

# REPORT ON THE OBSERVANCE OF STANDARDS AND CODES (ROSC) Poland

## ACCOUNTING AND AUDITING

July 25, 2002

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### Executive Summary

This report provides an assessment of accounting and auditing practices in Poland using international standards as a benchmark, while focusing on the institutional framework and application of given standards. The conclusions of this report are based on an initial self-assessment carried out by a National Steering Committee organized under the patronage of the Ministry of Finance, supplemented by additional due diligence exercise conducted by World Bank staff. The policy recommendations could be used as a basis for preparing a National Action Plan for accounting and auditing developments in Poland.

In the recent past, Poland has taken steps in reducing the gap between Polish Accounting Regulations and International Accounting Standards. This is demonstrated in the provisions of the Accounting Act (Dz. U. No. 113, item 1186), dated November 9, 2000, and the financial reporting and disclosure requirements set by the Securities and Exchange Commission for the publicly traded companies. Further steps are needed for full adoption of the requirements set by the International Accounting Standards Board. A review of 30 sets of financial statements of select listed companies shows that there are divergences between various established accounting regulations and actual accounting practices.

There are no Polish Auditing Standards for one-third of the areas covered by International Standards on Auditing. Also, most of the existing Polish Auditing Standards need updating in line with these international standards. Practicing auditors generally comply with the strict wording of written Polish Auditing Standards, however the lack of detailed standards and shortage of practical-oriented implementation guidelines seem to constrain the application of high quality audit methodology. Although the education and training arrangements appear to be of high quality, there is a shortage of well-trained accounting and auditing instructors in many institutions of higher learning. Moreover, there is a need to update curricula focusing on practical application of internationally recognized accounting and auditing standards and professional accounting code of ethics.

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This report was prepared by a staff team from the World Bank on the basis of the findings from a diagnostic review carried out in Poland. The staff team comprised M. Zubaidur Rahman (OPCFM), John Hegarty and Iwona Warzecha (ECSCS). The review was conducted through a participatory process involving various stakeholders and led by the country authorities.

## I. INTRODUCTION

1. As part of the initiative on preparing Reports on the Observance of Standards and Codes (ROSC), the World Bank undertook reviews of observance with international accounting and auditing standards in Poland. The reviews mainly focused on strengths and weaknesses of the institutional arrangements that underpin the corporate financial reporting system in the country. The International Accounting Standards and the International Standards on Auditing were used as benchmarks in assessing Poland's accounting regulations<sup>1</sup> and auditing standards. The review involved an assessment of mandatory requirements and actual practices using a diagnostic template developed by the Bank.

2. Prior to the start of economic transformation in Poland, accounting rules facilitated meeting the information needs of a centrally planned economy. The launching of economic reform for market economic transformation in the late 1980s was accompanied by introduction of various market-oriented regulatory actions, including new rules of accounting and auditing. The process of economic reform has been expedited by the preparation for European Union accession. From this perspective, the Accounting and Auditing ROSC exercise in Poland was conducted from February to April 2001, under the management of a National Steering Committee and with direct support of the Ministry of Finance. The World Bank staff assisted the Steering Committee in carrying out review work and prepared the report based on review results.

## II. INSTITUTIONAL FRAMEWORK

### A. Statutory Framework

3. **The Accounting Act of September 29, 1994, and the comprehensive amendments of the Accounting Act adopted on November 9, 2000, have brought Polish Accounting Regulations (PARs) more in line with the International Accounting Standards (IASs).** The accounting regulations have moved the focus of Polish accounting away from the emphasis on tax compliance toward a more business-oriented approach aimed at meeting the information needs of various stakeholders in a market economy. Most enterprises are required to maintain books of account and prepare financial statements according to the provisions of the Accounting Act.<sup>2</sup> Appendices to the Accounting Act provide sample formats of balance sheet, income statement, statement of changes in equity, and cash flow statement. Deviation from these formats is allowed provided that the financial statements fairly and clearly presents the financial position and results of operations in accordance with the rules of accounting practice as stipulated in the Accounting Act. The publicly traded companies are required to

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<sup>1</sup> Polish Accounting Regulations (PAR) are issued in the form of act of law, ordinances and decrees. At the time of writing the report there was no Polish Accounting Standards although the Accounting Standards Committee was established in April 2002. Therefore, the term "Polish Accounting Regulations" is used in the report.

<sup>2</sup> Enterprises include commercial companies, banks, insurance companies, investment funds and investment fund companies, pension funds, pension fund companies, foreign corporate bodies, foreign entities without legal personality, and those other business enterprises (sole proprietorship and various types of partnerships) that had revenue during the preceding financial year amounting to at least the Polish zloty equivalent of EUR 800,000.

prepare financial statements in accordance with the formats prescribed in the Decree of the Council of Ministers concerning public issue of securities.

4. **The amended Accounting Act has eliminated audit requirement for small-size enterprises.** The threshold for an enterprise to be subject to annual statutory audit is meeting at least two of three conditions during the immediate past financial year: (a) annual average of 50 full-time equivalent employees; (b) total assets at fiscal year-end of at least the Polish zloty equivalent of EUR2,500,000; and (c) net sales revenue and financial income of at least the Polish zloty equivalent of EUR5,000,000. Prior to the amendment, a large number of smaller-size enterprises were required to have a statutory audit once every three years—at present, this requirement does not exist. The Accounting Act also requires an annual statutory audit of banks, insurance companies, publicly traded companies, investment funds, pension funds, holding companies, and joint stock companies.

5. **Statutory auditors are appointed at the annual general shareholders' meeting unless the articles of association provide for the supervisory board to make such appointments.** Moreover, the Commercial Code provides shareholders of limited companies, who represent at least ten percent of the company's share capital, the right to appoint auditors to conduct an investigative audit.

6. **The top management of companies is legally responsible for the financial statements.** According to the Accounting Act, a fine or a penalty of imprisonment for two years may be imposed on the top management of the company in cases of failure to maintain books of account and to prepare and present financial statements in accordance with the Accounting Act. Financial statements must be prepared within three months of the date on the balance sheet, and should be presented for approval at the annual general shareholders' meeting within six months (eight months in the case of consolidated financial statements of a group). The audited financial statements, including the audit report and other information, should be filed with the registration court and published in the official gazette, *Monitor Polski B*, within 15 days of approval at the annual general shareholders' meeting.

7. **There are additional reporting requirements for the publicly traded companies.** Publicly traded companies are required to have semi-annual financial statements reviewed by independent auditors and to submit these statements to the Securities and Exchange Commission (SEC). At the end of 2001, these companies were required to include in the financial statements a description of major differences between the adopted accounting policies and IAS requirements, and reconciliation of both the net profit and net equity figures in the financial statements to that which would arise under IAS. A decision was made in early 2002 to suspend these additional disclosure requirements.

8. **The Act on Auditors and their Self-Governing Body, dated October 13, 1994, and its subsequent amendments regulate the audit profession in Poland.** This Act provides legal framework for the creation, governance, and operation of the National Chamber of Statutory Auditors (NCSA). The Ministry of Finance is responsible for supervision of the NCSA; the finance minister may lodge a complaint against the NCSA to the District Court for the city of Warsaw if it violates the legal requirements or departs from its statute.

## B. The Profession

9. **Of about 7,700 NCSA members, 4,250 are active.** The introduction of “chartered accountant” designation by a decree of the Council of Ministers in 1957 was the beginning of professional accounting qualification in Poland. Through a resolution of the Council of Ministers in 1959, a two-stage examination system was established for awarding the qualification of chartered accountant. The Ministry of Finance was in charge of awarding the diploma and registering the qualified chartered accountants. The chartered accountants were generally employed in the accounting department of business entities. Also, the chartered accountants were authorized to conduct the statutory audit of the financial statements of state-owned and state-cooperative enterprises. In such cases, the Ministry of Finance usually assigned the chartered accountants to enterprises outside their regular place of work for a particular period of time to inspect books of account and to issue certificates of “correctness” on financial statements. Under the Act on Auditors dated October 19, 1991, all the existing chartered accountants were registered with the NCSA and obtained audit license without taking any qualification examination; these NCSA members were required to complete training in the new rules of taxation, accounting, and auditing. After introduction of the new Act on Auditors in 1994, all the existing NCSA members were automatically recognized as statutory auditors in accordance with the provisions of the new Act.

10. **Two professional bodies in Poland have received membership in the International Federation of Accountants.** The membership of the International Federation of Accountants (IFAC) was awarded to the National Board of Chartered Accountants Association in Poland (NBCAAP) in May 1989 and to the National Chamber of Statutory Auditors in November 2001. The NBCAAP was created within the structure of the Accountants Association in Poland (AAP) with its membership of chartered accountants.

11. **The AAP, a voluntary organization of accountants, financial specialists, auditors and information technology accounting specialists, was established in 1907.** The AAP comprises more than 30,000 individual members, including accounting sector specialists and qualified chartered accountants, and more than 12,000 member organizations. When the Act on Auditors (1991) was introduced, chartered accountants in AAP were able to register as statutory auditors and NCSA members. Some 7,700 out of 11,000 chartered accountants have requested such registration. According to the AAP charter, its main objectives are protection of rights, integrity, and interests of its members; training and continuing professional education; promotion of professional community and ethical behavior; cooperation with government and local authorities in accounting areas; and cooperation with international organizations to implement European standards into the profession. The AAP membership is open to anyone employed in activities related to accounting, bookkeeping, auditing, taxation, banking, and finance. The AAP is not a self-regulatory body as defined in Polish legal framework and its activities are regulated by the Act on Associations.

12. **The NCSA is well organized as a professional body.** The NCSA is legally authorized to prescribe the qualification requirements for and grant the title of statutory auditor, establish professional standards for auditors in consultation with the Finance Minister, set a code of professional ethics, supervise the professional conduct of its members, and impose disciplinary penalties for breaches of conduct. Statutory auditors are obliged to be members of

NCSA. Only in rare exceptions is a statutory auditor allowed to practice jointly with other professions. The NCSA statute was passed by the National Assembly of Statutory Auditors (the supreme body of NCSA) and approved by the Finance Minister. The National Assembly appoints the chairman and other members of the National Board of Statutory Auditors (executive body). The National Assembly may dismiss all Board members, including chairman, before their term of office has elapsed. The term of office of the National Board of Statutory Auditors and other constituent bodies is four years. The National Board presents an annual activities report, including financial statements, to the Finance Minister. In June 2002 the Extraordinary National Congress of Statutory Auditors appointed the members of the National Supervision Committee, a newly established body of NCSA. As a control body, the National Supervision Committee oversees that statutory auditors are practicing with due care and in compliance with auditing procedures.

13. **There is a Code of Professional Ethics in Poland.** In 1996 the Extraordinary National Congress of Statutory Auditors approved the Code of Ethics for Statutory Auditors in Poland, which became effective January 1, 1997. The Extraordinary National Congress of Statutory Auditors passed in June 2002 a new Code of Professional Ethics in Poland, updated in line with the IFAC Code. Although the principles of the Polish Code of Ethics are similar to those of the IFAC's, availability of a detailed and practical-oriented implementation guidelines would enable the practicing auditors to understand and properly apply all aspects of the IFAC's Code. Moreover, efforts were needed for motivating the practicing auditors to appreciate issues concerning auditor's independence, conflict of interest, and other aspects of professional ethics.

14. **While most of the listed companies are audited by the local member firms of large international network, a number of domestic audit firms have significant market share.** Of the auditors of 1999 financial statements of the top-100 companies listed in Warsaw Stock Exchange, 70 percent came from the big-5 firms and 30 percent came from other internationally affiliated firms. The clients of domestic firms generally include public sector entities, as well as medium- and small-size private sector enterprises. Several domestic audit firms have established a large network of firms throughout the country, and about 20 domestic firms have grown significantly in regional business centers. There are about 2,100 audit firms with one or two licensed auditors.

15. **The National Bank of Poland expressed concerns about the quality of bank audits.** The banking supervisors at the National Bank discovered unsatisfactory quality in a number of bank audits. In the case of one particular bank audit, the banking supervisors were critical of deficient quality in the performance by an audit firm over a number of years; however, the audit professional body (NCSA) did not respond to such complaints prior to failure of the same bank. The banking supervisors cited various other instances of shortcomings in the quality of bank audits.

16. **The demand is greater than the supply of skilled accountants and professionally qualified auditors.** The publicly traded companies and financial institutions try to employ skilled accountants for internal financial control and external financial reporting. However, the availability of such professionals remains somewhat limited and relatively expensive. In the recent past, better opportunity in the auditing profession has inspired talented students to

become qualified auditors. Since the qualification period ranges between five and seven years, the supply continues to lag behind the demand. At present, the average age of about 75 percent of the NCSA members is 60 years old.

### **C. Professional Education and Training**

17. **The required academic standard for entering the auditing profession appears to be high; however, shortage of experienced instructors seems to affect the quality of accountancy education in a number of higher learning institutions.** Enrollment as a candidate for professional examination to become a statutory auditor requires a university or equivalent degree in Poland; the degree gained in a foreign country must be recognized as equivalent to a Polish degree. There is no need for the candidate to have prior academic training in economics, accounting, or related subjects. Responding to the needs of a market economy, the higher education institutions in Poland introduced new courses covering subjects taught in business schools in Europe and the United States. The new generation of candidates for statutory auditor examination tends to take business courses, including accounting and finance, in the degree program. While a few universities have world-standard accounting instructors, many suffer from a scarcity of experienced full-time instructors. Moreover, many of the full-time accounting instructors are involved in audit practice, and a number of these instructors take up part-time teaching jobs in several educational institutions.

18. **There is a need for improving the curriculum of professional education and the system of professional examination for statutory auditors.** These improvements should be made with reference to the guidelines issued by the Education Committee of the IFAC, as well as requirements of the European Union's Eighth Company Law Directive, dated March 21, 1994, which specifies qualification requirements for statutory auditors. The NCSA prepares and administers the statutory auditor examination. The candidates for this examination need to pass examination in ten subjects in four phases. This examination is heavily focused on memory work of the national rules and regulations, with less testing of candidate's critical thinking ability. Between 1994-2000, about 4,350 candidates were enrolled in the qualification examination. At the beginning of this examination period, the success rate was low. Only a few each year gained membership in NCSA. However by April 30, 2002, a total of 550 candidates had successfully passed final examinations and become new members of NCSA.

19. **There is a practical experience requirement for entry into the profession.** Prior to obtaining the professional qualification, a candidate is required to gain practical work experience for at least three years—at least one year as an accountant in an organization and at least two years' professional training under the supervision of a statutory auditor. The practical experience/training of individual candidates needs to be approved by the examination commission of the NCSA. In special cases, the NCSA may waive the one-year accounting work experience; however, the two-year professional experience requirement cannot be waived.

20. **Each practicing member of the NCSA is required to attend 30 hours of continuing professional education every year.** The NCSA strictly enforces this requirement. The NCSA encourages its members to undertake professional training courses offered by the Association

of Accountants in Poland, qualified audit firms, and regional NCSA offices. The large audit firms in the country sometimes offer in-house training programs, attendance of which is generally approved by the NCSA as fulfillment of the requirement continuing professional education.

#### **D. Setting Accounting and Auditing Standards**

21. **The Accounting Act mandated the Finance Ministry to establish an Accounting Standards Committee (ASC).** The ASC was established under Minister of Finance in April 2002. The main task of the ASC covers the issuance of Polish Accounting Regulations independently from tasks performed by the Ministry of Finance. The ASC provides a forum for exchange of views on the most problematic issues that appear during the changes process in the national accounting system. Polish Accounting Regulations set by the ASC will take into account the Polish specific economic circumstances, as well as the European Union pre-access adjustments requirements. When provisions are not covered, the Accounting Act provides for potential application of accounting standards issued by ASC, and the eventual application of IAS in cases when Polish Accounting Regulations are lacking coverage. Thus the jurisdiction of ASC and the Polish Accounting Regulations will extend to all entities covered by the Accounting Act. In addition to the accounting requirements stipulated in the Accounting Act, there are some specific accounting and disclosure requirements set in decrees issued by the Finance Minister for some financial institutions including banks, insurance companies, investment funds, pension funds, and brokerage houses. Moreover, the separate decree issued by the Council of Ministers requires additional disclosures by the publicly traded companies.

22. **The National Chamber of Statutory Auditors is legally authorized to set auditing standards.** The NCSA sets auditing standards in consultation with the Ministry of Finance and the Securities and Exchange Commission, and in relation to banks after consultation with the Banking Supervision Commission. When drafting auditing standards, efforts are made to adapt internationally recognized standards to country circumstances. To date, the NCSA has issued eight auditing standards: (a) general principles on auditing of annual financial statements; (b) auditor's report and long-form auditor's report on annual financial statements of an entity other than a bank or an insurance company; (c) auditor's report and long-form auditor's report on annual financial statements of an insurance company; (d) auditor's report and long-form auditor's report on annual financial statements of a bank; (e) auditing of consolidated financial statements of a capital group; (f) general principles in relation to the review of interim financial statements; (g) auditing of annual financial statements of entities not subject to the mandatory annual audit (this norm related to small entities that were subject to audit every three years; currently this norm is not applied in practice since the obligation for smaller companies to have an audit of financial statements every three years has been revoked); (h) auditor's report and long-form auditor's report on annual financial statements of investment or pension funds. If particular auditing issues are not covered by the local standards, the NCSA permits the use of appropriate International Standards on Auditing (ISAs).

## E. Compliance with Accounting and Auditing Standards

23. **The Securities and Exchange Commission has established a system of monitoring and enforcing disclosure requirements.** The SEC, on a regular basis, reviews financial statements of the listed companies and other participants in the securities markets, which include brokerage firms and investment funds. In addition to conducting other regulatory inspections, the SEC seeks to identify violations of established accounting and disclosure requirements. For such violations, the SEC is authorized to institute administrative proceedings. From early 1998 to March 2001, the SEC identified 32 cases of noncompliance with disclosure requirements in the financial statements of listed companies, and imposed various sanctions—in one case, the company’s listing in the stock market was cancelled and a financial penalty was imposed. In eight cases financial penalty was imposed on each of the companies. In 23 other cases, the companies received letters of admonition from the SEC. Despite some success in monitoring and enforcement, there is a shortage of human resources capable of conducting proper monitoring activities.

24. **The statutory regulators need to improve capacity for enforcing financial reporting requirements based on international standards, as IAS will be more commonly applied.** The current emphasis of the legal requirements concerning the use of International Accounting Standards necessitates strengthening monitoring capacity of all the regulatory bodies.<sup>3</sup> At present, a shortage of well-trained and experienced specialists in these bodies constrains detailed and systematic review of financial statements for the purpose of determining noncompliance with International Accounting Standards.

25. **The statutory regulatory bodies rely heavily on the auditors for ensuring compliance with the established accounting and disclosure requirements.** But due to lack of legal limitations and the independence of statutory auditors guaranteed by the legal acts, these bodies rarely enforce actions against those statutory auditors who fail in ensuring compliance with the accounting and disclosure requirements. Such enforcement actions can be taken by NCSA.

26. **The National Chamber of Statutory Auditors is empowered to take disciplinary actions for enforcing the code of professional ethics and auditing standards.** The NCSA may impose the following disciplinary penalties against errant auditors: admonishment, reprimand, suspension for 1-3 years from the auditing profession, and cancellation of auditing license. As a part of its monitoring mechanism, the NCSA organizes practice review of statutory auditors and audit firms once every three years, through the National Supervisory Commission. The members of this Commission are entitled to examine all documents relating to audits performed by the auditor/audit firm. If need be, they may summon witnesses and demand written or oral explanations from the auditor/audit firm.

27. **Efforts are needed for improving compliance with auditing standards.** Although over the past seven years a visible step forward has been made in fine-tuning an audit into a practice consistent with international standards, there are many instances where the certified auditors do not comply with Polish Auditing Standards. During the past three years, the most

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<sup>3</sup> Regulatory bodies include the Ministry of Finance, the SEC, the General Inspectorate for Banking Supervision, the Office for Insurance Supervision, and the Office for Supervising Pension Funds.

common problems identified in the course of practice review included deficiencies in the form and content of working papers; a breach of the professional code of ethics; and noncompliance with various other professional practice norms. Most common penalties included admonition and reprimand. The main reason for the gap between established standards and actual practices seems to be an inability of many practicing auditors to properly apply standards. This inability is due to insufficient training and to many retired auditors who work without upgraded skills. More importantly, there are resource constraints at the NCSA with regard to enforcement. Some practitioners pointed out that there is a need for improving the methodology applied for practice review by the National Supervisory Commission of the NCSA, and for increasing the number of well-trained and experienced personnel involved in conducting supervision.

**28. Public availability of practice review results and attendant enforcement actions would have demonstration effect in bolstering a culture of compliance.** Currently, the NCSA keeps confidential the results of practice review. Some experienced auditors and academics see advantages to public disclosure of the results of monitoring and enforcement activities. Public disclosure increases incentives for the practicing auditors to abide by the auditing standards, rules, and regulations.

### **III. ACCOUNTING STANDARDS AS DESIGNED AND AS PRACTICED**

**29. While Polish Accounting Regulations have improved over years, proper application has not yet achieved complete success.** Although significant progress has been observed during the past five years in the area of accounting requirements, the proper application of PARs has been more difficult. According to experienced practitioners in the country, the established practice of preparing financial statements primarily for tax purposes leads to either misapplication of requirements or reluctance to use IAS whenever a PAR is not available (for example in lease accounting). As a result of this, the financial statements tend to lose usefulness from the point of view of general purpose financial reporting.

**30. The amended Accounting Act of 2000, which went into effect January 1, 2002, reduces the gap between Polish Accounting Regulations and International Accounting Standards.** This Act allows for using IAS when comparable Polish regulations do not exist. However, the lack of standardized guidance on application of PARs supplemented by IASs gives rise to divergences in practice. In circumstances where there is no ambiguity about nonexistent Polish regulations, the use of IASs is clear. However, in circumstances where a PAR is comparable to IAS in appearance but not in substance, the preparers take more liberal license in interpreting and applying the standard in more suitable ways. In order to determine the extent of comparability between PARs and IASs, Part 2 of the World Bank diagnostic template was completed by a working group of experts in Poland representing the Ministry of Finance, SEC, NCSA, and AAP, and two local members of the international accounting firm network. A joint analysis by this group addressed 164 accounting requirements under applicable IASs, and determined comparability of the counterpart PARs, categorizing them approximately as follows—50 percent fully comparable, 15 percent broadly comparable, and 35 percent noncomparable or nonexistent. However, at the time of preparing the analysis, the specific regulations and decrees accompanying the amended Accounting Act had not been issued yet. “Broadly comparable” seems to denote that there are inconsistencies between

PAR and IAS requirements that could lead to differences in certain respects of financial reporting for many enterprises under Polish Accounting Regulations.

**31. The analysis of the requirements under applicable Polish Accounting Regulations reveal various incompatibilities with International Accounting Standard requirements.**

Selected significant areas of difference include the following:

- Polish Accounting Regulations have no requirement on financial reporting under hyperinflationary economic conditions. Only public securities issuers are obliged to adjust the main items of a financial statement with adequate inflation index if reporting under hyperinflationary conditions.
- Although revaluation of fixed assets is allowed, it is not voluntary and should be performed when ordered by the appropriate authorities. No mechanism of the regular revaluations is built in PARs as they are in IASs. Similarly, PARs do not include IAS-comparable requirements on accounting for impairment losses of tangible and intangible assets.
- Contrary to IAS requirement on consolidation, a parent company does not have to prepare consolidated financial statements if 2 out of 3 thresholds for the whole group are met: (a) average annual employment is less than 250 people; (b) total end-of-year assets is EUR7.5 million; and (c) net revenue from sales of goods and financial activities is less than EUR15 million. Although all the listed holding companies are required to prepare consolidated financial statements irrespective of these thresholds, existing regulations allow non-consolidation of some subsidiaries on the following grounds: the parent company and the subsidiaries are involved in dissimilar business activities; and the high cost of obtaining necessary information for consolidation purposes from the subsidiaries registered outside Poland.
- The concept of segment reporting, as defined in IAS, does not exist in PARs. Nonetheless an entity is obliged to disclose a breakdown of the net sales by activity type and by territory (domestic and foreign). Commencing in 2003, public securities issuers will be obliged to disclose information on business and geographical segments in consolidated financial statements, which is also required by IAS.
- Due to the absence of IAS-comparable definition of the research versus development costs, many research and related costs that should have been expensed are capitalized.
- Apart from the IAS-comparable definition of finance lease, no further guidance is available in Polish regulations on accounting for leases.
- IAS-compatible accounting requirements for employee benefits do not exist. Although Polish Accounting Regulations require provision for employee benefit on a balance sheet, no further definition is provided.

- There is a lack of IAS-comparable disclosure requirements with respect to various accounting and reporting areas, including related party transactions, fixed assets, intangible assets, and investments.
- Many of the additional disclosure requirements for banks and similar financial institutions, included in the relevant IAS, do not have fully comparable PAR counterparts.

32. **The review of 30 sets of financial statements of select listed companies in the Warsaw Stock Exchange revealed some shortcomings in actual application of accounting regulations valid as of December 31, 1999 (before the amendment of the Accounting Act.)** The review found that the overall presentation of financial statements needs to be streamlined and standardized. In many cases, financial statements included excessive information on immaterial aspects and inadequate information on more relevant aspects. Based on the review results, some divergences between established accounting regulations and actual practices follow:

- ***Disclosure of Accounting Policies.*** Many companies disclosed accounting policies in a generalized way and referred to the Accounting Act. In many cases companies did not disclose specific accounting policies in a systematic way.
- ***Earnings Per Share.*** Various companies used different interpretations on how to provide supporting data on calculation of basic earnings per share and diluted earnings per share. Some companies did not provide this information at all.
- ***Consolidated Financial Statements.*** Many companies did not provide information on all the subsidiaries and associates. Also, adequate information was unavailable on which subsidiaries were excluded in consolidation, in pursuance of the established norm on exclusion from consolidation. Moreover, many of the required disclosures in consolidated financial statements were not available.
- ***Related-Party Relationships and Transactions.*** The financial statements of many of the sample companies did not provide information on related-party relationships. Also, adequate information was unavailable to determine the magnitude of related-party transactions. However, an examination of the operational activities and company structure indicates that these companies had related parties. Some companies provided aggregated information on related-party transactions that was not in compliance with the requirement for detailed disclosures in additional explanatory notes.
- ***Segment Reporting.*** Although the segment-reporting requirement in the PAR is not in full conformity with IAS, there is a requirement on disclosure of revenue in different types of business activities and in different geographical locations. Except in the case of some large-size enterprises, this type of information was rarely disclosed in the financial statements.
- ***Leasing.*** Due to the lack of clarity in the disclosure requirements, companies generally did not provide adequate information on leased assets.

- **Financial Instruments.** A number of companies did not provide the required information on maturity, market price, and financial risk of the financial assets. Due to the lack of clear guidance, different companies presented information in various formats.
- **Cash Flow.** In some cases, additional required information on reconciliation to cash flow was not provided.
- **Restriction on Fixed Assets.** Most of the companies did not provide clear information on restricted fixed assets that were pledged as security.
- **Differences between Polish Accounting Regulations and International Accounting Standards.** The disclosure rules established by the Council of Ministers' decree required listed companies to provide information on financial implications of these differences. However, the companies in general provided some descriptions of these differences without quantifying the consequences of these differences.

#### IV. AUDITING STANDARDS AS DESIGNED AND AS PRACTICED

33. **In comparison to the International Standards on Auditing, Polish Auditing Standards give only a general guideline on audit objectives and procedures.** Unlike ISAs, the Polish standards are not structured to cover separately particular audit areas. As a result, the provisions of the Polish Auditing Standards only partially cover the areas covered by the ISAs; and the scope, extent, and precision of provisions of the Polish standards appear to be limited. Notably, the Polish Auditing Standards contain a provision that requires the auditor to be guided by the knowledge enriched by the professional literature and especially ISAs. In this respect, there is a need for development and dissemination of practical-oriented implementation guidelines to assist practitioners in conducting audits. The National Chamber of Statutory Auditors, in addition to issuing eight auditing standards, has issued the guidelines on the following areas: auditing of the company's assumption regarding going-concern assessment; wording of auditor's opinion on annual financial statements; wording and content of long-form auditor's report on annual financial statements; auditor's participation in physical inventory count; and auditing of balance sheet and income statement items/captions.

34. **Practicing auditors generally comply with the strict wording of written Polish Auditing Standards; however lack of ISA-compatible requirements in certain areas affects the audit quality.** In order to assess the auditing practices in Poland, World Bank staff facilitated a discussion with practicing auditors in Warsaw in April 2001. The participants were experienced practitioners representing large- and medium-size audit firms. The audit practitioners shared a view that the lack of detailed Polish standards and implementation guidelines generally leads to divergences in the practical application of comparable international audit practices. However, the discussion revealed that the auditors generally comply with the Polish standards and large audit firms make best efforts to apply ISA-compatible procedures and practices. Since ISAs are not mandatory, it was not possible to determine the degree of compliance. However, because Polish standards are less prescriptive than ISAs and do not include certain areas covered by ISAs, there is a possibility that the actual auditing practices in the country might depart from some important international

standards. This possibility is reinforced by the concern of the National Chamber of Statutory Auditors for enforcement of the requirements reflected in the strict wording of the Polish Auditing Standards and Code of Ethics for Statutory Auditors.

35. **Even if auditors comply with all the Polish Auditing Standards, the deficiencies in these standards may adversely affect the quality of audit.** Some of the deficiencies in Polish standards in reference to ISAs are reflected in the following list.

- **ISA 220, *Quality Control for Audit Work*.** There are no comparable Polish Auditing Standards.
- **ISA 230, *Documentation*.** The existing Polish standards are not comparable. They provide a list of obligatory components of the audit documentation including description on what kind of documents may constitute working papers, and how they should be marked/indexed and stored. The audit documentation remains the auditor's property as the client's trade secret (under separate relevant regulations).
- **ISA 240, *Fraud and Error*.** Polish standards do not cover the following important issues: fraud and error as separate sources for material misstatements; inquiries with the management as to any fraud or significant error that was discovered at the planning phase; and withdrawal from engagement in case of occurrence of fraud. The requirements under Polish standards on reporting fraud and error to the management and to users of the auditor's report are generic and relate only to the actually detected fraud or error and not to the suspected fraud or error. It appears from the current requirements that the auditors are not required to make any particular efforts for detecting fraud and error.
- **ISA 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*.** The Polish standards do not specifically cover the consideration of laws and regulations in an audit of financial statements. They provide for reporting of material noncompliance with the laws and regulations that the auditor became aware of during the audit in the "long-form auditor's report."
- **ISA 401, *Auditing in a Computer Information Systems (CIS) Environment*.** There are no comparable Polish standards.
- **ISA 402, *Audit Considerations Relating to Entities Using Service Organizations*.** There are no comparable Polish standards.
- **ISA 500, *Audit Evidence*.** The Polish standards are limited in coverage of the aspects dealt with in ISAs. Moreover, lack of detailed guidelines impedes proper application of this standard.
- **ISA 501, *Audit Evidence—Additional Considerations for Specific Items*.** There are no comparable Polish standards.

- **ISA 510, *Initial Engagements—Opening Balances*.** The Polish standards do not cover specific procedures for first time engagements and for situations when another auditor worked on financial statements in a prior period.
- **ISA 520, *Analytical Procedures*.** Contrary to ISAs, the Polish standards include rather limited and general wording in relation to the procedures performed at the initial/planning stage of the audit. There is no mention of a need for analytical procedures to be performed near the final stage of the audit.
- **ISA 530, *Audit Sampling and Other Selective Testing Procedures*.** There are no Polish standards covering comparable requirements/practices.
- **ISA 540, *Audit of Accounting Estimates*.** There are no Polish standards covering comparable requirements/practices.
- **ISA 550, *Related Parties*.** There are no Polish Auditing Standards covering comparable requirements/practices.
- **ISA 560, *Subsequent Events*.** The Polish standards do not include ISA-comparable requirements. Specifically, there is no mention of the procedures in relation to the reissuance of the auditors’ report, and public offerings of securities and role of the auditor.
- **ISA 580, *Management Representation*.** The Polish standards are not consistent with ISA. The Polish standards do not cover: (a) representations on items other than completeness of operating activities captured in the accounting records for the audited period, completeness of the disclosed contingent liabilities, and completeness of information received from the entity on post-balance sheet events; (b) guidelines if the situation occurs when the representation by management is contradicted by other audit evidence; and (c) date of management representation letter.
- **ISA 610, *Considering the Work of Internal Auditing*.** There are no Polish Auditing Standards covering comparable requirements/practices.
- **ISA 620, *Using the Work of an Expert*.** There are no comparable detailed requirements in the Polish standards. In Polish Auditing Standard No. 1, there is one sentence requiring that “the auditor using work of independent expert should ensure that the report issued by the expert is reliable.”
- **ISA 710, *Comparatives*.** There are no Polish Auditing Standards covering comparable requirements.
- **ISA 720, *Other Information in Documents Containing Audited Financial Statements*.** There are no Polish Auditing Standards covering comparable requirements.

## V. PERCEPTION OF THE QUALITY OF FINANCIAL REPORTING

36. **The investor community has mixed perception on the quality of financial reporting.** In order to collect information on perception of investor community on the quality of financial reporting, 35 institutional investors active in Warsaw Stock Exchange were asked to respond to a questionnaire—15 responses were considered in the results. Although the reliability of responses from such a survey is not statistically accurate, the general findings seem to be consistent with the results of due diligence exercise conducted by World Bank staff in connection with this Accounting and Auditing ROSC exercise in Poland. The findings of the survey are summarized as follows:

- The quality of corporate financial reporting has improved in the recent past.
- Divergent interpretations of International Accounting Standards and their use along with Polish Accounting Regulations lead to confusions on the part of the users of financial statements.
- Lack of adequate disclosures on relevant issues (such as segment reporting and related-party transactions) and too much information on some less important issues adversely affect the usefulness of financial statements from investor's point of view.
- About 80 percent of the respondents did not *strongly agree* with the statement that corporate financial statements for external users are generally prepared in full compliance with the mandatory reporting requirements.
- About 80 percent of the respondents did not *strongly agree* with any of the following statements: when the financial statements receive clean opinion from auditors, they are perceived as being accurate; the audited financial statements provide a transparent representation of the underlying economics of transactions; the practicing auditors strictly adhere to high quality standards of professional conduct, are independent, and perform their responsibilities with integrity and objectivity; auditors are serious about compliance with accounting and auditing standards; and there is an active regulatory oversight for ensuring compliance with the established accounting and auditing standards.

## VI. POLICY RECOMMENDATIONS

37. At a meeting held in Warsaw in April 2001, a group of national experts, under leadership of the representatives of Ministry of Finance, discussed with World Bank staff various issues concerning problems and prospects of accounting and auditing in Poland. Some policy recommendations resulting from the Accounting and Auditing ROSC assessment were also discussed. It was agreed that the following policy recommendations would form the basis for designing and implementing an Action Plan on Accounting and Auditing Developments in the country.

38. **The role of Accounting Standards Committee.** In view of the fact that European Union membership obligations will require all listed companies to follow International

Accounting Standards and International Financial Reporting Standards issued by the International Accounting Standards Board, there is a need to clarify the role of the Polish Accounting Standards Committee. The ASC should get involved in the due process for standards set by the International Accounting Standards Board. The international standards should be adopted in Poland without any modification. In areas where international standards do not exist, the ASC could issue interim guidelines based on international best practices. In areas where international standards exist, the ASC should deploy resources at its disposal for development of implementation guidelines and detailed interpretations in the context of business environment in Poland. The scope of work of the ASC should be influenced by the plan to make international standards mandatory for all listed companies in the European Union from 2005 onwards, by which date Poland is due to be a Member State. Following this, the jurisdiction of ASC could be focused on development of accounting standards for non-listed companies or small and medium enterprises (SMEs).

**39. Accounting requirements of public interest companies and small and medium enterprises.** In an effort to differentiate between the accounting requirements of these two entities, full compliance of International Accounting Standards and International Financial Reporting Standards should be mandatory by all public interest companies, including but not limited to publicly traded companies; banks, insurance companies and other financial institutions; other significant publicly and privately owned commercial entities; and entities that are in the process of transformation into any of these. In addition, a definition of SMEs should be developed in order to exclude them from required compliance with IAS and International Financial Reporting Standards. Until new accounting standards—in line with internationally accepted principles—are developed for the SMEs, the ASC should provide detailed guidelines on accounting and financial reporting by SMEs.

**40. Monitoring and enforcing compliance with accounting regulations.** The Securities and Exchange Commission needs to strengthen its capacity for systematic monitoring of compliance with accounting and disclosure requirements by publicly traded companies. Also, the National Bank of Poland needs to put in place an efficient monitoring mechanism for ensuring compliance with accounting and disclosure requirements by banks. Both of these institutions need to strengthen mechanisms to monitor the quality of audited financial statements of the entities under their supervision and take appropriate actions against those companies, company management, audit firms, and auditors who have failed to comply with established accounting and financial reporting regulations.

**41. Further development of auditing standards.** With expanded efforts for regional and international integration of Polish economy and with increased complexity of national and international business transactions, audit methodology needs updating in line with the current promulgations by the International Federation of Accountants. From this perspective, it would be more meaningful and efficient to translate and adopt all IFAC-issued auditing standards and related guidelines without any country-related modifications. This way scarce local resources could be devoted to development and dissemination of implementing guidelines and audit practice manuals. Moreover, it is necessary to fully adopt the updated IFAC Code of Ethics for Professional Accountants and to develop detailed guidelines on implementation of the Code in the context of specific circumstances in Poland.

**42. Strengthening capacity of the National Chamber of Statutory Auditors to effectively regulate the auditing profession.** In order to discharge its legally mandated responsibilities with regard to the governance of auditing profession, the NCSA requires strengthening of its capacity. Specifically, the function of monitoring and enforcing compliance with established standards, rules, and regulations needs to be restructured in line with best practices in other European Union member countries. In this regard, a twinning arrangement between the NCSA and an audit professional body of a continental European country would help in transfer of knowledge and best practices. Such an arrangement would also facilitate the process of improving the curriculum of professional education and the system of professional examination.

**43. Independent oversight of the auditing profession.** According to the current legislation on auditing, the Ministry of Finance has oversight over the NCSA. In order to assist the Ministry of Finance in its role, an independent body should be established and charged with oversight of the public interest activities of the NCSA and oversight of the auditing profession in general. An important objective of the independent body should be to advise the Ministry of Finance on actions to ensure consistency with recommendations of the European Union on the accountability and monitoring mechanisms on audits and auditors and of the IFAC on the quality assurance of statutory audits. Also, in a report to the Ministry of Finance, the oversight body should assess whether the auditing profession is appropriately serving the interests of users of audited financial statements and the wider public. The oversight body shall consist of representatives of the Securities and Exchange Commission, National Bank, and Stock Exchange; and individuals of high integrity and reputation drawn from diverse functional and geographic backgrounds, to give a balance of interests to the membership as a whole.

**44. Education, training, and improving accounting and auditing capacity.** Improving accounting and auditing capacity requires reforming higher educational curricula to include components on practical application of international standards promulgated by the International Accounting Standards Board and the International Federation of Accountants, and Code of Ethics for Professional Accountants. In this regard, special emphasis should be given to developing a critical mass of well-trained instructors. Moreover, efforts should be made to ensure the quality of accountancy training conducted by various institutions and commercial training providers. The training programs should focus on preparing trainees to be capable of leading the development of a high quality and internationally comparable financial reporting regime in Poland.