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ADOPTING INTERNATIONAL FINANCIAL REPORTING STANDARDS THROUGH CHANGE MANAGEMENT

Introduction

Since 2005 stock companies and banks have a duty to prepare consolidated financial statements according to International Financial Reporting Standards (IFRS), but also the right to decide about the form of their individual financial statements as well as about the form of reports of companies included in the corporate group. This right also applies to Poland-based subsidiaries of parent companies, whose securities have been admitted to trading within the European Union. Optional introduction of accounting changes adjusted to IFRS regulations requires that the information system should be remodeled and potential advantages considered. It is the best when changes are well-weighed and structured; change management might prove useful for the process.

Change is most often understood as any important modification of a specific part of an enterprise and, in particular, any transformation of an existing system into a new one, based on some accepted procedures. The concept of change management has been worked out in order to ensure that change will bring about the expected effects and create a certain value for the enterprise. The change management concept refers to planned, implemented and controlled changes of various objects located in various environments. Change management addresses the problems of organisation, management the employees, corporate management as well as communication and information. The paper deals the use International Financial Reporting Standards as bases accounting first time and so deals with the information needed in the change management process and, in particular, value measurements required in change management. The paper aims to bring together the change management theories and requirements of preparing

financial statement according to the International Financial Reporting Standards. The methodology of audits is literature studies of the national and international literature of the object, and also analysis and synthesis of got results.

1. Requirements for preparing financial statements, according to the International Financial Reporting Standards

International Accounting Standards Board published IFRS 1 *The use International Financial Reporting Standards by a First-time Adopter* on 19 June 2003. Amendments to the standards were introduced in the next years. IFRS 1 establish the requirements for preparing financial statements according to the International Financial Reporting Standards. IFRS 1 requires that financial reports should be prepared according to standards and interpretations in force on the day of balance date, and so with omission of earlier versions of IFRS and the temporary requirements of individual standards.

IFRS 1 contains the following solutions:

1. In the first financial statement compatible with IFRS, the entity must meet all IFRS regulations in force on the balance date and also adhere to backward compatibility (with some exceptions).
2. The opening balance sheet should be prepared according to IFRS on the day of transition to IFRS.
3. All assets and obligations should be presented according to IFRS regulations. All assets and obligations incompatible with IFRS should be removed from the financial statement.
4. Assets and obligations comprised in an IFRS-compatible balance sheet should be priced according to IFRS regulations, and in particular with IFRS1 regulations.
5. All estimated values should be set according to IFRS directions.
6. The effects of changes to accounting principles should be shown in the capital section of the opening balance sheet (with some exceptions).
7. All IFRS requirements regarding presentation and disclosures, including asset reclassifications, should be adhered to.
8. Information regarding the previous statements should be fully compatible with IFRS (with some exceptions).
9. A document should be prepared to present adjustments between previously applied accounting principles and IFRS regulations regarding a/ capital section and b/ profit and loss accounts.
10. There are several optional and mandatory exemptions from backward compatibility with general IFRS1 regulations if costs of IFRS adoption would exceed users' benefits or IFRS introduction would pose considerable difficulties.

2. The essence of change management processes

Change management is an inherent part of global corporate management that most frequently revolves around the goals of so-called stakeholders, which manifests itself in:

- Value Based Management,
- Economic Value Management,
- Economic Value Creation.

In broad terms, we can say that in theory numerous parts of such a process can be differentiated in corporate management and all of them focus on value enhancement. This is not limited to change management only but it also extends to include the concepts which have been increasingly popular in the recent years, such as:

- management of shareholders value,
- project management,
- quality management,
- risk management.

Implementation of changes is driven by the intention to take care of the quality of processes which are underway and the quality of goods and services provided by an enterprise, and should be subject to ongoing measurement, analysis and review. Implementation of changes carries risk and therefore we try to manage this risk in order to rationalize all our actions, due to limited knowledge about the reality. The change, which is implemented, may take the form of innovation or improvement of the existing processes. In both cases it can be related to the concept of project, which needs to be managed in order to be effectively completed. Hence, we manage projects. Finally, when managing change we tend to aim at shareholders' wealth.

Value, in its business sense, is not a homogenous category (we cannot find one specific definition of value in the literature). Value, with reference to any concrete object, is the content which enables communication between business units with the specific meaning. It would be difficult to formulate one homogenous definition of value as this notion can be presented and interpreted in different ways for every user and every decision-making problem. We can find a number of value subcategories in the literature. The terms we use include: market value, fair value, book value, residual value, goodwill, shareholders value, economic value or tax value, liquidation value, present value and future value (the time value of money, value in use, replacement value and many others). That is why various categories of value measurements are introduced and used for numerous purposes.

Value measurement in change implementation and management is a strategic element. According to the methodology of change management concepts, the following areas need to be taken into consideration when planning to implement change:

- value area (tells us whether we are going to benefit from the implementation of the given change),
- strategy area (tells us whether we are implementing the right changes and doing the right things),
- architecture area (tells us whether changes are implemented in the right way),
- execution area, including the timetable of changes to be implemented.

3. The role of information in change management

Nobody needs to be convinced that management is impossible without information and that misleading or inaccurate information results in mistakes which may cost a lot. Therefore, accounting is highly respected as an information system. In terms of change management, the following aspects need to be taken into account in the accounting system:

1. The activities related to the organization of accounting at the workstation level: either new division of competences and responsibilities in the old organisational structure, or a new organisational structure using the existing staff, or new workstations to handle new processes.
2. The reconstruction of the information system in order to incorporate the data about new processes, activities aimed at improving compatibility of computer hardware and its user friendliness.
3. The choice of the direction for the information flow, including budgeted figures and their control – ‘top-down’ or ‘bottom-up’ concepts. The information flow direction should comply with the change management concept accepted by the enterprise.
4. The implementation of changes and innovativeness involve the selection of an appropriate cost accounting system, to meet the information needs of change management processes. According to the predominant view in the literature on the subject, traditional cost accounting systems do not suit the change management needs. It is believed that Activity Based Costing (ABC) is one of the most suitable cost accounting systems for change management. It is usually assumed in the change management process that costs of specific activities and factors affecting these costs and their size will stay at a relative steady level in the short run¹.

¹ R. Carducci, C. Kisker, J. Chang, J. Schrimmer: *Answering the Call for Accountability: An Activity and Cost Analysis Case Study*. „Community Collage Journal of Research and Practice” 2007, 31:1-17.

5. The need to update and modify the accepted cost accounting system after the change is implemented. The accepted cost accounting model should show a true and fair view of the progress of activities (processes) carried out in the enterprise. Any modifications to the currently conducted processes, emergence of new processes or new cost objects, shifts in responsibilities between the organisational units within the enterprise, should immediately find their reflection in the accepted cost accounting model. Otherwise, we fail to report real processes but introduce a faulty basis for measurement of our performance. Unfortunately, a large part of enterprises do not update their accepted cost accounting systems until they find out that the information processes and presented is outdated.
6. The acceptance of appropriate principles and frequency of reporting on the performance connected with the implemented change.
7. The selection of appropriate managerial accounting tool – a budget, a deviation analysis and remedial actions.
8. The measurement of value which was or was not created as a result of the implemented change.
9. The measurement of an enterprise's accomplishments connected with the implemented changes. As a minimum, the following accomplishments should be aggregated:
 - the number of implemented new processes and their impact on the measurement of accomplishments,
 - the number of changes which improve the existing processes and their impact on the measurement of accomplishments,
 - the number of planned, improving changes in processes or new processes, success prospects, deadlines and planned accomplishments related to the implementation of individual changes,
 - deviations from planned accomplishments related to the implemented changes: size, reasons, preventive measures,
 - evaluation of the enterprise and its organisational units, including the effectiveness of implemented changes.

The important components of change management are designing the course of processes, drawing up appropriate budgets, day-to-day monitoring of their execution and measuring improvements. The main budget produced for the change management purposes comprises, in particular:

- operating budget, which takes into account changed processes and the impact of changes on measurement of these processes,
- financial budget, which includes e.g. investment plans connected with implemented changes,

- strategic budget, which shows how to raise capital for the implementation of the changes and which sources of finance are most profitable.

Progress monitoring has to perform the following functions:

- a preventive function, i.e. contributing to the execution of appropriate processes and obtaining of appropriate results,
- an informative and indicative function,
- a corrective function, i.e. directing towards the model processes by means of correcting deviations,
- an advisory function,
- a stimulant – justification to the achieving expected results.

4. Possibility to measure investors' expectations concerning implemented changes²

Economic efficiency, defined as maximizing welfare in given conditions (with given resources), is believed to be the basic criterion for valuation, i.e. the criterion for evaluation of any activities carried out by economic entities, including changes they introduce. Measures of accomplishments which can be used to estimate the value (improvement) can be referred to a number of criteria, from the perspective of customers, shareholders or products.

A key issue, when talking about investors' expectations concerning implemented changes, is the fact that they expect a rate of return on capital invested which should exceed the Weighted Average Cost of Capital (WACC). The WACC describes the threshold return on investment with a given risk level which, in turn, determines the level of reference to evaluate real rates of return. Investors expect to generate such a rate of return which will compensate an estimated risk of investment.

Moving on, we can list analytical tools which are used. We can use, for instance, the Capital Asset Pricing Model (CAPM) to evaluate investments (investment-related change) or the Arbitrage Pricing Theory (APT). CAPM is used to estimate the expected rate of return, starting from a risk-free rate of return and adding the premium which is appropriate for a given risk³. This model results from the following formula:

² A. Karmańska: *Wartość ekonomiczna w systemie informacyjnym rachunkowości finansowej*. Difin, Warszawa 2009, s. 102-136; A. Black, P. Wright, J. Bachman: *W poszukiwaniu wartości dla akcjonariuszy*. Dom Wydawniczy ABC, Warszawa 2000, s. 35-76.

³ G. Pennacchi: *Theory of Basset Pricing*. Pearson, London 2008, s. 57-65.

$RE = RRF + \beta(RM - RRF)$, where:

RE – expected rate of invested capital, cost of equity,

β – index of risk,

RRF – risk free rate,

RM – average market rate.

The Arbitrage Pricing Theory (APT), developed by S. Ross, is the basic multifactorial model of the relative pricing of assets, in this sense, that the risk-bounty determines them for all assets.

When calculating the value generated by the implemented change we can use the measure which is generally referred to as return on capital. We have two basic methods to measure return on capital, namely:

- the gross method, which does not take into account costs incurred in order to collect capital;
- the net method, which takes into account costs incurred in order to collect capital and, therefore, it tends to be the return generated that exceeds the risk-free rate such as, for example, the average market re-financing rate or the government bond interest rate. Return measures which take into account risk include also the Risk Adjusted Performance Measure (RAPM).

The RAPM concept is based on the assumption that every unit of undertaken risk should be compensated by additional return, as maintenance of capital needed to cover risk generates additional costs of capital. In general, the RAPM concept involves the comparison between the performance adjusted by risk and the capital of the enterprise, including the capital for covering risk⁴.

There are:

- Risk Adjusted Profitability Management (RAPM),
- Return on Value at Risk, applies by foreign banks, using the Value at Risk method to estimating the risk.

RAPM basic model is this, which is leaning on the profit and measures rentability corrected about the undertaken risk. There are three general measures of adjusted rentability about the risk, namely:

- Return on Risk Adjusted Capital (RORAC),
- Risk Adjusted Return on Capital (RAROC),
- Risk Adjusted Return on Risk Adjusted Capital (RARORAC).

In order to determine the value which has been brought about by the change implemented in the enterprise we can also use such methods as Economic Value

⁴ B. Dratwińska-Kania: *Pomiar rentowności z uwzględnieniem ryzyka – rozwinięcie koncepcji RAPM*. W: *Zintegrowany system pomiarów dokonań w rachunkowości*. Red. H. Buk, A.M. Kosteń. Wydawnictwo Akademii Ekonomicznej, Katowice 2009.

Addend, (EVA), Market Value Addend (MVA), Shareholder Value Addend (SVA), Cash Flow Return On Investment (CFROI), Customer Value Addend (CVA), Total Shareholders Return (TSR), People Value Addend and Employee Satisfaction (PVA). They are based on the assumption that the accomplishments may be measured by change in shareholders' value and their wealth. When evaluating the implemented change we consider the fact whether this change will add value, assuming that the other conditions remain unchanged.

Economic value added (EVA) is a measure which describes the change in a firm's value in a given period of time caused by core operating activities carried out by this firm. The EVA measure is expressed by the following formula:

$$\begin{aligned} \text{EVA} &= \text{ROIC} \cdot \text{IC} - \text{WACC} \cdot \text{IC}_{t-1} \text{ or} \\ \text{EVA} &= \text{NOPAT} - \text{WACC} \cdot \text{IC}, \end{aligned}$$

where:

IC t-1 – invested capital at the end of t-1 period,

ROIC – the rate of the return of company from capital invested in her assets,

ROIC = NOPAT/IC_t,

WACC = (the cost of the own capital * the part of the own capital) + (the cost of the debts* the part of the debts).

By means of the EVA measure we can express the economic profit after deducting opportunity costs. This is the measure of the operating results of the enterprise with regard the cost of the total capital.

Market value added (MVA) is the difference between an enterprise's market value and the capital invested in this enterprise. It is expressed by the following formula:

$$\begin{aligned} \text{MVA} &= \text{MV} - \text{IC}, \\ \text{MVA} &= \text{IC} + \text{EVA} / (1 + \text{WACC})^t \text{] and} \\ \text{MVA} &= \text{SVA} + \text{RV}. \end{aligned}$$

where:

RV – Residual Value,

IC – is the value of invested capital (cash invested by owners in assets which enable the enterprise to carry out its operating activities),

MV – is the market value of an enterprise, which is equal to total discounted EVA which may be generated in the future and the value of invested capital.

In case when: $\text{EVA} / (1 + \text{WACC})^t < 0$, MVA is a negative figure. Then, it is believed that the enterprise is not able to generate any new value and there are concerns about its ability to create added value in the future. In case when: $\text{EVA} / (1 + \text{WACC})^t > 0$, MVA is a positive figure. The enterprise will create value for its owners.

There are true the dependences:

$$\begin{aligned} SHV &= MVA + \text{THE INITIAL CAPITAL,} \\ SHV &= \text{THE VALUE of the COMPANY} - \text{THE DEBTS,} \\ SHV &= (\text{EBITDA} - \text{THE DEBTS}) / \text{WACC,} \end{aligned}$$

where:

EBITDA – Earnings Before Interest, Taxes, Depreciation and Amortization.

Shareholders Value Added (SVA) this the measure leaning on the future cash flows. This is the measure of the enterprise's value for shareholders. Net Operating Profit After Taxes minus the cost of the capital is the basis of estimating SVA:

$$\begin{aligned} SVA &= \text{OFCF}_t + \text{BV}_{\text{beg}} * (1 + \text{WACC}), \\ SVA &= \Delta \text{NOPAT} + \Delta \text{NOPAT} / \text{WACC} - \text{Inett}, \\ SVA &= \text{NOPAT} - \text{THE COST OF CAPITAL,} \end{aligned}$$

where:

Inett – Net Investments in year t,

NOPAT – Net Operating Profit After Taxes,

OFCF_t – Operating Free Cash Flow, the prognosis of free cash flows from the operating activity in year t,

BV – baseline value.

Cash Value Added (CVA) is the difference between the cash flows which should be generated by the company to cover the costs of capital and the cash flows which are generated at present. This is cash value added from the customers. One can introduce CVA the following example:

$$\text{CVA} = (\text{CFROI} - \text{THE COST CAPITAL}) * \text{INVESTMENT CASH.}$$

The Cash Flow Return on Investment (CFROI) requires the transformations of the formula:

$$\text{GI} = \Delta (\text{GCF} / (1 + \text{CFROI})^n),$$

where:

GI – investments,

GCF – money flows.

Total Shareholders Return (TSR) reflects all changes in the enterprise which they are essential for wealth of the shareholders of the enterprise (stock company). TSR is given the formula:

$$\text{TSR} = (\text{P}_t - \text{P}_0) / \text{P}_0 + \text{D} / \text{After,}$$

where:

Pt – sale price of the stock,

Po – purchase price of the stock,

D – paid dividend for the period of the stock.

The measure PVA shows on the satisfaction drawn by workers mainly and belong to nonfinancial measures.

Conclusion

The adoption of an accounting system to IFRS regulations is a challenge for an entity, also an organizational challenge. If introduction of IFRS is not obligatory, one should consider potential benefits and costs of IFRS acceptance. The concept of change management might facilitate decision making as well as implementing necessary changes in accounting system. We require from accounting more and more newer, manageable, precise information. Because there are also innovations and different changes among cases, suitable information is necessary them for the needs of the management, in this the value measurement. At last years the larger attention applies himself to such parameters as economic profit and real cash flows, meanwhile profitability as the measure of financial results goes down on second plan. There are many conception of the value measurement, in this also measurement based on economic profit and cash flows. The most important from them summed up in the article. At lased time we require from accounting real results, measurement and more and more true and fair reporting. This is the point to renovation and change of informative tools.

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Summary

During the introducing obligatorily changes in accounting adapted to the solution IFRS should one rebuild the informative system and consider the respect of potential advantages. The paper deals with the information needed in the change management process and, in particular, value measurements required in change management. The paper aims to bring together the change management theories, dispersed in the literature on the subject. The methods of induction and deduction are used in the paper. The theses will be evidenced using a theoretical study.