research paradigms in accounting

The research design in this thesis assumes that the accounting function is shaped by its institutional context which in turn influences the development of institutions. The process of transition from command to market economy involves complex changes in the relative power of the state and other agencies which impact on the accounting role. According to Chua (1986) these influences are too complex to be incorporated into the mainstream accounting research which primarily adopts the highly quantitative, positivist approach although some quantitative research has been adopted to enhance the findings from qualitative research.

Fundamental to the positivist approach is the belief in the existence of independent reality that can only be verified by observation (Ryan, Scapens and Theobald, 2002). The observations are real and therefore not subject to interpretation, bias or the researcher's 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. For example, in the area of international financial reporting the positivist approach has been widely utilised to study the economic impact of the adoption of IFRS (Christensen *et al.,* 2007; Daske *et al.,* 2008). In these studies the market mechanism is assumed to be efficient and to act as a benchmark in the evaluation of the IFRS regulatory framework. In this type of research stock market returns are seen to be an objective fact that is unquestioned and totally independent of the researcher. 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. Using the examples of economic consequences of the adoption of IFRS mentioned above only a small range of variables can be incorporated into the model and throughout the neo-classical model of profit maximisation and efficiency of the capital markets is assumed. In transition economies these assumptions do not necessarily hold because the markets are less efficient and accounting practice may not impact directly on stock returns.

Nevertheless, the positivist approach has powerful explanatory power and a high level of external validity. For this reason the study adopts a positivist approach as one of its methodologies by empirically evaluating the difference between IFRS profit and Polish GAAP profit using Gray’s Comparability Index (Gray, 1980) to complement and triangulate with the other research methodologies employed in the thesis. The aim is to provide some objective, external evidence to support the qualitative interpretive research undertaken and provide some concrete data to act as a point of discussion with the respondents. A shortcoming of this type of research methodology is that it does not explain or interpret the source of the differences. Furthermore as the results are presented in a form of an index and so the magnitude of the differences is not evident and therefore the relative importance of the various differences between Polish GAAP and IFRS is not apparent.

The deficiencies of the positivist model concern the over-simplification of the view of the world arising from the need to generalise relations between variables. Guba and Lincoln (1994) describe this as ‘context stripping’ whereby only certain variables are specified in the model and a change to the variables can result in very different outcomes. The positivist approach ignores the purpose and meanings that are assigned by human beings (Guba and

Lincoln, 1994). This means that for the purpose of this study, a positivist research design would ignore the socio-economic context in which accountants operate in transition economies. They are seen as neutral technicians that apply their skills to produce technical financial information for the decision makers. In transition economies the accountant's role has changed dramatically in the light of the political and economic system changes and the positivist approach is unable to capture the effects of the change on the accounting profession.

The limitations associated with quantitative studies have led 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 (2005:2).

In the light of the deficiencies identified above an interpretive, holistic approach utilising qualitative methodology was chosen as the most suitable research paradigm to study the accounting practice in a transition economy. This approach views the world as being socially constructed and institutionalised over time through the actions of its actors (Schwandt, 1994). The approach allows a multiple view of reality because the reality is created by human action. Using this paradigm the research is no longer objective and neutral but rather attempts to assign meaning to actions and interpret the evidence based on past experience and historical background. The process of interpretation places the researcher at the centre of the research and allows him to impute subjective perspective to the research. Relevant to this study is the author's birth and upbringing in Poland during the communist era provided a common historical background and a shared experience with the interviewees. On the other hand, author's professional accountancy training and experience of working for a Big 4 firm of accountants in the UK provided a distance from the subject. According to Alvesson

(2002:131) this position of 'both emphatically and intellectually distant from and close to the subject' allows better understanding and interpretation of the qualitative research being undertaken.

In the context of accounting, this thesis maintains that although accounting numbers provide some insight into the study of the adoption of IFRS, in itself, they are not sufficient to explain in depth the reasons for the observed accounting practice. The adoption of qualitative methodology allows richer data to be collected about the role of accounting that lends itself to an in-depth analysis of complex socio-economic influences on accounting arising from the communist past.

Therefore, by adopting an interpretive stance it is possible to combine data at company level with explanatory variables at macro level to develop a theoretical model which provides a structure and offers better understanding of the accounting practice without having to make artificial assumptions and simplifications associated with the positivist approach.

Nevertheless, the interpretive paradigm has been criticised for its inability to evaluate effectively the results given the subjective interpretation of observed behaviour. Chua (1986) identifies three possible weaknesses. Firstly, assessment of an explanation based only on the extent of interviewee's agreement is logically flawed for example where there is a disagreement between the researcher and the actor. Secondly, critical evaluation is problematic and not objective because of the assumption that the researcher is not an independent observer but a subjective participant in the research activity. Finally, the researcher has a preconceived view of the social setting and so may not appreciate the various dimensions influencing the study such as major conflicts of classes within society.

This research addressed the above issues so as to provide a robust research design and minimise the problems identified above. Firstly, multiple research methods were used so that evidence from variety of sources could be triangulated thereby reducing the subjective bias of using interview data alone. The evaluation of compliance with IFRS of reporting practices by companies was made more objective by the use of a standard checklist and the degree of deviation of Polish accounting from IFRS was measured using quantitative methodology. This robust evidence was then used as the basis for discussion with the various actors to provide a much richer analysis. Secondly, a theoretical model was logically developed from the relevant literature and specific research methods were mapped against the model to enhance the rigour and reliability of the research.

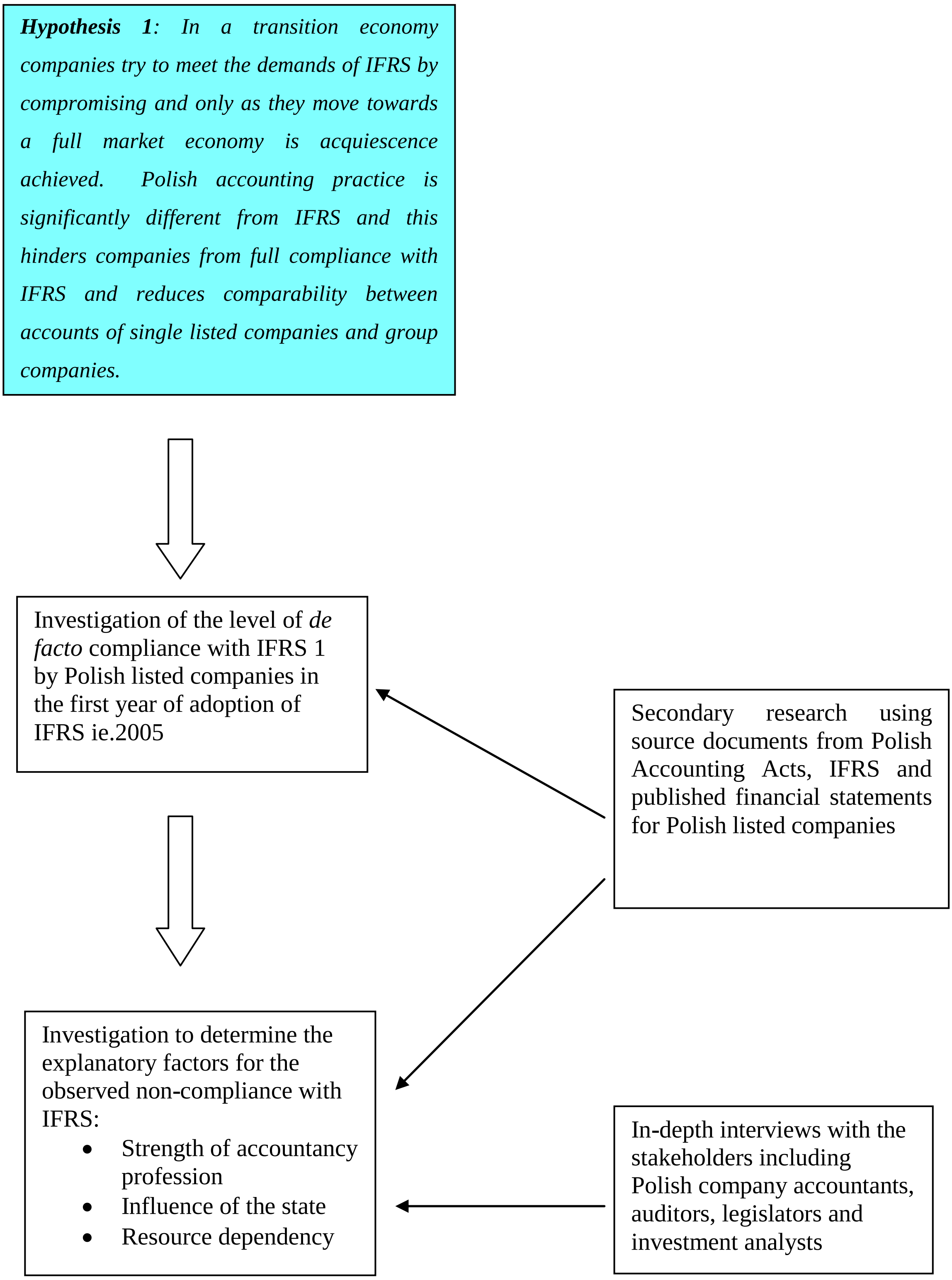
4.3 Research Design

The underlying research method is a country study based on Poland as a representative of transition economies that were required to conform to IFRS for consolidated financial statements from 2005. Within Poland the research was narrowed to firstly calculate the differences between reported profit using IFRS basis and Polish GAAP basis and then to consider the application and compliance with IFRS1 '*First time Adoption of International Financial Reporting Standards'*. From the theoretical institutional perspective this part of the research allows the responses of the companies to the requirement to adopt IFRS to be evaluated. In the face of new regulations companies can respond strategically in different ways as suggested by Oliver (1991) ranging from full acquiescence to defiance by failing to comply with IFRS.

The results of both of the above research strands formed the basis for in-depth exploratory interviews. The latter aimed to explain and follow up on the findings from preliminary research to better explain the change in accounting given the broader institutional changes in Polish economy. Hopwood (2000:764) believes that insufficient attention is devoted in financial accounting research to the specific national conditions affecting accounting and states that: 'attention needs to be focused on the location and mobilisation of accounting discretion, on the linkages between corporate financial officers, auditors and officials in regulatory agencies'. As identified by Hopwood, in this study the relevant stakeholders were interviewed, namely auditors, Ministry of Finance officials, company accountants and investment analysts in order to provide a richer and more in-depth insight into accounting practice.

The research was carried out in three main stages and each stage was supported with a different theoretical perspective and research methodology. The research design utilized both quantitative and qualitative approaches giving the opportunity for the findings from the documentary sources to be contextualized and analysed through in-depth interviews providing a more holistic view of accounting in Poland. The explanatory factors were derived from the theoretical model grounded in the new institutional theory as proposed by DiMaggio and Powell (1983) and Oliver (1991). The detailed methodology linking the theoretical framework to hypothesis and research method is set out in the next section 4.4 (Research Method).

The research process can be outlined from the overarching hypothesis as follows:



Source: Iwona Vellam, 2010

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 a multi-method approach allows the study not only to identify the accounting differences but also to examine and explain the complex reasons for observed differences that are rooted in the institutional and historical context. The main advantage of using multiple methods is to increase the reliability and the validity of the results by reducing 'the personalistic biases that stem from single methodologies' (Denzin 1978:294). 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).

Although, multiple approaches provide a much deeper understanding of the issues according to Denzin and Lincoln (1994:2) 'objective reality can never be captured. Triangulation is not a tool or a strategy of validation, but an alternative to validation. The combination of multiple methods, empirical materials, perspectives and observers in a single study is best understood, then, as a strategy that adds rigour, breadth and depth to any investigation'.

As noted by Denzin and Lincoln (1994) triangulation has drawbacks which are relevant 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 the comparability indices 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 within the institutional framework.

Secondly, the different methodologies may address different aspects of the research and do not necessarily confirm each other but enhance the theoretical contribution of the thesis. In this case the study of the relationship between the financial results calculated using IFRS as compared to the results calculated using Polish GAAP measure differences between the reporting frameworks and allow the level of compliance to be evaluated using institutional lens. Companies may either comply fully with IFRS, compromise through partial compliance or defy and therefore fail to comply.

These strategic responses contribute to the next stage of the research which aims to explain the reasons for the lack of compliance with IFRS by listed Polish companies. This aspect of the research is also important from policy perspective because limited adoption of IFRS will not improve comparability and may in fact cause confusion for the reporting companies who are concurrently applying very different principles. This situation arises only because consolidated accounts are prepared in accordance with IFRS whilst single company accounts of the subsidiaries as well as those companies that do not prepare group accounts continue to apply Polish regulations. From the user's perspective an investor wishing to compare the relative performance of two Polish listed companies, one preparing consolidated financial statements using IFRS and the other preparing single company financial statements under Polish GAAP may not be able to do so easily thus undermining the comparability objective which is a key attribute of accounting in the IASB '*Framework for the Preparation and Presentation of Financial Statements'* (IASB, 2007b). The aim of the study is to measure *de facto* differences in the context of Polish compliance of IFRS rather than to provide a full summary of *de jure* differences which have been done extensively in other studies such as Deloitte Touche Tohmatsu (2010) and Krzywda and Schroeder (2007).

The study explores the reasons for the accounting differences between Poland and IFRS that could subsequently be extended to a comparative, 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 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 focusing on a single country it is possible to gain a deep understanding of the institutional and historical 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 minimisation 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 of US dollars 659.2bn in 2008 (OECD, 2010) in the region and the highest population although in terms of per capita GDP it lags behind both Hungary and the Czech Republic. Its experience of reforms will be indicative of the possible course of harmonisation for 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 nearly three times that of the next largest country (Czech Republic USD256.9bn) (OECD, 2010) 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. The City of London Corporation Report (2003) suggests that there exists a relationship between the level of effective financial regulation and the success of the stock exchange. Poland has been judged to have a high level of financial regulation and using the EBRD index for financial regulation the report found that: 'the four countries with the highest regulation scores – Hungary, Poland, Slovenia and Estonia – saw an increase of 52 per cent in the number of firms listed between 1996 and 2002. The four countries with the lowest scores – Latvia, the Czech Republic, Lithuania and Slovakia-experienced a decrease in the number of firms listed by 31 per cent' (Corporation of London, 2003:10) . The Polish Stock Exchange is therefore an important agent for promoting adherence to regulations by Polish companies and is also an influential financial body in the region. Poland also has the largest stock exchange in the Central and East European region. With the domestic market capitalisation of 112 billion Euros (Federation of European Securities Exchanges, 2010) the Warsaw Stock Exchange (WSE) is at least twice as large as the next largest exchange – The Budapest Stock Exchange. The trend of increasing cross border listings means that more foreign East European companies are listed on the WSE and therefore Polish influence is likely to radiate to the other transitional economies.

Fluent knowledge of the language and deep understanding of 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. Furthermore, the researcher was also able to combine her technical accountancy competence with the understanding of the Polish society and business environment to provide a unique insight into the implementation process of IFRS in Poland.

Having developed the research design and considered the various methodological alternatives the next section of the chapter sets out in detail the method employed for each stage of the research.

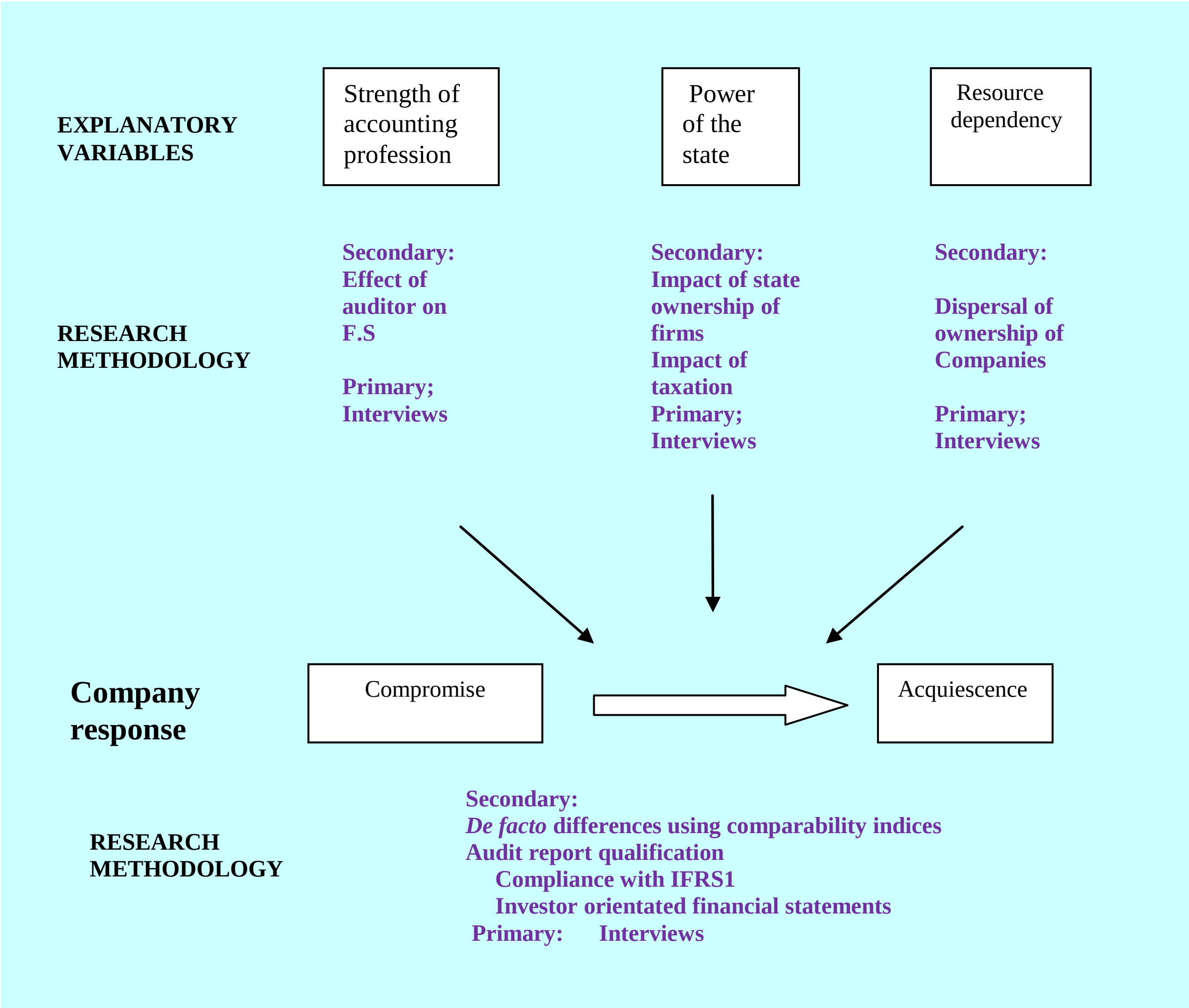
4.4 Research Method

The use of various methods in this research including interviews and secondary research is mapped against the theoretical framework as summarised below:

Mapping of Research Methods against a Theoretical Model

The diagram shown below is derived from the theoretical model outlined in chapter 3.5 and it is enhanced with the mapping of specific research methods against each part of the research hypothesis and propositions.

Figure 7: A Map of the Research Methods against the Theoretical Model



Source: Iwona Vellam, 2010

To investigate whether Polish companies fully comply with IFRS or compromise by being non-compliant in many aspects was tested using an *a priori* approach to study *de facto* practices in Poland in the context of IFRS. The purpose of the analysis was to identify areas of non-compliance which can then be investigated further through interviews with regulators, auditors and investors. According to Scott (1998) a deficiency of some of the institutional research is that institutional effects are asserted but they are not supported with data. This study partly addresses this through the quantitative part of the research because the extent to which companies are compliant with IFRS is an indirect measure of institutional embeddedness. Those that fail to comply with IFRS are considered to be adhering to the old rules and are unable to change in the light of imposed requirements to adopt IFRS.

Having established the extent of compliance with IFRS the interviews aimed to inform the theoretical model by explaining the reasons for non-compliance with IFRS and to ascertain whether the adoption of IFRS in Poland is necessarily the most suitable route to presenting accounts that are relevant, reliable and understandable in the Polish context. Thereafter, each of the explanatory variables drawn from DiMaggio and Powell (1983) framework namely, the strength of the accountancy profession, the power of the state and resource dependency were investigated using mixed methods of interviews and secondary data.

4.4.1 The financial impact of adopting IFRS on the accounts previously prepared under Polish accounting principles.

The thesis provides a unique opportunity to determine the extent of measurement harmony of accounting within Poland by comparing the impact on profit and equity of adopting IFRS by listed companies compared to using Polish regulation.

A shortcoming of this type of research methodology is that it does not explain or interpret the source of the differences. Furthermore as the results are presented in a form of an index and so the magnitude of the differences is not evident and therefore the relative importance of the various differences between Polish GAAP and IFRS is not apparent. Nevertheless, the positivist approach has powerful explanatory power and a high level of external validity. For this reason the study adopts a positivist approach as one of its methodologies by empirically evaluating the difference between IFRS profit and Polish GAAP profit using Gray's Comparability Index to complement and triangulate with the other research methodologies employed in the thesis and discussed in section 4.4.3.

The use of comparability indices is an accepted method of studying similarities and differences between financial statements produced under different reporting frameworks using data provided in the financial statements. This method was selected because is very reliable as the reconciliation data is produced by the company and sanctioned by the auditors.The use indices here has been made possible by the availability of comparable data recorded under both IFRS and Polish accounting regulation for a single year only whilst holding all other variables constant resulting from the requirement of IFRS 1 '*First-Time Adoption of IFRS'* for companies to provide detailed disclosure of how financial statements have been affected by the introduction of IFRS in the first year of adoption.

In most cases, the reconciliation information is not available and so alternative methods such as simulation studies are employed where the actual reports or artificially constructed accounts are restated using different accounting methods (Walton, 1992). However, such method is inferior to that adopted in this study as considerable assumptions have to be made in respect of the accounting treatments adopted. Other studies focus on disclosure practices

using binary method (Roberts *et al*, 2005) where disclosed item is coded as 1 and not disclosed as 0. This method has been used to investigate voluntary disclosure but has been criticised on the grounds that it is difficult to select which items should be included.
In contrast, the use of indices provides a reliable measure that is unaffected by researchers interpretations or assumptions.

Relevant to this methodology has been the research carried out to quantify the impact of different reporting frameworks on the company profits and equity. Gray *et al.* (2009) considered differences between US GAAP and IFRS for 134 companies based in the EU that provided F-20 reconciliation in the period 2002-2006. F-20 reconciliations were also used to study US GAAP versus IFRS for 20 Chinese companies. Tsalavoutas and Evans (2007) applied similar methodology to compare IFRS with Greek GAAP but used a single period, the year of adoption of IFRS in 2005.

Research related to Poland is limited to a study by Krzywda and Schroeder (2007) who compared differences between IFRS and Polish GAAP for 2001, 2003 and 2004. The major limitation of the work by Krzywda and Schroeder is that all the years under consideration are prior to the adoption of IFRS in Poland. The data for 2001 and 2003 provides only a descriptive summary of differences as required by the Prospectus Decree 2001 (*Rozporządzenie Rady Ministrów, 2001*) (Krzywda and Schroeder, 2007). Although the differences between IFRS and Polish GAAP were quantified in 2004 as required by the Prospectus Decree (2004) *(Rozporządzenie Rady Ministrów, 2004)* 'listed entities were provided with an escape clause which stated that if the quantitative differences between IFRS and Polish GAAP could not be estimated in a reliable manner despite the exercise of due diligence, then the requirement to quantify the differences did not apply' (Krzywda and

Schroeder, 2007:5). This opt out clause meant that complete and reliable reconciliations were not fully mandatory until the implementation of IFRS in 2005 which is outside of the time frame adopted by Krzywda and Schroeder (2007). It is expected that better disclosure by companies will improve the reliability of findings as indicated by Krzywda and Schroeder (2007:26): ‘preparers successfully resisted the quantitative disclosure requirement desired by regulators until the publication in 2004 of the IASB approved Polish translation of IFRS’.

The comparability index, first developed by Gray (1980) quantifies the effect of IFRS on profit and equity for Polish companies reporting in 2005, the first year requiring IFRS financial statements. The differences in profit and equity were quantified in the first year of the adoption of IFRS because IFRS 1 ‘*First-time Adoption of IFRS’* paragraph 38 requires that: ‘an entity shall explain how the transition from previous GAAP to IFRSs affected its reported financial position, financial performance and cashflows.’ (IASB, 2007g)

The formula used to quantify changes in profit is calculated as follows:

$$1 - \frac{(\text{Profit}_{\text{IFRS}} - \text{Profit}_{\text{PAR}})}{\text{Profit}_{\text{IFRS}}}$$

Where profit is defined as income after tax and extra-ordinary items.

And for equity it is:

$$1 - \frac{(\text{Equity}_{\text{IFRS}} - \text{Equity}_{\text{PAR}})}{\text{Equity}_{\text{IFRS}}}$$

An index value of more than 1 signifies profit or equity calculated under Polish regulation as being higher than under IFRS and conversely an index of less than 1 means that IFRS profit and equity are higher. The index has the advantage of highlighting material differences between numbers reported under different frameworks. For example, an index of 0.9 means that the equity reported under IFRS is 10 per cent higher than under Polish accounting.

A null hypothesis was stated as follows: H_o Median of index of equity = 1

H_o Median of index of profit = 1

This means that the profit and equity of Polish listed companies are not affected by the transition to IFRS and so there is no difference in the reported results between Polish Accounting Regulation and IFRS.

The research hypothesis is stated as H_1 Median of index of equity ≠ 1

H_o Median of index of profit ≠ 1

The research hypothesis maintains that the comparability index for profit and equity for Polish companies will differ from IFRS. The hypothesis was tested using a two tail *t*- test at 5 and 10 per cent confidence level using the following formula.

$$t = \frac{x - \mu}{sd/\sqrt{n}}$$

where: x = median comparability index

μ = 1

sd = standard deviation

n = sample size

Following (Tsalavoutas and Evans, 2007) median was used as the appropriate measure of average.

The index uses the IFRS values in the denominator as the IFRS regime is considered to be of higher quality than the Polish accounting method. Furthermore, IFRS is the benchmark reporting system and therefore it is appropriate to give primacy to this in the formula as investors would view any deviation as being from IFRS and not from Polish GAAP.

As noted by Weetman *et al.* (1998) one of the disadvantages of using this formula is that where profit figures are extremely low then the index will result in an exceptional outlier that can distort the overall results. In this study the companies with extreme values were identified and considered separately from the main sample to avoid the distortion of the majority of the firms.

This study also extends the Weetman *et al*. (1998) research by comparing the impact of adoption of IFRS on the Return on Equity (ROE). This ratio is a key performance measure used widely in financial performance appraisal and in screening for potential investment opportunities. The study will make additional contribution by quantifying the impact of the change in accounting framework on ROE utilising the same sample of companies as for the calculation of comparability index.

Return on Equity is calculated as follows:

$$\text{Return on Equity} = \frac{\text{Profit after Tax}_{\text{IFRS}}}{\text{Equity}_{\text{IFRS}}}$$

$$\text{Return on Equity under Polish GAAP} = \frac{\text{Profit after Tax}_{\text{Polish GAAP}}}{\text{Equity}_{\text{Polish GAAP}}}$$

The sample consisted of Polish listed financial statements for the year ended 31st December 2005. In total a sample of 40 companies was selected out of 304 Polish listed companies from the Warsaw Stock Exchange web site. As the reconciliation between national GAAP and IFRS is only required for IFRS accounts and only consolidated accounts need to comply with IFRS the sample excluded all single company accounts. This meant that the sample was biased towards the larger companies as it was generally the smallest companies that produced single company accounts only. In line with other studies (Tsalavoutas and Evans, 2007) accounts of banks and other institutions were also excluded because the unique nature of reporting by these entities is not comparable to the reporting in other sectors.

The sample selected for investigation was divided into two components to ensure full coverage of companies. A previous study (ICAEW, 2007) points to significant differences between large and small listed companies. Large companies have to maintain their reputation and in some cases could be subject to government intervention if they seen not to act in public interest so the level of compliance should be higher for these companies. This is particularly true for former state owned enterprises where there is higher level of interest from a broader range of stake holders (Al-Shammari, *et al.*, 2008). Large companies are also more likely to be international and where they are listed on multiple exchanges the compliance has been shown to be higher (Street and Bryant, 2000).

The need to consider smaller companies as a distinct group was based on the findings from the ICAEW study who found that: ‘the experience of smaller quoted companies was often very different from larger companies. ‘Resources available to manage the transition and to deal with ongoing changes were far more limited, preparation tended to be undertaken at a later stage, and it was much less likely that the company or their auditors had prior experience of IFRS' (ICAEW, 2007:45). The findings are also consistent with Jaafar and McLeay (2003) who also found that size and international orientation was a useful explanatory factor for compliance with IFRS (also see section 3.2.3).

Although other factors such as ownership concentration and auditors, among others, have been found to be related to accounting quality (Raonic and Isidro, 2012 forthcoming) Polish companies are typically less differentiated in terms of concentration having highly concentrated shareholdings so the size dimension was deemed to be a more appropriate discriminating factor for the study. The audit dimension was also studied in depth but using qualitative research so that the combined effect of size and auditor influence could be explored.

The sample was divided into the twenty largest listed companies based on total market capitalisation at the time of the data gathering and twenty smaller companies chosen from the remainder. The sample size of the largest companies was determined by the number of companies that compose the key index of Polish leading shares on the Warsaw Stock Exchange WIG 20. These are Polish premier firms that have the greatest analyst following and the highest trading volumes. Given the high level of public interest in these companies it has been assumed that they are more likely to produce high quality financial statements than the smaller companies. In order to maintain comparability an equal number of companies was chosen from the remaining listed shares. The sample for the smaller companies was selected by assigning a number to each company and selection made using excel to generate a sample randomly. Where the random company was not suitable for analysis because it did not produce consolidated accounts an alternative with the most similar capitalisation was chosen. The largest companies selected for investigation represented 40 per cent of market capitalisation whilst the twenty smaller companies represented only 3 per cent of market capitalisation. The latter were nevertheless important as all were expected to comply with IFRS independent of size. Other studies of disclosure in Polish companies used sample sizes as follows: Borowski and Kariozen (2007) selected 23 companies to study disclosure of financial instruments; Kaczmarczyk and Walinska (2007) used 20 largest listed companies from WIG20 to study fixed asset disclosures whilst the Oversight Commission (Komisja Nadzoru Finansowego) reviewed 66 listed companies as part of their oversight role.

As the table below indicates the sample has been drawn from a range of sectors ranging from industrial to service. The sample of companies shows that the largest are concentrated in strategically important sectors such as oil, gas, metal and media whilst the smaller are far more widely dispersed through the different industrial sectors. This stratification of the sample ensures that a comprehensive coverage of firms with different characteristics is considered.

Profile of the industrial sectors from which the sample of companies was drawn:

Table 5.1: Representation of sample companies in industrial sectors

Industrial Sector (using WSE classification)	**Largest 20 companies**	**Smaller 20 companies**
Oil and gas	4	
Metal industry	3	2
Telecom	2	
Retail	2	3
Chemical		2

Engineering		3
Light industry		2
Building	5	4
Media	2	
Informatics	1	1
Food manufacture		2
Other	1	1
	20	20

Some companies, in spite of being required to produce reconciliation, have failed to do so and were excluded from the sample composing the comparability index due to lack of data. These companies were however, analysed in the context of compliance with IFRS in the context of the audit report and presentation of financial statements in Chapter 5.3.2.

Areas of *de jure* differences between Polish GAAP and IFRS were evaluated for the sample selected but the research method did not aim to compare the detailed *de jure* requirements of IFRS versus Polish accounting regulation as this has been extensively investigated by professional firms such Deloitte Touche Tohmatsu (2010) so this information was already available. However, the information regarding *de jure* differences formed the basis of subsequent investigation, which employed interviews to establish the reasons for the persistence of differences and their impact on the comparability of financial information in Poland.

The information was gathered in an electronic form from the company's audited, annual published financial statements for the year ended 31st December 2005 posted on the company web sites. This was a single unique year where the differences between Polish regulation and IFRS were explained and measured. The use of original documents overcame the problems of inaccurate translation of detailed regulations that have been a limitation of some of previous studies. Original sources were used that referred to international regulations embodied in IFRS and EU legislation as well as Polish regulations contained in the Accounting Acts of 1994 and updated in 2002 (*Ustawa z dnia 29 września 1994 r. o rachunkowości*) and the Decree of the Council of Ministers 2001 (*Rosporządzenie Rady Ministrów z dnia 16 października 2001r*). Finally, the researcher drew on the information already available from Deloitte Touche Tohmatsu (2010) on the *de jure* differences between IFRS and Polish GAAP.

The next part of the research was designed to test the level of *de facto* compliance with specific IFRS.

4.4.2 *De facto* compliance of Polish companies with the requirements of IFRS 1 (*First Time Adoption of International Financial Reporting Standards*)

This part of the research considered the extent to which Polish listed companies that purport to comply with IFRS actually do so in practice as is required by IAS 1 '*Presentation of Financial Statements*'. IAS 1 (IASB, 2007c paragraph 14) requires that: 'An entity whose financial statements comply with IFRSs shall make an explicit and unreserved statement of such compliance in the notes. Financial statements shall not be described as complying with IFRSs unless they comply with all the requirements of IFRSs '. Given the wide spectrum of requirements of IFRS it was decided that it would be impractical to test compliance with all the provisions of IFRS and so the research was focussed on the *de facto* compliance with a single standard namely, IFRS 1 '*First Time Adoption of International Financial Reporting*

Standards' (IASB 2007h) using the same sample of companies as for the quantitative research outlined in table one in section 4.4 above. The source for this comparison was the 2006 version of IFRS 1 and which incorporates changes to pronouncements made until 2005. The advantage of testing compliance with this standard is that all companies are affected and must make the relevant disclosures in relation to IFRS 1 so the population of companies affected is very large. This is not the case with other standards which may not affect a company and so no disclosure is made. For example, IAS 38 '*Intangible Assets'* (IASB, 2007g) will only be relevant to companies that actually carry intangibles in the balance sheet and so the possible population of companies available for testing is smaller.

The second reason for selecting IFRS 1 follows from the findings by Krzywda and Schroeder (2007) who found that 34 per cent of the Polish companies reporting in 2004 did not provide a quantitative reconciliation between IFRS and Polish GAAP as required by Polish law. Such reconciliation is also required by IFRS 1 and therefore by selecting this particular standard it is possible to track the change in the level of compliance over time and the impact of the change in reporting framework on compliance.

The theoretical model applied in this case identifies the accounting profession as playing a significant role in the quality of financial statements and therefore the auditor details will be noted and the audit report reviewed for possible qualification. This information gathered from the sampled companies is used to explore the relationship between the auditors and *de facto* compliance with IFRS.

The research design was also informed by an international comparative study carried out by the Institute of Chartered Accountants in England and Wales (ICAEW, 2007) on behalf of the

EU. One of the aims of the ICAEW study was to assess the level of compliance with IFRS requirements by EU companies. The ICAEW study differed in its design from this work as the focus was on international comparisons rather than specific countries and so the sample consisted of companies from all twenty five EU member states. A limitation of this approach lies in the fact that very few companies were selected from any one country making it difficult to form any conclusion on the adoption of IFRS in a particular EU member state. Out of a total sample of two hundred companies only five were Polish. All five of the Polish companies selected by the ICAEW study were in the top 20 largest Polish companies by capitalisation and included a financial institution. The research design in this study contends that the level of compliance with IFRS will be lower amongst the smaller listed Polish companies where there is limited technical expertise and highest amongst the largest companies. This view is supported by the findings from the ICAEW report (2007:26) 'the experience of smaller quoted companies was often very different from larger companies because, for example, of limited resources and a lack of prior experience of IFRS'. Therefore the research design used in this study included a broad cross section of companies rather than focusing on the largest that either already have the experience of international reporting or they have the required resources to buy in the expertise from the top accountancy firms.

The ICAEW (2007) study also had a broader scope in its remit undertaking a technical analysis in the areas of presentation of financial statements, early adoption of IFRS and the use of optional accounting treatments. However, the research methodology placed greater reliance on the auditor's report and company's own statement of compliance than was the case for this thesis. This research primarily involved direct analyses of the entries in the financial statements on the grounds that audit reports may only be qualified for major transgression with many departures from IFRS being passed over especially where local accounting firms are employed.

In order to measure compliance with IFRS 1 a disclosure checklist was constructed detailing the disclosure requirements of the standard against which *de facto* compliance by the sample companies was measured. Disclosure checklists are commonly used tools in the audit function by the major accountancy firms as well as in academic research (Street and Bryant, 2000; Al-Shammari *et al.,* 2008). The advantage of using a checklist is that the actual disclosure can be measured against a benchmark in a systematic and standardised manner even when companies adopt very different modes of disclosure.

The broad disclosure requirements of IFRS 1 that companies are expected to comply with when adopting IFRS for the first time are as follows:

'An entity's first IFRS financial statements shall include at least one year of comparative information under IFRSs' (IASBh, 2007, Para 36)

'An entity shall explain how the transition from previous GAAP to IFRSs affected its reported financial position, financial performance and cashflows' (IASBh, Para 38). This requirement entails the provision of detailed reconciliation of opening and closing equity, profit and cashflow sufficient for the user to understand the impact of the adjustments. Only the basic requirements that all companies would be expected to comply with as shown above were checked. Other items such as separate disclosure of errors or impairment were excluded because, in cases where such items were not mentioned, it was impossible to say whether the company was not compliant or if that company was not affected by these items because it did not have them.

In addition to the disclosure requirements IFRS 1 also offers some exemptions from the application of other IFRSs. In the context of Polish accounting practices the most relevant exemption relates to the valuation of fixed assets, where using Polish GAAP, revaluations are regulated by the Ministry of Finance with the last revaluation having taken place in 1995. However, Para 16 of IFRS 1 states that 'an entity may elect to measure an item of property, plant and equipment, investment property or an intangible asset at the date of transition to IFRSs at its fair value and use that fair value as its deemed cost at that date'. Study by Krzywda and Schroeder (2007) shows that the majority of Polish companies recognise valuation of fixed assets as being one of the most important sources of difference between IFRS and Polish Accounting Regulation. The study therefore considered the level of disclosure related to the level of revaluations as required by IAS16 (*Property, Plant and Equipment*) for those companies that undertook revaluations.

Finally, IFRS reconciliations were only produced by companies that adopted IFRS for the first time in 2005. Some companies utilized the the option in Polish law that allowed them to apply IFRS in earlier years and so did not produce the reconciliation between IFRS and Polish accounting regulation. There were 5 early adopters of IFRS and although they were excluded from this part of the content analysis these companies provided useful data about the characteristics of companies that voluntarily adopted IFRS.

4.4.3 Secondary review of financial statements in respect of investor orientation of financial statements, share holding and audit report

For the sample of companies identified in table 5.1 in section 4.4.1further review of financial statements for the year ended 31st December 2005 was undertaken to consider the extent to which the financial statements were investor orientated and therefore whether they met the basic IFRS characteristic of being understandable for a wide range of stakeholders. The discriminating factor between user orientated accounts and others that were not deemed to be user orientated was whether charts of accounts were used or narrative form was employed for reporting. Where a set format, presented in excel files was used these accounts were deemed not to meet the needs of the users and were therefore not reflecting the spirit of IFRS. No other judgmental criteria were employed thereby ensuring that person bias was not introduced into the content analysis.

The thesis identified the audit firms and the wider accountancy profession as having influence on the quality of financial information disclosed. This research proposes that where the auditor is a global firm the compliance with IFRS will be greater. To investigate whether this is the case information regarding the auditors of the companies and whether the audit report was qualified was also gathered for the forty selected companies and triangulated with the interview data. A distinction was only made between the largest four audit firms, namely, PWC, KPMG, Ernst and Young and Deloitte Touche Tohmatsu, whilst the rest were deemed to be small audit firms. Medium sized firms such as BDO were classified as small as they are much less likely to have significant international influence due to their structure, which is one of affiliation with local firms.

Resource dependency was selected in this research as being a further explanatory variable for the compliance of IFRS. In this context the concentration of shareholding and who were the key providers of capital were used as a proxy for resource dependency. It was assumed that companies that had widely dispersed shares were more likely to communicate with shareholders in a variety of ways than when the concentration was lower. Therefore data was gathered relating to the concentration of shareholding and the level of communication with the shareholders. Communication with the shareholders was evaluated by checking the individual company web sites to see if investor presentations were published for the wider audience and if investor orientated financial statements were published.

4.4.4 Interviews to explain and triangulate the findings from previous stages of research

Semi-structured interviews were carried out with various players that shape Polish accounting in order to explore in depth the reasons for the findings from documentary research in the context of the Polish accounting framework as well as in the international setting. The interviews were structured in the sense that all interviewees were aware of the main areas for discussion but the interviews were sufficiently open ended to allow for open and unstructured discussion to take place. The interviews served as a powerful explanatory aid to the understanding of the observed differences between actual practice and IFRS requirements. Kvale (1983) 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). According to Foddy (1993:1) the use of survey and questionnaire techniques continues to be the preferred technique in social research because: 'Asking questions is widely accepted as a cost efficient (and sometimes the only) way, of gathering information about past behaviour and experiences, private actions and motives, and beliefs, values and attitudes (ie. subjective variables that cannot be measured directly)'. Interviews were particularly useful in this study because they allowed the interviewer to explore the reasons for the adoption of various accounting practices and to examine the broader issues concerning with the role of accounting in a 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 their reliability. 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 because: 'qualitative research 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).

The secondary research involving the review of financial statements was supported by primary field research using semi-structured interviews. The interviews aimed to gain a deeper understanding of the issues and address the following questions:

- Why do differences in accounting frameworks persist and how has the work of accountants changed from that done under communism?
- What are the reasons for companies not complying with IFRS requirements?
- How does lack of comparability affect financial analysis?
- How are accounting transgressions dealt with?
- What policy implications arise from the findings of this study?

Furthermore, the purpose of the interviews was to gain qualitative information, to confirm and clarify the findings from the review of financial statements. A major limitation of document based research employed in the prior stages of this research was that financial statements in their own right do not provide enough information about the motivations for the choice of accounting disclosure or the impact that financial statements have on the comparability of financial information for decision making. The interviews served to explain the differences identified through documentary research by providing detailed information about the accounting orientation existing in Poland. As all accounting statements are based to a greater or lesser degree on subjective estimates and a choice of permitted treatments the cultural background and economic context in Poland was highly relevant. This is particularly applicable to a transitional economy such as Poland 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.

Previous studies of Polish accounting practices and their compliance with EU regulations and IFRSs have almost exclusively used secondary sources to highlight the major differences in the accounting requirements (Kamela Sowinska, 1995; Jermankowicz and Rinke, 1996, Craner *et al.,* 2000 Krzywda and Schroeder, 2007 etc). This study adopted a similar approach as set out in the first part of this research methodology chapter (see section 4.4.1) where differences between Polish GAAP and IFRS were identified using the reconciliation statements. However, this thesis has made an additional contribution by extending previous works with detailed interviews.

To date interview techniques in the context of international comparative accounting have not been widely used. The most recent and relevant study employing interview technique was the ICAEW report (2007) where roundtable discussions with relevant IFRS interest groups took place. The discussions were held in five different European locations to ensure that the international dimension of the issues was fully captured. Each meeting involved between 10 and 20 participants representing auditors, preparers, regulators and senior users. However, the large groupings and international composition of the participants would preclude a deep and frank discussion of the issues that may affect only one country. The use of focus groups has also been criticised because the discussions could become dominated by individual members so the full breadth of opinions may not be disclosed (Foddy, 1993). Finally, the participants in the ICAEW study represented various interest groups with their own specific agendas with little commonality between them. It was felt that these issues are better explored individually in an interview setting rather than in a single group.

In order to enhance credibility of the research purposeful sampling method of respondents was adopted. The basis for the selection was derived from the theoretical framework of new institutionalism. That is an institutional field of financial reporting in Poland was identified and the interviewees were representatives of this field defined as being ‘a set of interdependent populations of organisations participating in the same cultural and social sub-system’ (Scott, 2008:434). The benefit of utilising this unit of analysis was that it allowed a more holistic approach to be adopted focusing on the importance of institutions and providing a wider perspective not confined to the companies alone. Furthermore, subjectivity was reduced and the researcher was able to ensure that actors representing all elements of the field were included in the interviews by specifying the field before the respondents were identified.

The sample size was identified for variety of respondents rather than number of respondents to ensure that most of the field was covered. All respondents were experts in their field being sufficiently well qualified and familiar with IFRS and Polish GAAP to be able to provide meaningful responses to the questions posed. In addition all respondents held relevant positions and were suitably experienced to comment authoritatively on the regulatory issues in Poland. Nevertheless, it must be recognised that the interviewees may have been unwilling or unable to comment on some matters especially if related to the confidentiality involving client relationships.

The interviews in this study took the form of semi-structured interviews with various expert stakeholder groups including representatives from the audit profession, regulatory community and users of financial statements (see appendix 1 for a list of interviewees) and lasted approximately 1-2 hours. In total 11 interviews were carried out with 9 of the interviews being held in Poland and 2 were held in London. The interview coverage was comprehensive in that they included respondents from all groups, except for one, identified as being part of the financial reporting institutional setting. It was however, impossible to gain an interview with the state enforcement agency (*Komisja Nadzoru Finansowego*) in spite of numerous requests. None of the respondents were known to the interviewer prior to the interviews taking place and in 9 of the cases access was gained following an initial e-mail contact with the relevant organisation. The researcher initially found it impossible to gain access to the investment analyst group and the interviews were eventually facilitated through personal contacts.

All interviews except one were held at respondents' place of work in July 2009 and then in February 2010. A single interview with a former Ministry of Finance official was held in London in 2008. The timing of the interviews was three to four years after the adoption of IFRS (first IFRS compliant accounts were for the year 31st December 2005) so the respondents based their evaluation on three years of published accounts. This time lag had significant advantage for the researcher because it meant that at the time of the interviews the respondents had sufficient experience of the application of IFRS to be able to comment and reflect on the *progress* of conversion to international standards with a certain benefit of hindsight. The time gap between the two sets of interviews allowed the researcher to draw on the findings from the first set of interviews when planning for the second round of interviews so that data could be corroborated from different sources thus enhancing the credibility of evidence.

In order to further improve the validity of research findings from content analysis of financial statements informed the discussion with the respondents. The financial statements for the year 2005 offered unique data regarding differences between Polish GAAP and the IFRS as well as one off opportunity for companies to revalue fixed assets not available in subsequent years and so this data was used throughout the research process. This did not reduce the value of the research as all respondents interviewed in the period 2008 to 2010 concurred with the findings from the financial statements and believed that little change in terms of Polish attitudes to financial reporting has taken place in the subsequent years.

It is important to note that two of the interviewees were of British origin and so their cultural and professional background was significantly different to the Polish born interviewees. However, this variation enhanced the value of the interviews as their perspective better reflect the international dimension of financial reporting being outsiders to the Polish institutional setting. As both of the British respondents were partners of audit firms they were also able to comment from an insider's perspective on the actions of Big 4 firms in relation to their strategy for East European countries.

Three of the interviewees were also employed in their positions during the communist era namely, one accountant working in a previously state owned enterprise, one Ministry of Finance official and the Member of the Accounting Standards Committee. The in-company accountant was also a state registered auditor who undertook audit function of other state enterprises. These interviewees could draw on their experiences and so were also asked about the changes that have taken place in their work during the communist era thus providing insight into a much more transformational period than the period around the adoption of IFRS.

The interviews were based around a set of prepared questions so that an initial common structure was given to every interview although the respondents were able to deviate from the initial questions so that a deeper and more meaningful discussion could take place. The structure of the interviews was informed by the concepts from new institutional theory as well as by the findings from documentary evidence related to published financial statements. Conversely, the semi-structured nature of the interviews allowed the interviewer to respond and follow up from the initial answers given by the respondent without having to refer to the prepared script. The value of the interviews was significantly enhanced by the fact that the researcher has carried out content analysis of the financial statements prior to the interviews taking place. The interviewer used the primary, factual findings from the content analysis of financial statements as a platform for exploring the deeper reasons and motivations for why companies were adopting certain policies or presentations identified in the documentary evidence. The findings from the financial statements therefore acted as a vehicle for mobilizing institutional theory and constructs such as coercion, professionalism and power to provide a deeper understanding of the factors driving financial reporting in Poland. The interview process also served to confirm or otherwise that the findings in the sample of financial statements were representative of Polish financial accounting practice and therefore enhanced the reliability of the data derived from the financial statements.

All interviews were recorded, transcribed and translated into English. The transcripts were then categorised according to the themes of the role of the incentives of the state, the accountancy profession and resources established in the theoretical framework. Care was taken to ensure that all information was considered by crossing out the parts of transcript once it has been incorporated into the analysis. This procedure meant that the risk of selective use of data was avoided and that none of the themes were suppressed. Quotations were brought into the text of the analysis when the author felt that they added credibility to the analysis and enhanced the understanding of the emergent themes.

Particular care was taken in the drafting of the questions as the researcher recognised that: 'question and answer behaviour involves complex interrelationships between sociological, psychological and linguistic variables.' (Foddy, 1993: preface). The symbolic interaction theory as developed by Blumer (1966) (cited in Foddy, 1993) postulates that human beings do not respond to questions in a simplistic and direct manner but attempt to interpret the interviewer's intentions and plan their answers based on their perceived understanding of the question and the motives for the enquiry. Where the questions are unclear then the respondents engage in a greater amount of interpretation picking up on clues from the interviewer. This behaviour may lead to misunderstandings between the actors which will have the effect of reducing the validity of the interview.

Foddy (1993) argues that the researcher not only has to be clear about the information he is gathering but also be aware that the respondent processes this information in his own unique way which the researcher needs to interpret from the answers provided.

The above processes were taken account of as the basis for good interview design that aimed to minimise the problems associated with interpretation and lack of clarity. The risk of ambiguity in questions was reduced in this study by virtue of the fact that the findings from the content analysis of financial statements were available and formed a factual basis for discussion with the various actors interviewed.

4.5 Limitations of the study

The study is limited by both conceptual and methodological issues. The first limitation of the study concerns 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 but Ryan, Scapens and Theobold (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). In this thesis a theoretical model was developed and tested utilising a combination of qualitative and quantitative techniques. However, the sample size of forty companies used in the secondary research was too small to be able to generalise about all companies listed on the Warsaw Stock Exchange. Nevertheless, the primary objective of the thesis was to try to provide the reasons for the non-compliance using a mixed methodology and so the use of a smaller sample for a part of the research was deemed to be sufficient.

The theoretical model developed in this thesis identified the state, the accountancy profession and resource dependency as three explanatory variables for the observed lower level of compliance with IFRS. These are however, not exhaustive variables and so the model can never be a comprehensive evaluation of accounting practice in Poland. The literature review in section 3.2.3 revealed that the level of *de facto* harmonization is affected not only by country specific characteristics but also by firm characteristics such as concentration of ownership, international nature of the firms, external financing needs and others. The thesis did not attempt to evaluate these other characteristics except for size of companies and it is possible that the observed poor level of compliance with IFRS is partly due to firm specific matters. However, the thesis is grounded in new institutional theory which postulates that external institutional factors are primary drivers of behaviour. In particular it is argued that the economic and political country factors are so dominant in Poland due to the very significant influence of the state on every aspect of the society that they overshadow the impact of firm specific factors.

Furthermore the model did not treat culture as a separate factor. Scott (2001) suggests that each institutional pillar should be studied independently and this approach was followed in the thesis. Availability of factual accounting data better lend itself to the study of the regulatory and normative factors so these were the key variables incorporated in the model. The interviews with the actors were clearly embedded in the cultural setting of the respondents but due to the difficulties of operationalising the cultural construct (McSweeney, 2002) it was decided that the study should focus on the exploration of the role of the state and the professional bodies in shaping of Polish accounting practice. Nevertheless, the study of behavioural aspects of Polish accountants undertaken in this study provides a useful insight into the cultural norms and beliefs that then shape institutional behaviour.

A further limitation arises from the inability to measure the relative contribution of each variable. This means that it is not possible to state which factor is the most influential and whether the relative influence of each factor is increasing or decreasing. For example, we do not know what influence of the growing strength of the professional bodies has on the tax orientation of the accounting systems. Over time the different isomorphic forces are likely to change as Polish society continues to be influenced by global pressures. As was noted by Zucker (1991) it is also impossible to clearly distinguish between resource dependency and regulatory pressure. For example sanctions arising from non-compliance with regulatory requirements of the state have resource implications if the company has to pay fines or is exposed to additional compliance that would involve higher costs.

The thesis employs both qualitative and quantitative methodology, and as was noted earlier, the results for each method are not directly comparable with other data. However, it is postulated that each method serves to support other findings and enhances the quality of evidence but does not act to validate the findings. In the study content analysis was used to identify factual level of compliance with IFRS and this information was used to investigate the reasons for non-compliance thus enhancing the research. Another criticism of triangulation and qualitative research more widely arises from the fact that interview data may conflict between respondents. In this research such conflicts did not arise even when there was criticism of one institution by another. For example auditor view that there was no consultation between the Ministry of Finance and the external institutions was confirmed by the Ministry employees. The use of interviews has a number of limitations and some have already been discussed earlier in the chapter in the context of broader aspects of qualitative research. Specifically relating to the interviews the following limitations apply: The selection of respondents was done judgmentally from the known pool of suitably qualified individuals through personal contacts of the researcher. The sample was not selected objectively from a total population of all possible actors thereby introducing personal bias to the research and limiting the scope of the interviews. The justification for this approach was that this method was the only realistic way of gaining access to suitable interview respondents. Furthermore, despite repeated requests, it was not possible to gain an interview with a representative of the Komisja Nadzoru Finansowego (*Financial Oversight Commission*) which would clearly have provided useful information in respect of the role of financial regulator. However, discussions with all other actors would suggest that his body plays a very limited role in accounting oversight and concerns itself predominantly with Stock Exchange listings and oversight of financial institutions which were excluded from this research.

Prior research also shows that the very act of conducting an interview influences the behaviour of the respondent and the answers that are given. The researcher also brings personal bias not only in the questions set but also in the interpretation and analysis of the responses gained from the interview. This view is derived from the theory of ‘symbolic interactionism’ first coined by Herbert Blumer (Foddy, 1993). In essence the relevance of this theory to the limitations of interviews is concerned with interviews being perceived as a complex form of social interaction so it is impossible to always correctly encode and decode the messages that are exchanged between interviewer and interviewee. For example, the respondents may be unwilling to share information or disclose particular attitudes especially if the interviewer is perceived to come from outside of Poland. For example, any admission that Polish accounting may not be fully compliant with IFRS could be perceived as questioning the competency of Polish accountants which would affect the national pride and so the respondents may not be completely truthful or unwilling to admit to certain behaviour. This may be particularly applicable to questions that require the respondents to give their opinions or interpretations rather than facts. The possible problems related to relative perceptions and interpretations by the participants have been countered in the design of the research by the interviewer being aware of the context of social interaction and the possible limitations arising from this phenomenon and through careful construction of the interview questions as set out in the previous section 4.4 of the methodology chapter.

The limitations outlined above have led to some researchers to question the value of qualitative research as concluded by Foddy (1993:11): 'There is much evidence to support the conclusion that the verbal data we collect are very often of dubious validity and reliability. It is also clear that we have lacked a proper understanding of the causes of these shortcomings.' Arising from the criticisms by Foddy (1993) interview methodology has a further limitation in that it is impossible to directly compare with the outcomes of other interviews or to replicate the interviews exactly in another setting. To improve the validity of the research interview data secondary research of financial statements was also undertaken and the findings were used to explore in more depth the underlying causes of the differences.

A further drawback to the study was that the financial statements under consideration refer to 2005 and therefore would be out of date if there were to be significant changes in the regulatory framework in the period post 2005. However, IASB has announced that in the light of the complexity of implementation of existing IFRSs there would be a moratorium on the issue and amendment of new standards 2009. Furthermore, the work is relevant because differences between IFRS and national accounting frameworks persist well into the future as was proved by Nobes and Kvaal (2010) who investigated compliance with IFRS for 2008/2009. Nevertheless, it is likely that Polish GAAP will change in the future in the light of the implementation of IFRS so it is anticipated that in the future the study will be extended to take account of any new developments in the Polish accounting system and in IFRS. The study is also primarily concerned with exploring institutional factors affecting financial reporting rather than the standards *per se* and so small technical changes to the IFRS do not detract from the main hypothesis and prepositions of the thesis.

The research methodology offers a unique opportunity to study transition from one accounting system to another but this restricts the study to a single year and specific companies affected by the change namely, listed consolidated financial statements for the year ended 31st December 2005.

In terms of *de facto* compliance a number of methodological issues arose. Firstly, for some items where financial statement disclosure required by IFRS 1 was not made it was not possible to ascertain whether the company was non-compliant or simply the item was not relevant for the company. This was the case of IFRS 1 requirement for companies to 'explain how the transition from previous GAAP to IFRSs affected its reported financial position, financial performance and cashflows' (IASB 2007: para 38). Many Polish companies did not provide a statement showing the reconciliation of cashflow but it was impossible to ascertain whether there was no impact or if the company was non-compliant. In the circumstances a judgment was made by the researcher as to whether, based on the nature of the adjustments made to equity and profit, there should be a disclosure of cashflow or there was no impact. The same issue affected the disclosure of fundamental errors that should be shown separately but again it is impossible to ascertain whether there are no errors or are they not identified correctly.

The same limitation has been identified by other studies. For example, Pierce and Weetman (2002) show, using data in respect of deferred tax for Ireland and Denmark, that the indices are distorted by the level of disclosure. Lack of disclosure is problematic because it is not clear whether companies have failed to disclose a particular item or whether they do not have this item and therefore disclosure is not applicable. Pierce and Weetman (2002) argue that greater level of harmonisation will be recorded over time due to better disclosure and not necessarily by the fact that more companies use a particular accounting method. This conclusion is broadly in line with the findings by Krzywda and Schroeder (2007:26) who emphasized that their study was limited by: ‘the high non-disclosure of quantitative data and the considerable diversity in disclosure practices.’

Aisbitt (2001) studied harmony between and within Nordic countries and found results to be inconclusive. The author sighted methodological problems in the interpretation of the indices. Pierce and Weetman (2002) conclude that to remedy these problems data needs to be carefully classified between applicable and non-applicable cases.

4.6 Conclusion

The aim of this chapter was to develop a suitable research methodology which would adequately address the hypothesis and propositions set out in chapter 3.5. Using typology developed by Llewelyn (2003) meaning and significance are created by comparing accounting practice against the requirements of the IFRS framework which in Llewelyn’s model represent theorising through differentiation. The research was framed within an individual country namely Poland which provides a suitable setting for studying accounting in an economy that is undergoing fundamental transition from command to market economy. The exact research methods were mapped against the main research hypothesis in section 4.4 of this chapter.

The research design considered alternative approaches to accounting research that have been used previously in this type of research, setting out their advantages and shortcomings of qualitative and positivist approaches. Having evaluated both types of methodologies in the context of the research question the researcher decided to adopt a mixed method approach, combining quantitative analysis with interview data in order to provide a deeper and more meaningful explanation for the accounting practices in Poland. A purely positivist research methodology was rejected on the grounds that the complexity of the political and institutional changes affecting accounting in a transition economy such as Poland could not be captured in this type of research. However, quantitative tests using the financial statements of 40 Polish listed companies have been employed in this research to provide evidence of issues but not the explanation for the findings. A deeper understanding of the issues that give rise to non-compliance with IFRS was gauged by utilizing semi-structured interviews with various actors, namely auditors, regulators, users of financial statements and company accountants. The quantitative findings derived from the financial statements of sample companies were used as the basis for the interviews thus helping to direct the questioning and enhancing the value of the information gathered through qualitative means.

The next chapter provides the analysis of both qualitative and quantitative findings in the context of the theoretical model set out in previous chapter.

5. ANALYSIS OF RESEARCH FINDINGS

5.1 Introduction

The aim of this chapter is to evaluate the hypothesis and propositions developed in the theoretical model by analysing the data gathered from primary and secondary sources using financial statements of a sample of Polish listed companies and various actors as described in the previous methods chapter. The introduction to this chapter sets out the specific methods that were used to test the hypothesis and each of the propositions developed in the theoretical model. The theoretical model was derived from the new institutional theory as first put forward by DiMaggio and Powell (1983) and then developed to incorporate dynamic dimension by Oliver (1991). The analysis then proceeds to discuss the findings relevant to each proposition.

Hypothesis: In a transition economy companies do not comply fully with IFRS due to their different institutional orientation.

This hypothesis is first tested by considering *de facto* compliance of Polish companies that purport to comply with IFRS using the following criteria:

- Existence of investor orientated financial statements (section 5.2.1)
- Voluntary adoption of IFRS (section 5.2.2)
- Qualification of the auditor’s report (section 5.2.3)
- Compliance with IFRS 1 (*First-time Adoption of IFRS*) (section 5.2.4)
- Comparison of financial results prepared using Polish Accounting Regulation with IFRS as measured by the Comparability Index (section 5.2.5)

The findings allow the level of compliance to be evaluated in strategic terms ranging from full compliance to compromise and defiance where companies fail to meet the requirements of IFRS.

The theoretical model proceeds to identify three explanatory variables that lead to the differences in *de facto* compliance with IFRS namely:

- Strength of the profession (section 5.3)
- The power and influence of the state institutions (section 5.4)
- The level of resource dependency (section 5.5)

Each of these explanatory variables is formulated into a proposition which is subsequently evaluated using a combination of primary and secondary data.

Proposition 1: A weak accountancy profession in Poland leads to compromising by companies with regard to IFRS. Companies continue to adhere to previously established accounting practices and do not adopt IFRS fully. Where the auditor is a global firm of accountants the compliance with IFRS is greater.

The influence of the accounting profession is evaluated from three perspectives namely:

- The role of the accountancy professional bodies (section 5.3.1)
- The audit role and the impact of the Big 4 firms of auditors (section 5.3.2)
- The role of accounting education (section 5.3.3)

The broad changes in the perception of the accounting profession are explored using interviews and thereafter the impact of the auditors is investigated using sample financial statements.

Proposition 2: Where there are competing demands arising from state agencies and from accounting regulation the companies will fully adhere to the state demands, primarily the tax authorities, at the expense of IFRS compliance. Polish accounting regulation is significantly different from IFRS and this hinders companies from full compliance with IFRS and reduces comparability between accounts of single listed companies and group companies.

The influence of the state is considered to be pervasive and deemed to arise from four main sources which are evaluated in section 5.4 of this chapter. These are:

1. Accounting regulation (section 5.4.1)
2. State oversight of accounting practice (section 5.4.2)
3. Fiscal function (5.4.3)
4. Control resulting from the state share ownership in companies (5.4.4)

Proposition 3: Compliance with IFRS will be greater where there is the greatest economic necessity to raise funds.

The analysis maintains that fiscal and state control of enterprises is inextricably linked with resource dependency. The impact of state and foreign control of enterprises is investigated in section 5.5 by considering the ownership structure of sample companies.

The research findings set out in this chapter have been informed by using mixed methodology encompassing both positivist and interpretive research which allows the author to overcome some of the problems associated with the extreme nature of positive and interpretive research. The thesis avoids the conceptual conflict between the two paradigms by assuming that data contained in financial statements is actually viewed as being objective by the actors in the field even though interpretive stance would deem all data to be subjective. Drawing on Norreklit *et al*, (2006) the adopted approach enhances the validity of the findings because reality cannot be characterised by either of the two main research perspectives but consists of 'the integration of four dimensions – fact, logic, value and communication –each of which is a necessary source of reality'. (Norreklit *et al*, 2006:43).

The hypothesis that Polish companies fail to comply fully with IFRS adopts positivist approach and in so doing implicitly accepts that disclosed financial reporting information is epistemologically objective (Mouck, 2004). This part of the research focuses on the outcomes of accounting process in terms various measures produced using either Polish GAAP or IFRS based on secondary data was drawn from the financial statements of forty companies listed on the Warsaw Stock Exchange. The sample was further subdivided into the twenty largest companies and twenty smaller companies drawn from companies that produce IFRS compliant accounts. The data was accessed from the Warsaw Stock Exchange and individual company websites.

Although this positivist approach to the analysis of financial data is essential for establishing the level of compliance with IFRS it is not sufficient for explaining the motivations and the reasons why companies would choose between being fully compliant and being only partially compliant. The thesis mobilises New Institutional Theory to address these issues and in so doing accepts that institutions are socially constructed and therefore accounting is only a part of a wider belief system. In this context interpretive research was adopted as the principal paradigm for the three propositions related to the accountancy profession, the state and resource dependency as being the key explanatory factors for non-compliance with IFRS. The research examined the influence of each factor over an extended period of time from the period of adoption of IFRS in 2005 to the time of the interviews so that respondents could comment on the process of conversion to IFRS. Primary data was based on interviews held in July 2009 and February 2010 with the actors that DiMaggio and Powell (1983) see as being central to the isomorphic transformation, that is: representatives of the state, the accounting profession and the accountants working within companies (see appendix 1 for the list of interviewees).

5.2 Evidence of *de facto* compliance of Polish listed companies with IFRS

The hypothesis examines the responses of the companies in Poland to the institutional requirements of IFRS financial reporting instigated by the EU and implemented into Polish law. The thesis maintains that in spite of the fact that adoption of IFRS became a legal requirement for listed companies in 2005 companies have adopted a wide range of responses in respect of the level of compliance ranging from full and early adoption of the provisions of IFRS to a much lower level of compliance that does meet the intended objectives of the new regulatory framework. In some cases companies are undertaking symbolic action by explicitly stating their compliance with IFRS in order to gain legitimacy whilst in reality they continue to prepare the financial statements is not dissimilar way as they have done prior to the implementation of IFRS (Kosmala, 2007). These changes are therefore 'largely ceremonial' but, according to DiMaggio and Powell (1983) they are not inconsequential. This proposition was addressed through interviews and the review of financial statements to ascertain what level of *de facto* compliance was achieved in the first year of mandatory introduction of IFRS in Poland. Support for the first proposition, is provided by the evaluation of the state of Polish accounting by a Polish senior audit manager of a major audit firm:

> *'Apart from one or two notes the presentation of financial statements for the smaller listed companies is not very different to what was published prior to 2005 when there was a prescribed format for companies. Also additional notes are not always presented. So in terms of, say, valuation companies will undertake the valuation but will not give the correct level of disclosure. They simply do not attach any weight to disclosure. For them it is important that the amounts are correct not to give too much detail. This gives an impression that the accounts are not fully IFRS compliant so we immediately ask ourselves whether the amounts are correct.'*
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> *(Senior audit manager of Big-4 global audit firms in Warsaw interviewed 15th February 2010).*

The interpretation of this view is twofold. Firstly, isomorphism and inertia act to retain the existing routines and practices by constraining the actors so that when new demands are made they are not complied with. This finding is consistent with the main tenet of institutional theory that once behaviour becomes accepted and objectified changes are either rejected or minimally complied with. Secondly, interpretive stance suggests that reality is socially created and so laws and regulations are not merely adopted wholesale but are actively translated to produce new meanings and versions appropriate for the Polish context. Here the accountants are finding their own local solutions to the changing law and regulations by interpreting and also ranking what they consider to be important. This local adaptation supports research by Kosmala (2007) who interviewed Polish auditors in her study of auditor independence who describes the interpretation as being '*na chłopski rozum'* (with a peasant's mind). That is when faced with new or unknown situation a meaning is created by Polish accountants that allow them to operationalise the new standards. The disclosure of information over and above that which is essential is viewed as being superfluous and therefore Polish accountants have assigned their own meaning to the standards that is different from the Anglo-Saxon view embodied in IFRS. The reason for the reluctance to disclose full information to readers of financial statements is also associated with cultural characteristics such as preference for secrecy emerging from traditions from the communist era where the state was omnipresent and information was either never given to the public or data was falsified for propaganda purposes. As was explained in chapter 2.3, the role of accounting function was also very different. Under communism companies reported their results to central authorities for planning purposes in a manner that was more akin to management accounting without having a wider reporting role to stakeholders.

The view that broader disclosure of information was downgraded in the financial statements by Polish accountants was supported by analysis of the disclosures related to the revaluations of fixed assets, a major item of reconciliation between IFRS and Polish accounting regulation. The analysis revealed that only one of the companies out of the total sample of forty reviewed gave full details of the revaluation as would be required in circumstances other than at transition to IFRS. IAS 16 *Property Plant and Equipment* (IASBd, 2007) requires full details of the valuer, his qualification and the basis of valuation to be disclosed. Those data give better information to the reader about the validity of the valuations but does not affect the recorded values. The review found that, Polish companies gave minimal amount of information, at most stating that the assets were revalued to fair value by a qualified valuer. In the light of the widespread use of this option to revalue and its large impact on the accounts the level of disclosure is deemed to be inadequate and confirms the view expressed above.

The initial findings arising from the interview with an auditor together with a review of disclosure of fixed asset revaluations in the financial statements would point to a lack of *de facto* compliance with IFRS. The evaluation of the first proposition by the audit manager above was triangulated with the findings from the review of financial statements in the next section.

5.2.1 Evaluation of the presentation of financial statements for the extent of user orientation of financial statements

A review of the presentation of financial statements provided further corroboration of the view expressed by the auditor above that some Polish companies pay little attention to the communication with their shareholders. Using institutional lens it is clear that a process of change is taking place. Whilst majority of small companies continue to adhere to the existing routines preparing accounts in the format that was expected prior to the introduction of IFRS some companies are transforming their financial reporting frameworks. Evidence of institutional embeddedness can be measured by the number of companies that do not present investor orientated accounts.

IFRS framework requires that financial statements are understandable to a wide range of users. The review of the Polish financial statements for the 40 companies revealed a wide variation in the presentation of accounts. In particular it is possible to discern that some companies produce financial statements that can be used by a wider audience and are clearly designed as a marketing tool. These accounts are extremely varied and are characterized by glossy designs utilizing corporate logos that enforce company identity. Complex financial data is presented in a simplified way making extensive use of summaries and pictorial representation. Typically, the data is provided for the wider stakeholder groups and so considerable space is devoted to the description of the wider business and its context as well as communication about the broader strategy of the group.

It is noticeable that all large state owned enterprises produced investor orientated accounts. These companies are strategically important for Poland and must accommodate the demands for information from a far wider group of stakeholders than non-state owned companies. According to Scott (2004) all organisations are subject to technical and institutional pressures although the strength of each source of pressure differs across sectors. For the state owned companies, ceremonial and symbolic reason for disclosure is the dominant pressure originating not only from the professions and the law but also from the public, environmental groups and others. In contrast, resource dependency together with institutional pressure from the law and professions shape the behaviour of non-state owned enterprises leading to different responses, in terms of disclosure, being made by different companies.

Polish accounts that are not investor orientated are presented in a way that would be extremely difficult for a non-specialist to understand. They are characterised by a lack of narrative explanation and different parts of the financial statements are placed in different files making it difficult to access the data or to interpret data contained in different files. The vestiges of the former chart of accounts are also evident as the accounts are prepared in a set format and all numeric data is shown by means of excel tables. The prescribed proformas or charts of account for presenting financial results were compulsory during the Communist era but it is clear that Polish accountants still prefer to follow this format. All the notes to the accounts are standard and in excel format and no additional information is provided. The accounts clearly do not play any function in the broader investor dialogue but are designed to meet the legal requirements as prescribed by the Warsaw Stock Exchange and Polish accountancy regulation.

Table 1: Number of Polish Companies Producing Investor Orientated Financial Statements

	Investor orientated financial statements		Regulation orientated financial statements		Total
	(number of companies)	Per cent of total number	(number of companies)	Per cent of total number	(number of companies)
Large companies	12	60%	8	40%	20
Small companies	6	30%	14	70%	20
Total	18	45%	22	55%	40

(Sample financial statements at 31st December 2005 of 40 Polish companies listed on the Warsaw Stock Exchange)

Within the sample selected it is apparent that regulation orientated financial statements predominate with 55 per cent of companies following a set presentation according to a previous chart of accounts. This would suggest that state regulation plays a significant influence in spite of the fact that there is no longer a requirement for a standard chart of accounts and these financial statements now purport to comply with IFRS. The institutional pressure therefore acts in conflicting directions. On the one hand the IFRS framework requires more useful reporting from the companies and yet the returns to the regulatory bodies such as to the Warsaw Stock Exchange are highly prescriptive requiring strict conformity with the listing requirements using proforma returns. This form of reporting has therefore been accepted by the companies as the norm to be adopted and not questioned. The state therefore validates the existing environment. Not surprisingly these divergent institutional expectations lead to a range of responses and may hinder the provision of more user orientated statements for some companies. In significant number of cases the form and style of those accounts do not meet with the basic objective of IFRS which is to produce relevant and understandable reports although IFRS does not prohibit the use of formal presentation as employed by many of the Polish companies.

The expectation would be that the move to a market based economy would result in general improvement in the overall standard of accounting and yet the findings above clearly point to a lack of change in financial reporting in Poland and general intransigence arising from the institutional setting. According to DiMaggio and Powell (1983) stability and survival of firms is more likely if companies adhere to the existing institutional environment. However, in post communist countries the institutions themselves are changing leading to mixed responses from the companies. It is apparent that de-institutionalisation of old habits and practices is taking place and is being replaced for some companies whilst for other companies the old practices remain. The question arises as to what distinguishes the two sets of companies. Here a distinction has to be drawn between the large listed companies and the smaller listed companies. The fact that forty per cent of the largest Polish companies fail to provide investor orientated accounts is a clear indication of preference by those companies for reporting data that is necessary to meet legal requirements without providing information that would fully satisfy the wider groups of stakeholders.

The large companies have a greater adaptive capability and are able to change as per DiMaggio and Powell's (1983) notion of coercive isomorphism. This distinction is explained by an employee from the largest auditing firm in Poland whose experience is with the top Polish companies:

> *'The large companies have the resources to pay for specialist advice so that they are constantly aware of what is happening. Here I would evaluate the quality of IFRS accounts to be high for Polish market. The largest companies are comparable to say UK or German accounts. Regrettably, the smaller the company the worse is the situation. This arises from lack of experience. Polish companies continue to have a low level of disclosure.'*
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> *(Senior audit manager of Big -4 global audit firms in Warsaw interviewed 15th February 2010)*

It would appear that a distinction must be drawn between large and small firms when evaluating the *de facto* compliance with IFRS. The analysis so far arising from findings in sections 5.2 and 5.2.1 would point to proposition one being confirmed for small companies. That is, small listed companies do not conform fully with IFRS. In contrast, the findings do not provide clear support for the hypothesis that large Polish companies are not compliant with IFRS. Review of the financial statements shows that a significant minority of large companies did not produce investor orientated statements and yet their accounts were judged to be of high quality by the auditor. This discrepancy could be explained by the fact that the interviewed auditor would only be concerned with the conformity with IFRS and the Polish Accounting Acts and so would not comment on the wider style and presentation of the financial statements that lie beyond the statutory audit role.

To summarise, these findings clearly show that the adoption of investor orientated financial statements has not been an easy process especially for the smaller listed companies. The results provide an insight into institutional transformation at its earliest stages. Some companies have adopted the new way of presenting financial information and these companies could be expected to lead the process of embedding new routines which in time will become institutionalised. For institutionalisation to be completed other companies will need to either mimic the progressive companies or be coerced to change through regulatory enforcement or other agents such as the stakeholders or the auditors. Overall, investor orientated accounts are not produced by a large minority of companies representing 45 per cent of the sample in spite of the fact that all companies surveyed are listed and so it would be expected that all sample companies would have a broad engagement with their investors.

The next sections utilise published financial statements to evaluate the quality of IFRS reporting and test the view expressed that large companies have a better level of compliance with IFRS whilst the smaller companies suffer from poor level of disclosure. The three factors which provide evidence as to the IFRS quality of financial reporting are firstly whether the company adopted IFRS prior to the mandatory date (section 5.2.2 below), secondly, whether the audit report has been qualified (section 5.2.3) and finally whether the companies complied with the provisions of IFRS 1 (section 5.2.4). The findings from this part of the research form the basis for the interviews that aim to identify the explanatory factors governing financial reporting in Poland.

5.2.2 Evidence of voluntary adoption of IFRS

The willingness of companies to adopt IFRS voluntarily before the mandatory transition date is an indication of high quality of financial statements. This was confirmed by Gray *et al.* (2009) and Schipper (2005) who showed that the level of compliance with IFRS is highest for companies that adopt IFRS voluntarily. Prior research also suggests that the cost of borrowing is lower and the terms of lending typically more favourable for the companies that voluntarily decide to switch to IFRS (Kim *et al.*, 2010) again confirming the value placed by the market on voluntary adopters. Therefore, full and genuine compliance is expected for the early adopting companies and they are less likely to compromise in their application of IFRS.

From the sample of Polish companies selected only five out of forty or 12.5 per cent have adopted IFRS on voluntary basis prior to the mandatory date of transition of 31st December 2005. Early adoption requires a high level of accounting and systems expertise and companies are likely to have some external motivation and stimulus to do so. As would be expected, and consistent with the views of the auditors, the voluntary adopters were all drawn from the large company sample and account for ten percent of market capitalisation. From the discussions it became apparent that most companies in Poland were reluctant to embrace change through the voluntary adoption of IFRS and coercion was the key mechanism for implementing IFRS accounting.

> *'There is very, very little voluntary adoption of IFRS. I mean, we do a lot of due diligence work on companies that have been taken over by our Western clients who require compliance with IFRS and it is actually very rare, even in this day, for companies to have even thought of the consequences of either seeking a Western investor as a strategic partner or alternatively of floating on the stock exchange. I mean it really is off the horizon screen. It is not something that that the accounting profession has done to publicise in any way'*
>
> *(Audit partner of a medium sized international accounting firm interviewed 16th July 2009)*

This view is confirmed by reviewing the financial statements of listed companies where none of the smaller listed companies of the sample examined had voluntarily chosen to adopt IFRS prior to 2005 and it was the largest five companies that voluntarily adopted IFRS. Early compliance is associated with coercive requirement placed on Polish firms when a foreign investor acquires the firm.

Table 2: Ownership of Companies Adopting IFRS Voluntarily

Companies adopting IFRS prior to 2005 and their auditors	Industry sector	Controlling stake holding
Telekomunikacja Polska SA (Deloittes)	telecom	41% France Telecom with significant France Telecom representation on the Board of Directors of TP SA
Netia SA (Ernst and Young)	telecom	Dispersed shareholding including a 24% US investment fund participation
TVN SA (PWC)	media	3 Polish individuals control 58% of the shares in ITI group being the holding company of TVN SA registered in Luxembourg via shares in Dutch registered companies, N Vision BV and Strat Europe BV
Agora SA (KPMG)	Media	35% Agora Holding, 28% WBK Asset Management owned by Allied Irish bank
GTC SA (Ernst and Young)	Property development	46% owned by a Dutch group

(5 firms voluntarily adopting IFRS from a sample of financial statements at 31st December 2005 of 40 Polish companies listed on the Warsaw Stock Exchange)

The early adoption of IFRS appears to be related to foreign investor as three of the five companies have strategic foreign partners. It is not clear whether the forces that led to the early adoption were predominantly coercive or mimetic although IFRS reporting is most appropriate for group companies operating internationally as reconciliations between different national frameworks can be minimised and comparability is achieved for the whole group. This would suggest that the early adopters may have undergone the change in order to enhance efficiency and not for ceremonial, symbolic reasons. The substantive reasons for the change would lead the author to predict that the level of compliance would be highest for these companies.

It is noticeable that early adoption is related to specific industry sectors. Consistent with Whittington (2005) the early adopters of IFRS companies in this study are disproportionately represented in specific industry sectors, namely the media and the telecom sectors. The decision to switch to IFRS may therefore be related to the accepted norms within the sector where mimicking behaviour is prevalent conveying higher confidence and better understanding about the company as analysts are able to benchmark companies using a common reporting framework.

Using the DiMaggio framework imitation provides greater legitimacy although the actions may not necessarily be linked to better efficiency or task performance. In this sample the agent for imitation appears to be a foreign investor as three of the five early adopting companies have strategic foreign partners. The evidence for imitation, in common with other studies such as Fligstein (1991), is indirect and does not preclude other reasons such as resource dependency (Pfeffer, 1992) also being valid whereby companies are able to gain further capital as investors are attracted by higher quality IFRS reporting. Conversely, early adoption of IFRS involves considerable investment by the company in terms of changes to the accounting systems, training of personnel and restatement of prior years accounts. In the light of the fact that very few companies voluntarily adopted IFRS would suggest that the costs of implementation outweigh the benefits.

According to Oliver (1991) imitation and compliance demonstrate acquiescence on the part of organisations when faced with changing institutional environment which in this case is the implementation of IFRS. Companies comply by taking an active decision to adopt IFRS even before there is a legal imperative to do so. In order to be certain that imitation is taking place it would be necessary to prove that one company preceded the others in the adoption and also that the later adopting companies were aware of the potential benefits of mimicking behaviour of others. The data necessary to do this was however, not available in this study and could be a potentially rich area for future research. The early adopters of IFRS also employ global firms of auditors and so the influence of the accountancy profession acting on behalf of clients located in different jurisdictions cannot be underestimated. In the new institutional theory professions are seen as the primary agents of institutionalisation. In this instance the standardisation of accounting practice presents clear benefits for the audit firms who gain in terms of costs of knowledge acquisition and audit complexity if a single reporting framework is adopted worldwide.

To summarise, early adoption of IFRS has in prior studies been shown to be related to higher quality of accounting. This study has demonstrated that early adoption of IFRS in Poland is relatively rare and confined to the largest listed companies. The concentration of early adopters in the media and telecom industries would suggest that some mimicry is taking place although the exact timing of adoption of IFRS by each company has not been investigated and so mimicry cannot be proven. Early adoption has also been associated with the existence of foreign investors and so coercion seems to be the driving force behind the decision to adopt IFRS prior to the official EU implementation date.

Furthermore, there are clear benefits of using a single accounting framework in a group of companies and so the companies that are in a group environment would do so for technical and efficiency reasons rather than undertaking a symbolic, ceremonial action. The widely held belief by the early institutional researchers that ceremonial conformity drives behaviour is disproved in this case and points to industry sector and ownership as being influential in determining whether real or ceremonial adoption is taking place. This would suggest that the level of compliance with IFRS could be predicted based on motives for the adoption and where the reasons for the adoption of IFRS are clear the level of compliance should be higher.

5.2.3 Qualification of the audit report

The opinion given by the auditors in the audit report is the first and most obvious measure of compliance with IFRS. The auditor is specifically required to state that the published accounts present a true and fair view and the financial statements have been prepared in accordance with IFRS. An audit report may be qualified if there is material departure from the requirements which could arise either from uncertainty or from disagreement with the auditors.

In total three companies out of forty or 7.5 per cent have received qualified audit report so there is a strong presumption that these companies were not fully compliant with IFRS but the situation has improved as compared to the earlier phase of transition. Study by Krzywda *et al.* (1998) of Polish audit qualifications issued in the period 1992 to 1996 revealed that 14 per cent of non-financial firms received audit qualification. Internationally, his figure is much lower than in some European countries. For example, nearly 50 per cent of Greek listed companies received qualified audit reports in 2006 (Tsalavoutas and Evans, 2007). Qualifications in this study concerned both disagreement and uncertainty issues. From the institutional theory perspective, qualification of an audit report may be evidence of defiance where there is a clear breach of IFRS and a disagreement with the auditors. Defiance has been defined by Oliver (1991) as an active form of resistance to institutional processes and is likely to occur 'when the potential for external enforcement of institutional rules is low' (Oliver, 1991:156). In the long term the external enforcement of accounting rules by the external auditors will preclude companies from continuing the defiant behaviour because qualified audit report will cause adverse market reaction and force companies to comply.

One company's audit report was specifically qualified for breaching IFRS requirements. For two of the large companies the qualifications concerned either the measurement or recognition aspects of fixed assets in financial statements. This finding is consistent with the interview results where auditors point to valuation of assets as being a major area of concern for both companies and auditors. For the smaller company the qualification concerned uncertainty as to the value of subsidiaries as they had not been audited but had been included in the consolidated statements.

Table 3: Companies with an Audit Qualification in 2005 Financial Statements

	Number of companies with audit qualifications	Reason for qualification
Largest companies	2	• Uncertainty regarding the valuation of fixed assets • Uncertainty regarding the valuation of an investment • Disagreement - Value of hotels has been overstated by applying the test for impairment using EBITDA (Earnings Before Interest Taxation, Depreciation and Amortisation) rather than DCF (Discounted Cash Flow) • Disagreement- Use of land (perpetual usufruct) has been capitalised rather than treated as operating lease (off- balance sheet) contrary to IAS17
Smaller companies	1	• Uncertainty- Subsidiaries have not been audited but included in the group financial statements

(Based on a sample of financial statements at 31st December 2005 of 40 Polish companies listed on the Warsaw Stock Exchange)

From the interviews held it is expected that smaller companies would be more likely to receive a qualified report than a large company as explained by a partner of a medium size audit firm:

> *'From the due diligence work we know that the quality of accounting in Polish companies is very poor and continues to be very poor although subsidiaries of foreign companies are generally well versed in IFRS.'*

(Audit partner of a medium sized international accounting firm, interviewed 16th July 2009)

This has not been supported with evidence from the review of financial statements as only one small company received a qualified report as compared to two large companies. The fact that smaller companies received fewer audit qualifications can be linked either to the quality of the accounting which is better than is supposed in this study or to the quality of the statutory audit which is not sufficiently robust to identify departures from IFRS. The role of the audit profession in ensuring compliance with IFRS is explored in section 5.3.2.

In summary, review of the audit qualifications in sample companies would point to a generally low level of audit qualification suggesting that there is good level of *de facto* compliance with IFRS. Whereas the auditors interviewed rate the standard of IFRS accounting for small companies to be low, this has not been confirmed, and in fact, it was the large companies that received higher number of qualifications.

5.2.4 Evidence of compliance with IFRS 1 (*First-Time Adoption of International Financial Reporting Standards)*

The evaluation of hypothesis as to the *de facto* compliance with IFRS tests the compliance of the sample companies with IFRS 1. Although the issue of a qualified audit report is the most obvious confirmation of a failure to comply with IFRS it does not mean that companies are always compliant when they receive a clean audit report. Non-compliance may not lead to a qualified audit opinion if the departure from IFRS does not have a material impact on the measurement in the financial statements. In this study the level of disclosure was considered in relation to IFRS 1 (*First-time Adoption of IFRS*) (IASBh, 2007) and mapped against the strategic responses identified in the theoretical framework as put forward by Oliver (1991).

Within the context of financial reporting the most relevant responses that companies are likely to make would be to acquiesce fully by conforming with all aspects of IFRS 1 or to compromise by adopting the main principles of the standard but not meeting the detailed requirements so as to ‘balance the expectations of multiple constituents and to placate and accommodate institutional elements’ (Oliver 1991:152). In this case the companies balance the regulatory attempt to introduce IFRS with the existing systems, practices and knowledge of the Polish accounting framework which does not promote openness or investor orientated disclosure. In cases where there is a significant omission of information this response could be considered to be one of avoidance. Oliver (1991) defines avoidance as ‘the organisational attempt to preclude the necessity of conformity, organisations achieve this by concealing their non-conformity, buffering themselves from institutional pressures, or escaping from institutional rules or expectations’ (Oliver, 1991:154). The concealment takes the form of purporting to comply with IFRS whilst not meeting the main provisions of IFRS. This avoidance response differs from compromise in the extent to which companies do not comply, in the former case there is a greater level of compliance than in the latter case.

The more extreme response identified by Oliver of defiance is unlikely to be applicable to the adoption of IFRS by Polish listed companies for two reasons. Firstly, there is a collective will of the Polish society to continue the integration process with the EU and so the additional regulations introduced by the EU are generally adopted even if this takes place in a symbolic manner. Secondly, the policing system which utilises the external auditors does not allow for such behaviour and would only be apparent in cases where there is an audit qualification.

To fully appreciate the level of compliance with IFRS 1 the disclosures made by the companies were assessed against IFRS requirements using a disclosure checklist. The results of this review are presented below.

IFRS prescribes the methodology and guidance for companies when they are preparing the first set of accounts using the IFRS 1 framework. The aim of the standard is to ensure that the first IFRS financial statements are fully comparable with prior years when a different framework was applicable. This standard is therefore mandatory for all Polish listed group companies reporting in 2005 that had not adopted the IFRS in earlier years on voluntary basis.

IFRS 1 requires not only that the financial statements for the first year of IFRS are IFRS compliant but also the comparative reporting period should also use the same framework.
In addition 'the entity shall explain how the transition from previous GAAP to IFRS affected its reported financial position, financial performance and cashflows' (IFRS 1:38).

In order to comply with the above requirement a number of reconciliations need to be provided. The analysis of the level of compliance with this disclosure for the sample companies that are required to comply with IFRS 1 (excluding five companies that are not adopting IFRS for the first time) is given below:

Table 4: Number of Companies not in Compliance with IFRS 1 disclosure requirements

	Largest companies (15 companies)	Small companies (20 companies)
explicit statement of compliance with IFRS	none	none
Reconciliation PAR to IFRS of equity at 31st Dec 2004	1	none
Reconciliation PAR to IFRS of equity at 1st Jan 2004	1	3
reconciliation PAR to IFRS of profit for 2004	1	2
explanation of reconciliation	2	2

(Sample financial statements at 31st December 2005 of 35 Polish companies listed on the Warsaw Stock Exchange excluding those that were early adopters of IFRS and so were not required to prepare an IFRS 1 reconciliation)

In this study all listed group companies have complied and produced IFRS financial statements for 2005 and for the previous year 2004. This is both a legal requirement in the Polish law and European Law and a requirement of Prospectus Decree, 2004 so it is expected that companies would adhere to the basic requirement. All companies have also explicitly stated, in the accounting policies to the financial statements, their compliance with IFRS as mandated by the European Union. At the highest level of compliance with IFRS this response is consistent with the acquiesce behaviour as outlined by Oliver (1991).

When the level of detailed disclosure is considered in relation to IFRS 1 then the position regarding compliance deteriorates and it becomes clear that a compromise response is adopted by many companies. Companies symbolically state their compliance whilst failing to meet the detailed requirements due to a variety of reasons that are discussed in the following sections.

The additional information regarding the reconciliation of equity at 1st January 2004 and reconciliation of 2004 profit was not complied with by 7 out of total of 35 companies (excludes those early adopters not required to comply with IFRS1) which represents 20 per cent of companies. It is expected that all companies would have provided a reconciliation of equity at 31st December 2004 as they were required to prepare comparative financial statements under IFRS statements so all raw data was already available. In fact, one company did not fully comply by describing the changes rather than supplying a reconciliation at 31st December 2004. The other 6 companies failed to produce reconciliation at 1st January 2004.

This level of non-compliance can be compared to the results by Krzywda and Schroeder (2007) who carried out a similar evaluation in 2004 and found that 59 out of 113 companies or 52 per cent of the sample did not provide all prescribed reconciliations. The findings in this and prior studies point to a significant and continued failure to comply with IFRS. However, the level of compliance has increased significantly between 2004 and 2005. The improvement can be explained partly by the fact that the requirement for reconciliation in Krzywda and Schroeder's study was based on accounts that were produced according to Polish Accounting Regulation and not IFRS so it was more difficult for companies to evaluate the potential differences that would arise from IFRS, at that time it being a hypothetical situation. The difficulties experienced by companies in preparing such reconciliation in 2004 were noted at length by Krzywda and Schroeder (2007). This study employed first IFRS compliant financial statements from 2005 and companies were by that time obliged to undergo the change to IFRS so the compliance with the disclosure was easier to make. The findings from this study are therefore a more reliable test of compliance with IFRS than those of Krzywda and Schroeder's research.

Evidence from other countries also shows poor levels of compliance in the early years of adoption of IFRS. For example in the study of compliance with IFRS by the Gulf member states Al-Shammari *et al.* (2008) reports an average of 68 per cent compliance rate which compares unfavourably with the findings in this study. However, Al-Shammari's research tested compliance with 14 standards whilst this study focused on a single standard. Had a wider range of standards been included it is possible that the level of compliance for Polish companies would also have been reduced.

5.2.5 Comparison of financial results prepared using Polish Accounting Regulation with IFRS as measured by the Comparability Index

In the previous sections *de facto* compliance of Polish companies with IFRS was investigated and the role of accounting regulation was explored through qualitative interviews and the level of compliance with prescribed standards. This section will measure the extent of *de facto* differences between Polish Accounting Regulation (PAR) and IFRS as recorded by Polish companies in their reconciliation statements and measured by a comparability index. Where the index is equal to one this will indicate that there are no differences between Polish accounting framework and IFRS. The further the index deviates from one the greater are the differences between the two frameworks. This is significant from the convergence perspective because it will be more difficult for Poland to converge if the national law differs significantly from IFRS.

Table 5: Summary of Equity and Earnings Comparability Indices

	Equity Comparability Index			Net Earnings Comparability Index		
	All companies	Large companies	Small companies	All companies	Large companies	Small companies
Comparability index > 1 (number of companies)	5	3	2	15	10	5
Comparability index =1	2	0	2	2	0	2
Comparability index < 1 (number of companies)	27	12	15	17	5	12
Excluded due to IFRS prepared in prior years (5) or insufficient data (1)	6	5	1	6	5	1
Total no. of cos.	40	20	20	40	20	20
Mean index		0.85	0.93		1.07	0.93
Median		0.87	0.97		1.04	0.94
Standard deviation		0.18	0.12		0.31	0.22
Minimum value of index		0.49	0.59		0.83	0.38
Maximum value of index		1.12	1.07		1.4	1.44

(Sample financial statements of 40 Polish companies at 31st December 2005 listed on the Warsaw Stock Exchange)

Table 5 above shows the effect of transition from Polish Accounting regulation to IFRS on the financial position and performance as measured by the equity and earnings comparability index which will be explained in subsequent section. The results are based on 34 companies out of the total sample of 40 companies selected after excluding those that either adopted IFRS in prior years, and so did not provide the necessary reconciliation or did not give sufficient information to be able to calculate the index.

5.2.6 Calculation of Equity Comparability Index

Overall, the majority of companies (79 per cent) increased their equity directly as a result of change of accounting regulation as evidenced by a comparability index of less than one. The results are comparable for both large and small companies where 12 out of 15 (80 per cent) of the largest companies adopting IFRS for the first time reported the equity index of less than one and for the smaller companies the corresponding figure was 15 out of 19 companies (79 per cent).

In terms of the size of the variation in the equity index, large companies recorded the greatest differences between their IFRS equity and PAR equity. The mean index was 0.85 (median 0.87) for large companies compared to 0.93 (median 0.97) for smaller companies. The results for the equity index for large companies were significant at 5 and at 10 per cent using a two tail *t*-test but were not significant for the smaller companies. These findings are consistent with Tsalavoutas and Evans (2007) who studied the transition to IFRS by Greek companies and also showed a positive impact on equity resulting from a transition to IFRS. According to Krzywda (1996) Polish accounting is conservatively orientated and therefore the findings support the notion that equity of Polish companies will increase on the adoption of IFRS framework. The findings of Borowski and Kariozen (2007) also support these results as they have shown that on adoption of IFRS the equity of 12 Polish companies reviewed has increased by 13.85 per cent.

The results also support Haverty (2006), who as in this study, used the comparability index and applied it to 11 Chinese companies listed on the New York Stock Exchange using information drawn from F-20 reconciliations in the period 1996 to 2002. Haverty (2006) found material lack of comparability between IFRS and US GAAP although he confirmed that convergence between the two accounting frameworks was increasing over time.

In contrast, the findings in this study contradict results obtained by Aisbitt (2006) who reported that net assets for the largest UK listed companies are not significantly different under UK GAAP than they are under IFRS. The findings suggest that the accounting system operating in Anglo-Saxon countries such as UK are far more closely aligned to the IFRS framework than countries such as Poland where there are significant differences between Polish accounting regulation and IFRS. From the institutional perspective the results show that the adoption of IFRS in Poland has been far more transformational in nature than has been the case in the UK.

The increase in equity has been caused primarily by the decision of most companies to revalue their tangible assets. The impact of revaluations demonstrates not only a significant difference between Polish GAAP and IFRS but also between US GAAP and IFRS pointing to the ability to revaluate assets as being a major obstacle to convergence. This is supported by Haverty (2006) who found that revaluations were a major reconciling item between IFRS and US GAAP. The ability to revaluate under IFRS is the result of application of two standards namely; IAS 29 *(Financial Reporting in Hyperinflationary Economies)* and IFRS 1 *(First Time Adoption of IFRSs)* and both had the effect of increasing the carrying asset values and therefore equity. Poland was considered to be a hyperinflationary economy until the end of 1996 and so any assets owned prior to that date were revalued in accordance with IAS 29.

The revaluation that took place under government direction on 1st January 1995 does not meet the criteria of IAS 29 and so companies were subject to a further adjustment on the adoption of IFRS (Kaczmarczyk and Walinska, 2007). The revaluations also had a secondary effect by increasing the deferred tax liability which in turn lowered the net assets and equity. This is a relatively new form of liability which did not affect companies under Polish accounting regulation because tax and accounting were largely aligned and so there were few timing differences.

In the past under Polish accounting regulation companies commonly used depreciation rates for both accounting and tax purposes so there was no difference in the life of the assets and therefore no deferred tax liability.

For all other fixed assets, acquired since 1996, and so not subject to IAS 29, IFRS 1 allows companies to revalue their fixed assets at the date of adoption of IFRS and treat this value as an assumed cost. For Polish companies this option had the effect of increasing the value of fixed assets and therefore equity. Under Polish regulation assets can only be revalued as result of a legal regulation (*Rozporządzenie*) by the Ministry of Finance. This clearly points both to the conservative nature of Polish accounting and also to the control exercised by the state over financial reporting by Polish companies. As was noted earlier, common depreciation rates were used for both tax and accounting purposes in Poland and so the value of fixed assets had a material impact on the tax receipts and fiscal strategy. For this reason revaluations were not permitted under Polish Accounting Regulation. This revaluation was last carried out in 1995 using indices and so the adjustment to current values in 2005 was large and had a material impact both on the assets and the equity. The difference in the treatment of fixed assets between PAR and IFRS has resulted in a serious loss of comparability between listed single companies reporting under PAR and listed consolidated companies reporting under IFRS. As was noted by one of the analysts, the majority of listed Polish companies are relatively small, single companies that would not prepare IFRS and therefore would carry their fixed assets at 1995 valuation. In contrast, IFRS companies would have revalued assets at 2005 but this would be considered to be the opening cost so could also be misleading to the reader who may not be aware that this is in fact a valuation.

The revaluations were more common to large companies with 12 out of 15 companies (80 per cent) revaluing fixed assets in comparison to 8 out of 20 smaller companies (40 per cent) revaluing. The largest increase was experienced by the company Lotos SA which experienced a 53 per cent increase in fixed assets and arose predominantly as a result of revaluation to fair value. The median of the comparability index of smaller companies was not significant at 5 and 10 per cent confidence levels. The greater preponderance of revaluations in large companies would explain the reason for a greater variability in the index between the two samples and the lower mean for the equity index in the larger companies. The variable incidence of revaluations means that there is lack of comparability not only between IFRS and PAR companies but also within IFRS compliant companies.

In contrast, Callao *et al.* (2007) has showed that majority of listed Spanish companies tested have not revalued their fixed assets. Similarly, KPMG and Von Keitz (2006) show that only 3 companies out of a sample of 147 companies surveyed in 11 countries chose to revalue fixed assets. The results from comparative studies point to a lack of comparability between the results of firms located in different countries. However, it is important to note that the lack of comparability does not arise from the differences in the treatment of fixed assets between national and international systems of accounting but from the alternative treatments that are allowed within IFRS. IFRS allows fixed assets to be either revalued or carried at cost and this discretion appears to be determined by national factors associated with the institutional country setting. It is clear that the majority of Spanish companies retain the cost basis but Polish companies chose to revalue.

This means that comparability actually worsens as a result of the introduction of IFRS as companies can exploit different accounting options within IFRS as well as applying local GAAP for non-consolidated accounts. The policy implications of the findings regarding the similarity of accounting treatments are twofold. Firstly, the national variations in the application could be interpreted as evidence of lack of the consistency in the application of IFRS and may weaken the case for the adoption of IFRS. For example, SEC in the US could arguably contend that the IFRS are simply not robust enough to be suitable for the US setting where differently reported accounting numbers would raise the risk of litigation. Secondly, the variety of accounting treatments permitted within IFRS may need to be reduced by IASB because they do not reflect the different economic circumstances facing individual companies. IASB permits alternative treatments so that company accounts can fully reflect the true and fair view of the financial position of each entity. However, the findings both in this study and in the research by Kvaal and Nobes (2010) suggest that it is the wider institutional and national features that determine accounting policies and not the particular circumstances of each company thus rendering the alternatives unnecessary.

Kvaal and Nobes (2010) found that companies in different countries select accounting options allowable under IFRS along national basis. They propose that drivers of policy are based on the preference of companies, whenever possible, to continue using the same policies as were used in the past under national GAAP to reduce the cost of transition. The authors also suggest that many subsidiaries prepare accounts using local regulation and on consolidation the information is already nationally orientated and this national orientation feeds into the group accounts.

This research supports Kvaal and Nobes (2010) in that there was a national preference in Poland for the revaluation of assets but not in Spain. However, Kvaal and Nobes justification for national orientation is not valid. The companies in Poland are actually choosing to revalue fixed assets, a method that is significantly different from Polish accounting and one which entails significant costs. The finding has important institutional implications because the revaluation of fixed assets contradicts the main premise of institutional theory and suggests that companies are not continuing in their existing institutionalised routines but are willing to change.

The main reason for asset revaluations has been shown in prior studies to improve the image of the company to foreign investors and creditors and thereby to increase the borrowing capacity of the companies (Missonier-Piera, 2007). Therefore, the reason for the revaluations in Poland is linked to resource dependency and confirms that companies will not adhere to existing practices as proposed by institutional theory but will change when there is sufficient incentive to do so.

Although it is not clear why smaller companies were reluctant to undertake the revaluation, a possible reason that was identified by an audit manager, was lack of expertise in the area of valuation and increased costs as suggested by Kvaal and Nobes (2010). This applies not only to the accounting profession but also to the lack of expert valuers and surveyors in Poland in general, a point that was emphasised throughout by the auditor interviewees. Shortage of expertise coupled with a long tradition of using historic costs in continental Europe (Nobes, 2006) led to a prediction that future revaluations are unlikely to take place. IFRS companies may decide to revalue fixed assets in the future under IAS 16 (*Property, Plant and Equipment)* (IASBd, 2007) but the revaluation in 2005 can be seen as a one off transition adjustment under IFRS 1 *(First Time Adoption of International Financial Reporting Standards)* in order to establish a 'deemed cost' rather than a desire to show all fixed assets at fair value. The benefit of revaluations under deemed cost option rather than IAS 16 is that the companies will not be bound to revalue at regular intervals in the future so the costs of revaluation will be restricted to a one off expense.

Lack of expertise will also have implications for other aspects of IFRS framework and affect future periods irrespective of whether or not revaluations have taken place. For example IAS 36 (*Impairment of Assets*) (IASBf, 2007) requires assets to be subject to impairment test annually at the balance sheet date. This procedure calls for availability of accurate fair values and may well require estimates of future cashflows and discount rates. Lack of expert knowledge calls into question whether Polish companies will be able to meet the requirements of IFRS in the future.

The second most common adjustment found in the reconciliation between PAR and IFRS related to the perpetual usufruct right to use assets and demonstrates the continuing tension between the two frameworks. This item is a legacy from the communist era when enterprises were granted such rights to assets by the state although the enterprise did not have the legal title of ownership. In many cases the rights have been capitalised under fixed assets in accordance with PAR. On transition to IFRS the perpetual usufruct right did not meet the criteria of an asset as required by IAS 17 *(Leases*) (IASBe, 2007) and was removed from the balance sheet and treated as an operating lease. The impact of this adjustment would be to decrease IFRS equity and so increase the equity comparability index. In one of the sample companies PWC has qualified the audit report on the grounds that the perpetual usufruct was incorrectly treated by the directors as an asset rather than as an operating lease. The differing treatment of these rights and dispute with the auditors illustrates the inability of the IFRS framework to deal with local circumstances affecting transition economies. The usufruct rights are unique to post –communist countries and in many cases it is likely that full legal ownership will pass to the enterprises. The treatment required by IAS 17 may therefore be inappropriate in the circumstances. Listed single companies continue to capitalise the rights and so once again there is a lack of comparability between the two frameworks.

5.2.7 Calculation of Earnings Comparability Index

Consideration of the earnings comparability index shows a more even split between companies reporting higher profit under IFRS (index of less than 1) and those reporting lower profit (index of more than 1). The results for this test were inconclusive and the variation in the median of the earnings index was not significant for the large and small company sample at 5 and 10 per cent confidence level using two tail *t* – test. Overall, slightly more companies increased their profits on the transition to IFRS and fewer decreased their profits (15 increased and 12 decreased). However, when the size of the companies was considered far more large companies reduced their profits on transition than small companies. This is reflected in the mean of indices where the mean for large companies was 1.07 and for small companies it was 0.93. Drawing on Krzywda *et al.* (1995) Polish accounting using PAR would be expected to show a greater level of conservatism resulting in lower profits than if IFRS was applied. This is clearly not the case and the low IFRS level of profit can be partly explained by the depreciation adjustment as a result of revaluations which were undertaken more frequently by large companies. Depreciation is calculated on the revalued amounts and as larger asset values resulted from the revaluation the depreciation charge also increased and depressed the profitability.

Profits were also negatively affected as a result of the conversion to IFRS due to the costs related to perpetual usufruct rights being written off to income statement as expenses rather than being capitalised as assets.

Only two companies, both of which were small, had an index exactly equal to one which indicates that there were no differences between profit reported under PAR and IFRS. Study by Borowski and Kariozen (2007) of 12 Polish listed companies showed an increase in profit of only 2.27 per cent on transition from Polish Accounting Regulation to IFRS in contrast to an increase of equity of 13.85 per cent. Therefore they confirm the findings of this study that the impact on transition to IFRS on equity is considerably larger than on profits.

5.2.8 Impact of transition to IFRS on key performance measure (Return on Equity)

The overall effect of the transition to IFRS has been evaluated by considering the impact of the adjustments on a key performance measure of return on equity. Return on equity is widely used as a performance metric which combines the effect of profitability with return on equity in a single ratio. In total 33 companies (15 large and 18 small) were used to evaluate the impact of IFRS. Early adopters of IFRS and those firms not supplying sufficient information were excluded.

Table 6: Summary of Return of Equity for Sample Companies

	Large companies			Small companies		
	Number of firms	ROE for 2004 (%) IFRS	ROE for 2004 (%) PAR	Number of firms	ROE for 2004 (%) IFRS	ROE for 2004 (%) PAR
Comparability index > 1 (number of companies)	14			9		
Comparability index =1	0			2		
Comparability index < 1 (number of companies)	1			7		
Excluded due to: • IFRS in prior years • lack of information	5			2		
Total no. of cos.	20			20		
Mean index		12.8%	16.7%		21%	19%
Median		14.97%	18.6%		15.7%	14.4%
Standard deviation		10.11	10.38		15.53	11.31
Minimum value		0.9%	0.2%		7.4%	6.5%
Maximum value		27.4%	27.5%		68.3%	41.4%

Sample financial statements of 40 Polish companies at 31st December 2005 listed on the Warsaw Stock Exchange)

The table above shows that for large companies transition to IFRS has resulted in a large reduction in return on equity from a mean value of 16.7 per cent to 12.8 per cent. This reduction can be primarily attributed to the revaluation of fixed assets which resulted in a large increase in equity. This has been partly offset by higher level of depreciation charged to the income statement and other smaller adjustments but overall the effect has been to reduce the rate of return on equity because of the very large impact of revaluations which dwarf all other adjustments.

In contrast, for smaller firms the return on equity has increased from 19 per cent to 21 per cent although the increase was smaller than the change recorded for large companies. As was mentioned earlier smaller companies did not undertake the same level of revaluations and so there was no comparable increase in equity. Without the effect of revaluations other adjustments such as reversal of depreciation on goodwill had a positive effect on profit which contributed to the increase in return on equity.

In summary, the review of financial statements and interviews show that proposition one offers mixed results when evaluated against the criteria outlined in the introduction to this chapter (section 5.1). That is, in a transition economy companies try to meet the demands of IFRS by compromising with the standards rather than fully meeting all requirements. The proposition is supported by virtue of the fact that many companies continue to prepare accounts that are not investor orientated and the disclosure of information regarding revaluations is also generally low.

On the other hand, *de facto* compliance has improved significantly in respect of the compliance with IFRS 1(*First-time Adoption of IFRS*) from non-compliance in some aspects of IFRS 1 of 52 per cent to 20 per cent when compared to the findings by Krzywda and Schroeder (2007) for the previous year. The majority of companies are in fact meeting the key requirements of IFRS 1 so proposition one is not fully confirmed.

Furthermore, the level of audit qualification is relatively low which would suggest overall compliance with IFRS. Interviews and analysis of financial statements revealed that care must be taken to distinguish between large and small companies. Large companies generally have a higher *de facto* level of compliance on all measures with the exception of the number of qualifications where small companies experienced fewer qualifications. However, the audit qualifications could be more a factor of audit quality than that of accounting. That is smaller, local audit firms are less likely to identify accounting transgressions.

Voluntary adoption of IFRS also raises the standard of accounting in Poland as it is generally accepted that the quality of IFRS financial statements is higher than Polish accounting. The research showed that foreign owned companies are more likely to adopt voluntarily adopt IFRS and so the existence of foreign investment does improve the quality of accounting as the adoption is more likely to be for technical rather than ceremonial reasons.

Using comparability indices the analysis demonstrated that there are important differences between Polish Accounting Law and IFRS which particularly affect assets and equity. The differences in reported net profit are less clear and have not been shown to be statistically significant. The results show that the transition to IFRS from Polish Accounting Regulation has had an impact on both the Income Statement and on the Balance Sheet of sample companies resulting in a significant change in the key performance indicator, Return on Equity as summarized in the table below for the 40 sample companies at 31st December 2005:

Table 7: Summary of Equity, Earnings Indices and Return on Equity

	Large companies	Small companies
Equity index	0.87	0.97
Earnings index	1.04	0.94
Return on Equity based on IFRS	15.0%	15.7%
Return on Equity based on PAR	18.6%	14.4%

The key areas of *de facto* differences concerned the revaluation of fixed assets and the treatment of usufruct right to use assets. Furthermore, the chosen option to revalue assets utilizes the alternative treatment permitted under IAS 16 *(Property, Plant and Equipment)* and so differences in the treatment of fixed assets may persist even when IFRS is the only reporting system. The fact that so many companies decided to revalue fixed assets contradicts institutional theory which posits that companies will not change unless there are some specific 'jolts' for them to do so. Revaluations are not only optional within IFRS framework but also costly and difficult in a country such as Poland where there is lack of professional expertise so it is surprising to see such a large scale adoption of the revaluation option. This thesis posits that resource dependency plays an critical role in triggering the change in valuation policy as higher balance sheet values lead to improved borrowing capacity and this is discussed in the next section of the findings. The calculation of the equity comparability indices suggest that revaluations significantly impact on the key performance indicators and so the reason for the revaluations is not ceremonial but economic.

The findings confirm proposition number one that *de facto* Polish accounting practice is significantly different to IFRS and the use of both frameworks for listed companies negatively affects the comparability between companies and leads to confusion for the users. The change of framework had a greater effect on the large companies with more large companies deciding to revalue fixed assets than small companies. The changes introduced as a result of the adoption of IFRS have also impacted on return on equity which is a key performance measure and likely to affect investment decisions. These results point to the far reaching changes that were required to the Polish accounting system demonstrating the transformational nature of the adoption of IFRS not found in Anglo-Saxon countries.

5.3 The role of the accounting profession in determining the quality of financial statements

The first proposition of this research arising from new institutional theory identifies the accountancy profession as being instrumental in determining the quality of accounting (Chand and Patel, 2008) and that it is weaknesses in the profession that lead to deficiencies in financial reporting. In this research accounting profession has been differentiated into two groups: namely, accountants working in enterprises and auditors. The distinction is important because their functional responsibilities are considered to be different. The former are responsible for the preparation of accounts and therefore for the quality of financial statements. Auditors have an enforcement role and statutory responsibilities to report on departures from accounting norms. The effectiveness of this enforcement has been shown to influence the level of compliance with IFRS.

The central role of professionals within organisations has been recognized in new institutional theory. DiMaggio and Powell (1983) view normative pressure as arising primarily from two sources, namely from professionalization and from education. Organisations become similar because they employ professionals who have common qualities irrespective of the organisation in which they work. Their shared sense of reality is transmitted to the enterprises providing legitimacy and reducing uncertainty as accountants are seen to be knowledgeable, objective and ethical. Professions are normally characterised by having certain qualifications and the members are normally organised into self-regulating professional bodies. The professionals are seen to be highly qualified and able to work autonomously which allows them to influence the organisations transgressing institutional or industry contexts. New institutional theory sees the professions as actively promoting isomorphism through coercion or normative pressure. However the role of the accountancy profession as expounded by DiMaggio and Powell is different and less well understood in transition economies where the accountancy function itself has undergone a fundamental transformation to meet the needs for the efficient operation of the capitalist economy. According to Miller (1998) norms and logics within professions are not constant but can change over time. Within the context of central European countries the accountancy profession has undergone deinstitutionalization from the communist system and then subsequent reinstitutionalisation for capitalist economy. As a result of this process the influence of the accountancy profession is weaker than has been suggested by new institution theorists because activities such as professional development, monitoring of professional conduct and membership which are seen as key requirements for isomorphism are not well established in Poland. Whereas under communism accounting was largely a clerical function the needs of the market economy have demanded changes to the role of the accountant that have led to the increased professionalization of the accountancy profession.

The economic, social and political environment in Poland has meant that Polish accounting has a very short history in comparison to western economies. Furthermore, the professions were created by legislation so do not have the same autonomy as the self regulated professions in Anglo-Saxon countries. An example of the relationship between the state and the profession is apparent in the creation of the Krajowa Izba Biegłych Rewidentów (KIBR) (*National Chamber of Statutory Auditors*). This independent professional body was created following the legal requirement of the *Ustawa z dnia 19 października 1991r. o badaniu i ogłaszaniu sprawozdań finansowych oraz biegłych rewidentach i ich samorządzie*. (The Act of 19th October 1991 on the Audit and Publication of Financial Statements and on the Self-regulation of Auditors). It is notable that KIBR has been formed through legal instruments although it is a self regulated body that publishes auditing standards in its own right.

Exactly what role the accountancy profession plays in the financial reporting process in Poland and how that role differs to the Anglo-Saxon countries is explored in the next section. In undertaking the analysis the emergence of new identity professional identity is explored and considered in the context of the institutionalization process put forward by Greenwood *et al.,* 2002.

5.3.1 The role of the accountants working within firms in determining the quality of the financial statements

Polish in-company accountants are responsible for the preparation of financial statements and for the implementation of IFRS and yet their professional status is not as well established as it is in the Anglo-Saxon countries. The transition of Polish economy from a command economy to a market economy has led to changes in the location and context of accountants' work and the tasks undertaken. In terms of location more accountants are now working in professional practice firms and not only in state owned industries. Furthermore accountants' work has expanded into other disciplines such as IT, audit and tax advisory services which were unknown under communism. The re-establishment of the Warsaw Stock Exchange in 1991 and the shift in the provision of loan capital from the state bank to private institutions has meant that stakeholders began to demand financial information that was informative and useful for decision making. The economic 'jolt', described as the first stage of institutionalization by Greenwood *et al.* (2002) has meant that financial reports acquired real value where before they had no wider meaning beyond meeting state demands. This need for information has created opportunities in Poland for the formation of new firms of accounting practice and allowed the entry of the Big 4 firms of accountants.

DiMaggio and Powell (1983) argue that where there is competitive pressure acting then adoption of practices is more likely to take place. In Poland the pressure for financial reporting has allowed a distinct identity of accounting profession to emerge. As a result accountants were no longer seen as book-keepers by various actors but increasingly obtained professional standing through their ability that to produce relevant information. This is consistent with the findings by Launsbury (2002) who showed that there was a positive relationship between increased market orientation and professional development. Prior to the fall of communism the title of an 'accountant' was either not known to the wider society or regarded as a basic clerical position assigned to a person working in diverse state enterprises. As transition progressed accountants were increasingly seen as being seen at the centre of decision making especially where the holding company was a foreign listed company:

> *'It is no longer enough for me to know about Polish accounting requirements. I also need to be able to apply the Swiss principles and operate new IT systems 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 Chief Financial Officer.*
>
> *(Accountant working in a Swiss owned subsidiary)*

The above statement clearly shows that Polish accountants operate in a complex institutional field. The source of rules originates not only from national institutions but also from international norms. By specifying the different sources of authority the accountant is implying that the demands made by each institution are different and complex. These competing demands and the responses made as evidenced by the IFRS disclosure will be explored in the subsequent analysis.

Part of the professionalization process was the acquisition of knowledge in different disciplines thereby giving perception of being expert in the field. It was also interesting that contact with foreign accountants and holding companies based overseas were seen as promoting legitimacy as evidenced by full and unquestioning acceptance of foreign rules and directives. Discussion with the accountants both within professional accountancy firms and those working in industry indicated that their standing in the community has increased significantly since the communist era in terms of financial rewards and the level of responsibility as described above. In this sense the introduction of IFRS has enhanced the status of accountants who are now able to present themselves as professionals in possession of expert body of knowledge.

However, this competitive pressure did not extend to the professional bodies to the same extent and so the transformation was slower and less effective. According to DiMaggio and Powell (1983:152) an important source of isomorphism in the professions is 'the growth and elaboration of professional networks that span organizations and across which new models diffuse'. In contrast to the external, competitive pressure acting on the accountants based in industry the Polish accountancy profession exerts less influence than one would expect in more mature economies. In Poland these networks have been much weaker partly because historically the state had captured the professions weakening the links with industry and secondly the global accounting firms had not sufficient time to exert their own influence.

In capitalist societies the members of the accounting profession share similar mind set and educational attainment resulting from rigorous professional training. Accountants are seen as experts who can transcend the industry focus of their employers by close association with the institutes. Although this is a somewhat idealized view of the accounting profession Suddaby *et al*., (2009) have measured the degree of professionalization among the Canadian chartered accountants and found that there is considerable commitment to the profession.
In contrast during the communist era in Poland the profession of accounting did not exist and the finance related posts were held by graduates from the economics discipline. The key posts in the Ministry of Finance and on the influential committees are still held by academics that according to one interviewee:

> *'….are like amateurs playing at accounting and make pronouncements on IFRS that show lack of understanding of IFRS'*

(Chief Risk Officer and Partner of Big-4 global accountancy firm interviewed 14th February 2010)

The view expressed was by an auditor who originates from the UK and who is clearly using his in-depth experience of the application of IFRS in an Anglo-Saxon setting without necessarily appreciating the contextual setting of Polish accounting. The dismissive language used in the quote can be interpreted as being extremely revealing about the relationship between the Big 4 firms and the other actors in Poland. The use of the word 'amateurs' indicates a gap between the Big 4 firms who it is implied are the professionals and the amateur national institutions. This perception points to a lack of goal congruence and a conflict between the different institutional players. The word is used in a derogatory manner portraying both superiority and power of the Big 4 firms who clearly do not see themselves as being part of the Polish accounting profession. Furthermore the use of the word 'playing' suggests lack of seriousness of Polish accountants who, according to the Big-4, should simply leave the work of financial reporting to the international firms.

Professionalisation can be seen as an imported construct where accountants improve the technical efficiency within firms whilst Polish accountancy bodies such as the Polish Accounting Standards Committee (*Komitet Standardów Rachunkowości*) play a relatively minor role in the normative process. This position can be explained by the relative impact of accounting. Within company reporting there is a real imperative to improve the quality of accounting for decision making or for group consolidation purposes. However, the Polish Accounting Standards Committee, although it issues Polish accounting standards, has a secondary role in clarifying the accounting position of IFRS in the Polish context. The interviews revealed that where IFRS does not offer clear instructions or where there are alternative treatments Polish accounting preference is always to adopt the options that involve minimum use of judgment and the least disclosure. The Polish standards act to remedy this by providing more precise guidance for the accountants. However, the Committee is funded and administered by the Ministry of Finance with limited engagement of other stakeholders leading to a negative assessment of the national standards by the auditors as expressed below:

> *'What is unfortunate is that the Ministry of Finance chose not to make IFRS voluntary for all other companies which wouldn't be so bad if Poland had its own accounting standards. It doesn't have its own complete set of standards and it will be another twenty years before it does. There are six standards and they do give some normative solutions. The real question is why Poland is going down the route of developing its own standards when sooner or later it is going to have to adopt some version of IFRS for all companies because this is the way the European Union and the rest of the world is going. If the US is beginning to recognise IFRS why should Poland be so different?'*
>
> *(Audit partner of a medium sized international accounting firm, interviewed 16th July 2009)*

Another interviewee supported this view by arguing that the development of Polish Accounting Standards detracted from a more worthwhile role that Polish regulators could play in influencing IFRS standard developments in an international arena through International Accounting Standards Board (IASB) or the European Union. Yet another accountant questioned the adoption of Polish Accounting Standards rather than IFRS on issues that are not regulated in Polish law. The common thread in the discussion with the auditors was that Polish standards are lower quality when compared to IFRS and should not be used.

This view was contradicted by Walińska and Urbanek (2001) who found increasing support for local standards in a survey of 550 accountants engaged in the preparation of financial statements. It would therefore appear that whilst the international firms of auditors interviewed in this study rate IFRS more highly the accountants are looking for local solutions that are more specific to their needs. The findings would support the assertion by Sunder (2010) who suggests that the Big 4 firms of auditors have taken the policy decision to promote IFRS and have devoted considerable resources to do so. Sunder tentatively suggests that this strategy has been adopted in order to take a larger share of the audit market from the smaller and local firms whilst the benefits of IFRS monopoly have been considerably overstated.

Given the limited scope of Polish accounting standards it is true that currently they are not fit to meet the needs of stakeholders. However, it is the view of the author that the development of Polish standards has been hindered by the normative impact of IFRS. In terms of institutional theory it is clear that IFRS confers considerable legitimacy and the Big 4 firms of accountants are not prepared to consider any alternative even where there is clear local preference for the development of local standards.

Resistance to the adoption of IFRS was also due to lack of accounting knowledge. A common thread in the discussions with the auditors, regulators and accountants interviewed point to the lack of experience of working with IFRS and the complexity of the standards themselves. It appears that the smaller listed companies lack the capacity to fully meet the requirements. Oliver (1991:164) hypothesizes that: 'the lower the degree of consistency of institutional norms or requirements with organisational goals, the greater the likelihood of organisational resistance to institutional pressures' Using the model developed by Oliver's (1991) acquiescence by Polish companies is lower because there is a lack of consistency between the internal goals and external expectations. Polish financial reporting prior to 2005 was governed by highly generalized principles embodied in statute amounting to some 80 pages of statute which aimed to align accounting law to fiscal law. In contrast the IFRS is shareholder orientated, extends to over 2000 pages and assumes a sophisticated knowledge not available to a large majority of Polish accountants. The training of accountants also has cost implications so a conflict arises between the external expectations of the standard setter and internal capabilities to meet these requirements. The acquisition of accounting knowledge is also hampered by the frequent changes to IFRS which cause problems not only to the accountants responsible for the preparation of financial statements but also to the legislators who have to incorporate agreed changes into Polish law.

> *'The IFRS change very often. Even though there was supposed to be a stable platform until 2009 this did not hold. The European Commission is accepting changes piecemeal so there is no complete version of IFRS. The Commission has produced a complete revised IFRS 18 months ago but since then there were changes so we have to follow every amendment in order not to miss anything that may affect our work on the Polish legal framework.'*
>
> *(Ministry of Finance official interviewed 17th February 2010)*

Apart from technical accounting issues significant obstacles arise from translation difficulties. Problems associated with translation have been identified at implementation level by companies and auditors and at the level of legislation.

'Abstracting from bad translation is impossible and the companies have no chance of understanding the texts without referring back to the source English language legislation. Part of the problem is that there is no appropriate equivalent terminology in Polish vocabulary'

(Audit partner of a medium sized international accounting firm interviewed 16th July 2009)

Using the interpretive paradigm meanings are assigned in a particular language according to the cultural and social background of the country. It is widely accepted literal translations are inadequate to fully reflect the concepts in another language. Referring to the post-communist countries many of the terms commonly used in market economies had no equivalent meaning and were completely unknown at the start of the transition in 1990. Major accounting firms have the English language skills to interpret correctly legislation and convey that to their clients thus furthering institutional change. However, smaller listed entities apply their own interpretations without expert advice relying on limited support material in terms of technical guides which in themselves are subject to translating interpretations. The technical complexity of the standards coupled with the lack of adequate language skills means that companies audited by smaller firms of auditors are not able to fully and accurately implement all provisions of IFRS.

The technical and translation advantage of international firms means that the firms can embed themselves at a deeper level than that indicated by their function alone. They facilitate the shared understanding which is diffused to all large companies without being bound by the coercive and normative forces within the Polish jurisdiction. Through these actions they increase their power but at the same time expose 'contradictions' with the national actors.

The legislators also acknowledge the inability of the Polish language to reflect the technical terminology used in the original English version of IFRS and who also utilize the source standards as noted by a Ministry of Finance official responsible for drafting of Polish company law:

> *'The European Commission guarantees full translation of IFRS into all member languages and the Polish translation is not bad due to professional translation. I personally only read the English version because if I use the Polish version I have no idea about the meaning.'*
>
> *(Ministry of Finance official interviewed 17th February 2010)*

Further translation complications arise from the fact that both IASB and EU have a policy of translating all IFRS into major languages including Polish. This means that there are two official translations which leads to confusion as different terminologies are adopted in each version. Again in this area the international firms of accountants who use English as their business language are able to exploit lack of clarity and the multiple sources of reference to facilitate better understanding of the terminology through their contacts with the client companies and thereby play an important role in the development of a shared meaning of IFRS language.

In summary, the status of accountants in Poland has increased significantly since the demise of the command economy and they are now recognised as professionals rather than simply book-keepers. The thesis argues that this professionalization has predominantly arisen from competitive market needs for financial information. The institutional upheaval resulting from the transition provided far greater opportunities for a professional class to emerge than would have been possible in a well established market economy. However, the accounting profession is not as well organised or as powerful as it is in Anglo-Saxon countries due to underdeveloped system of networks between members and much weaker influence of the global accounting firms. Much of the accounting regulation is embodied in statute so the Polish Accounting Standard's Committee's role is to support and interpret the law through the issue of national accounting standards rather than to lead on accounting developments. Nevertheless, in this area the Accounting Standards Committee competes with IFRS and appears to be at the margin of the accounting framework as far as the auditors who were interviewed are concerned. In contrast, Walińska and Urbanek (2001) show growing support for greater engagement by the Polish Accounting Standards Committee probably because this body is perceived as being more in tune with Polish conditions. In Poland there is no equivalent to the UK's Institutes and the legal institutions continue to dominate at the expense of self-regulated professional bodies.

To conclude, lack of a strong profession hinders the acquisition of sophisticated knowledge that is required for the correct application of IFRS. Lack of compliance with IFRS arises partly from the lack of alignment of organisational goals with those of external standard setter namely the IFRS.

5.3.2 The role of the audit profession

During the communist era there were no professional auditing firms in Poland and the boundaries between accounting and auditing functions were blurred. There were no separate accountancy and audit firms and so the identity of Polish audit profession was very weak.

The task of statutory audits of state enterprises was discharged by accountants working in other enterprises and as explained by one accountant who has worked as a company accountant prior to the start of transition:

'I normally took two weeks holiday every year from my full time job and used the time to carry out a statutory audit of another state company. The audit report of my company was signed by another accountant from a firm where I was also a partner'

(Accountant from a previously state owned company employed prior to 1989)

The above quote clearly demonstrates that during communism there was no notion of either independence or professional auditing role and the audit was done almost as a friendly favour partly because the accounts themselves had no real meaning. The rational logic was that statutory requirements needed to be met but there was no value in the audit function beyond compliance with the rules so the actions were purely symbolic. The distinction between accounting and audit was therefore blurred and resulted in much lower adherence to the core professional logics.

During the transition the trigger of private firms needing to have their accounts certified as 'true and fair' has led to the notion of audit independence becoming a central feature of auditing. This need for auditor endorsement has created a separation between the firms and the auditors which contributed to the emergence of an auditing profession which was physically identifiable with clearer boundaries being set between an accounting function and the audit function. By setting the auditors apart from company employees they now were able to transcend the setting of individual companies and portray themselves as experts thereby leading to the greater professionalization of the audit profession than was the case under communism.

Professionalisation of both accountants and auditors was also enhanced by the fact that within market economy higher level capabilities are demanded from the profession. For the first time auditors were expected to use their professional judgment and form an opinion about the financial statements. However, is true to say that the notion of 'true and fair' concept as well as auditor independence was construed and interpreted differently by the actors in the field of auditing in Poland than was understood in the Anglo-Saxon countries (Kosmala, 2007). Polish approach to these constructs is far more rule based but nevertheless the adherence to the Ethics Codes has had the effect of installing the values and assumptions that underlie the auditing profession.

Significant improvement in the quality of accounting in Poland was achieved through the activities of the audit firms. However, a distinction has to be drawn between large global accounting firms and small national firms. The Big 4 audit firms not only act to change the practice of accounting itself but also legitimate the financial statements of companies through their international reputation and standing. According to Greenwood *et al.* (2002) the big firms are much less likely to be structured around the existing routines as they work closely with international clients and so are exposed to competitive rather than institutional pressures and they have the financial and political resources to resist traditional practices. There is no doubt that the transformation of institutional setting as a result of fall of communism has created demand for professional services in Central Europe from the global firms in the traditional field of accountancy and finance but also in areas such as consultancy related to privatisation, trade liberalisation and economic policy. Through these activities the Big 4 international audit firms were able to help to reduce the high level of uncertainty associated with the dismantling of existing institutional arrangements and with the development of new structures.

The data in respect of the nature of the auditors shows that global firms of auditors dominate in the large company sector with seventy per cent of the 40 firms sampled using one of the Big 4 auditors.

Table 8: Number of Companies Audited by Large and Small Audit Firms

	Audited by Big 4 audit firm	Percentage of firms	Audited by small firm	Percentage of firms
Largest companies	14	70%	6	30%
Smaller companies	6	30%	14	70%
Total number of companies	20	100%	20	100%

(Sample financial statements of 40 Polish companies listed on the Warsaw Stock Exchange)

The position for smaller firms is exactly reversed and seventy per cent of them use Polish audit firms. Using the institutional lens both technical and ceremonial reasons explain the adoption of auditors. At technical level this finding is to be expected as the largest firms are more likely to have complex group structures and to use sophisticated accounting techniques that demand a high level of technical competence from an audit firm. Ceremonially, large audit firms provide a seal of approval for the external stakeholders and enhance the reputation of the companies' financial statements. Conversely, smaller companies are less likely to engage in sophisticated accounting practices, place less reliance on the external investors and be less able to pay for top audit firms. Large companies also have the resources to be able to afford to pay the high audit fees charged by the large audit firms.

From the review of financial statements it is evident that the largest twenty companies have received more qualified audit reports than small companies in 2005 and those qualifications for the large companies were all issued by the Big 4 audit firms. Intuitively, we would expect the opposite to happen and the level of compliance to be higher for the top listed companies than for the smaller companies. The rationale for that would be that smaller companies have less expertise and so cannot be relied to produce financial statements of comparable standards to the large companies.

However, the result in this research is consistent with the interviews and prior studies by DeAngelo (1981) and Krzywda *et al.* (1998) that show large audit firms will demand higher earnings quality and therefore be more likely to report deviations from IFRS to the shareholders by issuing a qualified audit report. Furthermore, large audit firms are in a more powerful position and are able to challenge companies by publically disagreeing with them. In future this action by the auditors would be expected to lead to a higher level of compliance with IFRS. In this sample the disagreement opinions were issued by Ernst and Young and PWC both of whom were in the Big 4 audit firms.

In contrast small firms are more embedded in the existing routines focusing on legalistic compliance and as has been noted below do not have the resources to adapt to a changing environment. The distinction between the large and small audit firms was clearly drawn by one respondent:

> *'Apart from the top 6 audit firms are a large number of companies that are audited by very small firms. The small local auditor does not have the knowledge or access to technical advice and that is reflected in the quality of accounts produced by the company. The size of the audit firm and the quality of accounts are inextricably linked.'*
>
> *(Senior audit manager of Big 4 global audit firm in Warsaw interviewed 15th February 2010)*

Review of the financial statements appears to support this view. It is notable that none of the seven companies that failed to comply with IFRS 1 *(First-time adoption of IFRS)* as shown in section 5.2.4 were audited by a Big 4 firm of auditors. In spite of the fact that the financial statements did not comply with IFRS 1 they were not qualified by the local auditor. This could be due to the fact that the disclosure did not have a material impact on the numbers in the financial statements. However, there is a strong possibility that had the companies been audited by Big 4 audit firms these firms would provide expertise and possibly would exercise coercion to ensure full disclosure. This finding clearly suggests that the auditor has significant influence on the quality of financial statements.

Krzywda and Schroeder (2007) corroborate this view in their analysis of differences between IFRS and Polish Accounting regulation between 2001 and 2004. Their study found that entities with a multinational auditor reported more differences than entities with domestic auditor. They concluded that: 'preparers are influenced in their IFRS disclosures they make by their statutory auditor and this influence is strong' (Krzywda and Schroeder, 2007:86)
Major firms of auditors also influence the accountancy profession through their membership

of the National Chamber of Statutory Auditors (*Krajowa Isba Bieglych Rewidentow*). This professional, self-regulated body was formed in 1991 by the enactment of the Audit Act 1991 (*Ustawa z dnia 19 października 1991 o badaniu i ogłaszaniu sprawozdań finansowych oraz biegłych rewidendach i ich samorządzie*). The Chamber accredits all auditors practicing in Poland so it is a powerful association at national level. The interviews revealed that this organisation is seen as focusing on the interests of its members rather than promoting the highest standards of audit quality. The large firms of auditors can act as agents for change to this inward orientation through their financial contributions. As the contributions are based on firms' turnover the top global firms are gaining far greater participation and influence than was achieved in the past whilst denigrating the position of smaller firms that earn lower revenues and therefore contribute less. In this sphere, once again, the tension between change and adherence to traditional practices become apparent. According to Greenwood *et al* (2002:73) the smaller firms 'are much more embedded in the institutes' routines. Consequently, the routines of professional association may work to reproduce prevailing practices, but their influence will be distributed unevenly'. The engagement of international firms acts as a conduit for normative change as proposed by DiMaggio and Powell:

> *'The National Chamber of Statutory Auditors was a completely closed shop to the international firms but now we pay them one per cent of our turnover so we have our people represented. The Chamber earns in the region of eighty per cent of its income from the western firms '*
>
> *(Chief risk officer and partner of Big-4 global firm interviewed 14th February 2010)*

The above statement explicitly shows that resource dependency is a critical factor in the strategy of acquiring power and influence by international firms within the national auditing body. This power is indirect and ongoing allowing international firms to participate at the established institutional level and thereby embed themselves in the country's existing institutions.

The use of phrases such as 'our people' suggests an 'us and them' perception which again confirms a gulf between the national institutions and the Big-4 firms. The recurring thread from the Big-4 interviews is that the financial reporting field is not homogenous but contested and conflictual.

On the other hand, the Big 4 firms are not as influential in Poland as they are in Western economies due to the domination of the state. The procedural steps for standard setting are well established in the international setting. In Anglo-Saxon economies and at IASB 'best practice' evolves out of a transparent process involving consultation and responsiveness on the part of the IASB (International Standards Committee Foundation, 2006). Proposals for major accounting changes are publicised in advance giving opportunity to all interested parties to participate. Draft discussion papers are widely circulated to various groups of stakeholders as well as the academic body and responses to new IASB proposals are posted on the IASB website. Decision to undertake particular projects are taken at public IASB meetings and those proceedings of IASB meetings are videoed and also published on IASB website. The process of standard setting follows a prescribed format involving the publication of discussion papers and exposure drafts before the final standard is published. At each stage the IASB invites public comment to ensure that full consultation takes place. This process allows the Big 4 firms to contribute to the debates and to influence the outcomes.

In contrast, the cultural background of Poland means that there is no experience of consultation and many decisions are made internally by various departments of the Ministry of Finance without reference to stakeholders. The inability of the audit firms to develop strong networks that can transcend individual organizations in the field provides a powerful explanation for the weakness of the accountancy profession and lends support for the first proposition of the thesis. This was evidenced by an audit partner of a major firm of accountants:

> *'We know that the Ministry is working on a project but we do not always know what it is. There is a process of consultation but the notification is received say two or three weeks before the changes are adopted so there is no time to influence anything.'*
>
> *(Audit partner of a Big 4 firm of accountants interviewed 15th February 2010)*

This lack of consultation can be interpreted in either as a deliberate method of retaining power by the Ministry or as a cultural underlying feature. Although the outcome is the same the motivations would be very different. In the former case if consultation does not take place then the Ministry avoids having to explain, account or compromise with the firms of accountants who would gain influence as a result of this process. This withheld knowledge therefore gives the Ministry officials power through information asymmetry. The latter interpretation arises from the historical and cultural Polish orientation. Consultation does not take place because Polish tradition under communism was to impose from above and this method of operation has been accepted by the society and the Ministry continue in their set routines avoiding change. If this approach is accepted the Ministry processes are simply evidence of institutionalized behaviour without any desire for exclusion of the accountancy firms. In this study it was not possible to separate the different motivations but the power explanation can be supported with other evidence in the research.

The review of the website of the Ministry of Finance confirms that view with no evidence of public consultation either by the Ministry itself or by the Polish Accounting Standards Committee. The Committee publishes minutes of its meetings although all references to issuance or revision of standards relate to the actions of the Committee members but no external input was identified. The general tendency towards secrecy by government bodies means that even if there are any comments submitted on proposals they are not published for other interested parties to see and so it is very difficult for the Big 4 firms to prepare a co-ordinated response and to engage in debates that would influence the changes to accounting regulation in Poland.

Although the findings of this study clearly point to the considerable power of the Ministry of Finance the relationship between the large audit firms and the state is more complex than that suggested above. It must be appreciated that the large firms of auditors are also complicit with the state regulators and do not exert as much pressure on the Ministry in order to safeguard their own commercial interests. As discussed in section 5.4.4 the state is a significant investor in many of the largest Polish companies, all of whom are audited by the Big 4 firms of auditors so there is a clear conflict of interest for the firms in their role as promoters of best accounting practice and auditors of state controlled enterprises. It is in the interest of the audit firms to maintain good relationship with the Ministry in order to retain the lucrative audit and consultancy contracts. Given the dual role played by the state as both a legislator and an investor it is unlikely that the audit firms would challenge the Ministry on regulatory and legislative issues if this action would risk losing the audit contracts of state controlled enterprises.

The audit firms are also reluctant to associate too closely with the Ministry in order to be seen to be independent of any political party. It is a feature of the Polish society that the senior civil servants are not fully independent, as is the case for example in the UK, but are appointed by the politicians. Due to frequent changes in government resulting from unstable coalitions the position of the officials is not secure because it is likely that they would be replaced on the change of the ruling party. The audit firms wishing to protect their own long term interests are therefore taking a rational stand in not wishing to be seen as supporting any single political party through a close association with the Ministry of Finance.

To sum up, the auditing firms impact on accounting practice in Poland both directly through their statutory role as company auditors and also indirectly through their influence on the legislators in shaping accounting regulation. From the investigations carried out it can be concluded that Big 4 firms of auditors have considerable influence on companies that ensures compliance with IFRS. Where there is a failure to comply the Big 4 firms are sufficiently powerful to challenge the companies and issue qualified audit reports. Small audit firms are less likely to issue qualified audit reports and more likely to condone lack of compliance with IFRS. This leads to a conclusion that whereas Big 4 firms promote change smaller firms compromise and play a limited role in ensuring full adherence with IFRS.

The institutional features of a transition economy hinder global accountancy firms from being able to influence effectively the legislators involved in accounting regulation. As was the case during the communist era the Ministry of Finance continues to impose regulations in a top down manner and the audit firms have not been able to participate effectively due to lack of openness and transparency of the regulation setting process. On the other hand the auditors are also complicit in their reluctance to engage arising from a conflict of interest in their role as auditors of state controlled enterprises and as stakeholders in ensuring best practice in accounting. One state institution where Big 4 firms have been able to influence since the start of the transition is the National Chamber of Auditors. This government endorsed body has in the past operated in a closed manner but financial dependency on the Big 4 has forced that institution to change as a result of external forces.

5.3.3 Accounting education

One of the key consequences of the transition to market economy in Poland has been the creation of an accountancy profession that is totally different to the accountant's role under communism as described in chapter 2. The modern accountancy profession was created in a much shorter time than has been the experience in market economies. For example the finance profession in the US was developed gradually over a period of 30 years Lounsbury (2002) in comparison to the 10 to 15 years that Polish accounting profession took to gain authority and status. This enhanced status and pivotal role played by accountants can be attributed to the fact that accountants needed to acquire high level of technical expertise in order to report financial performance, apply IFRS, meet investor needs, all of which were unknown activities during the communist era. In terms of professional accountancy education in Poland a parallel development of national and global training has been taking place since the 1990's whereby the global qualification ACCA was competing against national qualification set by the Polish Chamber of Auditors. Lack of access to this body created a closed shop and forced many international firms to rely on international professional bodies for training.

> *'I started to work in the Warsaw office some fifteen years ago and at the time our firm did not even have the opportunity to sit the examinations of the Chamber of Auditors (Krajowa Isba Biegłych Rewidentów). When we were able to put forward our staff for their examinations only one in two hundred entrants passed'*
>
> *((Chief Risk Officer and partner of Big-4 global firm interviewed 14th February 2010)*

In contrast to the high barriers to entry experienced since the start of the transition, auditors who practiced as State Authorised Auditors prior to the formation of the National Chamber of Polish Statutory Auditors in 1991 were admitted to the Chamber without any formal examination. Currently there are approximately 500 registered auditors trained under the new regime and some 6000 registered under the old regime (Kosmala, 2007). This divergence in the level of qualification within an institution acts as a powerful explanatory factor for the variable audit quality observed and evaluated by the technical audit manager of the major firm of accountants in section 6.2 of this chapter. As some twenty years have passed since the start of the transition many of the 'old' style accountants will be reaching the retirement age and so demographic changes will result in a more homogenous profession.

Current requirements for the qualification as state registered auditor are set out in the Audit Act (2009) (*Ustawa z dnia 22 maja 2009 r. o biegłych rewidentach i ich samorządzie, podmiotach uprawnionych do badania sprawozdań finansowych oraz nadzorze publicznym*). The Act clearly demonstrates the continual influence of the Ministry of Finance. Firstly, by setting out the broad syllabus for the qualification rather than devolving this function to the professional body and secondly by retaining the majority of seats on the examination committee where the Ministry of Finance retains 10 out of the 19 members.

The power of the state has however been reduced by the mutual recognition of accounting qualifications imposed by the European Commission in the 8^{th} Directive (2006), and incorporated into Polish Audit Act (2009), precluding the perpetration of the 'closed shop' mentality of the national auditors. In particular the EU directive states that: 'It should therefore no longer be possible for Member States to insist that a majority of the voting rights in an audit firm must be held by locally approved auditors or that a majority of the members of the administrative or management body of an audit firm must be locally approved.' (European Commission: Article 6 of the Directive 2006/43/EC)

The effect of the Directive has been to allow global qualification such as ACCA (the Association of Chartered Certified Accountants) to be recognised and to break the power of the National Chamber of Statutory Auditors leading to greater internationalisation of the accountancy profession. The majority of the audit firms now accept either Polish qualification from the Polish Chamber of Auditors or an international qualification. In the long term the divergence in the educational background of the audit members that have been subject to rigorous professional training and those that have not will close but so far the differences conspire to weaken the profession.

5.3.4 Section summary– the role of accounting profession

The above analysis investigated the role of accountancy profession in the adoption of IFRS and in so doing has provided insight into the changing nature of the accountancy profession.

According to institutional theory actors within an organizational field interact with eachother in a stable and predictable manner which is well understood by all participants. Furthermore professions are expected to be a homogenous group with strong networks, similar background and shared beliefs. This study has revealed that accountants in Poland do not conform to this profile. They are not a uniform group but consist of academics, Big 4 international firms and local accountants many without professional qualifications and so the pressure they exert is more fragmented and therefore less strong than in an Anglo- Saxon context. The dominance of the state in shaping of Polish accounting legislation has meant that the emergent firms of accountants have not been able to network effectively and to transcend the individual organizations and so have not been accepted as the unquestioned authority on accounting matters as is the case in many Anglo-Saxon economies.

It is also evident that Polish accountants are subject to pressures arising not only from investors but also from the state and from their historic background of the actors. The existence of multiple logics lead to lower level of adoption of IFRS than suggested by the proponents of the International standards.

The study also revealed that the field of accountancy is not static but contested with the Big 4 firms intentionally attempting to gain power and influence and in so doing they are changing the profession at the regulatory level as well as at the in-company level. The relationship between the international firms and the local actors has been shown to be conflictual clearly pointing to the fact that the international firms through their entrance into Poland have undermined the existing structures by introducing different logics and beliefs.

The findings also confirm the positive impact of the major firms of auditors on financial reporting practice as they fill the gap between the internal capabilities of the companies and the expectations of the IFRS regime (Oliver 2001). Polish accountants lack both the technical and or language capabilities to fully implement the IFRS. The large distance between IFRS requirements and Polish Accounting Requirements as shown by the comparability indices makes the conversion to IFRS difficult. Review of financial statements illustrates that where there is a Big 4 firm of auditors digressions from regulatory requirements are more likely to be challenged than where the auditor is a local firm.

Big 4 firms play an important role in the diffusion of investor orientation and the understanding of IFRS to the wider professional audience. As the Big 4 are seen to be experts in this field they are able to interpret and guide their clients thereby building a shared understanding. This indirect influence is highly significant as it operates at deeper cognitive level rather than rule level which is more likely to be challenged or manipulated. However, the Big-4 firms also have a negative effect on the local accountancy firms. The perception of being experts is largely diffused by the Big-4 firms who by the use of negative language about the local accountants were able to create a rift within the accountancy profession.

In the case of accounting education it is clear to see that the severe restrictions and adherence to the ‘old’ system that have been a feature of the state auditing body in Poland in the 1990’s has been transformed by EU driven changes. However, lack of consistent and comparable educational background of the members of the Polish Chamber of Auditors means that the shared sense of identity of the profession is not as well developed as in the Anglo-Saxon countries and leads to variable audit outcomes. The strength of the profession is also affected by the legal framework that not only specifies the syllabus for auditor training but also controls the entry process to the profession. Pressure for change arising from EU is acting to reduce the monopoly for accounting education of the existing body but the state, whilst implementing the changes, continues to develop laws that favour its involvement in the profession.

The state also has a direct impact on the behaviour of accountants once they have entered the profession through their regulatory role and tax raising function. As is explained in the next section the changes relating to state institutions are frequently resisted and it is the external pressures that lead to real institutional change.

5.4 The role of state agencies in determining financial statement quality

The second proposition identifies the various state bodies as being critical to the quality of accounting. This section evaluates the interview data to establish what impact the state has on accounting in Poland.

Accounting behaviour in Poland is based predominantly on accounting regulation arising from national and EU law and from tax authorities. These bodies play a critical role both in changing behaviour through the introduction of new legislation but also act as a constraining force preserving the uniformity and status quo arising from the communist era. As was discussed in section 5.3, the state through its legislative powers, has also been instrumental in the formation of National Chamber of Statutory Auditors or KIBR. National law and fiscal regulation arise from two departments within the Ministry of Finance which has existed as a government body since the communist era. The Ministry was responsible for the financial management of the command economy and the legacy of control and coercion continues to dominate. This adherence to social and cultural behaviour arising at the time of founding of the institutions have been referred to as organisational imprinting (Scott: 2008) and explains the persistence of practices that were a feature of a centrally planned economy. This was explained by a former employee:

> *'The government wishes to retain as much central control of the subjects as it can. Even when the EU relaxes some of its regulation the Ministry will find alternative rules in order to keep its power. After all, these are the same people that were employed during the communist era and they were simply moved to another building.'*
>
> *(Former Ministry of Finance employee interviewed 8th October 2008)*

The desire for the state to continue to control the accounting framework suggests that future regulatory proposals arising from the EU that are not mandatory are likely to be rejected as much for political reasons as for valid economic reasons. For example, Poland could converge with IFRS further by adopting IFRS for Small and Medium Enterprises for the non-listed companies. However, even if this was a favourable course of action for Polish companies the Ministry of Finance officials have expressed great reluctance to move in that direction.

In the following analysis the impact of the state distinguishes between the influence of the accounting legislators, regulators and the fiscal authority. Although all agencies are located within the Ministry of Finance the remit of each agency is very different and they are therefore considered separately. The state also exerts its influence through direct shareholding in enterprises and this influence is also explored.

5.4.1 Impact of accounting regulation on accounting practice

According to the European Commission Regulation No. 1606/2002, group listed companies in Poland are required to use International Financial Reporting Standards (IFRSs) as adopted by the European Union (EU). This regulation has been incorporated into the Polish company law and so coercive mechanisms clearly play a fundamental role in the development of Polish accounting principles. In order to adhere fully to the EU requirements the role of the accounting function had to change from being a passive processor of information to being a key player responsible for providing information for decision making and raising finance on capital markets. Lack of comparability in legislation arises from the fact that Polish listed companies that do not prepare consolidated accounts continue to apply Polish Accounting Regulation thus maintaining a dual system of accounting. The impact is to reduce the comparability between listed companies depending on whether they are consolidated or not.

The organisational features of imprinting by the Ministry of Finance dating to the communist era continue to play a critical role in ensuring uniformity in Polish accounting and act as a major obstacle to change. The experience gained by the accountants within command economy was not relevant for future performance and Newman (2000:606) argues that:' in Central Europe the effects of institutional upheaval were felt quickly and strongly.' The high degree of accounting control over enterprises under communism was achieved by the Ministry of Finance by specifying, in detail, not only the tasks to be performed but also the format of data collection and the timing of returns. For example enterprises were required to produce uniform chart of accounts on regular basis. The review of financial statements shows that over fifty per cent of companies sampled continue to adopt the old chart of accounts format that is both difficult to understand and extremely limited in the information that is conveyed. This has been discussed in depth in section 5.2. The accuracy of recording of the data was paramount in the production of accounts, as one of the interviewees who was an accountant prior to the fall of communism stated:

> *'Our job was largely to process information. We were required to submit monthly returns to the Central Statistical Office (Główny Urząd Statystyczny or GUS). The work was very time consuming and we were as busy as we are now but we could never see any benefit of our efforts as the information was never really used within our enterprise.'*
>
> *(Accountant from a Swiss owned subsidiary employed prior to 1989)*

The above quote clearly demonstrates how the actions of the state meant that, within command planned economy, the decision making and higher aspects of financial planning were removed from the accountants' responsibilities thereby reducing their function to a purely clerical role that did not require any higher level of technical competence. It is also apparent that the separation of control from the recording of transactions meant that the accountants had no understanding either of the value of their work or the processes in which they were engaged. Furthermore, under a command economy standardization of financial reporting was a key requirement for effective control over enterprises. The system called for a high level of detail and did not allow the use of judgment which would have the effect of reducing the level of standarisation. The combination of routinising and prescribing tasks by the state coupled with a lack of comprehension of the accounting function resulted in the deskilling of the accountancy profession to the extent that the role became one of a clerk or a book-keeper. The outcome of this deskilling process was that at the start of the transition accountants were ill prepared for the role of a professional decision orientated accountant found in the market economies. In line with the findings by Elbannan and McKinley (2006) it is evident that in the face of a significant level of uncertainty during transition and ambiguous regulation set by IFRS Polish accountants continue to adopt the old templates that give them security and certainty of action.

Reflecting the economic and political transformation Polish accounting profession also needed to undergo a process of reconstruction from the role of book-keepers and low level clerical staff to elite accounting profession of managerial standing. Although very little research has been done in this area the state clearly plays an important role in this context.

The Ministry of Finance officials appear to play the role of intermediaries between Polish practitioners and the outside influences arising from IFRS. They understand the Polish context and try to find local, practical solutions that accommodate the Anglo-Saxon framework so that it can be applied to Polish reality.

This is exemplified by a Ministry of Finance employee:

> '*Our accountants are used to having detailed treatment given step by step. In this accounting transaction you should do this and in another do this. They (accountants) want to be led by the hand and it is a real problem to change this philosophy. They find this difficult. They have to move to a market economy from a socialist system where they were used to preparing accounts using a plan of accounts. This is what they expect from accounting law. It is a real challenge to change the mentality of the older accountants who are looking to produce extremely detailed and precise figures.*
>
> *(Ministry of Finance official interviewed 17th February 2010)*

It is interesting to note that the legislator is fully aware of the expectations of the accountants and feels that the Ministry would be failing in their duty if they did not provide a detailed guide to the accountants in the actual legal acts. This orientation is very different from the standard setting process adopted by IASB where implementation of standards is primarily driven by principle based considerations and implementation considerations are either taken account of in the consultation process or as supplementary information to the standard. The views of the Ministry of Finance officials contradict the survey findings by Walinska and Urbanek (2001) of 550 accountants who found clear preference for the development of local Polish Accounting Standards rather than relying on legal changes. This discrepancy would confirm the views that the Ministry acts to maintain its position and standing at the same time as Polish accountants are becoming more professionalized thus seeking greater autonomy and self-regulation. This tension between the relative powers of the state in comparison to the rising importance of the profession is a feature of transition economies and the actions of the legislator undermine the principle based accounting of IFRS by adhering to the existing routines. Within the institutional framework this action can be interpreted as manipulative response to institutional pressure. Oliver (1991:157) defines manipulation as: 'the purposeful and opportunistic attempt to co-opt, influence or control institutional pressures and evaluations.' This response is more potent than defiance adopted by companies when they fail to comply with IFRS because it actively changes and challenges the regulatory requirements of IFRS and at the same time increases the legitimacy of the Polish rule based system.

Review of official documents such as the Polish Financial Supervision Authority (2009) report on the review of financial statements show that the report is almost devoid of evaluation. The focus appears to be on the presentation of facts that are supported with detailed references to statute and IFRS. The end report is extremely difficult to read and suggests that the KNF are unable to say anything without an endorsement from IFRS.

Similar findings were reported by Kosmala (2007:327) in the context of audit independence in Poland who states: ‘In order to demonstrate knowledge and expertise there is an urge to appear to comply with regulation. Ability to provide an adequate citation, somewhat demonstrated the professional competence. The rule based approach is emphasized as the tradition of Polish practice’. It appears that Kosmala (2007) considers the rule bound behaviour to be a national cultural feature of Polish accountants. This study maintains that although cultural characteristics may play some role, rules have a vital role to play in that they provide a coping mechanism for the accountants in the face of a fast changing legal and economic environment. A paradox emerges from the interviews in that accountants display clear preference for the rules yet at the same time resist the full implementation of IFRS. Kosmala (2007) also identifies this paradox as an interrelationship between wishing to retain professional freedom but at the same time conforming to rules set by the state. From an institutional perspective the adherence to rules also has symbolic and legitimating effect. If accountants can always support their actions with specific rules then those actions will not be questioned and there will be implicit acceptance of their decisions. However, the problem arises in that IFRS principle based approach is designed to in such a way that the specific rules are not always provided thereby leaving accountants without the safety of rules that they are seeking.

The framework developed by DiMaggio and Powell (1983) does not deal with the fundamental transformation experienced by Central and East European countries but we would expect there to be a greater degree of adaptation in Poland than in mature economies.

On the contrary, from the statement by the Ministry of Finance official, it is evident that Polish accountants are finding it extremely difficult to adapt to institutional upheaval and are looking to the legal framework to provide them with relevant templates or models to use so that they can connect to their previous experience. In many ways accountants are resisting the change in the face of economic and political transition. This view would support Newman's (2000:602) construct of: 'an inverted U-shaped relationship between institutional change and organisational transformation'. Newman purports that up to a point organisational transformation will increase as the institutonal environment changes but when the institutional level change is extreme and affects all aspects of society then the transformation will be reduced because: 'the context for operation is too chaotic, cause-effect relationships cannot be discerned, and past experience has little value as a guide for future action.' (Newman, 2000:605).

5.4.2 State Oversight of Accounting Practice

In recent years a system of financial oversight has been developed in Poland to enhance the quality and reputation of Polish financial institutions by developing regulatory frameworks based on international models. An example of such supervision is Polish Financial Supervision Authority (*Komisja Nadzoru Finansowego - KNF*) which aims to achieve best practice by the adoption of the CESR's (Committee of the European Stock Exchanges) guidelines. However, in spite of the best intentions the KNF appears to be unable to adapt to the Polish environment and according to one interviewee, who worked in the Supervisory Commission for the Warsaw Stock Exchange that was subsequently subsumed within the broader Financial Supervisory Commission, is no longer seen to be effective:

'I worked in the Securities Commission (Komisja Papierów Wartościowych) before taking up my present post as an analyst. It should be interesting work attracting the best people. In the 1990's the Commission was more dynamic and was acting more spontaneously when the Warsaw Stock Exchange was first formed. But from year to year this institution becomes more set in its ways. Maybe these institutions should be dissolved every few years'

(Investment Analyst and Fund Manager investing in Polish listed companies interviewed 15th February 2010)

The lack of real oversight by Polish Financial Supervision Authority is evident when the report produced by this body on the level of compliance with IFRS for Polish companies was considered (Komisja Nadzoru Finansowego, 2009). The report reviewed financial statements of 66 Polish listed companies and found that the information given be companies was incomplete, not fully clear and not transparent. The report then listed, in bullet form, around 50 specific deviations but there was no attempt to either evaluate the magnitude of the problems or to suggest possible remedies. It was simply a statement of fact that clearly aimed to meet with CESR principles but had no real role in improving the compliance of Polish financial statements as there were no details of the firms or the action that the Commission took to remedy the errors.

More specifically the value of supervision over financial reporting has been questioned by an audit manager who echoes the previous findings:

> *'Part of KNF (Financial Supervisory Commission) has responsibility for the review of financial statements. They concentrate on companies that are entering the market as this is, of course, the key moment. Then they review financial statements on regular basis. I have not heard that they (KNF) would engage strongly. Maybe there is insufficient number of people and there are a large number of new entrants so they focus on IPO's (Initial Public Offering) rather than what is already on the Warsaw Stock Exchange. These people are also learning but I can see that in the future they will ask increasingly more difficult questions of companies who in turn will need to seek expert advice or improve their own knowledge.'*
>
> *(Audit manager of Big-4 global audit firms in Warsaw interviewed 15th February 2010)*

The above quote indicates that the Warsaw stock exchange is characterised by a large number of new listings that preclude the Commission from fulfilling its ongoing enforcement function. Therefore the specific market conditions applicable to Poland may not result in the same outcomes as in other capital markets although as Poland develops its institutions the level of enforcement is likely to be raised.

There is further evidence of increasing oversight in the auditing profession from the formation of a Commission for Audit Oversight (*Komisja Nadzoru Audytowego*) in 2009 *(Ustawa z dnia 22 maja 2009 r. o biegłych rewidentach i ich samorządzie, podmiotach uprawnionych do badania sprawozdań finansowych oraz nadzorze publicznym)* . The aim of the Commission, which was formed as a result of EU Directive, is to increase the quality of external audits and to improve the public and investor confidence in published financial statements. Although, there has been insufficient time for the evaluation of the work of this agency it is likely that in the longer term the actions of the Commission will raise the standing of the audit profession and improve the audit function.

However, once again the state has ensured its control by assigning a large number of the places on the Commission to the Ministry of Finance including that of the Chair of the Commission. This composition limits the independence of the Commission and precludes the selection of experts drawn from wider business.

In summary, the legacy of the communist system, through the actions of the state, continues to permeate the accounting function of the present day. During the communist era the state required standardized and detailed information to be produced for central planning purposes. Although this central control is no longer exerted accountants continue to adhere to the old mentality preferring certainty and detailed instructions to be supplied by the Ministry of Finance. The other aspect of state engagement concerns its ability to enforce accounting regulation. The research suggests that enforcement continues to be very weak and ineffective and in spite of the fact that recourse to law is possible this option has not been exercised by the auditors or the regulators. Enforcement of financial reporting of listed companies has been delegated to KNF who have instituted a system of oversight required by CESR but once again the actions appear to be ceremonial with no evidence of transgressions being dealt with in an effective manner.

5.4.3 The role of fiscal regulation

Undoubtedly, the most important agent for determining the nature of accounting through enforcement is the tax authority (*Urząd Skarbowy*) either through direct demands or through their influence on Polish accounting law. The power of individual groups was identified by Covalesky and Dirsmith (1988:585) who, in their study of budgeting process, found that ‘powerful groups used their power to enforce institutional compliance’. In Poland the tax authorities contribute to the symbolic application of IFRS because accounting bodies are less powerful than tax authorities and so the compliance with tax legislation will always take precedence over accounting legislation. This power was originally vested during the communist era when in the 1970’s some elements of competition were introduced into Poland and the fiscal authorities were given additional powers to collect tax revenues and to request audits of state owned enterprises. In the present environment the power of the tax authorities continues through a draconian system of penalties and is enhanced further where there are no clear regulations and tax officials become the ultimate arbitrators. The taxpayer’s position in relation to the authorities is further reduced by the inefficient functioning of the courts which would, in a more efficient economy, be relied upon to act in a balanced and fair way. This constantly changing and uncertain fiscal position lead companies to avoid making any changes because the outcomes are uncertain.

This was explained by one ex-Ministry of Finance official:

> *‘Lack of clarity in the tax law frequently gives additional powers to the authorities and in reality an individual has very little power in relation to the state. We recently had a case where tax clearance was sought and given from the tax office on a VAT issue. Subsequently the same office claimed payment of VAT and large penalties for the very thing for which they had given clearance! They took over the company offices and stock and the company was forced into liquidation. Recourse*

can be sought through administrative courts but the process can take five or six years. The courts can nullify the original decision but cannot change the decision. In effect the tax payer is sent back to the tax authorities who can then give a ruling that is only marginally different from the original decision.'

(Former employee of Ministry of Finance interviewed 8th October 2008)

This lack of clarity in fiscal law has also been noted by the management of one of the largest Polish petro-chemical companies, PKN Orlen SA:

'The general opinion of Polish industrialists is that Poland is a country that has excessively large fiscal risk. Frequent amendments to fiscal regulations make them unclear and ambiguous, and produce different legal interpretations within administrative bodies themselves and between those bodies and tax payers. The taxation system in Poland is unstable. The system is highly regulated and enforced with rigorous sanctions'

(Notes to the consolidated financial statements of PKN Orlen S.A. Capital Group for the year 2005:177)

When asked, all interviewees named the tax authorities as being the main source of coercion sanctioned with heavy penalties for non-compliance and bureaucratic means of operating. This power is exercised at the expense of accounting compliance which is weakly or very rarely enforced in spite of the fact that the Accountancy Act allows for penalties and imprisonment for up to two years for non-compliance. Report of the Observance of Standards and Code in Poland (ROSC) (World Bank, 2005:3) confirms this view: 'Despite a high incidence of qualified audit opinions the ROSC team found little evidence of sanctions, either legal or market driven, against directors of companies where the financial statements included a qualified audit opinion' Nevertheless state influence in the Polish psyche is pervasive:

> *'Accountants are extremely scared of the state institutions, of paying penalties, of being investigated.'*
>
> *(Ministry of Finance official interviewed on 17th February 2010)*
>
> *'We have many issues with the tax offices such as the length of tax control visits, slow repayments and difficulty in pursuing legal cases through the courts.'*
>
> *(Audit partner of a medium sized international accounting firm interviewed on 16th July 2009)*

The high level of compliance and adherence to fiscal rules also demonstrates the coercive nature of the relationship between the entities and the tax authorities. The tax offices retain a high level of control either through physical visits or detailed rules that need to be followed.

This has been summarised by one accountant:

'We are in a tax repayment position so a tax official spends at least two days a month at our premises. They require corroborating evidence for every allowable expense claimed. My time is mostly spent dealing with these people'

(Company accountant interviewed on 9th July 2009)

As the tax authorities are perceived to have far greater coercive power than auditors the tax based information is often used as a proxy for the official financial statements and provide a source of information about the financial position of companies:

Poland is so leaky in terms of information that financial statements are not that useful as everyone knows what is what. Monthly Corporation Tax returns are filed so unless there is a fraud there is very little difference between the sum of monthly tax returns and the year- end profit.

(Audit partner of a medium sized international accounting firm interviewed on 16th July 2009)

The fiscal requirements continue to shape accounting in Poland and the interviews point to compliance with tax legislation and simplicity of recording of transactions as being the primary factors affecting accounting practice rather than meeting shareholder needs.

These priorities are explained by an accountant:

'We are not concerned with following a method that may give a more meaningful result. If the tax authorities permit the write off of certain payments we will always do that because it is the simplest method.'

(Chief Accountant of a Swiss owned company interviewed on 10th July 2009)

Whereas in Anglo-Saxon countries the full impact of different accounting treatments on the various performance measures would be considered, in Poland the impression is that these issues are not important and externally there is little value in producing the financial statements. In fact, the value of the financial statements appears to be the basis for tax calculation and little else.

In addition to the direct influence of the tax authorities coercion is also exerted by linking tax law to accounting law thus preserving the old systems of control. It could be argued that the Ministry is unwilling to relinquish power to determine the form of accounting in Poland even if the IFRS for small and medium entities, which was published in 2009 and is designed to reduce complexity, is accepted in the EU:

'We need to have our own system of accounting and not just IFRS accounting for tax reasons. We would like to reduce the cost of accounting for businesses. What is possible to utilise from accounting for tax purposes would be preferable. This is an important element otherwise small entities would have to prepare both IFRS accounts and tax computations. Businesses are far more concerned to ensure compliance with the tax office rather than accounting. The differences between Polish Accounting law and tax law are small. There are obvious differences but all

companies know what the differences are so this is not a problem. This is much simpler than having to apply IFRS.'

(Ministry of Finance official interviewed on 17th February 2010)

The fiscal authorities play a dual role through a coercive direct influence on companies but they also shape the accounting law through their influence on legislators. The Polish framework of accounting has a well embedded, institutionalized relationship between taxation and accounting which hinders change in a national context and requires external influences to effect institutional transformation.

In summary, the role of the state in a transition economy such as Poland is pervasive in shaping the accounting practice through legislation, fiscal authority, and participation in state owned enterprises. The accounting differences arise predominantly from a tax orientation of Polish law and lead to a lack of comparability between those companies that report under Polish regulation and IFRS companies.

It is apparent that there are competing demands being placed on accountants originating from two state agencies namely, tax and accounting authorities. However, the relatively greater coercive power of the tax authorities ensures that tax compliance is achieved but at the expense of accounting enforcement. The interviews revealed that accounting enforcement is rarely exercised and the penalties are ineffective. This would suggest that the impact of the various state organs is variable and is largely dependent on the relative power of each agency. The scale of penalties affects the resources of the companies and the so there is a resource dependency aspect to the relationship which is discussed in the next section.

5.4.4 The role of the state in its capacity as an investor in former state enterprises

A defining feature of transition from communist to market economy is the privatization of state owned enterprises. This was successfully achieved in Poland with 70 per cent of state enterprises having been privatized by 2001 (OECD, 2001). However, some of the largest enterprises still retain government participation where private investors would consider the investment to be commercially unattractive. Whereas private firms are influenced only indirectly by the state either through legislation or tax collection, in the context of state owned enterprises, the state plays an important direct role as an employer, manager and an investor. This has wide ranging implications because as has been shown by La Porta Lopez-De-Silanez and Shleifer (1999) most large corporations even in advanced common law countries are controlled either by the state or families. Furthermore, in their empirical work the authors found that these state or family shareholders have control that far exceeds their entitlement to cashflows, that they actively participate in management and that their power is not augmented by other shareholders.

In the sample selected, four out of the ten largest Polish companies were previously state owned enterprises and the Polish treasury continues to influence the business environment through direct shareholding. The companies are all very large and located in the energy and heavy industry sectors employing tens of thousands of workers. The continuation of state ownership means that competitive change is more difficult to achieve and so the influence and attitudes of the old system continue to be diffused to a far greater extent than would be expected in a capitalist market economy as explained:

> *'I follow the energy sector and this is a different world from the normal private companies. They have arrangements with the regulators and it is a structure set in stone. They were operating in the communist era and they live in yesterday's world. Part of the problem is that where the state is a major shareholder the remuneration set for the directors is very low as compared to the private companies. There is a difference in motivation and they are not putting in as much effort. Management is very poor although they may have very good technical knowledge. This may arise because they have agreements in place that do not allow redundancies for many years. Eventually they will change but this will take many years'.*
>
> *(Fund Manager investing in Polish listed companies interviewed 15th February 2010)*

Normally changes in skilled labour would act as a conduit for change but it is clear that low salary levels inhibit progress. The imprinting of the previous system is in fact reinforced by inflexible labour practices and lack of recognition for excellence in management.

Nevertheless, the state owned companies are responsible for what are perceived to be national assets and so have a broader range of stakeholders than privately owned companies. Given this public interest role there is a greater political imperative to communicate with stakeholders as widely as possible in terms of corporate reporting. These enterprises require greater level of endorsement and legitimacy to fulfill their role rather than needing to provide value relevant information to the markets. In the sample studied all of the state owned enterprises produced investor orientated accounts and employed big 4 firm of auditors suggesting that the quality of the financial statements is be higher for former state owned enterprises. It is however interesting to note that none of the companies that are state owned adopted IFRS on voluntary basis prior to 2005 although they were in the largest ten companies and so could be expected to lead in the development of best accounting practice.

Overall, the results regarding the influence of the state as a majority shareholder appear to be contradictory. On one hand the state promotes openness and transparency in financial reporting but in other ways it hinders progress though its adherence to existing practices.

5.5 The impact of resource dependency on the quality of financial statements

The final proposition of the theoretical model predicts that the level of compliance with IFRS will be greater where there is the greatest economic necessity for companies to raise funds externally.

Where companies can see a clear economic advantage in adopting IFRS they are far more likely to accept the new framework and produce high quality IFRS financial statements that enhance the value of the information supplied to the shareholders (Soderstrom and Sun, 2007). The introduction of IFRS has significant economic benefits and costs associated with its implementation as discussed in the literature review. The economic benefit accrues to the companies from listing on a recognised capital markets which may require the adoption of IFRS as part of its listing requirement (Soderstrom and Sun, 2007). However, the implementation of IFRS is costly in terms of acquisition of know-how, changes in reporting procedures and adjustments required to IT and other operating systems. It is only when the benefits exceed the costs that real compliance will take place. Where companies see little benefit for the organisation they will adopt a compromise position by stating that the company has complied with IFRS in order to meet the regulatory requirements but in reality they fail to conform fully to the IFRS provisions Carpenter and Feroz (2001). In the latter case the adoption of IFRS will be largely ceremonial aimed to satisfy the regulator with little change in the existing and accepted routines.

Unlike the major Western stock exchanges, the Warsaw Stock Exchange is characterized by high concentration of shares held by strategic investors and a low level of liquidity (Kozarzewski, 2003). For Polish companies where there is a strategic investor there is a lower imperative to communicate with stakeholders as the investor can obtain information directly through private channels without being reliant on published sources. In contrast, where the shares are dispersed the company has a greater motive to communicate widely to ensure the continual demand for shares as explained below:

> *'There are a lot of listed companies but their capitalisation is low, really these companies should not even be listed. These companies feel that there is no need for the stock market which is just a necessary evil. If they have a strategic investor then only a minority of shares are listed and these companies really do not care about investor dialogue'*
>
> *(Investment Analyst and Fund Manager investing in Polish listed companies interviewed 15th February 2010)*

Further incentive to disclose information is linked to the remuneration of the directors and consistent with the positive accounting theory (Watts and Zimmerman, 1979). Managers will ensure that potential investors have all the information that they require if the additional information disclosed leads to enhanced share price. This was elaborated upon by a fund manager investing on behalf of a US financial institution:

> *The largest companies have very good IFRS information and they really care about investor communication especially when their remuneration is linked to the share price. The greatest value of this information for me is in the evaluation of foreign investments. We invest in Czech and Austrian companies and do not have the time to enquire into different national standards'*
>
> *(Investment Analyst and Fund Manager investing in Polish listed companies interviewed 15th February 2010)*

As would be expected, in the sample of financial statements reviewed more large companies produced investor orientated accounts than small companies. The large companies have a broader base of shareholders or have a foreign investor and therefore they are more likely to attach importance to communication with investors. In contrast the shareholding of the smaller companies is more concentrated in individual investors so there is less need to communicate with the minority of external investors.

When considering the smaller listed companies IFRS accounting does not afford the same level of competitive advantage and so the primary motive for the adoption of IFRS is to gain institutional legitimacy rather than any real benefit in terms of resources. In effect it would appear from the quote below that the whole process of producing financial statements for the investors is largely symbolic.

> *'Financial statements are the starting point for the discussion with management and not the answer. Really, I don't see the sense for smaller companies to produce fuller accounts as there are significant costs attached. I will never invest in a company where I didn't meet the management. It is even better if all the information is not there as I will then construct my own vision of the company. For example they may take profit on long term contracts at a point in time when I know they haven't even put a single spade in the ground to start the contract. I will only appreciate this by meeting with the company.'*
>
> *(Investment Analyst and Fund Manager investing in Polish listed companies interviewed 15th February 2010)*

Support for this view was also expressed by an audit partner who suggested that the market is well aware of market sensitive information well before the release of published information (see section 5.4.6). Comparability may therefore not be the most important goal as has been portrayed by the standard setters as investors are able to overcome the shortcomings of any regulatory framework and obtain the necessary information directly.

The general discussion with the investment analysts suggest that the type of accounting system applied by the companies was not of any great significance to the analysts. Both analysts interviewed were sophisticated users of financial statements as they were employed by US investment banks based in Poland and in London tracking Polish companies. It would appear that time pressure was a factor in the amount of analysis undertaken by them. The analysts were required to produce first recommendation within one hour of the publication of the results with a detailed analysis being produced by the end of that day. This short time span does not allow them to undertake a high level evaluation of complex accounting adjustments made on transition from one accounting framework to another. Meetings with management are however very highly valued and allow the analysts to adjust their forecast valuation models based on the evaluation of the discussions with the management. These findings bring into question the whole notion of usefulness of financial statements and support the view of Ball (2006) who argues that imperfect accounting information is of little consequence as the users will always be able to acquire the information without the necessity for regulation.

The preference for relying on personal contacts rather than formal channels and rules has been identified by Peng (2003) as a feature of transitional economies. Peng (2003) hypothesises that in the early part of transition there is a far greater reliance on personal networks which afford better quality of information than could be guaranteed by the regulatory framework. Peng (2003) contends that in transition there is uncertainty and the rules are not fully formed so personal networks are perceived to be a more reliable source of information. Evidence of personal networks observed in this study would suggest that the methods of communication common under communism and early transition continue to be a feature of the Polish culture persisting in spite of the changes. The implication is that the role of accounting in Poland is, at least for some companies, different than the investor orientated objective envisaged in the IASB Framework for Financial Reporting.

High percentage ownership from a single investor will impose significant power over the company and lead to change only if it originates from that investor. Conversely, where power is more diffused among investors then organisations are more likely to conform to regulatory pressures because all investors are seeking similar level of access to company financial information. Where there is a strategic investor there is far less pressure to publish meaningful information or enter into a dialogue with analysts. This would suggest that even where the strategic investor is a foreign holding company the majority holding by the overseas investor acts to hinder change.

A resource dependency relationship is confirmed by comparing the audit firms with the shareholding structure of the audited companies. The most striking finding is that large companies with highly concentrated holdings do not use global firms but prefer to use small audit firms whilst large companies with widely dispersed shareholding employ Big 4 firms of auditors. The concentrated companies are comparable in complexity to the other large firms and so it would be expected that they would employ global firms of accountants if technical expertise was essential. The review of financial statements revealed that, of those six companies not using global firms four have majority shareholders who are individuals and one company has a shareholder with an individual stake of 46 per cent. This finding supports the notion that companies owned by individuals are less reliant on the external funding and so they are less concerned with the preparation of published financial statements. For those companies, communication with the minority shareholders and the portrayal of a quality image is less important than it is for the companies with dispersed shareholding.

In contrast, where the shareholding is dispersed then in all cases a major firm of accountants is employed. Majority of large companies employ top 4 auditor firms either where there is no single significant investor or the influential investor is either the state or a foreign investor.

Table 9: Relationship between ownership structure and audit firm for the large company sample of 20 companies

Ownership structure of large companies sampled	No. of companies with big 4 audit firm	No. of companies with small audit firm
Polish state investor with influential share	3	0
Foreign investor with influential share	5	1
No single investor holding influential share	5	0
Individual shareholder with influential share	1	5
Total	14	6

(Sample financial statements of 20 largest Polish companies at 31st December 2005 listed on the Warsaw Stock Exchange)

The review of financial statements suggests that foreign investors hold a significant proportion of shares in Polish listed companies. This is not surprising as Poland has received huge inflows of foreign capital especially since its accession to EU in 2004 and this has had a deep influence on the development of Polish economy and business practices. According to

Ernst and Young (2008) Poland is the second most attractive investment destination after the UK having received 17 billion euro in 2007 (15bn euro in 2006) . The large scale foreign investment in Poland has acted as an agent for real change and the interviews point to the dynamic effects of investment rather than restrictive effect as proposed by DiMaggio and Powell (1983). All interviews pointed to the implementation of change and acquisition of know-how as a consequence of foreign investment rather than static adherence to existing practices. The change has been real and widespread and the interviews did not reveal ceremonial changes without substance.

> '*Since 1996 the holding company has invested over $1.5million in new accounting systems. We now receive detailed management reports and can obtain information in a much more meaningful way. Our key personnel have been to the US for training and we have regular in-house training on the new systems.'*
>
> *(Accountant working in a Swiss owned subsidiary interviewed 11th July 2009)*

Although it was evident that Polish companies were in many cases holding out the foreign companies as providing the best practice and a good example for local firms it is difficult to distinguish the mimetic behaviour from coercive pressure as frequently the two mechanisms were inextricably interrelated. The coercive aspect for the subsidiary to conform to group reporting procedures provides an example of this interaction:

> *'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 new IT systems 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 Chief Financial Officer.

(Accountant working in a Swiss owned subsidiary interviewed11th July 2009)

Many Polish businesses aspired to acquire the expertise and know-how of the foreign multi-nationals who were seen as being more successful than the Polish enterprises. This meant that the management of the subsidiaries was far less resistant to change especially since many Polish companies were at point of bankruptcy when the foreign investor stepped in:

'The Swiss have been very good to us. They continue to invest in this plant and we really can't fault them. At first they didn't trust us and you can see that from the pattern of investment. At first they invested a small amount and then increased the investment when they could see that they could rely on us to deliver good results'

(Accountant from a Swiss owned company interviewed 11th July 2009)

As was shown in chapter two the Warsaw Stock Exchange is still a relatively minor provider of capital to industry and commerce. Resource dependency rather than institutional conformity also lies at the heart of the changes driven by the banks who continue to be the main source of funding for businesses in Poland. In order to evaluate the loan application banks are demanding more financial information so as to evaluate the risks associated with the companies that are then used in the lending decisions. In this case the provision of accounting information affects the company's ability to borrow and the cost of the loans. These implications are based on economic efficiency principles and have little relevance to the gaining of legitimacy or ceremonial reasons. Financial statements are seen to be increasingly used as tools by a broader group of stakeholders this raising awareness of the importance of financial information in the broader society.

> *'Banks are important agents for improving accounting as they are finding it increasingly difficult to extract personal guarantees from the directors of companies so the banks are training their staff to use company financial statements to evaluate loan applications and for debt factoring. Financial statements stand between having security and not having security.*
>
> *(Audit partner of a medium sized international accounting firm interviewed 16th July 2009).*

However, the demand for financial information by banking institutions does not mean that the quality of IFRS will improve. Banks, through their power to grant loans, can demand information directly without companies needing to disclose better information to the wider public.

In summary, proposition three of the theoretical model states that the improvements to quality of financial statements will depend on resource dependency factors. In a transition economy the capital market is characterized by a large number of listed companies with either state participation or strategic investors. These companies have much lower imperative to communicate with external shareholders than would be expected in a large stock exchange. The above analysis has demonstrated that companies that have dispersed shareholding are highly dependent on the stock market for raising capital and make much greater effort to communicate with the investors through the production of investor orientated financial statements and greater disclosure which improves the quality of financial statements. These companies are also more likely to employ the Big 4 firms of auditors and, as was shown in section 5.3.2, the large firms of auditors act to improve IFRS accounts.

Conversely, where there is lower dependency for resources through concentrated shareholding, investor dialogue is less important and so the orientation of financial statements is not investor focused and so existing routines are maintained. Companies with highly concentrated shareholding are more likely to employ small firms of auditors who do not demand as high level of compliance with IFRS as Big 4 firms.

The clearest evidence that resource dependency is an important agent of institutional change is provided from the content analysis in the decision of companies to voluntarily exploit the revaluation option in order to increase lending capacity as discussed in section 5.2.6.

5.6 Relevance of IFRS in the Polish context

Having examined the actual financial reporting practices in Poland it is clear that although Polish listed companies have adopted the main provisions of IFRS there are considerable deviations particularly in the area of disclosure which would suggest that IFRS does not fit well in a country specific environment. Lack of relevance for local needs arises partly from country characteristics but also from the motivations of the standard setter who, according to Chand and White (2007) promotes the private interest of the major stakeholders rather than being concerned with the public interest of the country in which IFRS is applied. This section firstly, discusses the conflictual aspects of IFRS in the context of the existing structure of Polish accounting which, it is argued, renders the framework less useful in Poland than it would be in Anglo-Saxon countries. Secondly, the section focuses on the origins of IFRS themselves and critically discusses the motivations that drive the developments of IFRS by IASB.

The adoption of IFRS by Polish listed companies in 2005 was the result of EU directive so no account was taken by the supra-national bodies as to whether the framework was suitable for Polish conditions. Furthermore, none of the transition economies had any input into the debate regarding the terms of adoption of IFRS as the decision to adopt IFRS was taken in 2002, prior to the transition economies joining the EU. In fact the fundamental concern of the Polish state, regulators and audit profession at the time was to ensure that Poland met all conditions required for EU accession and not with any consideration of wider public interest responsibilities to a broad range of shareholders. Therefore, unlike local regulations the standards do not reflect the country's institutional, cultural or economic environment and so are less likely to fully reflect Polish companies' performance.

Although the advantages for the globalisation of accounting have been widely trailed for their ability to improve consistency and comparability of accounting this view ignores the private motives for the globalisation of IFRS that have been less well appreciated but are equally important (Rodriques and Craig, 2007). Focus on consistency, comparability and efficiency aspects of IFRS portrays the decision to adopt them as rational and economically derived so there is little opposition to their global adoption. If it is accepted that private motives are important then IFRS are not necessarily superior standards from the perspective of the users and so other local models of accounting may be more relevant. In the review of prior literature Chua and Taylor (2008) find only weak evidence for the economic benefits of the adoption of IFRS which leads them to conclude that economic advantages are overstated.

Improved comparability and consistency accrue from the adoption of IFRS to international companies that are listed on multiple exchanges (Daske *et al*, 2008). However, IFRS applies not only to multinational companies but also to all other listed local companies. The level of acceptance and therefore of compliance with IFRS by multinationals as compared to local companies will differ due to very different characteristics of each group of companies.

The thesis examined Polish listed companies which were not multi-nationals and argued that Polish companies gain legitimacy by decoupling their actual reporting practice from their statement of full compliance with IFRS. The adoption is largely ceremonial because Polish companies face strong institutional pressure from the state so they attempt to meet competing objectives from the state and from supra-national IASB complying superficially with IFRS whilst not meeting many of the detailed provisions.

The benefits of global standards for individual countries are much more limited. For example, Poland has many international companies but they are not listed on the Warsaw Stock Exchange so at the local level individual subsidiaries continue to report under Polish GAAP requirements and not IFRS so comparability is not enhanced. Doubts over assumed country benefits are also expressed by Chand and White (2007:613) who explain: 'it is of grave concern that international accounting standards are assessed to be suitable to the economy of Fiji, as minimal benefits may be realised by the domestic reporting entities, including local government, not for profit entities and large proprietary companies'

Whereas local companies are embedded in their institutional context causing them to become isomorphic with their environment multinational companies will attempt to avoid local regulation where possible and adopt global norms such as IFRS that suit their own mode of operation. According to Kostova, Roth and Dacin (2008:998)) multi-national enterprises and their subsidiaries: 'face multiple, fragmented, nested, or often conflicting environments'

Multinationals are able to chose different models because they are often under lesser pressures from local institutions to comply with all the rules and customs that are imposed on domestic companies. The desire by the local country to attract foreign investment has in many countries, including Poland become the central aim of the government policy so the multinationals are able to influence the regulatory landscape through their perceived expertise and Western outlook so that the institutional environment is more accommodating and flexible for these companies than it is for domestic companies.

Furthermore, multi-nationals typically enter a country with their own systems of operation developed in the context of multiple environments and are much more resistant to local influence. This means that they are less likely to engage in ceremonial action or be under strong isomorphic pressures to comply with local pressures. In the context of accounting, companies are able to produce financial statements using a single reporting framework thereby reducing the cost of having to reconcile accounts under different accounting regimes and reduce complexity of operating different accounting systems. This is a powerful argument that supports the notion of competitive isomorphism at international level so it is not surprising that demands for international standards have been embraced by global agencies and multinational companies who advise them irrespective of individual country concerns,

The pressure for the development of global standards has also been applied by the Big-4 accountancy firms who clearly benefit from globalisation but in so doing ignore the impact on individual country players. Although the Big-4 firms portray themselves as being different from other multinational companies preferring to be regarded as professional, expert and ethical organisations they are in fact private, profit driven multi-national firms that exhibit similar characteristics to the multinational enterprises. Invariably their survival depends on the fees earned from multinational companies and so their profit motive is far more important than the consideration of broader stakeholders in individual countries (Sikka, 2008). Like multinationals Big-4 firms operate in diverse international environments and so are less structured in local practices dismissing and disengaging from the local customs and practices. This lack of legitimising behaviour was apparent in the greater willingness of the Big-4 to qualify audit reports of Polish listed companies whereas local auditors condoned deviations from IFRS without qualifications.

In addition the Big-4 firms are seen as experts in the area of accounting and engage in the standard setting process so can influence the content of the standards to their own advantage. Big-4 firms are able to benefit financially by taking audit and accountancy work from the local firms on the grounds of greater expertise and better understanding of the language of IFRS. Through this competitive action Big 4 can penetrate markets that were previously closed to them as was the case with transition economies. For example in Poland Big 4 have been able to capture over 70 per cent of the audit work. These firms are able to exploit economies of scale in terms of knowledge acquisition, training and resources being able to deploy staff worldwide if the need arises. However, none of the advantages accruing to Big 4 benefit the local accounting profession and in fact their actions hinder the development of local expertise by concentrating the professional services in the hands of a few international firms. It is argued that the adoption IFRS actually puts the local accountants and companies at a disadvantage as they have more difficulty in interpreting the judgmental aspects of IFRS and overcome the language barriers. As was seen in this research Big-4 firms are very dismissive of the Polish GAAP and clearly feel that they are not able to provide appropriate IFRS accountancy and audit services.

The public interest argument was emphasised by Hail and Leuz (2007) who argue that it is insufficient to consider only the capital markets responses in evaluating IFRS as value relevance is only one aspect of the impact of IFRS. Greater disclosure of information to the wider audience including trade unions, pressure groups and tax authorities increases proprietary costs which must be offset against any liquidity or cost of capital benefits.

Criticism of the IFRS regime also arises from the nature of the standard setting process rather than the accounting needs of the countries. Using the power perspective, Rahman (1998) argues that the benefits of international standards are counteracted by the lack of participation and influence of the developing countries in the standard setting process even when they have equal voting powers. For example, Japan is one of the countries that has not yet mandated IFRS due to the standards' inability to reflect Japanese business orientation although even Japan has now agreed a protocol of convergence with IFRS and voluntary adoption of IFRS is permitted from year ending 31st March 2010 (Deloitte IAS Plus, 2009). The problem has been caused partly by the lack of Japanese influence in the standard setting process. The membership of IASB in fact includes only one Japanese representative out of the total membership of 15 in contrast to the US and EU who together hold 9 seats. The concerns expressed by the smaller nations appear to be vindicated by Zeff (2002) who believes that the objectivity of IASB has been compromised as a result of political lobbying which has adversely affected the standard setting process. Likewise, Durocher and Genron (2010) argue that there is minimal involvement of sophisticated users of accounts in the standard setting process and the IASB only plays lip service to the needs of the users in their taken for granted approach to fundamental concepts such as comparability.

The findings in this thesis show that in many instances financial reports of Polish listed companies are not dissimilar to those produced prior to the adoption of IFRS and so a question must be asked what are the tensions between IFRS and Polish GAAP that lead to lack of full adoption and is the IFRS framework the right system of accounting in Poland. The findings of this research are consistent with the results of a study by Dobija and Klimczak (2010) who, in their study of Polish companies in the period 1994 to 2008 showed that there was no increase in value relevance of earnings after 2005 when IFRS was adopted. If the IFRS were fully implemented and were of higher quality than local GAAP there would be an expectation that value relevance would increase. The findings would suggest that Polish listed companies compromise to meet the requirements without fundamentally changing the orientation of reporting so there is limited benefit to investors from IFRS.

The lack of real change in financial reporting is not surprising as: 'accounting is shaped by economic and political forces' (Ball:2006:5) and Polish institutional and cultural setting is very different to the sources of IFRS rooted in advanced market economies so tensions and inconsistencies continue even after adoption of IFRS. The foundations of IFRS lie in the primacy of the shareholders and so the financial statements are predicated on the notion that the information contained therein will be useful for investors in their decision making not for the government. Therefore, the adoption of IFRS framework may not be appropriate for Poland because, as was shown in the thesis, financial reporting is used for a different purpose than it was intended for,

IFRS are designed primarily to meet the needs of shareholders and so it is doubtful that the same framework would be suitable for different groups of users. Specifically, in Poland the state requirements rather than investor needs are highly influential and combined with weak accountancy infrastructure influence the financial reporting practice. This means that there is a multiplicity of objectives that may not be fully met by the adoption of IFRS and results in poor compliance. As was discussed in chapter 2.3 the power of the state in Poland is rooted in the Communist ideology of central planning. In economic terms the needs of the state were expressed through direct control over enterprises leaving individual organisations with very little autonomy or discretion to make decisions. The primary aim of central planning was to allocate resources within economy and accounting was the tool that was used to achieve that goal. Within this system the state needs took priority over the needs of the enterprises that had no external shareholders and therefore no profit motive. In spite of the fact that Poland has now transformed into a market economy the findings in section 5.4 show that in Poland the Ministry of Finance continues to dominate through taxation, regulatory and enforcement role and state shareholding of Polish enterprises. On the fall of communism in 1989 the authorities drew on the pre-war Germanic model to create continental system of accounting which is characterised by a rule based tax orientation and so again reinforced the role of the state.

Nobes (1998) argues that there are only two key variables that give rise to different accounting systems namely culture and method of financing. Using this classification model Poland could be classified as being ‘culturally dominated’ based on the fact that it does not have a own strong tradition of accounting and only twenty years ago became independent from the Soviet domination. Poland also exhibits features of ‘weak equity outsider’ where, the Warsaw Stock exchange is smaller, illiquid and generally less well developed than the Anglo-Saxon exchanges as discussed in chapter 2. Majority of financing in Poland therefore does not rely on capital markets but comes from direct foreign investment, bank lending and continued investment by the state. Drawing on this classification, in relation to Poland, the thesis supports Nobes' argument that the introduction of Anglo Saxon system of accounting to many of the post-communist countries may be inappropriate although where there is real societal commitment to equity funding a system such as IFRS could be adopted for listed companies.

The top down demands of the communist state also shaped the cultural orientation of the Polish society. Interviews showed that Polish accountants were 'frightened' of the state officials and of 'not doing the right thing' indicating a strong power distance between the authorities and accountants. This orientation has resulted in preference for certainty and clear rules rather than principles. Through its asymmetric power the state has been able to exploit the principle based IFRS by requiring the adoption of certain permitted alternatives such as accounting treatments that aligned tax and accounting without considering the need for a fundamental quality such as relevance. In the light of the Polish cultural orientation a more legalistic framework would be better suited to Polish accounting reality and would protect accountants from the interests of the state.

The lack of congruence between Polish accounting system and IFRS means that the primacy given to 'relevance' in the IFRS framework is far overstated relative to 'reliability' of information in the context of Poland and does not meet the diverse needs of a broad group of users or even the investors for whom IFRS were designed for. For example, the widespread adoption of fair values specifically addresses the needs of the investors for current values but may increase opportunity for manipulation and increase unreliability if there is insufficient data or lack of market liquidity to establish these fair amounts so that a strong case can be made for the use of historic costs. The thesis has shown that Polish companies significantly altered the asset values on the balance sheets on transition to IFRS but gave almost no information regarding the method of valuation.

This finding supports the view that the global adoption of IFRS may give the impression that accounting has been standardised even when this is not the case in practice. Ball (2006) remains sceptical about the ability of enforcement agencies to ensure consistency of IFRS internationally and suggests that investors may in fact be misled into believing that accounts are more consistent than they are. He concludes that: 'Uneven implementation could increase information processing costs to transnational investors by burying accounting inconsistencies at a deeper and less transparent level than differences in standards' (Ball, 2006:15).

The appropriate use of IFRS requires considerable expertise not only in the area of accountancy but also in related professions which, as shown in the findings Poland does not have and so is unable to implement some of the requirements of IFRS. In Anglo-Saxon countries whole professions are set up to support the valuation process and include the actuarial profession, chartered surveyors, brand consultants etc. In Poland these professions were unknown until the start of transition which has implications for the adoption of IFRS. Even though some twenty years have passed since the fall of communism many professions are still at infancy stages and the deficiencies in these areas will not be solved by simple training of staff. The changes will require the establishment and acceptance of new professions that are highly regarded and able to present information in a credible way to the wider business audience. Currently, lack of expertise means that Polish companies are simply unable to apply the judgmental aspects of IFRS in the spirit that was intended in the standards thereby rendering this framework unsuitable in the Polish setting.

Furthermore, the IFRS does not meet the needs of local economies where there are country specific issues that IFRS has not addressed. For example, Chand and White (2007) single out agriculture where little attention has been given to this sector by IASB but it is a very important sector in Fiji. This research has shown that in Poland there are also country specific issues which limit the usefulness of IFRS. In particular usufruct assets are a specific feature of post-communist economies but there is no clear accounting treatment within IFRS so the relevance of IFRS for transition economies has been reduced in this respect.

Practical problems associated with the implementation of IFRS also present considerable challenges in terms of costs of transition to IFRS, development of new IT systems and acquisition of technical knowledge. The analysis section of this thesis clearly shows that lack of financial resources by smaller listed companies is a major barrier to the full application of IFRS. The findings are consistent with the results of the study of implementation of IFRS in EU (ICAEW, 2007). The ICAEW study found that the cost of implementation of IFRS for EU listed companies with turnover below 500 million euro was 0.31 per cent per company in the first year of adoption but that percentage dropped to 0.05 per cent for companies with turnover above that amount. The findings clearly point to the fact that the smallest listed companies suffered the highest proportional cost of implementation and given that the majority of Polish listed companies are considered to be small by European standard this means that the cost of implementation for Polish companies is disproportionately high both in terms of own training costs and auditor fees. To date Polish companies have benefitted from substantial financial support from the European Union (see section 2.4) and so had some resources for training and consultancy which could have been used for accountancy training. However, given the euro crisis, the level of EU support from 2013 is likely to be lower and so lack of resources is likely to continue to be a barrier to full and consistent adoption of IFRS by smaller and newly listed companies. It should also be noted that the cost of conversion to IFRS is not a single, one off cost but there are also ongoing costs that are likely to continue into the future associated with the changes to IFRS as IASB tries to reach greater convergence with US GAAP. Therefore the problem of poor implementation of IFRS may persist in spite of the adoption of IFRS having taken place.

The cost implications also extend to stakeholders and external fees paid to the auditors. For example, the PWC (2006) survey showed that 27 per cent of European fund managers had little or no knowledge of the IFRS changes pointing to a need for better training not only of preparers of accounts but also of stakeholders. Similar findings were reported by the ICAEW survey (2007) where roundtable discussions revealed concerns about the complexity of the standards and of the frequency of changes especially in the application of fair value accounting. This study has revealed that analysts continue to rely predominately on personal networks and own assessment of management in their investment decisions rather than relying on the financial statements thereby putting into doubt the value of financial reports for the wider stakeholders. This arises partly from their lack of understanding of the complex provisions of IFRS and so familiarisation with the main provisions of IFRS will be an ongoing challenge for the users of financial statements.

In summary, this section argues that the benefits put forward for the adoption of IFRS are far overstated when considered in the light of a transition economy such as Poland. Whereas IFRS clearly benefit multi-national companies and the Big- 4 firms of accountants in terms of increased comparability, for local accountants and national listed companies the disadvantages associated with increased complexity and lack of specific country focus outweigh many of the benefits. Furthermore, a single global set of standards cannot meet the needs of all countries and in particular the needs of those smaller countries who are not represented on IASB and whose cultural and economic orientation is very different to the countries that are driving the IFRS agenda.

Poland will unquestioningly adopt all EU Directives but the motives for the adoption are predominantly to gain legitimacy and to be seen to be in line with international developments rather than to enhance the information provided to stakeholders. Current position of Polish listed consolidated accounts being prepared using IFRS whilst single listed companies reporting using Polish GAAP produces the worst outcomes in terms comparability. However, this approach clearly demonstrates the tensions between the national state interests and international demands.

5.7 Summary of the analysis

Mandatory adoption of IFRS in EU in 2005 has changed the financial reporting landscape in EU member countries. In an attempt to provide insight into the effect of these changes this study utilised a case study of the introduction of IFRS in Poland to evaluate the level of compliance by Polish listed companies in the year ended 31st December 2005 being the first year of adoption of IFRS. This research hypothesises that there are significant institutional factors that influence the level of compliance namely, the accountancy profession, the state and resource dependency. Poland, as a transition economy, has a very different institutional context to the 'old' member states and so the introduction of IFRS offers a unique opportunity to evaluate the introduction of an Anglo Saxon system of accounting to a post-communist economy.

The hypothesis that Polish companies do not comply fully with IFRS when they purport to do so was only partially confirmed.

The level of *de facto* compliance with IFRS was evaluated using interviews and secondary data. The findings point to reluctance by companies to produce informative, understandable and investor orientated financial statements and so the spirit of greater openness and transparency envisaged by IFRS has not been adhered to. In particular, the value of information that does directly impact on the accounting numbers is not given sufficient importance in Polish accounts. This view was voiced by a number of auditors interviewed and was confirmed by the analysis of financial statements. Overall, only 45 per cent of the sampled companies produced investor orientated financial statements and the disclosures regarding the revaluations such as name of the valuer or the basis of valuation were not given. The findings are consistent with the main premise of institutional theory that the wider institutional setting causes organisational isomorphism and a reluctance to change from the existing routines.

Contrary to the above findings, review of financial statements for 40 sample companies revealed that Polish companies only rarely receive audit qualification. In the sample of forty companies reviewed 3 sets of financial statements were qualified. This either means that the quality of accounting is high and in conformity with IFRS or the auditing process is lax and insufficient to identify deviations. Obviously, lack of audit qualification can only be an indication of compliance and other measures also have to be taken account before full evaluation can be made.

Furthermore, compliance with a specific standard IFRS 1 *First Time Adoption of IFRS* (IASB, 2007c) has improved as compared to a similar study by Krzywda and Schroeder (2007) for the previous year. In Krzywda and Schroeder's study 52 per cent of companies were non compliant whilst in this study only 20 per cent (7 companies) of companies failed to provide full disclosure The standard sets out specific reconciliations that are required and so majority of companies have conformed with this requirement. One area where there was a lower level of compliance was in the provision of reconciliation at 1st January 2004 that is the start of the conversion process where six companies failed to comply. It is likely that accountants did not attach sufficient importance to reconciliation that has lower impact on the presented figures and this could be the reason for non-compliance. The findings confirm that Polish accountants have a strong preference for rule orientated accounting approach and will conform when given detailed requirements. This preference is rooted in the central planning system when uniformity and adherence to charts of accounts was demanded. Interestingly, the Ministry of Finance officials reinforce these attitudes because they are well aware that accountants need clear rules and so they legislate in ways that meet the expectations of the accountancy profession, avoiding broad principles and giving clear instructions in the Accountancy Acts.

The research used comparability indices to measure the differences between IFRS and Polish Accounting Regulation for a sample of companies applying IFRS for the first time. The results show that both equity and income have been affected by the transition to IFRS and the adjustments had a significant impact on the Return on Equity. Equity was shown to be higher under IFRS (0.87 for large companies and 0.97 for small companies) largely due to the decision of most companies to revalue fixed assets. Impact on income was mixed with the large companies reporting lower profits under IFRS (comparability index of 1.04) but smaller companies reporting higher profits under IFRS (comparability index of 0.94 for small companies.

It is however, important to note that the revaluation of fixed assets is based under the alternative treatment under IAS16. If some companies decide to carry the assets at cost then the inconsistency will remain due to IFRS options rather than lack of comparability with Polish accounting Regulation. Exactly why so many companies decided to revalue fixed assets is not clear but there is a national and contrary to findings in other studies (Kvaal and Nobes, 2009). The preference for revaluations provides further insight into institutional theory. The findings contradict the main tenet of organisational embeddness because the revaluing companies decided to do so voluntarily without any external influence whilst institutional theory posits that companies would not change unless they were forced to. In fact the process of revaluations was both time consuming and requiring considerable expertise so the decisions were deliberate and extended to a large number of companies. The findings strongly support the view that resource considerations are critical for change decisions.

The other major adjustment in the reconciliation was found to concern the treatment of usufruct assets, a legacy from the communist era. These were the rights to use assets such as land granted by the state. Typically these assets were capitalised under Polish Accounting but as they did not meet the definition of an asset were treated as expenses and written off under IFRS. The need for such an adjustment again shows considerable differences between accounting in transition economies and those originating from Anglo-Saxon countries such as the UK. The transition to IFRS by Polish companies involved transformation not only of accounting but, as shown by usufruct assets, also the way in which economic reality is portrayed. The lack of recognition of the specific conditions of transition economies points to the fact that the IFRS framework is not necessarily appropriate or beneficial to all countries forced adopt it.

The findings confirm proposition one that Polish accounting is substantially different from IFRS and the maintenance of both systems leads to a loss of comparability between different companies. The adjustments had impacted on the return on equity which fell significantly from 18.6 per cent to 15 per cent for large companies but increased only slightly from 14.4 per cent 15.7 for small companies on the adoption of IFRS. Return on equity is a key measure of performance for companies and is widely used in investment appraisal so change in the magnitude recorded in this study may have significant implications for the companies.
The research also shows that the existence of a dominant foreign investor influences the accounting framework adopted by the companies as demonstrated by the fact that foreign owned companies were more likely to adopt IFRS voluntarily than the Polish owned companies and so raise the quality of financial reporting.

The thesis' first proposition that the accountancy profession has a significant impact on the accounting practice was evaluated in the context of both accounting and audit function. The research revealed that the Polish accounting standards play only a minor role in the wider framework of accounting largely by providing detailed practical guidance on accounting issues. However, the standards do not provide a complete and comprehensive local reporting system as only six standards have been issued to date. Unlike the standard setting bodies in Anglo Saxon countries such as the Accounting Standards Board (ASB) in the UK or Financial Accounting Standards Board (FASB) in the US, Polish Accounting Standards Committee does not have the high level of influence or power over the reporting function and appears to operate at the margin of the profession.

The weakness of the Polish Accounting Standards Committee arises partly from the fact that majority of accountancy regulation is embodied in legislation thus reducing the need for a separate standard setting body. The relative power of the state in the standard setting process has been shown to be far more influential whilst the accountancy profession continues to be far weaker. Legacy of secrecy and central control give little opportunity to the audit firms to engage and shape accounting legislation.

The auditing profession in Poland is also weakened by the educational background of its members which is composed of two groups of auditors, namely, those who practiced prior to 1991 and those qualified since that date. According to DiMaggio and Powell (1983) professions are characterised by similar educational backgrounds of its members. However, in Poland state authorised auditors who practiced during the communist era were admitted to the National Chamber of Auditors in 1991 without taking any formal entry examinations. In contrast, since 1991 tough professional examinations were introduced that had the effect of restricting the membership of the Chamber. The existence of auditors with such different qualification within one profession has been identified by the interviewees as the main cause in the variability of the audit quality. The state also reduces the power of the Chamber of Auditors by legislating the syllabus for auditor training and by statutory means ensuring that the examination committee has a Ministry of Finance majority.

The second proposition identifies the various agencies of the state as having an influence on the compliance with IFRS. The state shapes the accounting practice in Poland through accounting legislation, enforcement and tax collecting function. The Ministry of Finance was a powerful body during the communist period. The interviews confirm that in spite of the introduction of IFRS the Ministry continues to shape the accounting law by incorporating aspects of international regulation into Polish Accountancy Acts. The officials feel that they have a duty to guide the accountants and provide local interpretations to meet the expectations of accountants. The operations of the Ministry of Finance are not open and transparent as confirmed by a lack of timely consultation with various stakeholders.

The interviews show that the most potent source of influence on Polish accounting has been the tax authority. Due to their far reaching power and high level of sanctions compliance by companies with tax regulation is far higher than with accounting regulation where the enforcement is rarely exercised. Companies are therefore taking a rational economic decision to comply with tax rules to avoid possible penalties. The implication for accounting practice is that little attention is paid by the accountants to the wider principle based issues affecting accounting because tax considerations always take priority.

In terms of enforcement Poland has created a Commission for the Financial Oversight (KNF), an administrative body that has the responsibility for enforcement of compliance of the financial information. However, the body appears to have a largely ceremonial role in that it complies with the CESR Standard Number 1 on Financial Information by reviewing and noting the departures from IFRS but no meaningful information is given regarding action taken to remedy the deficiencies. Interviews with auditors and investment analysts confirm the fact that there is little evidence of KNF playing any real enforcement role for listed companies.

Finally, the last proposition identifies resource dependency as having an impact on the quality of financial statements. Poland is characterised by high concentration of share ownership and low liquidity. Resource dependency for capital is greatest for companies that have widely dispersed ownership of shares. These companies appear to engage more readily with the shareholders and are more likely to produce investor orientated financial statements. A further relationship was found between the degree of owner concentration and the type of auditor firm. Firms with wide dispersion of shares were found to be more likely to engage a Big 4 firm of auditors whilst those with a concentrated share ownership were more likely to engage local auditor. This suggests that legitimacy offered to the companies by the Big 4 firms is an important factor for the companies that need to engage with the wider investor groups.

The findings so far point to isomorphic behaviour by the accountants and regulators with the communist legacy continuing to dominate the accounting framework in Poland. National economic and institutional factors strongly influence the practice of accounting so that even when international standards are fully adopted local variation preclude the communication of financial information in a consistent and comparable manner.

However, the research points to influences that act to change the existing practices. External influences arising from EU Directives such as European Commission in the 8th Directive (European Commission, 2006a) regarding the roles, training and responsibilities of auditors have been implemented into Polish law as have the transnational guidelines arising from regulators such as CESR (The Committee of European Security Exchanges). The changes are designed to enhance the effectiveness of auditors and improve the governance of listed companies. In the long run the changes will move the power from the state to the professions thus facilitating the transition to full market economy although in the first instance the changes can be considered as being largely ceremonial as discussed in sections 5.3.3 and 5.4.2. However, the accountability of the audit profession is likely to increase in the light of the measures taken by the European Union following the global financial crisis of 2008. Amendment to the 8th Directive of 2008 (European Commission, 2008a) introduced public oversight requirement for auditors and other restrictions being placed on them such as the rotation of auditors and limitation on the non-audit work being done by auditors.

Pressure for change also arises from the changing nature of share ownership of Polish listed companies. As discussed in chapter 2.4 Poland is receiving some 60 billion Euros in the period 20010-2013 creating considerable growth in the economy and attracting further FDI. The findings in section 5.5 show that foreign investors have an important role to play in shaping accountancy practice and they will continue to instigate changes that will make accounting practice in Poland comparable to international norms. However, adverse outcome of higher level of strategic investment is that companies have little incentives to disclose high quality of information to a broad base of stake holders.

6. CONCLUSION

The aim of this thesis has been to utilize New Institutional Theory as expounded by DiMaggio and Powell (1983) and Meyer and Rowan (1977) to provide a rationale for the lack of compliance with IFRS by Polish listed companies in 2005, being the first year of adoption of the IFRS framework. In order to do achieve this aim a hypothesis was developed to test whether *de jure* adoption IFRS in Poland as required by the EU (Commission of the European Communities, Regulation 1606/2002) has resulted in *de facto* compliance by Polish listing companies (chapter 3.5). Specifically, the extent of *de facto* compliance was ascertained (evidenced in chapter 5.2) using a number of criteria such as compliance with IFRS 1 (*First-time Adoption of IFRS*), the quality of presentation of financial statements and the level of audit qualification.

Thereafter, three propositions were developed to ascertain what forces have caused non-compliance and how those forces interacted with each other. The thesis proposes that institutional country specific characteristics prevent full compliance with IFRS and local variations in *de facto* practice of accounting persist in spite of the change of accounting regime. Drawing on new institutional theory the research proposes that the accountancy profession, the state bodies and resource dependency by the companies were the determinant factors for non-compliance with IFRS. Recognition of the relative strength of each of the factors enhances our understanding as to what shapes accounting in transition economies and specifically in Poland and allows future outcomes to be proposed based on national institutional characteristics. The findings suggest that Poland’s communist history has meant that the influence of the state continues to be pervasive whilst the accounting profession is a far weaker influence. Resource dependency by companies has been shown to be the key driver of institutional change.

6.1 Research method and design

The research methodology was designed to address the hypothesis and propositions identified above. Specific research methods were mapped against the theoretical model in order to enhance the rigour and reliability of the research as shown in chapter 4.4. The research was carried out in different stages and each stage was supported with a different theoretical perspective and research methodology. The research design utilized both quantitative and qualitative approaches giving the opportunity for the findings from the documentary sources to be contextualized and analysed through in-depth semi-structured interviews. The evidence from variety of sources was triangulated providing a more holistic and richer view of accounting in Poland.

The hypothesis that Polish listed companies do not comply with IFRS even when they purport to do so was tested using quantitative methodology supported with a content analysis of a sample of financial reports for 40 Polish listed companies at 31st December 2005. This quantitative evidence was then used as the basis for discussion with the various respondents to address the three propositions derived from the new institutional theory. The interviews were held with various actors that represented the institutional field of financial reporting in Poland and included government officials, auditors, accountants and users of financial statements. The interviewees were selected for variability to ensure that they reflected different interest groups and all were considered to be experts in their field.

6.2 Methodological contribution

The thesis makes a unique methodological contribution by applying new institutional theory to explain the practice of accounting in a transition economy. It is the combination of the theory to a non-capitalist context that allows a novel and deeper understanding of the institutional forces that drive accounting in Poland. Prior studies have focused largely on the study of organizations in market economies predominantly in US, Canada and UK (Suddaby *et al.*, 2009; Greenwood *et al.* 2002; Carpenter and Feroz 2001). This means that understanding of organisations operating in different environments which were shaped by unique historical events as such as Poland is limited and remains under researched. For example whereas in the Anglo-Saxon the concept of accountancy profession has a shared meaning and considerable research has been undertaken into the operation of Big 4 accountancy firms the influence, location and context of this profession in other countries has not been subject to this level of research.

Institutional theory has also been most commonly applied to public body organizations in the belief that they are most influenced by legitimacy concerns rather than competitive pressures. This study makes a further contribution through its application of institutional theory to profit orientated listed Polish companies. The rationale for the adoption of this stance is that Polish companies are less affected by competitive pressures having been in most cases state owned enterprises prior to the transition.

The thesis makes a further methodological contribution by utilizing a mixed method combining quantitative with qualitative research methods. Typically research utilizing institutional framework has been confined to qualitative research based on case studies. In this study the value of interpretative, interview based approached has been recognised but the research has been enhanced by the content analysis of financial statements. The analysis of financial statements in the first year of adoption of IFRS allowed the outcome of institutionalization to be evaluated and this information provided evidence for the degree of adherence to existing rules which was utilized to inform the interpretive research in the second stage.

Suddaby (2010) argues that the balance of research methods in the area of institutionalism has now shifted too far towards positivist direction due to greater availability and ease of analysis of data. However, this shift has meant that insufficient attention has been given to the study of meanings, motivations and other cognitive-cultural aspects of institutional theory. This research addresses the methodological gap and employs interpretive methodology to make sense of the roles and motivations that affect the organization field of financial reporting in Poland. The adoption of this perspective allows the author to gain deeper understanding of the reasons why observed practices were adopted.

6.3 Theoretical contribution

Using financial reporting in Poland as a case study this thesis has provided additional insight into new institutional theory in a number of areas that will be discussed in this section. Firstly, the study has shown that organisations are subject to varying institutional forces from sources that are themselves institutionalized and in conflict not only with the organizations but also with eachother. Secondly, the research shows that the power construct is a powerful explanatory factor in the way that coercion and normative pressure is applied on companies but this influence has not been fully addressed in new institutional theory. Thirdly, resource dependency was shown to be an important element that conferred power and explained the influence exerted on organizations but has not been incorporated in institutional theory. Fourthly, the study contributes to the theoretical understanding of institutional arrangements by recognizing that they are highly dependent on the economic and social background of the country concerned.

DiMaggio and Powell (1983) and other proponents of institutional theory such as Meyer and Rowan (1977) and Oliver (1991) have developed the institutional theory outside of any country specific context. However, given that the theory has its roots in the social environment the theory needs to recognize the institutional settings of different countries. This is particularly important for transition economies where the communist influence has shaped the socio-economic landscape and resulted in different relationships and networks between the state, enterprises and individuals than would be found in market economies. The introduction of investor orientated IFRS into a highly structured state orientated environment has resulted in conflicting and contested institutional setting where the actors involved were guided by very different motivations depending on the source of their authority. The transition to market economy and the adoption of IFRS has also transformed the status of the accountancy profession. This research provides greater insight into institutional theory dynamics as international rules are imported into Polish setting.

This study evaluates the explanatory variables of the accountancy profession, state influence and resource dependency in the context of the adoption of IFRS in Polish socio-economic environment. In the critique of New Institutional Theory in section 3.4.7 areas for further refinement and development were identified with a view of addressing some of the gaps in the theory. In particular two strands of current emerging research were particularly relevant to this study and were applied to the financial reporting context. Firstly, drawing on the work of Lounsbury (2008) the notion of multiple, institutional logic was employed. The research found that the financial reporting organisational field consists of organizations, state organs, investors and accountancy professionals who interact with eachother in a complex exchange and who are guided by different, often competing logics. Secondly, addressing the criticism by Lawrence (2008) and Greenwood *et al* (2008) that insufficient attention has been given to the role of power in institutional research this study focuses on the variable power and influence of different actors implicated in financial reporting.

The research has confirmed DiMaggio and Powell's (1983) assertion that the state is the key actor in institutional isomorphism but the influence of various organs is not uniform, the motivations are different and the manner of enforcing compliance also differs. This research found that coercion by the state is the main institutional driver of financial reporting practices in Poland. The coercion is in fact a manifestation of power being exercised to a different extent. The thesis has shown that power plays a significant role in determining these different outcomes and organizations manage varying institutional expectations and logics in a strategic manner consistent with Oliver (1991). In contrast prior research by Mizruchi and Fein (1999) has shown that within the Anglo-Saxon context mimetic isomorphism was the dominant mechanism for achieving isomorphism.

In Poland two sources of state influence both emanating from the Ministry of Finance have been identified namely the tax authorities and the accountancy legal department. Although both agents draw power from the Ministry of Finance the means of exercising this power and the institutional logic underpinning their operations is different.

The legal department draws its power from having detailed rules that prescribe accounting treatments and restrict possible options that organizations can apply when producing financial statements. This form of embedded control is pervasive in the field and provides a great deal of legitimacy to organizations. It is largely hidden manifestation of power and is seen as a weak form of legitimisation by the organizations and by the individuals in the legal department. The institutional logic of the legal department is that by providing the rules and guidance the individuals are acting in the interest of the organizations helping the accountants to produce better accounts. This rationalization of the legal department activities legitimates the output of accounting law thereby increasing the goal congruence between the state and the organisations. It is clear that rules in Poland are an important source of legitimacy but it is impossible to evaluate the role of culture as opposed to regulation itself in the individual's preferences for strict compliance.

In contrast, the manifestation of power by the tax authorities is made much more explicit through, penalties and frequent physical visits by the tax officials. Together the method of operation of the Tax officials is designed to bring about compliance through fear and unquestioned compliance. The outcome of this system of coercion is that tax authorities have created their own social identity of a force imposing rules from a higher authority. A more subtle but equally pervasive method of coercion is also exercised through the opacity of tax law. Contradictions, omissions and lack of clarity in the tax legislation reduces the ability of organizations to challenge tax decisions thereby increasing the power of the state.

Overall, the research has shown that the state exerts far greater power in Poland than the normative forces originating from the accountancy profession. Furthermore, an important finding that has emerged from the thesis is that the three factors studied do not act independently but frequently conflict and interact with each other. This issue has not been addressed in the framework presented by DiMaggio and Powell (1983). In particular there is a trade-off between the legitimizing influence of the state and the influence of the accountancy profession. Increasing strength of the accountancy profession results from responsibilities for accounting and audit regulation being transferred from the Ministry of Finance to the professional bodies.

From the organisation's perspective companies have to manage the multiple logics arising from various agencies. The findings support the notion of institutional rationality as proposed by Lounsbury (2008) where actors are no longer seen as passive and embedded in existing routines but respond logically in the context of different institutional demands. The thesis contributes to our understanding of resistance of organizations to institutional rules by studying the level of compliance with IFRS by Polish listed companies drawing on the model developed by Oliver (1991). The thesis found that 'compromising' was the most common response from 5 possible strategic responses. That is companies were meeting the IFRS requirements sufficiently to avoid audit qualification ie formal sanction but still not complying fully. Compromise was also evident in the widespread embedded belief of actors that tax treatment should be followed whenever possible pointing to tax authorities being a deeply embedded institutional force.

Whilst new institutitonal theory focuses on the stability and permanence of institutions the transitional economy context also allowed this research to gain insight into the changing nature of institutions and the forces that maintain and alter them. The contribution of this thesis to the institutional theory has been to demonstrate how the process of institutionalization of the accountancy profession was driven by technical imperatives of the market economy and supra-national agencies ie IASB but was also contested by the existing institutions including the state and the national accountancy and audit bodies. The study found that Big 4 accountancy firms were highly successful in entering the Polish economy as evidenced by the fact that they now audit the majority of the largest Polish listed companies as they had the necessary resources and expertise to effectively compete against local firms. From institutional perspective it is apparent that the accountancy profession in Poland is not homogenous but deeply divided between local firms and Big-4 firms, each group having different orientation, cultural background and motivations. The distinction between local and international firms was found to be exacerbated by the Big-4 firms who purposely denigrated the skills of the local accountants whilst increasing their own power through their ability to assign meanings to the International standards in the Polish context thereby influencing the reporting environment at unconscious but deeper level.

However, Big 4 firms were also excluded from the existing institutional processes resulting in reduced level of power and influence in Poland. Their institutional influence was strongly contested by the existing institutions namely the Ministry of Finance and the local accountancy and audit association who adopted various strategies to maintain existing embedded arrangements. In the context of institutional theory the Big 4 can be seen as 'institutional entrepreneurs' who are: 'interest driven, aware and calculative' (Greenwood and Suddaby, 2006:29) but their efforts appear to have been only partially successful and the existing structures are able to withstand the challenge from these international firms for the time being.

The transfer of regulation for financial reporting to IASB has significantly decreased the power of the state to set national company laws. However, the state organs counteracted this loss of influence by increasing their participation on important professional body committees, by setting company law without consultation and by retaining controlling interests in professional training and accreditation of accountants.

Resource dependency was shown to be the most potent source of change to accounting practice in Poland as evidenced by the decision to revalue fixed assets. The findings would suggest that companies are not always preferring to follow the existing practice as suggested by institutional theory but readily implement real (technical) and important changes when they see an imperative to do so.

In this case a revaluation of fixed assets has a significant uplifting effect on the net assets of the company and so accountants are actually making a rational decision in choosing this option in spite of considerable obstacles associated with obtaining the valuations. The revaluation of fixed assets increases the borrowing capacity of the company and so the finding from this study allows us to conclude that resource dependency motivates companies to change and overcome the preference for permanency and inaction.

The need for country specific approach when using institutional theory is confirmed by the fact that in the Polish sample selected 80 per cent of large Polish companies and 40 per cent of smaller companies revalued their assets. In contrast Callao *et al.* (2007) has showed that majority of listed Spanish companies tested have not revalued their fixed assets. Similarly, KPMG and Von Keitz (2006) show that only 3 companies out of a sample of 147 companies surveyed in 11 countries chose to revalue fixed assets.

The revaluation of assets examined in this study also clearly demonstrates that accounting is socially created and so influenced by the accountant's background and culture and not neutral and objective as purported in mainstream accounting. The review of financial statements revealed that the revaluations were carried out in nearly all cases internally and not by external qualified valuers. This lack of externality puts into doubt the reliability of the recorded asset values because employees of the company have vested interest in the financial standing of the company so any judgmental valuation is always likely to be affected by the personal motivations of the employee.

6.4 Contribution to knowledge

Central premise of institutional theory is that organizations conform to the established social norms and their behaviour is driven predominantly by the need to gain legitimacy from the society at large and not necessarily by economic imperatives. The consequence of this behaviour is that companies will be embedded in their existing routines and they will not change unless they are forced to by external forces. The findings from the study confirm this premise and are consistent with the notion of isomorphism and legitimacy proposed by new institutional theory.

IFRS are adopted by Polish companies but in a largely ceremonial way with only partial changes to the financial statements as summarized in section 6.1 above. Utilising the framework from Oliver (1991) it can be concluded that Polish companies typically compromise by making minimum changes to the financial statements in their adoption of IFRS whilst outright defiance was rare as evidenced by a very low number of audit qualifications noted in the sample of companies reviewed.

Politicians, IASB and the Big 4 accountancy firms have all purport that the global adoption of IFRS results in improved comparability of financial statements as summarised: 'A single set of international standards will enhance comparability of financial information and should make the allocation of capital across borders more efficient' (Tweedie, 2005:2). The thesis challenges this position and contributes to the debate, by providing objective evidence of the lack of comparability arising both from *de jure* and *de facto* perspective of accounting. The research counters the view of the advocates of IFRS that compliance is achieved through adoption alone. The findings confirm (Durocher and Genron, 2010) and Weiβenberger *et al.* (2004) that the benefits of IFRS have been overstated in terms of its main objectives of increased comparability.

In prior studies comparability was shown to increase when the distance between the local accounting framework and IFRS is small. For example Aisbitt (2006) found little difference between UK accounting regulation and IFRS. This suggests that in Anglo-Saxon countries the national accounting framework is already closely aligned to IFRS but for a transition economy there are significant differences. These differences are important because they give an indication as to how easily companies can adapt to IFRS. Where the differences are great, the changes that the accountants need to make in terms of knowledge acquisition and system change in order to comply with IFRS are much greater than where the differences are minor. The difference between Polish accounting regulation and IFRS in respect of equity and net income was measured using Gray's comparability indices. The findings for a sample of companies showed that equity increased significantly on adoption of IFRS pointing to a significant difference between Polish accounting and IFRS. Furthermore in Poland, single listed companies continue to use Polish GAAP whereas consolidated listed companies use IFRS so there is considerable loss of comparability on the adoption of IFRS.

Generally, it is the presentation and disclosure that are given inadequate consideration and this omission can be linked to national characteristics of transition economies where there is little sense of openness and transparency. The results show that the preference in Poland is for strict adherence to the legal requirements and so wider needs of the stakeholders are ignored.

Nevertheless, the study did find evidence that convergence to IFRS was improving over time. In this regard Krzywda and Schroeder (2007) show the non-compliance rate with IFRS 1 to be 52 per cent in 2004 accounts but the figure in this study falls to 20 per cent for 2005 pointing to an improvement in the disclosure over the two years. The results showed that in spite of a very different institutional setting of a transition economy such as Poland the coercive pressure exerted by the EU has led to significant change in the behaviour of the listed companies reviewed. The research found that companies had a higher level of compliance when external requirement of IFRS was imposed on them by EU regulation then when the requirement for disclosure originated from the Polish authorities.

In the context of new institutional theory this thesis has confirmed that ceremonial adoption of some aspects of IFRS is taking place and listed companies are not adopting the spirit of full and transparent disclosure. However, the impact of IFRS has been noticeable in some important areas such as measurement of assets leading to the conclusion that real changes have taken place even though the disclosure has been deficient. Unlike in the Anglo-Saxon countries this research has shown that the accountancy profession does not exert significant normative pressure on accounting practice although international accounting firms are raising the standard of accounting. In contrast the coercive power of the state continues to dominate and shape accountancy in Poland and contributes to the continuation of existing practices.

In contrast resource dependency has been shown to be a major driver of change rather than promoting continuation of existing practices as evidenced by the fact that most companies decided to change their accounting policy from cost to current values where the primary reason for the decision to revalue fixed assets is to increase borrowing capacity. Furthermore, the adoption of IFRS before the mandated dates has been associated with foreign investment and again implicating resource dependency in the process of change.

6.5 Policy Implications

This work has clearly shown that comparability between financial results produced in different jurisdictions is unlikely to be achieved without taking account of the wider institutional factors. To date the supra-national regulatory agencies have ignored the fundamental features between countries that cause different outcomes depending on the nature of the companies and on the jurisdictions in which they operate. The IASB has so far ignored issues such as the level of understanding of IFRS, the legal frameworks of each country and the different company needs when implementing IFRS. By ignoring these country specific features differences in reported financial results are masked under the overall umbrella statement that companies comply with IFRS.

This position is misleading and suggests that IASB addresses the issues as follows: Firstly, when setting International Standards IASB needs to consider the ability of accountants in different countries to comply with the standards. This means that the IASB should pay more attention to reducing the complexity of the International Standards so that the standards are sufficiently understandable for the accounting profession to be able to apply them without being simplistic. Secondly, rather than ignoring the differences between national frameworks and IFRS national adaptation of IFRS should be allowed provided that clear explanation of differences is provided. Prior research has shown that investment analysts would find this acceptable provided full information is provided in respect of differences so that they can make their own adjustments.

From Polish perspective the option whether to adopt IFRS is very limited as all consolidated listed companies are mandated by the EU to produce IFRS compliant accounts. Given this position, the only way to improve comparability would be to require all listed companies (consolidated and single companies) to prepare IFRS accounts. At the same time Poland needs to modify the institutional setting of financial reporting in such a way that ensures better compliance with the principle orientated IFRS which have been shown to be of higher quality than national accounting frameworks (Barth, 2007).

The thesis has demonstrated that accounting in Poland is predominantly driven by legal imperatives and the small size of the Warsaw Stock Exchange points to continued creditor orientation (see chapter 2.4). In order to move to wider shareholder orientation as embodied by IFRS the enforcement regime could be significantly improved. From the policy perspective more effective and direct enforcement of accountancy compliance is required from the Polish Financial Supervision Authority (*KNF*) as it has been shown that legislation alone is insufficient to ensure compliance. The Authority should take action on the discovery of material departures from IFRS by listed companies either by taking legal action or by forcing the companies to change the financial statements if the accounts are misleading. Furthermore greater dialogue between the regulator and the auditors would strengthen the effectiveness of the oversight provision.

A striking finding of this study has been to expose the minimal lack of consultation by the Ministry of Finance in the standard setting process. In order to ensure the highest quality of accounting regulation in Poland the Ministry of Finance must improve the governance and consultation process of the Ministry and agencies responsible for the development of accounting regulation such as the Accounting Standards Committee. The work on new projects should be transparent, timely and subject to extensive consultation not only with academics but also with other stakeholders such as lenders, auditors and the analysts.

Greater clarification of fiscal law, further separation of tax and accounting law and better enforcement of the accountancy regulation need to be considered before Poland can move to a more investor orientated system of financial reporting.

For unlisted companies, the findings of the thesis lead the author to consider that, where possible, the most appropriate accounting framework for Poland could be one that builds on the national characteristics such as its legal orientation. As Poland clearly lacks a strong and effective accountancy professional body it should not continue with the development of local standards. Instead the accountancy profession should focus its efforts on more vigorous engagement in the consultation process of approval of new international standards.

The authority for accounting regulation could be delegated to the Ministry of Finance for unlisted companies and to IASB for listed companies. This approach would be more advantageous as it would simplify the system and be more acceptable in the Polish setting where far greater emphasis is placed on statutory regulation than that originating from the Polish Accounting Standards Committee. The legislators can utilise IFRS for Small and Medium Size Entities to provide detailed guidance currently provided by the Polish standards. The advantage of this approach would be to provide consistency between the IFRS framework and the Polish accounting regulation but at the same time build on the existing institutional preferences for statutory control.

The findings also show that in the areas where significant judgment is required for example for valuations there is a need for a greater level of professional development not only in the area of accounting and auditing but also in other areas where accountants rely on expert opinions such as actuarial and surveying professions.

6.6 Areas for Future Research

Transition economies continue to provide a rich source of research opportunities as their environment continues to change. Poland is facing many structural economic changes such as migration of labour from rural to urban areas as well as changes related to external influences such the entry into the euro-zone and high influx of FDI. Whilst mainstream new institutional theory focuses on the homogeneity and permanency of existing practices this thesis has shown that Polish accounting is changing and so the environment is dynamic rather than static. Further research should be undertaken to explore what factors lead Polish accountants to change their existing practices. For example this study has showed that most companies have voluntarily undertaken revaluation fixed assets. However, the reasons for doing so are not well understood especially since this was not the case in other countries and the revaluation process is both costly and time consuming. Prior studies have shown an association between revaluations and borrowing capacity (Missonier-Piera, 2007) but this was not proven in this study. Was this an example of institutional mimicry or were the companies driven by other forces and if so what were they?

An area of research that would enhance our understanding of institutions would be to examine the changes that are taking place in a cultural context which has not been dealt with in this study. As noted in prior research cultural characteristics of societies persist and are difficult to change even in the context of significant economic and institutional reforms. Lounsbury (2008;356) states that: 'a more complete approach to practice that accounts for institutional processes requires attention to the broader cultural frameworks that are created and changed by field-level actors'. Specifically characteristics such as secrecy and excessive adherence to rules whilst showing greater desire for freedom are common features in post communist societies and these could be explored in the context of accounting.

The thesis has shown that the compliance with IFRS depends on the relative influence of the State, the accounting profession and resource dependency. Future research could investigate how changes in the relative importance of each of the factors impacts on accounting practice. From the institutional perspective Polish accountancy profession offers extensive research opportunities to deal with the dynamic change of the profession. For example studies to explore how the profession was deinstitutionalized under communism and then reinstitutionalised since 1989 would improve our understanding of how institutions are theorized, reinforced and then institutionalized.

Further research on the development of the accounting profession and accounting education in transition economies would provide deeper insight into how accounting practice is affected by professionalization in countries where there is a very short history of accounting profession. For example as a result of the enactment of the revised Auditing Act in 2009 a new public oversight body Auditing Oversight Commission (*Komisja Nadzoru Audytowego*) was formed in Poland. Future study could investigate the role of this Commission in terms of its impact on the profession as well as on the on the impact on the auditing function in general.

A worthwhile area of research would be to consider the value of published financial statements to the stakeholders in a transition economy where the governance structures and financing of business is different to the Anglo Saxon countries. For example the existence of dual board system means that employees and other stakeholders are able to obtain financial information directly and so published statements may not be perceived in the same way as in Anglo-Saxon countries. This thesis also points to private sources of information being available to investment analysts so an argument can be put forward that standardisation of accounting is not necessary provided that sufficient information is available for the analysts to make their own comparisons.

The usefulness of IFRS in the context of transition economy could be investigated using purely positivist quantitative methodology, for example by regressing market data against accounting measures. This approach would be appropriate given the availability of five years of data since the adoption of IFRS in EU and the increasingly efficient Warsaw Stock Exchange.

Finally, comparative studies of different countries or regions such as China versus Central and East European countries would provide useful insight into different institutional arrangements of each country and could be used to explain the differences in accounting practices between different countries.

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Appendix 1 List of Interviewees

Job title/position of the interviewee	Institution represented	Category of interviewee
Audit Firm Representatives		
Chief Risk Officer and Partner	PWC, Warsaw	Auditor
Senior Audit Manager	PWC , Warsaw	Auditor
Audit Partner	Grant Thornton, Warsaw	Auditor
State Representatives		
Advisor to the Minister	Financial Institutions Department, Ministry of Finance, Warsaw (interviewed in London)	State representative
Head of Department	Department of Accounting, Ministry of Finance, Warsaw	State representative
Representative from the Department of Accounting responsible for the drafting of accountancy legislation	Department of Accounting, Ministry of Finance, Warsaw	State representative
Analysts and Fund Managers acting as shareholder representatives		
Fund Manager	Amplico PTE, SA, Warsaw	Analyst
Investment Analyst (based in London and tracking Polish companies)	UBS, London, (interviewed in London)	Analyst
Accounting standard setter		
Member of the Committee	Polish Accounting Standards Committee, Warsaw	Standard setter
Company Accountant		
Chief Accountant	Large manufacturing company with significant foreign (Swiss) participation	Preparer of financial statements
Accountant	Large manufacturing company	Auditor of state enterprises prior to transition in 1989 and currently financial accountant in a privatized company

Appendix 2 Interview Consent Form

An Interview Consent Form

Research Title: **What are the challenges of introducing International Financial Reporting Standards for Polish listed companies?**

Researcher: Iwona Vellam, University of Greenwich

- ☐ I have had the details of this research explained to me. My questions have been answered to my satisfaction, and I understand that I may ask further questions at any time.
- ☐ I understand I have the right to:
  - decline to participate;
  - refuse to answer any particular questions;
  - withdraw from the study at any time;
  - ask any questions about the study at any time during participation;
  - provide information on the understanding that your name will not be used unless you give permission to the researcher;
  - anonymity and confidentiality; be given access to a summary of the findings of the study when it is concluded

- ☐ I understand that the information will be used only for this research and publications arising from this research project.
- ☐ I agree/do not agree to my name being used in association with the information I provide.
- ☐ I agree/do not agree to the interview being audio taped.
- ☐ I also understand that I have the right to ask for the audio tape to be turned off at any time during the interview.
- ☐ I agree to participate in this study under the conditions set out.

Signed (Participant)	Date
Name in block letters	
Signature of investigator I Oellam.	Date

This Project is Supervised by: Dr. Lesley Catchpowle
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Research Information Sheet

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Working title of research: What are the challenges of introducing International Financial Reporting Standards for Polish listed companies?

Details of the research: The research is undertaken as part of a PhD thesis that aims to investigate the impact of the introduction of International Financial Reporting Standards (IFRS) on Financial Statements of Polish listed companies.

The information gathered from the interviews aims to:

- Ascertain if the quality of Polish financial reporting has improved as a result of the introduction of IFRS.
- Identify the problems that have been experienced in the process of adoption of IFRS.
- Explore the underlying causes for non-compliance with IFRS within a wider institutional and legal framework.

The interview:

- The interview is expected to last between 30 minutes and no more than 1.5 hours.
- The interview will be carried out by Iwona Vellam
- The participant is free to decline answering any questions and to terminate the interview at any time.
- The information provided in the course of the interview will be fully confidential and anonymous.
- Information gathered will only be used in this research and not passed to any third parties

Appendix 3: Interview questions for the auditors

1. How effective were Polish companies in the implementation of IFRS?

2. What were the main problem areas for companies in achieving compliance?
    a. Language difficulty?
    b. Lack of guidance notes in IFRS themselves?
    c. Alternative treatments allowed?
    d. Too complex?

3. What proportion of companies has not complied? Did any of the companies who failed to comply fully with IFRS receive qualified audit report and if so what steps did you take to try and resolve the conflict before issuing a qualified audit report?

4. Do you feel that the current enforcement environment in Poland is adequate to ensure compliance with IFRS?

5. Do you believe that you have sufficient sanctions and that the regulatory framework is sufficient to ensure that companies comply with statutory requirements?

6. Were client companies introducing IFRS in the spirit of improvement of financial reporting or simply complying with regulation?

7. What other factors influence the level of compliance with IFRS?

8. Were any sectors/ industries or companies with significant foreign holdings more or less compliant?

9. How compatible is the IFRS framework with Polish GAAP?

10. How appropriate is IFRS framework for Polish financial reporting?

11. What role do the accountancy firms play in the setting of standards in Poland?

What is the role of the auditor in ensuring that accounts are of high standard and comply with the regulatory regime? (role of the accountancy profession)

1. Do you feel that the audit professionals in Poland are sufficiently experienced and knowledgeable to pass an audit opinion on IFRS financial statements?

2. Is there a difference in the level of expertise of small audit firms as compared to say the top 4 firms?

3. Do you feel that Polish auditors have adequate training and receive enough guidance from the profession?

4. What are the main 'risk areas' in the audit of IFRS accounts?

Appendix 4: Interview questions for investment analysts

1. Do you use financial statements for investment appraisal?

2. Is the scope of information provided in FS of Polish companies wide enough eg. strategy, future plans, explanation of risks for your needs?

3. Has the change to IFRS changed the way you make investment decisions/ model performance? Have share prices or cost of capital changed on the production of IFRS accounts?

4. Do you believe Polish IFRS accounts are comparable across /industries or countries?

5. Are Polish IFRS accounts easier to understand by external users than Polish GAAP accounts?

6. How would you evaluate Polish companies reporting compared to reporting in other countries eg. German, UK, French or other CEE countries?

7. Are there special circumstances in Polish economy that require different treatment than that set out in IFRS? Eg. Valuation of state owned enterprises?

8. Where are the main areas where there are inconsistencies?

9. Are accounts thought of in Poland as means of communication or compliance? Where is the orientation?

10. Why do feel there is limited compliance with IFRS? Legal, tax, cultural orientation?

11. What areas are not adequately explained?

   - Reconciliation of net debt to c/flows
   - Tax payments to tax charge
   - Costs of acquisition /disposal of subsidiaries
   - Foreign currency translation impact on debt

12. If FS focus on IS and forecast statements is it appropriate for countries where bank lending is predominant source of financing?

Appendix 5: Interview questions for the Ministry of Finance officials

1. What is the role of the Ministry of Finance and what powers does it have?

2. Is it sustainable to maintain 2 systems? Why not move to IFRS for all companies?

3. What convergence to IFRS is taking place?

4. How aware is the Ministry of the problems of implementation of new law/stds?

5. What is the present system of enforcement of IFRS and accounting law and is it effective? Can accounts be changed if non-compliant?

6. Is it possible to have comparable accounts without central enforcement and what is the role of Ministry? Who should enforce?

7. What are the main areas of non-compliance?

8. What is the process for the introduction of new accountancy laws and the amendment of existing laws? What role does IFRS play in setting Polish standards?

9. Grant Thornton International survey of business owners (2005) found that Poland (together with Russia) topped the league of countries where the regulation and red tape constrained business expansion. Why do you think that is? Give example for accountancy.

10. Ministry determines the qualifications for authorisation as external book-keeper? Is this appropriate?

11. Given the power of Accountancy Act and Ministry of Finance what is the role of Stowarzyszenie Ksiegowych?

Appendix 6: Interview questions for the member of the Polish Accounting Standards Committee

1. What is the role of the Polish Accounting Standards Committee and what powers does it have?

2. Do Polish accounting standards lead to improvements in the quality of financial reporting?

3. What is the process of endorsement of Polish Accounting standards and how are they amended?

4. What is the present system of enforcement of Polish Accounting standards and is it effective?

5. What is the relationship between Polish Accounting standards, PAR and IFRS?

6. Are Polish Accounting standards needed given IFRS and IFRS for SMEs?

7. Grant Thornton International survey of business owners (2005) found that Poland (together with Russia) topped the league of countries where the regulation and red tape constrained business expansion. Why do you think that is? Give example for accountancy.

P. Szafraniec Krajowa Izba Bieglych Rewidentow

(These questions were prepared but not used as the interviewee cancelled the meeting)

1. What is the role of KIBR? Is it primarily a body to represent own members or does it have a duty to broader stakeholder groups?

2. How does the new system of oversight, Komisji Nadzoru Audytowego differ/improve the position of auditors? What is the position so far?

3. Are there enough safeguards to ensure that auditor remains independent at all times? Many acting as accountants and auditors?

4. Do you feel that the audit professionals in Poland are sufficiently experienced and knowledgeable to pass an audit opinion on IFRS financial statements and are there enough of them?

5. What proportion of IFRS accounts are qualified and is it similar percentage for Polish GAAP accounts?

6. Is there a mechanism to force companies to change incorrect accounts?

7. Do you feel that Polish auditors have adequate training and receive enough guidance from the profession?

8. Is there a difference in the level of expertise of small audit firms as compared to say the top 4 firms?

9. Is it feasible in the long run to maintain both Polish GAAP and IFRS?

10. Do you feel that the stakeholders are treated fairly by KIBR when breaches in auditing standards are referred to the judiciary and KIBR? (ROSC report suggests low number of sanctions and leniency?

Appendix 7: Interview questions for company accountants

1. What are the main areas of difficulty with the implementation of IFRS?

2. Should Poland retain Polish accounting standards or fully adopt IFRS?

3. Have you had sufficient training to enable you to understand IFRS and if so where?

4. Who do you focus on when preparing statutory accounts?

   - Shareholders and analysts
   - Holding company
   - Auditors
   - Tax authorities

5. How has the foreign holding company impacted on the accounting of the company?

6. How has the role of accountant changed since the transition?

7. What qualifications do most company accountants hold and how easy is to qualify as a registered auditor?

Appendix 8 Checklist for the disclosure requirements of IFRS 1

Company name: ……………………………………………….

IFRS 1 Reference	**Disclosure requirement**	complied	Not complied	Not applicable
Para 36	An entity's first IFRS financial statements shall include at least one year of comparative information under IFRS			
Para 37	In any financial statements containing historical summaries or comparative information under previous GAAP an entity shall: ○ Label the previous GAAP information prominently as not being prepared under IFRSs ○ Disclose the main adjustments that would make it comply with IFRSs. An entity need not quantify those adjustments			
Para 38	An entity shall explain how the transition from previous GAAP to IFRSs affected its reported financial position, financial performance and cashflows			
Para 39	Entity's first IFRS financial statements shall include: a) A reconciliation of its equity reported under previous GAAP to its equity under IFRSs for: ○ The date of transition to IFRSs and ○ The end of the latest period presented in the entity's most recent annual FS prepared under previous GAAP b) A reconciliation of the profit or loss reported under previous GAAP to IFRS profit or loss for the most recent year			
Para 40	The reconciliations given above shall give sufficient detail to enable users to understand the material adjustments to the balance sheet and IS			
Para 40	If a cashflow statement was presented under previous GAAP the entity shall explain the material adjustments to the cashflow			
Para 44	If an entity uses fair value in its opening IFRS balance sheet as deemed cost for an item of property, plant and equipment, an investment property or an intangible asset, the entity's first IFRS FS shall disclose, for each line item in the opening Balance Sheet: The aggregate of those fair values The aggregate adjustment to the carrying amounts reported under previous GAAP			

Appendix 9 Calculation of Equity and Earnings index for the largest 20 companies

Company	Sector	IFRS profit 2004 (in 000 zloty)	PAR Profit 2004 (in 000 zloty)	IFRS equity at 31st Dec 2004 (in 000 zloty)	PAR equity at 31st Dec 2004 (in 000 zloty)	IFRS equity at 1st Jan 2004 (in 000 zloty)	PAR equity at 1st Jan 2004 (in 000 zloty)	ROE IFRS %	ROE PAR %	Equity index 31.12.04	Earnings index	ROE Index
KGHM Polska Miedź SA	Industrial metal	1,376,715	1,392,459	5,666,244	5,332,243	3,815,840	3,489,257	24.3	26.1	0.94	1.01	1.07
Polski Koncern Naftowy ORLEN SA	Industrial chemical	2,482,227	2,588,981	13,191,608	11,449,650	10,968	9,155,986	18.8	22.6	0.87	1.04	1.20
ASSECO POLAND S.A. (dawny SOFTBANK SA)	IT	1,286	29,369	140,738	157,521	135,959	128,152	0.9	18.6	1.12	22.84	20.40
POLSKIE GÓRNICTWO NAFTOWE I GAZOWNICTWO S.A.	Industrial chemical	793,113	1,109,512	17,746,773	8,797,869	16,969,642	7,727,909	4.5	12.6	0.50	1.40	2.82
POLIMEX - MOSTOSTAL S.A.	Building	37,814	40,494	252,640	219,247	151,803	109,830	15.0	18.5	0.87	1.07	1.23
Grupa Lotos SA	Industrial chemical	542,807	572,002	2,542,630	2,081,336	2,106,040	1,525,351	21.3	27.5	0.82	1.05	1.29
LPP SA	Trade	42,141	42,686	190,804	192,013			22.1	22.2	1.01	1.01	1.01
Zakład Przetwórstwa Hutniczego Stalprodukt SA	Industrial metal	74,982	68,807	273,861	207,129	195,512	128,486	27.4	33.2	0.76	0.92	1.21
Cersanit SA	Industrial building materials	117,109	104,272	451,931	391,931	334,918	287,755	25.9	26.6	0.87	0.89	1.03
Echo Investment SA	Building	26,399	34,686	724,688	376,301	695,653	340,017	3.8	10.2	0.49	1.31	2.69
BUDIMEX SA	Building	8,362	770	520,177	498,976			1.6	0.2	0.96	0.09	0.10
Grupa KĘTY SA	Industrial metal	96,256	90,960	563,554	435,160			17.1	20.9	0.77	0.94	1.22
CCC S.A.	Trade	1,603	1,785	125,757	124,467	28,340	28,084	1.3	1.4	0.99	1.11	1.13
ORBIS SA	Other service	62,596	52,054	1,583,255	1,264,285	1,549,072	1,224,081	4.0	4.1	0.80	0.83	1.04
PBG SA	Building	13,964	18,141	305,796	309,195	164,524	166,007	4.6	5.9	1.01	1.30	1.28
											Outliers excluded	

	ROE IFRS %	ROE PAR %	Equity index 31.12.04	Earnings index 2004
Index >1			3	10
Index <1			12	5
Mean	12.8	16.7	0.8506587	1.07
Std dev	10.11	10.38	0.1768831	0.3094186
Minimum	0.90%	0.20%	0.49	0.83
Maximum	27.40%	27.50%	1.12	1.4

Appendix 10: Calculation of Equity and Earnings index for the sample of smaller 20 companies

reference	IFRS profit 2004 (in 000 zloty)	PAR Profit 2004 (in 000 zloty)	IFRS equity at 31st Dec 2004 (in 000 zloty)	PAR equity at 31st Dec 2004 (in 000 zloty)	IFRS equity at 1st Jan 2004 (in 000 zloty)	PAR equity at 1st Jan 2004 (in 000 zloty)	ROE IFRS % for 2004	ROE PAR % for 2004	Equity index at 31.12.04	Earnings index for 2004	ROE Index
AMICA	44,925	41,028	290,595	289,291	237,649	232,850	15.5	14.2	1.00	0.91	0.92
COMARCH	9,765	14,026	132,435	117,391	122,792	103,497	7.4	11.9	0.89	1.44	1.62
Alma Market SA	18,882	19,085	88,143	87,530	37,158	38,934	21.4	21.8	0.99	1.01	1.02
Polska Grupa Farmeceutyczna SA	63,311	58,740	229,055	221,729	201,547	200,274	27.6	26.5	0.97	0.93	0.96
FARMACOL	61,110	57,794	357,530	354,214	not given	not given	17.1	16.3	0.99	0.95	0.95
MENNICA	42,687	37,936	267,208	267,748	228,963	234,254	16.0	14.2	1.00	0.89	0.89
VISTULA	19,341	19,341	51,133	50,216	32,472	31,375	37.8	38.5	0.98	1.00	1.02
LUBAWA	3,624	3,624	27,305	26,541	not given	not given	13.3	13.7	0.97	1.00	1.03
KOPEX	16,655	12,120	92,098	83,741	74,003	73,179	18.1	14.5	0.91	0.73	0.80
MOSTOSTAL-EXPORT SA	13,391	9,141	51,776	54,985	106,767	106,767	25.9	16.6	1.06	0.68	0.64
KOELNER S.A.	17,131	20,096	148,214	134,574	39,256	39,256	11.6	11.6	0.91	1.17	1.00
ELBUDOWA	5,270	5,016	64,553	69,017	not given	not given	8.2	7.3	1.07	0.95	0.89
Apator SA	39,827	35,087	90,529	84,831	51,348	51,099	44.0	41.4	0.88	0.88	1.00
Zakłady Chemiczne i Tworzyw Sztucznych BORYSZEW SA	77,759	80,299	398,749	233,295	272,319	103,774	68.3	44.5	0.59	0.38	0.65
CIECH SA	92,340	79,250	757,984	551,377	680,330	473,196	12.2	14.4	0.73	0.86	1.18
CERAMIKA NOWA GALA	10,135	12,526	102,962	98,660	50,794	46,562	9.8	12.7	0.96	1.24	1.29
AMBRA S.A.	16,214	15,561	105,144	98,305	83,485	79,492	15.4	15.8	0.93	0.96	1.03
GRAAL S.A.	3,850	3,156	49,195	48,501	32,452	32,452	7.8	6.5	0.99	0.82	0.83

	ROE IFRS %	ROE PAR %	Equity index 31.12.04	Earnings index 2004
index >1			2	5
index = 1			2	2
index <1			15	12
mean	21.0	19.0	0.93	0.93
std dev	13.00	0.13	0.12	0.22
minimum	7.40%	6.50%	0.59	0.38
maximum	68.30%	41.40%	1.07	1.44

Appendix 11: Auditor details and compliance with IFRS1 for the sample of the largest companies

company name	% of total market capital	dominant holding	auditor	audit opinion in 2005	Accounting convention used	explicit statement of compliance with IFRS	reconciliation PAR to IFRS of equity at 31st Dec 2004	reconciliation PAR to IFRS of equity at 1st Jan 2004	reconciliation PAR to IFRS of profit for 2004	explanation of reconciliation	notes
KGHM Polska Miedź SA	8.9	31% state	PWC	Clean	1st adoption of IFRS 2005	1	1	1	1	1	
Polski Koncern Naftowy ORLEN SA	7.3	27% state	KPMG	Clean	1st adoption of IFRS 2005	1	1	1	1	1	
TELEKOMUNIKACJA POLSKA SA	6	41% France telecom	E&Y	Clean	prepares IFRS a/cs	1	IFRS pre 2005 so no reconciliation				
ASSECO POLAND S.A. (dawny SOFTBANK SA)	1.961	no single	E&Y	Clean with a note	1st adoption of IFRS 2005	1	1	1	1	1	clean with a note some subsidiaries were audited by different auditor or not audited
POLSKIE GÓRNICTWO NAFTOWE I GAZOWNICTWO S.A.	1.777	85% state	Deloittes	Clean	1st adoption of IFRS 2005	1	1	1	1	1	
GTC	1.632	46% of a Dutch grp	E&Y	Clean	prepares IFRS a/cs	1	IFRS pre 2005 so no reconciliation				
TVN S.A.	1.54	58%ITI group polish 3 indiv	PWC	Clean	prepares IFRS a/cs	1	IFRS pre 2005 so no reconciliation				
POLIMEX - MOSTOSTAL S.A.	1.194	no single dominant	E&Y	qualified	1st adoption of IFRS 2005	1	1	1	1	1	Qualified on the inability to value a building due to uncertainty of ownership, debts due in 2004 not verified due to lack of ac precision, uncertainty of subsidiary valuation.
Grupa Lotos SA	1.114	Nafta Polska 59% (state)	E&Y	Clean	1st adoption of IFRS 2005	1	1	1	1	1	
Netia SA	1.106	no	PWC	Clean	prepares IFRS accounts	1	IFRS pre 2005 so no reconciliation				
LPP SA	0.872	2 indiv control 62%	fraczkowicz	Clean	1st adoption of IFRS 2005	1	1	0	1	1	FA not revalued

company name	% of total market capital	dominant holding	auditor	audit opinion in 2005	Accounting convention used	explicit statement of compliance with IFRS	reconciliation PAR to IFRS of equity at 31st Dec 2004	reconciliation PAR to IFRS of equity at 1st Jan 2004	reconciliation PAR to IFRS of profit for 2004	explanation of reconciliation	notes
Zakład Przetwórstwa Hutniczego Stalprodukt SA	0.703	Mittal steel 38%, prev. State owned	Accord ab	Clean	1st adoption of IFRS 2005	1	not done but explained	1	1	1	investor FS do not include notes
Cersanit SA	0.664	M. Solowow 49%	GRUPA FINANS-SERVIS	Clean	1st adoption of IFRS 2005	1	1	1	reconciling items not shown	not done	very basic changes shown in table only
AGORA SA	0.652	WBK asset Management 28% Agora holding 35%	KPMG	Clean	prepares IFRS a/cs	1	IFRS pre 2005 so no reconciliation				
Echo Investment SA	0.646	M. Solowow majority	BDO	Clean	1st adoption 2005	1	1	1	1	0	
BUDIMEX SA	0.597		PWC	Clean	1st adoption of IFRS 2005	1	1	1	1	1	
Grupa KĘTY SA	0.579	ING17%no single	PWC	Clean	1st adoption of IFRS 2005	1	1	1	1	1	revaluation by directors
CCC S.A.	0.549	61% Milek	BDO	Clean	1st adoption of IFRS 2005	1	1	1	1	1	
ORBIS SA	0.543	Accor sa 41%	PWC	qualified	1st adoption of IFRS 2005	1	1	1	1	1	qualification due to right to use land included in B/S according to PWC it should be an operating lease, hotels valued using EBITDA but should use DCF, 4 hotels not on B/S but should be shown as sold to financial institution
PBG S.A.	1.457	wisniewski 46%	fraczkowicz	clean	1st adoption of IFRS 2005	1	1	1	1	1	
PERCENTAGE OF TOTAL MARKET CAPITALISATION SURVEYED	**39.8**										

Appendix 12: Auditor details and compliance with IFRS1 for the sample of the smaller companies

company name	% of total market capital	dominant holding	auditor	audit opinion in 2005	explicit statement of compliance with IFRS	reconciliation PAR to IFRS of equity at 31st Dec 2004	reconciliation PAR to IFRS of equity at 1st Jan 2004	reconciliation PAR to IFRS of profit for 2004	explanation of reconciliation	notes
AMICA Wronki SA	0.104	Amica holding sa 52%	Frackowiak	qualified	1	1	1	1	1	qualified as unable to quantify debtor in liquidation
ComArch SA	0.263	J. Filipiak and wife 69%	PWC	clean	1	1	1	1	1	all FA at cost
Alma Market SA	0.09	J. Mazgaj 48%	PWC	clean	1	1	1	1	1	
Polska Grupa Farmeceutyczna SA	0.244	szwajcowski 30%	Deloittes	clean	1	1	1	1	1	
Farmacol SA	0.28	olszewski +wife 62%	Horwath	clean	1	1	0	0	1	
Mennica Polska S.A.	0.086	42% Januszewicz	Misters	clean	1	1	1	1	1	
Vistula SA	0.15	podst.	BDO	clean						
LUBAWA SA	0.04	no single over 10%	Florian Osekowski	clean	1	1	0	1	1	
KOPEX	0.374	jendzejewski 60%	Zemelka	clean	1	1	1	1	1	
SWISSMED Centrum Zdrowia S.A.	0.024	Mr. Hargatner 59%	Audyt and Rachunkowosc 'UZR-CBR'	clean	1	1	0	0	1	
MOSTOSTAL-EXPORT SA	0.039	no single over 5%	KPMG	clean	1	1	1	1	1	noted in 2004 audit report that reconciliation to IFRS not done, company has going concern note

company name	% of total market capital	dominant holding	auditor	audit opinion in 2005	explicit statement of compliance with IFRS	reconciliation PAR to IFRS of equity at 31st Dec 2004	reconciliation PAR to IFRS of equity at 1st Jan 2004	reconciliation PAR to IFRS of profit for 2004	explanation of reconciliation	notes
KOELNER S.A.	0.11	amicus sa 58%	Frackowiak	clean	1	1	1	1	1	qualified in 2004 and 2005 due to subsidiaries not audited
ELEKTROBUDOWA SA	0.487		PWC	clean	0	0	0	0	0	Reconciliation to IFRS in single co acs **only**. 1st yr of consol due to IFRS req
Apator SA	0.317		Frackowiak	clean	1	1	1	1	0	
Zakłady Chemiczne i Tworzyw Sztucznych BORYSZEW SA	0.032	R.Karkosik 66%	Frackowiak	clean	1	1	1	1	1	large revaluation with v. Little information 2004 accounts give v. Good over-view of PAR/IFRS differences
CIECH SA	0.332		Deloittes	clean	1	1	1	1	1	
YAWAL S.A.	0.04	53% Mzyk family	BDO	clean	1	1	1	1	1	
NOWAGALA		18% one person	BDO note re tax	Clean	1	1	1	1	0	
AMBRA S.A.	0.043	61% foreign investor	BDO	clean	1	1	1	1	1	data from year ended 30.6.06
GRAAL S.A.	0.042	41.5% Kowalski	Kancelaria Porad Finansow	not avail	1	1	1	1	1	
PERCENTAGE OF TOTAL MARKET CAPITALISATION SURVEYED	3.10									