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# **IAS 2005**

## ***-Consequences for Swedish Group Accounting***

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## **Preface**

We would like to say *Thank you* to all those people that have helped us during this thesis, by answering questions and supplying us with material. Especially, we would like to say thank you to Mr. Jan Marton, who has been very helpful by giving us important and interesting information and opinions. Finally, we would like to say a very special thank you to our tutor, Mrs. Marcia Halvorsen, who has been an indispensable help to us and always encouraged our work.

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## Abstract

**Background:** There are several differences among international accounting, due to this, a number of bodies are working toward accounting harmonisation, for example, the International Accounting Standards Board (IASB) and the European Union (EU). During the last years, questions concerning accounting have been discussed even more. To enhance the international accounting harmonisation, in 2002, the EU issued a Regulation which requires an application of the International Accounting Standards (IAS) from 1 January 2005 for all listed companies in the Union in their consolidated reports.

**Problem:** Most people believe that an international harmonisation of accounting standards will be positive, while others talk about the negative consequences of adapting the IAS. Today, there are several differences between the RR 1:00 (the Swedish recommendation for group accounting) and the corresponding IAS, which will affect Swedish group accounting when Sweden change-over to the IAS. Furthermore, the Financial Accounting Standards Board (FASB) and the IASB have agreed to co-operate, which in turn might affect the IAS and consequently, Swedish accounting. Due to the several differences between the RR 1:00 and the corresponding IAS, and the IASB ED 3 on Business Combinations, we have chosen to concentrate this study on the changes concerning RR 1:00. Our main problem for this thesis is: *How will the regulation of Swedish group accounting be affected by the EU:s adaptation to the International Accounting Standards in 2005?*

**Purpose:** The main purpose of this paper is to study how Swedish group accounting will be affected by the European Union's adaptation to the International Accounting Standards in 2005.

**Limitation:** We will only study RR1:00 and not the other Swedish recommendations that concern a group of companies. Furthermore, we will only study the corresponding parts of the IAS 22, the IAS 27 and the ED3.

**Method:** This thesis is a qualitative study which includes both primary and secondary data. Our primary data consists of interviews, differences between the RR 1:00, the corresponding IAS and the ED 3. Our secondary data consists of literature, articles and the internet.

**Analysis and Conclusions:** There will be changes in the Swedish accounting regulation for listed companies in 2005, due to current differences between the RR 1:00 and the IAS 22 and 27, and possibly also due to proposed changes in the IAS. The main positive and negative effects caused by the conversion seem to be that Swedish companies more easily will be able to attract foreign investors, but it will also lead to costs when implementing the new system. The reasons for the decision to change to the IAS in the EU, the IASB-FASB co-operation, the role of the IASB/EU in the process towards global accounting and the future of the RR are discussed.

**Suggestions for Future Studies:**

We think that it would be interesting to study how Swedish group accounting and Swedish companies really will be affected by the adaptation to the IAS, to what extent the EU:s accounting will become more homogeneous, and how the co-operation

between the FASB and the IASB will develop and if/how it has affected accounting in the EU.

**Keywords:** Consolidation, merger, harmonisation, international accounting, Swedish accounting, goodwill

## Sammanfattning

**Bakgrund:** Det finns flera olikheter inom internationell redovisning. På grund av detta har ett antal organisationer börjat arbeta mot en harmonisering av redovisning, exempelvis International Accounting Standards Board och EU. Under de senaste åren har dessa frågor diskuterats allt mer. För att öka den internationella redovisningsharmoniseringen, utfärdade EU år 2002 en Förordning, som kräver att alla publika företag inom EU använder internationella redovisnings standards (IAS) i koncernredovisningen, från och med den 1:a januari 2005.

**Problem:** De flesta människor anser att en internationell redovisningsharmonisering kommer att bli positiv, medan andra talar om de negativa konsekvenserna vid anpassning till IAS. I dag finns det flera skillnader mellan den svenska rekommendationen, RR 1:00, som skall tillämpas vid koncernredovisning och de motsvarande IAS, vilket kommer att påverka svensk koncernredovisning när Sverige övergår till internationella redovisnings standards. Dessutom har the Financial Accounting Standards Board (FASB) och IASB beslutat att samarbeta, vilket kommer att påverka IAS och därmed även den svenska redovisningen. På grund av de skillnader som föreligger mellan den svenska rekommendationen för koncernredovisning (RR 1:00) och IAS samt IASB ED3 on Business Combinations, har vi valt att fokusera denna studie på de förändringar som RR 1:00 kommer att utsättas för. Vår huvudfråga i denna uppsats är: *Hur kommer regleringen av svensk koncernredovisning påverkas av EU:s anpassning till International Accounting Standards år 2005?*

**Syfte:** Det huvudsakliga syftet med denna uppsats är att studera hur svensk koncernredovisning kommer att påverkas av EU:s anpassning till International Accounting Standards år 2005.

**Avgränsningar:** Vi kommer endast att studera RR 1:00, koncernredovisning, och inte andra svenska rekommendationer som berör en koncern. Vi kommer även att endast studera IAS 22, IAS 27 och ED3 i de delarna de motsvarar RR 1:00.

**Metod:** Denna uppsats är en kvalitativ studie som inkluderar både primär och sekundär data. Vår primära data består av intervjuer, skillnader mellan RR 1:00 och motsvarande IAS och ED3. Vår sekundära data består av litteratur, artiklar och internet.

**Analys och Slutsatser:** År 2005 blir det en hel del förändringar i svensk koncernredovisning för publika bolag, dels p.g.a. de skillnader som idag finns mellan RR 1:00 och IAS 22 och 27, och dels p.g.a. de föreslagna förändringar till IAS som finns. De viktigaste positiva och negativa effekterna av övergången till IAS för svenska företag tros bli att de kommer få lättare att dra till sig utländska investerare, samt att övergången kommer medföra en del kostnader för implementeringen av det nya systemet. Orsakerna till EU:s beslut att övergå till redovisning enligt IAS, samarbetet mellan IASB och FASB, EUs/IASBs roll i processen mot en global redovisning samt RRs framtid är intressanta frågor att diskutera.

**Förslag till Fortsatta Studier:** Vi anser att det vore intressant att i framtiden studera hur svensk koncernredovisning och svenska företag verkligen har påverkats av anpassningen till IAS, i vilken utsträckning EU:s redovisning verkligen har blivit

homogen, samt hur samarbetet mellan IASB och FASB har utvecklats och om deras samarbete har kommit att påverka redovisningen inom EU.

**Nyckelord:** Koncernredovisning, samgående, harmonisering, internationell redovisning, svensk redovisning, goodwill

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# 1 Introduction

*In this chapter we will introduce the subject of this thesis. We will describe the purpose of this study and discuss the problems we will concentrate on.*

## 1.1 Background

The development of accounting in the industrial countries is characterised by two different accounting traditions, *the Continental/code-law* and *the Anglo-Saxon/common-law*. The Continental includes the West European countries with the exception of the United Kingdom, Ireland and Holland, while the Anglo-Saxon tradition includes the latter three countries and the United States (Smith, 2000). There are several causes of international differences. For example, differences in legal systems, providers of finance, taxation and the role of the professions. Also, there are many parties interested in international harmonisation. These include shareholders, stock exchanges, multinational enterprises, accounting firms and trade unions (Nobes, Parker, 1998).

The Swedish economy is to a high degree international. Even for smaller companies, a big part of its trading takes place on foreign markets. Many Swedish companies are more or less owned by foreign investors. Therefore, the Swedish Redovisningsrådet has decided that the Swedish accounting shall be made so that it as far as possible is accessible to foreign investors. The Swedish Redovisningsrådet has formed its recommendations based on the International Accounting Standards, IAS, that are issued by the IASB ([www.redovisningsradet.se](http://www.redovisningsradet.se)).

The harmonisation movement has grown steadily in importance in recent years. Harmonisation can be defined as a process of increasing the comparability of accounting practises by setting bounds to their degree of variation (Nobes, Parker, 1998). A number of bodies are working for harmonisation of accounting standards, for example, the International Accounting Standards Board (IASB) and the European Union, EU ([www.redovisningsradet.se](http://www.redovisningsradet.se)).

Questions concerning accounting have been discussed and worked on for a long time within the European Union. This has led to publications of several European Directives, which have been included in Swedish law, mainly in Årsredovisningslagen, ÅRL. During recent years, questions concerning accounting have been discussed even more (Nytt från Revisorn, 2002:11). Finally, in 2002 the EU issued a regulation which require an application to the International Accounting Standards (IAS) from January 1<sup>st</sup> 2005 for all listed companies in the Union in their consolidated reports, to enhance the international accounting harmonisation (Balans, 2002:5). The EU Commission also hopes that the introduction of the IAS as European Standards will make the standards global or make the US accept them as equivalent to the Financial Accounting Standards (FAS) (Dagens Industri, 2000).

As part of a continuing effort to bring about convergence of global accounting standards, the Financial Accounting Standards Board (FASB) and the IASB held a joint meeting in September 2002. At this meeting they signed a Memorandum of Understanding, by which they agree to work together toward convergence of global accounting ([www.iasc.org.uk](http://www.iasc.org.uk)). Probably, this co-operation in turn will affect the IAS and likewise the Swedish accounting.

## 1.2 Problem

Theory and practice concerning group accounting differ obviously from country to country. According to most people, the aim of harmonisation of international accounting standards is to narrow these differences. One factor that has affected the desirability of uniform accounting is the increasing globalisation of business (Brosse, 1997). According to Nobes and Parker (1998), this is due to the growth in international investment and the increase in multinational enterprises. This, in turn, has led to a growth in the number of accounting standard setting bodies. Even though most people believe that an international harmonisation of accounting standards will encourage trading and investment, some people talk about the negative consequences of adapting the IAS. Examples of negative consequences are the huge amounts of money that the harmonisation process will require and the risk of uncertainty and misunderstandings due to the complicated co-operation between the Swedish law and the IAS (Nytt från Revisorn, 2002:11).

There are several differences between RR 1:00 “Group Accounting” and IAS 22 “Business Combinations” and IAS 27 “Consolidated Financial Statements and Accounting for Investments in Subsidiaries” (Appendix 3, RR 1:00). Furthermore, the IASB issued an Exposure Draft 3 on Business Combinations (ED 3) in December 2002. The ED 3 contains proposals for changes in the IAS for business combinations. These proposals will, if accepted, be in force before 2005, and therefore also change Swedish group accounting for listed companies by the conversion to the IAS. Probably, the co-operation between the FASB and the IASB also will affect Swedish accounting.

Due to the several differences between the Swedish Group Accounting, the IAS and the ED 3, we have chosen to concentrate this study on the changes concerning RR 1:00. The main question for this thesis is:

*How will the regulation of Swedish group accounting be affected by the EU:s adaptation to the International Accounting Standards in 2005?*

To answer this question we will focus on the following issues:

- 1) *Accounting regulations and rules*
- 2) *Possible long-term and short-term effects on Swedish companies*
- 3) *The IASB/FASB harmonisation agreement*

## 1.3 Purpose

The main purpose of this paper is to study how Swedish group accounting will be affected by the European Union’s adaptation to the International Accounting Standards in 2005.

## 1.4 Limitations

We will only study the RR 1:00 and not the other Swedish recommendations that concern a group of companies. Furthermore, we have only studied the corresponding parts of the IAS 22, the IAS 27 and the ED3. Also, we do not have access to the public comments of the proposals in the ED 3 on business combinations because they will not be published until 4 April 2003. In other words, we do not know how the public have reacted on the proposals and, therefore, we don not know if the proposed

recommendations will be accepted or not. Moreover, we will not study accounting differences concerning group accounting for other member countries of the EU.

### 1.5 Abbreviations

BFN	Bokföringsnämnden
EC	European Community
ED 1	Exposure Draft 1 on First-time application of the IAS
ED 3	Exposure Draft 3 on Business Combinations
EEA	European Economic Area
EFRAG	European Financial Reporting Advisory Group
EU	European Union
FAS	Financial Accounting Standards
FASB	Financial Accounting Standards Board
FAR	Föreningen Auktoriserade Revisorer
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
NYSE	New York Stock Exchange
RR	Redovisningsrådet
RR 1:00	Redovisningsrådet's recommendation number one
SEC	Securities Exchange Commission
US GAAP	United States Generally Accepted Accounting Principles
ÅRL	Årsredovisningslagen

### 1.6 Disposition

This thesis is organised into six chapters. In this section, each chapter is described briefly.

*Chapter 1 - Introduction:* In this chapter we give a short introduction to the subject and explain the purpose and problems concerning this area. We also list important abbreviations that will be useful to the reader throughout the thesis.

*Chapter 2 - Method:* In this chapter we describe different ways of doing a research. We concentrate on the type of research that this thesis is based on and describe our way of gathering data. There is also a discussion concerning validity, reliability and source criticism.

*Chapter 3 - Theory: Swedish Accounting Regulation - The RR and International Influences:* In this chapter of theory we focus on the Swedish Accounting Regulation, the EU and the IASB. We describe the different organisations and the way Swedish Accounting Standards will be affected by the accounting harmonisation in the EU in 2005.

*Chapter 4 - Theory: Group Accounting: Purpose and Methods:* In the second chapter of theory we describe group accounting in general and group accounting for Swedish companies today. We focus on the different ways of combining groups of companies.

*Chapter 5 – Empirical Data:* In this chapter we describe differences between the RR1:00, the IAS 22 and the IAS 27. We also describe the differences between the IAS 22 and 27 and the ED3. Furthermore, this chapter includes a summary of the interviews.

*Chapter 6 – Analysis and Conclusions:* In this chapter we analyse our empirical data and theory. Characteristics that we have found of special interest, regarding the problems and purpose of the study are pointed out. We also present our overall reflections and conclusions. These are based on the theory and empirical data. Suggestions for future studies are also included in this chapter.

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## 2 Method

*In this chapter we will describe different methods when doing a research and gathering data. We will focus on the method for this study and discuss its validity, reliability and criticise the sources we have used.*

### 2.1 Explorative, Descriptive and Hypothetical Research

There are several different types of research. Most research can be classified from how much that is known about a certain area before the research begins. When the investigator has a lack of knowledge, the research will be *explorative*. The main purpose of explorative research is to gain as much information as possible about a special problem area. Several different techniques are often used to obtain this information. The purpose of an explorative research is often to achieve knowledge that can be the basis of further studies. Therefore, it is important to be full of ideas and be creative (Patel, Davidson, 1994).

The research will be *descriptive* when a certain amount of knowledge, sometimes even systemised into models, already is available. The descriptions may concern things that happened in the past or things that happen today. The limitation of the descriptive research is that it only studies a few aspects of the phenomena that are interesting. The descriptions are detailed and exhaustive. Often the investigator only uses one technique to gather data (Patel, Davidson, 1994).

Within areas where the quantity of knowledge is even more extensive and theories have been developed, the research will be *a test of a hypothesis*. A test of a hypothesis demands that there is enough knowledge concerning an area, so that assumptions about relationships in reality can be derived from theory. When testing a hypothesis, the researcher must, as far as possible, avoid the risk of influence on the result from other things than are mentioned in the hypothesis. The researcher also tries to use a technique for gathering information that will give as exact information as possible (Patel, Davidson, 1994).

The three different types of research mentioned above mostly are accomplished separately (Patel, Davidson, 1994).

This report is an explorative research. We will try to illuminate the consequences of accounting harmonisation for Swedish group accounting from different point of views. To enable us to do this, we will gather information through literature, articles, the internet, interviews and an unpublished thesis. This report can also lead to further studies in this area.

### 2.2 Qualitative and Quantitative Methods

The methodology approach to solve a problem depends on what kind of information that will be gathered. It is also significant for the shape of the study (Holme, Solvang, 1991). When information is gathered for research, it has to be systematized, compressed and worked up to be able to answer the questions of the research (Patel, Davidson, 1994). There are two different methods to choose between for an empirical study; the *qualitative* and the *quantitative method* (Holme, Solvang, 1991).

A qualitative study is when data that can not be quantified, i.e. measured in numbers, is collected, analysed, and construed. A quantitative study is when collected data can be expressed and analysed in numbers (Backman, 1998). In other words, the difference between qualitative and quantitative methods is how data is expressed for further processing and analysing. The purpose of the qualitative study is to describe a specific problem thoroughly, while the quantitative study uses quantified data to give a deeper and more detailed picture of the studied area (Lekvall, Wahlbin, 2001).

A qualitative method means an insignificant degree of formalisation. The method primarily has an understanding purpose. The researcher is not concentrating on testing the validity of the information. Instead, the central part is to achieve a deeper understanding of the complex of problems that are studied and to describe the whole that is included, by different ways of gathering data. The method is characterised by proximity to the source where information is achieved (Holme, Solvang, 1991).

A quantitative study is more formalised and structured. The method is by far more controlled by the researcher. It defines what is of special interest out of the problem that is chosen. The method also decides what the possible answers are. Arrangement and planning are characterised by selectivity and distance in proportion to the source of information. All this is necessary to be able to make formalised analysis, comparisons and tests to see if the results and conclusions are generalisable. Statistical methods are crucial when analysing quantitative information (Holme, Solvang, 1991).

The two different methods are often described as incompatible. In fact, today most of the research within the social and behavioural science is a mixture of both. What is crucial for choosing mainly a qualitative or quantitative method is how the problem is formulated (Patel, Davidson, 1994).

**This is a qualitative study.** We want to give a deeper understanding of the effects of international accounting harmonisation for Swedish group accounting and Swedish companies. To be able to give an understanding of the problems in this area we have gathered data in several different ways. The gathered data is not measured in numbers, which means that we do not give a detailed quantifying picture of the studied area. Instead we are describing the specific problem thoroughly.

### **2.3 Gathering Data**

Data can be gathered with the help of different methods, depending on what material is needed for the study. There are two different types of data; *primary data* and *secondary data*. Primary data is previously non-existing data that is gathered by the observer for the present study. Secondary data consists of existing statistics, previous studies, etc. (Lekvall, Wahlbin, 2001). According to Lekvall and Wahlbin (2001), the collected data always has to be analysed and then the researcher selects the good material. A difficulty concerning secondary data is that often the material is not adapted to illuminate the problems that are interesting for the research. Therefore, it can be difficult to analyse and value the quality and usefulness of the secondary data that is available (Lekvall, Wahlbin, 2001). The researcher has to make sure that it is not only data that supports his own theories that are selected. By selecting certain data the researcher can slant the material and as a result, give a false picture of an event. To be able to give a true picture of reality, the researcher ought to present and discuss facts that are contradictory to his own results (Patel, Davidsson, 1994).

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This report is based on both primary and secondary data. The primary data consists of a personal interview and two e-mail interviews. [The secondary data consists of information from literature, articles, an unpublished thesis, the internet, laws, accounting recommendations and Exposure Drafts.](#)

### ***Interviews***

According to Lekwall and Wahlbin (2001), there are three pure and common ways to communicate with the respondent by interviews:

*Letter interview:* The questions are asked and answered by mail, e-mail, homepage, etc.

*Telephone interview:* The questions are asked and answered orally by a phone call.

*Personal interview:* The questions are asked and answered orally at a personal meeting with a single respondent or a group of respondents.

When gathering information by interviews, the researcher has to take two aspects into consideration. First, the researcher has to consider how much responsibility that is left for the interviewer concerning the formulation of the questions and the mutual order of them. This is called the degree of standardisation. Secondly, the researcher has to take into consideration to what degree the interviewee can construe the questions depending on his earlier experiences or point of view (Patel, Davidson, 1994).

When interviewing, the questions can be sequenced by a technique called “funnel-technique”. This technique means that the interviewer starts to ask the big, open questions and finishes with the more detailed questions. This method is known to be motivating and activating because the interviewer may verbalise the way he likes. Another way to sequence the questions is to use the “reverse funnel-technique”. It means that the detailed questions are asked first and then finished with the more open questions (Patel, Davidson, 1994).

In this study we make one personal interview and two e-mail interviews. We have chosen to use the “funnel-technique” to motivate the interviewee. The interview questions were formulated and put in a special order before the interview. According to Patel and Davidson (1994), this makes the interview highly standardised. We did not use fixed answering alternatives. Instead we used open questions, which give the interview a low degree of structure.

Regarding the formulation of interview questions there are some things to consider. One should avoid long questions, make leading questions, negotiations, double-questions, presupposed questions, and “why”-questions. Most of the questions in our personal interview were short, even though a few questions included follow-up questions. We used “why”-questions as follow-up questions. According to Patel and Davidson (1994), why-questions can be very good as follow-up questions. We do not think that our questions are leading and we have not used negotiations, double-questions or presupposed questions, which makes our personal interview questions satisfactory. We also made the e-mail questions as thorough and relevant as possible in order to be able to receive useful information. In this case, we also used a ”why”-question as a follow-up question.

There are several advantages and disadvantages of the different interview methods. To attain as high validity and reliability as possible when interviewing, we have chosen to make a personal interview. One of the great advantages of a personal interview is that there are almost unlimited ways of asking questions. It can also be quite extensive and exhaustive if the respondent finds the interview interesting. The disadvantage is above all the cost per interview which often is multiple the cost of a letter interview (Lekvall, Wahlbin, 2001).

To be sure that everything the respondent says will be remembered exactly the way it was said, the interview was both written down and taped during the interview. The interview was also made in English, which means that we did not have to translate the interview from Swedish to English. This enhances the reliability of the interview (Lekvall, Wahlbin, 2001). Furthermore, we sent the interview that we had written down to the respondent for approval, to be sure that everything was construed in the right way. The interviews were analysed and compared with the other data gathered for this study.

According to Lekvall and Wahlbin (2001), the e-mail interview's advantage is the low cost per interview and that the respondent can choose to be anonymous if he wants to. The disadvantages are that there is a quite big "loss", because many people do not care to answer the questions sent to them or they misunderstand them and answer incorrectly. To limit this "loss" we have chosen to use a well formulated questionnaire with just a few questions. The control over the e-mail interview situation is often defective, because the interviewer does not know how carefully the questions are answered or in what order. Furthermore, it may not be possible to go back and ask the respondent questions if there has been a misunderstanding. We chose to make e-mail interviews instead of telephone interviews even though a telephone interview would have been more reliable. The reason for this, is that the interviewees were very busy and a telephone interview takes more time do than an e-mail interview.

## **2.4 Validity and Reliability**

The purpose of all studies is to produce valid and reliable results. Incorrect results are due to imperfections in the method. These imperfections can be of two kinds; low *validity* and low *reliability* (Lekvall, Wahlbin, 2001).

### **2.4.1 Validity**

Validity judges if the source measures what it claims it measures (Eriksson, Wiedersheim-Paul, 1997). It is only the information which is relevant for the purpose of the study that is considered to have a high validity (Patel, Davidsson, 1994). How trustworthy a source is can be analysed from an inner and an outer perspective, i.e. internal and external validity (Lekvall, Wahlbin, 2001).

#### **2.4.1.1 Internal Validity**

The internal validity concerns to what extent the obtained results conform to reality i.e. the connection between theory and empirical studies. When measuring validity, it is important to notice that the information always is construed or translated by someone, that a phenomenon can not be observed or measured without changing and that



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numbers, equations and words are abstract, symbolic representations of the reality and not reality itself (Merriam, 1994).

We use both primary and secondary data in this report. Lekvall and Wahlbin (2001) claim that interview questions can be misunderstood and the answers slanted, which reduces the internal validity. Even if it is impossible for us to be totally objective when construing the secondary data, we try to be as objective as possible by not having preconceived ideas when working with and analysing the data.

#### **2.4.1.2 External Validity**

External validity refers to what extent the results of the study are generalisable, i.e. if the results can be used in other situations than the studied one (Merriam, 1994). In his book *Fallstudien som forskningsmetod* (1994), Merriam discusses the generalisation of results. Is generalisation out of one single result possible? Merriam (1994) says yes, on the assumption that “generalisation” is redefined so that the conception reflects the basis or the prerequisites it is based on. According to Eriksson and Wiederheim-Paul (1997), external validity is independent of internal validity and it can not be judged without knowing how the empirical data has been gathered or what it looks like.

This thesis is not based on a specific listed company. We are studying the effects of the international accounting harmonisation on listed companies in general. This means that our conclusions will be of high external validity.

#### **2.4.2 Reliability**

Reliability judges if the method of measuring has the capability of resisting random influence and if what we measure is measured in an accurate way. If repeated measurements show the same results, the reliability is high. In that case, the measurement is not affected by the person who performs the measurement or by the present circumstances. The more standardised the proceeding of the measurement is, the bigger is the chance to achieve an acceptable reliability (Lekvall, Wahlbin, 2001). Likewise, Merriam (1994) claims that the reliability of a specific method is based on the assumption that there is only one single reality. This reality will give rise to the same result if the study is reiterated.

The reliability is considered to be high if the study is based on secondary data. This is due to the fact that the writer is considered to have less free scope for controlling the material to achieve a specific conclusion (Patel, Davidsson, 1994). We use both secondary and primary data in our report. The secondary data give the report a high reliability. On the other hand, our primary data includes interviews which can be affected by assessments of the respondent and us. To achieve as high reliability as possible when interviewing we chose to interview people who have great knowledge, of theory and practice, in the area that is being studied in this thesis.

#### **2.4.3 Source Criticism**

The gathered information is not always reliable. Therefore, *source criticism* is an important part of a research (Lekvall, Wahlbin, 2001). Source criticism is used to determine if the source is valid, important for the problem and free of systematic faults (Eriksson, Wiederheim-Paul, 1997). To avoid the risk of eventual faults in our report,

we have been critical of the selected secondary data. For example, we have tried to use data that, to a greater extent, is of current interest in this report.

We have also tried to, as extensively as possible, to use different independent sources to be critical and more easily to detect possible inaccuracies in the gathered data. When translating Swedish and English text some doubts have occurred, for example, the e-mail interviews are directly translated from Swedish to English. To avoid misunderstandings of the texts, we have discussed the translation that probably is the right one.

Some of our sources are from articles in business papers. We are aware that the kind of information published in these papers sometimes can have a deficient objectivity. The purpose of using these articles has been to achieve as current information as possible about the debates that are going on concerning our problem.

We also take into consideration that we only had the possibility to make one personal interview. We have contacted several chartered accountants in the hope of making more interviews, but everyone was very busy or did not have enough knowledge about the adaptation to the IAS. Interviewing a person who has not enough knowledge in this area would only give this thesis a lower reliability. Consequently, we can not rely too much on their answers or draw a conclusion out of them without being very critical. Despite these problems of obtaining only a few interviews, we still think that we can make some generalisations out of the interviews. The persons that were interviewed have, as mentioned earlier, a great knowledge in this area which makes their answers trustworthy. By making the interviews we were able to ask specific questions concerning this area, which gave us some information that is hard to find if only studying secondary data.

## **3 Theory: Swedish Accounting Regulation - The RR and International Influences**

*This chapter describes different organisations for accounting regulation. We will focus on the Swedish regulation today, the IASB and the accounting harmonisation in the EU. Furthermore, we explain the reasons for different accounting systems, why there is a need for accounting harmonisation and why the EU chooses to adapt to the IAS.*

### **3.1 Redovisningsrådet - the Financial Accounting Standards Council**

Today, the Redovisningsrådet (the RR) is the most important accounting standard-setting body in Sweden (Thomasson, 2000). The RR is, at least formally a purely private actor (The European Accounting Review 2002:1).

#### **3.1.1 History of the RR**

The Swedish Redovisningsrådet was set up in 1989 by the Swedish government through the BFN (The Accounting Standards Board), FAR (The Swedish Institute of Authorized Public Accountants) and Sveriges industriförbund (representatives of business). The purpose was to get one institution instead of those three, which would set the standards for public companies (Flower 1994, [www.redovisningsradet.se](http://www.redovisningsradet.se)).

The RR is supposed to issue recommendations on accounting matters. The purpose is to work for a homogeneous application of accounting rules and principles, enough disclosure in order to serve as a good base for decision-making, and a qualitatively high level of financial reports. (Foreword to RR recommendations, FAR 2002). The standards are primarily set for listed companies and companies that are of a general interest, due to their size. Regarding valuation and periodization matters, though, the recommendations should be applied by all companies. ([www.redovisningsradet.se](http://www.redovisningsradet.se)).

#### **3.1.2 The Recommendations**

The *RR recommendations* are generally considered as binding, although there is no direct legal enforcement of the RR rules. However, the Swedish law, to which there naturally is legal enforcement, only provides a framework on the accounting area, and instead, the relevant Acts (Companies' Act and Accounting Act) refer to "God redovisningssed" ("good accounting practice"). This must be followed, as a part of the law. "God redovisningssed" is an accounting practice followed by a qualitatively representative sample of companies. It evolves through recommendations, companies reading each others' financial reports, etc. Recommendations issued by the RR constitute "God redovisningssed" if they are followed by a qualitatively representative sample of companies, but they do not become a part of "God redovisningssed" simply by being issued. As Swedish companies have tended to follow the RR recommendations, they have become a part of "God redovisningssed". (Flower, 1994)

#### **3.1.3 International Influences on the RR**

The RR has an international perspective, motivated by the Swedish economy being highly international. Many Swedish companies do have high sale volumes on foreign markets, and in many Swedish companies there are foreign investors. Therefore, the RR tries to follow the IASB's recommendations to the extent that they do not conflict with the Swedish law or there are other strong reasons not to follow the IAS. Nevertheless, in

cases where there are several allowed alternatives in the IAS, the RR normally chooses only one of them, in order to promote comparability between companies ([www.redovisningsradet.se](http://www.redovisningsradet.se)). In 1998 the RR came to a decision to "catch up" with the IASB, and has since then transformed practically all the IAS into Swedish recommendations. Many of these new or revised (as a consequence of the IAS) recommendations shall be applied from the year of 2002 (Rundfelt 2000).

### **3.2 The International Accounting Standards Board (IASB)**

The International Accounting Standards Committee (IASC) was founded in 1973 in the hope of making an agreement about international accounting harmonisation. Its purpose was to formulate and publish accounting standards that shall be considered when economic reports are published and to work for the acceptance and application of the standards all over the world. Its purpose is also to work for an improvement and harmonisation of regulations, accounting standards and methods concerning publishing economic reports (Kedner, 1990).

The initiators of the IASC were representatives from auditing organisations in Canada, the UK and the US (Rundfelt, 1991:1). The original board members were the accountancy bodies of nine countries: Australia, Canada, France, Japan, Mexico, the Netherlands, the UK and Ireland, the US and West Germany (Nobes, Parker, 1995). The International Accounting Standards Committee (1973-2001) was the predecessor body of the IASB, *the International Accounting Standards Board*. Their Constitution was approved in its original form by the Board of the former IASC in March 2000 and by the members of IASC at a meeting in Edinburgh on 24 May 2000.

The IASB is an independent, privately-funded accounting standard setter and has a secretariat based in London, UK ([www.iasc.org.uk](http://www.iasc.org.uk)). Although the IASB is independent from all other bodies, it established in 1983 onwards a close contact with the International Federation of Accountants (IFAC). The IFAC concentrates on auditing, management accounting and International Congresses of Accountants whereas the IASB is concerned with international accounting standards (Nobes, Parker, 1998).

#### **3.2.1 The Organisational Structure**

The organisation's structure has the following main features: the IASC Foundation is an independent organisation having two main bodies, the Trustees and the IASB. It also consists of the Standards Advisory Council and the International Financial Reporting Interpretations Committee. The IASC Foundation Trustees appoint the IASB Members, exercise oversight and raise the funds needed, whereas the IASB has sole responsibility for setting accounting standards ([www.iasc.org.uk](http://www.iasc.org.uk)).

Seven national accounting standard setters have an IASB Member resident in their jurisdiction. These national bodies and the IASB work together to achieve the convergence of accounting standards world-wide. The seven national standard setters are accounting organisations from Australia and New Zealand, Canada, France, Germany, Japan, the UK and the US. Today, there are 41 International Accounting Standards ([www.iasc.org.uk](http://www.iasc.org.uk)).

### 3.2.2 The Need for International Accounting Standards

The need for an International Accounting Standards Programme has been ascribed to three factors (Blake, Lunt, 2001):

- *The growth in international investment.* When investors make decisions based on published accounts they also make decisions based on accounting policies. The accounting policies vary widely among different countries. The harmonisation of International Accounting Standards will help investors to make more efficient decisions.
- *The increase of multinational enterprises.* These companies must produce accounts for the countries in which their shareholders reside and in the local country in which they operate. A harmonisation will reduce the cost of producing multiple sets of accounts and it will also help to avoid confusion.
- *The growth in the number of accounting standard setting bodies.* The existence of so many rule-makers in various countries makes it difficult to compare companies following specific country accounting rules. This seems to be the factor that pushes the development of some form of international accounting standards.

### 3.2.3 The IASB Today

In April 2001, the IASB had its first conference and it was decided that the recommendations henceforth shall be called *IFRS* (International Financial Reporting Standards) and not IAS (Balans, 2002:5, [www.redovisningsradet.se](http://www.redovisningsradet.se)).

On 12 March 2002 the EU issued a regulation which requires an application of the IAS from 1 January 2005 for all listed companies in the Union in their consolidated reports, to enhance the international harmonisation (Balans, 2002:5). So far, about 275 listed companies in the EU practice the new standards. In 2005 seven thousands listed companies will be affected ([www.ad.se](http://www.ad.se)).

## 3.3 Reasons for Different Accounting Systems

There are several reasons for different accounting systems in the world. In the following sections we will describe some factors that have affected the development of the systems.

### 3.3.1 Economical Influences on Different Accounting Systems

There are many different accounting systems in the world. The overall reason for this is that accounting naturally is connected with the whole society. The political and economic system of a country influences the objectives and role of accounting (Roberts, 1998).

The industrial structure and corporate financing system also impacts the accounting system. If companies are generally small and family owned, there is little need for external capital and thereby external reporting. However, if business is dominated by big companies, mainly organised in groups, external financing, is important. This makes accounting more important and more emphasis will be put on group reports and extra disclosure requirements (Roberts, 1998). In continental Europe, there has traditionally been a strong connection between companies and creditors, whereas equity capital/stock markets have played the major role in the USA and UK. The interested parties of the

financial reports thus differ; in the US/UK the shareholders are in focus, whereas accounting in continental Europe additionally is directed towards creditors, employees and the state (Nobes, 2000).

### 3.3.2 The Legal Systems and Other Influences

The legal system of a country is an important factor in affecting accounting regulation. Within the western sphere, there are two types of legal systems: *the code-law* and *common-law* systems. Code-law has its roots in the Roman law and is characterised by the regulation to a high extent being written down as laws. According to code-law, accounting is considered to be correct if it follows the rules as precisely as possible. Countries that belong to the code-law tradition are countries in continental Europe, Latin America and most of Asia (Roberts, 1998, Smith, 2000, Flower, 1998). The common-law system, represented by the USA, UK and Ireland, is primarily based on custom and precedent cases. This accounting system has been developed by private actors, such as academics and the accounting professions. The view in common-law countries is that accounting is correct, when it is “true and fair” (Roberts, 1998, Smith, 2000, Flower, 1998, Epstein, 2001).

Sweden used to stand close to the code-law tradition, but has become more and more influenced by the common-law tradition. Sweden does have an Act regulating the accounting (“Årsredovisningslagen”), but this is not as specified and extensive as the codes in pure code-law countries. The standardising organs, such as the RR, are few and relatively young, which is a natural consequence of the transformation towards the common-law system (Nobes, 2000).

There are also other factors influencing the accounting, such as different accidents of history. For example, the early company and accounting legislation in the UK was the result of financial crises or collapse of companies (Roberts, 1998).

Although most EU countries legally are part of the code law tradition, the differences between them in accounting are significant (Cairns, 1997).

### 3.3.3 True and Fair View

Accounting techniques, institutions and concepts have been imported and exported around the world. The UK exported the concept of a “*true and fair view*”, first to the other countries of the British Commonwealth and, when the UK became a member of the EU, it also exported the concept to the other member states of the European Union by EU Directives (Nobes, 1998).

The true and fair view means that a certain freedom is given to companies in presenting their reports, in order to make the report reflect the true economic situation of the company as well as possible. A uniform application, instead, requires that the existing rules are followed as precisely as possible. The UK is an example of a country giving priority to a true and fair view, whereas Germany may be taken as an example of the opposite system. The US accounting is a mixture of these two, which has led to the rules being both extensive and detailed. True and fair view requires that an adaptation to different imaginable situations can be made, and uniform application requires all permitted ways of accounting to be written down in advance. Sweden does stand in the

middle, although it does not have such extensive regulation as the US (Bäckström, 2001).

### **3.4 The EU and Accounting Harmonisation**

Harmonisation of accounting has been an aim of the EU for a long time. It is a process by which accounting in the Member States shall come closer to each other. The end result is a state of harmony, and not necessarily uniformity (Roberts, 1998). Most important to the EU is not that accounting in the different Member States is identical, only that the remaining differences do not threaten the aims and activities of the Union. Today all the Member States mutually accept the accounting of each other: as long as reports follow the Directives (see section 3.4.2), actors in other Member States are not allowed to require supplementary information (Van Hulle, 1996).

#### **3.4.1 Reasons for Harmonisation**

There are three main reasons why the EU is interested in accounting harmonisation. Firstly, the EU is based on the principles of a common market in which there should be a free flow of all factors of production, such as capital and labour. Differences in financial reports between companies from different Member States make potential investors more reluctant to buy shares of companies from other Member States, simply because they can not evaluate the report in a satisfactory way if they do not understand it or find it mystifying. To make the common market function properly, companies must also be free to establish subsidiaries or branches wherever they wish. If accounting regulation differs significantly between states, this will add considerably to the costs of operating in different Member States (Flower, 1997). Secondly, it is considered that there is a legal obligation for the EU (Art 54, Treaty of Rome, the constituting treaty of the EC/EU from 1957) to establish protection of shareholders and others who have interest in a company.

But the most compelling motive behind the harmonisation of accounting has been a fear of a "race to the bottom" in accounting. In principle, companies are reluctant to reveal much about their affairs in their reports, for fear of the competitors. Also, states normally are in favour of companies establishing themselves in their territory (tax payment, employment). This could therefore lead to a situation where states would try to attract companies by lowering the accounting requirements, and through this "competition" poor financial reporting would drive out good financial reporting (=Gresham's law of accounting) (Flower, 1997). Moreover, the underlying aim of the EU is to establish "an ever closer union" (Treaty on the European Union, Art. 1). From this point of view, harmonisation is almost an aim in itself, and harmonisation in one or several areas creates the need for harmonisation in other areas.

#### **3.4.2 Harmonisation through EU Directives**

The EU has worked on harmonisation since the 1970s, mainly by issuing directives. In accounting, the two important Directives are the *Fourth* and the *Seventh Company Law Directives*. A directive is a special way of legislation that has been frequently used by the EU and creates an obligation on the Member States to incorporate the meaning of the directive in their national laws within a certain time-period (Roberts, 1998).

There have been discussions about whether the efforts of the Directives have been a success or not. On one hand, a number of studies provide evidence to the effect that

harmony in accounting among the EU Member States has increased since the implementation of the Accounting Directives. On the other hand, it is considered that the harmonisation through Directives has not provided a satisfactory level of comparability and equivalence. A problem with this kind of harmonisation is that the implementation process usually has been rather long. Also, several years often elapse between the first and the last transformation in national law. Moreover, the Directives only cover specific areas, and mostly focus on formal and disclosure aspects (European Accounting Review, 2002:1, Roberts, 1998). It could be said, that something has been achieved through the directives, but not enough and not quickly enough to meet the new/increasing demands (see section 3.5).

### **3.5 Harmonisation through an Adaptation to the IAS**

In the beginning of the 1990s, the world economic environment started to change more rapidly. Since then, we have witnessed a significant growth in trade and investment, also across state borders. Cross-border merger and acquisitions have increased largely in volume. In this process, Western Europe has been the most active region (European Accounting Review, 2002:1).

A parallel development has been the globalisation and increasing importance of capital markets. Companies regarded as "global players" became obliged to acquire capital for financing their global trade and investment activities. Therefore they needed to get access to highly liquid capital markets. A listing on a particular domestic stock exchange, especially the New York Stock Exchange (NYSE), turned out to be an advantage in marketing the companies' products in that country. There has been an increase of the market capitalisation on European stock exchanges, which has accelerated through the introduction of the Euro and a related growing interest of institutional investors, as pension funds (European Accounting Review, 2002:1, Flower, 1997).

All this has resulted in a strong increase in demand, especially by investors, for internationally comparable financial information, in order to be more useful for decision-making. This has also led to a political change in the EU: traditionally, accounting in (continental) Europe has not been primarily directed toward investors, but rather creditors and other actors, such as the workers. Moreover, the connection between taxation and accounting has been strong, which made the individual accounts the most important. Now the shareholder/investment perspective has become conspicuous even in Europe, and group accounts have increasingly become recognised as a solid basis for investment decisions (European Accounting Review, 2002:1, Flower, 1997).

European companies acting globally have also become aware of the costs that are related to preparing several financial reports according to different accounting principles. Such costs constitute a competitive disadvantage for European companies acting within the EU, compared to US companies. In some cases, this has also led to companies using the IAS or US GAAP in Member States where this has been an option. Using either of these internationally accepted standards also provides a possibility for these companies to compare their financial and earnings position with the position of their international competitors (European Accounting Review, 2002:1, European Commission 1995:2).



### 3.5.1 EU Accounting vs. US Accounting

Somewhere below the surface, there is also the factor that the EU is afraid of being too dominated by US accounting. The US stock exchanges, especially the NYSE, which is the largest in the world and increasingly attracts European companies, have made US GAAP, which actually only are national American standards, global. (European accounting Review, 2002:1, Balans 2002:4) The SEC (Securities and Exchange Commission), which decides upon what requirements companies have to fulfil in order to be listed on the US exchanges, has been very reluctant to accept other principles than US GAAP. This implies that European companies have been obliged to either use US GAAP in all their financial reports, or be disadvantaged in comparison to their US competitors. And neither of these effects is desirable from the EU point of view. All those recent economic and structural changes have put a pressure on the EU (European Accounting Review 2002:1, Flower, 1997).

### 3.5.2 Where We Are Today In the Process of Adaptation of the EU System to the IAS

The EU:s decision to change to IAS was accepted by great majority in the Parliament in 2002 (Balans 2002:12). Today, the EU has issued a Regulation, stating that the EU will change to the IAS in 2005 for listed companies in the Union. But the Regulation does not simply say that all current and future IAS will be adopted as a part of the EU legal system. The EU has built up the so-called endorsement mechanism, where an entity, named European Financial Reporting Advisory Group (EFRAG), plays an important role. All standards are under evaluation and if accepted, another Regulation will be issued mentioning the specific IAS that the EU has accepted. The objective is that the EU will be able to adopt all current IAS “en bloc”. The decision of which of the IAS to adopt should have been taken by 31 December 2002 (Balans 2002:12, European Accounting Review 2002:1). Due to delays with the translations of the standards into all the eleven official languages of the EU but primarily due to the political opposition to IAS 32 and 39 on financial instruments from some countries, this dead-line has been passed without the decision being taken ([The Financial Times, 2003](#)).

The EU is also working on some changes in the Directives to make the EC law harmonise with the IAS (Balans 2002:12). Consequently, there will be changes in ÅRL (DS 2002:42). The IASB has also issued an Exposure Draft (ED 1) on First-Time-Application of the IAS. If accepted, it will help European companies, when using the IAS for the first time, to make the transition as smooth as possible. The ED 1 also contains some exceptions that companies will be able to use during a transformation period (ED 1).

### 3.6 The EC Legal System

The decision of the EU to use the IAS from 2005 has been done in the form of a Regulation. A Regulation is a type of EC legislation that, unlike the Directives, is directly binding and applicable in all the Member States (EC Treaty Art 249).

The priority between the EC legal system and the national systems was uncertain in the beginning of the existence of the European Community/Union, as it had not been clarified in the Treaty. However, over the years, the European Court of Justice has, through a number of cases, developed a principle of supremacy of the EC law over the national systems (6/64 *Costa v Enel*, 106/ 77 *Simmenthal*).

## 4 Theory: Group Accounting: Purpose and Methods

*In this chapter we will describe group accounting in general, including different causes for group accounting and the ways of combining a group of companies. Moreover, we will describe different methods for Swedish group accounting today. This chapter also includes a summary of the Swedish recommendation RR 1:00, Group Accounting.*

### 4.1 Group Accounting in General

The prevalence of group accounting (or consolidation as it is sometimes called), has varied dramatically around the world. The first widespread adoption took place in the US at least as far back as the 1890's. At that time different methods were used; for example *the acquisition method, the equity method and the pooling method/merger method*. In the UK consolidation came later (Nobes, Parker, 1998)

There are important differences in the laws and practises of the US, the UK and several other countries in Europe. Theory and practices concerning consolidation accounting differ obviously from country to country. One aim of international accounting harmonisation is to narrow these differences between countries (Nobes, Parker, 1998).

#### 4.1.1 Acquiring a Company

The legislation in practically all countries allows that one company can be the owner of other companies. This is called *a group of companies* and the company which owns shares in the other company is called the *parent company* while the owned company is called a *daughter company* (Lönqvist, 2002). In most business combinations, one company acquires control over the net assets of another company. The transfer of control from one group of owners to another affects the economic interests of many people, including owners, managers, creditors and customers. Each group is interested in its impact on their prospects and welfare (Jensen, 1994).

Various conditions motivate companies to be acquired in business combinations. For example, an acquired company may have exhausted its sources of capital with the result that a business combination is the only way it can grow. In other cases, an acquired company may gain access to a larger market through combination or if it's a small company, it can avoid the risk of getting swamped by impending changes in technology or markets. Acquired companies can also be motivated to enter a business combination by personal financial circumstances of the owners (Jensen, 1994).

#### 4.1.2 Consolidation vs. Merger

Some business combinations create a new corporate structure, whereas others use only existing corporate structures. If the combined entity takes the form of a newly created corporation, then the combination technically is called a *consolidation*. On the other hand, if the combination takes the form of one of the original corporate parties to the combination, then the combination is technically called a *merger*. Some business combinations result in the liquidation of one or more of the corporate parties to the combination. Corporate liquidation is the process of converting all assets into cash or another distributable form, paying all creditors and expenses and distributing any remainder to stockholders. Thus, the corporate structure of a business combination depends on whether the combination is a merger or a consolidation and whether the acquired company liquidates or continues (Jensen, 1994). This [thesis only concerns](#) the situation where both the acquired and acquiring companies continue.

### 4.1.3 The Purchase and Pooling Methods

From an accounting point of view in countries which use the FAS or the IAS, there are two types of business combinations – *purchases* and *poolings* (IAS 22, Jensen, 1994). The FASB used to accept both the purchasing method and the pooling method. However, as a consequence of that similar business combinations were accounted for using different methods, which produced very different financial statement results, it was decided that only the purchase method would be allowed (FAS 141). In the IASB's ED 3 there is a proposal that countries that use the IAS will only be allowed to use the purchase method in the future ([www.iascplus.com](http://www.iascplus.com)). If the ED 3 is accepted, the countries which use the IAS today also will be affected by these changes. So far, it has been allowed to use the purchase method and, in very limited circumstances, the pooling method according to the IASB (IAS 22).

A business combination is identified as a purchase or a pooling on the basis of the terms of its transactions and by reference to criteria established by accounting standards. The theoretical difference between purchases and poolings is that the stockholders of the acquired company relinquish their ownership in the acquired company's net assets in a purchase but not in a pooling (of course minority interests might emerge, but the principle still applies). Although the differences between purchases and poolings are fairly easy to state in theoretical terms, purchases and poolings are quite difficult to distinguish in practice. The most striking difference between purchase and poolings concerns the valuation of acquired net assets. If a company constitutes a purchase, the net assets from the acquired company are revalued and recorded by the acquiring company at amounts that total the acquisition cost, including goodwill. If a company constitutes a pooling, the net assets are not revalued but are recorded by the acquiring company at their book value to the acquired company. In both purchases and poolings, the acquiring company prior to the combination is unaffected by the combination (Jensen, 1994).

## 4.2 Swedish Group Accounting Today

According to Årsredovisningslagen, a group of companies consists of a parent and one or several daughter companies. A daughter company is a company where the parent company holds more than 50 % of the votes for all shares in the daughter company. This does not mean that the parent company has to own more than 50% of the daughter company, but that the parent company controls more than 50 % of the votes (Lönnqvist, 2002). A parent company must have a right of determination on another company if a group of companies shall exist. The right of determination means the right to make a strategic decision. A minority interest will appear if the parent company does not own 100 % of the daughter company (Falkman, 2001).

### 4.2.1 Problems Concerning Group Accounting

Group accounting gives rise to problems concerning eliminations because many accounting units create one separate accounting unit. Every transaction (such as an inter-company loan or inter-company sales) between the different units shall be eliminated so that the group accounting will not be overestimated. The group account is made every year out of the various companies' accounts. Group accounting is regulated by the same laws and rules that are applied on the separate companies (Falkman, 2001). The fundamental principle is that the group account shall as far as possible be prepared as if the group companies were one single company (Lönnqvist, 2002) and the group

account shall follow the same accounting rules as the parent company (RR 1:00, p.8). However, if the accounting principles that are used for the parent company are affected by, for example, taxation considerations, other accounting principles are allowed to be used for the group account if there are special reasons. By allowing this, an accounting that pays more attention to the needs of the users of the information is possible (RR 1:00, p.9).

One problem concerning group accounting is to determine what is included in the group of companies. Another problem is how to deal with the internal transactions that shall not be accounted for in the group account. The difference between what is external and internal from the parent's and daughter's view must be analysed to be able to make a group account (Falkman, 2001).

Acquisitions of a company and merger of companies have different economical meaning. The differences shall be reflected in the accounting (RR 1:00, p.19). The fundamental principle states that the group account shall imitate the accounting that would have been done if the group of companies were one single company (Lönnqvist, 2002).

In practically all business combinations one company acquires a determinant influence on one or several other companies. This identifies the acquiring company (RR 1:00, p. 20). A controlling interest is indicated when a company owns, directly or indirectly, over 50 % of the outstanding voting shares of another company (Jensen, 1994). However, there can be exceptional circumstances that clearly show that such ownership of shares does not result in a determinant influence (RR1:00, p.20).

#### **4.2.2 Three Methods for Group Accounting**

The Swedish Årsredovisningslagen describes three different methods for group accounting (FAR, 2002):

- 1) *The purchase method*
- 2) *The pooling method*
- 3) *The equity method*

The pooling method is used for mergers. For acquisitions, the purchase method is absolutely dominant in practice. For daughter companies, the equity method is rarely used, as special criteria have to be fulfilled. It is primarily used when accounting for associated companies, i.e. when the owner's part is 20% to 49%. This issue is not covered by RR 1:00 (Lönnqvist, 2002). According to Lönnqvist (2002) there are some questions that all methods for combining a group of companies must answer. Out of these questions we will describe the different methods for making an acquisition.

#### **How shall assets and debts in the daughter company be valued?**

Normally, a company's assets are valued at the acquisition value minus subsequent depreciation and it should be the same for group accounting. The problem is that there are two acquisition values in the group account, one that arose when the daughter company bought the asset and one that arose when the parent company bought the shares in the daughter company, which indirectly is a purchase of the assets in the daughter company. According to the purchase method, the daughter company's assets shall be valued on the bases of the price that the parent company paid for the shares in

the daughter company. The equity method values the assets like this, while the pooling method values the assets according to the original price that the daughter company paid for the assets. Since the pooling method is meant to be used when two companies join and continue their business under a common management, the companies wish to stick to the companies' own valuation of the assets and debts.

**How much of the assets and debts of the daughter company shall be included in the group account if the parent company owns less than 100% of the shares?**

According to the purchase method, 100% of the assets and debts of the daughter company shall be included in the group account even if the parent company does not own all shares. This is motivated by the thought that the consolidation is supposed to show the size of the assets and debts are that are under the common management. The pooling method also includes 100% of the assets of the daughter company even if the parent company owns less than 100%. According to the equity method, it is only the part that is owned by the parent company that shall be included in the group account.

**Shall the daughter company be accounted for as a separate net item in the group account or shall the assets, debts, revenues and costs of the daughter company be added to the equivalent items of the parent company?**

According to the purchase method, every single item of the daughter company's accounting shall be added to the equivalent item of the parent company's accounting, i.e. the sales of the group of companies is the same as the sum of the companies separate sales, except for inter-company sales. The same is done when the pooling method is used. According to the equity method one shall use a net account for the daughter company. The balance sheet of the group account shows the daughter company as one item, the capital share, which is accounted for as the difference between the assets and debts of the daughter company.

#### **4.2.3 Summary of the RR 1:00 Group accounting**

The *RR1:00* shall be applied for annual and quarterly reports that concern the financial year that started from 1 January 2002. The RR 1:00 treats the accounting questions that arise when making a group account (RR1:00). The recommendation neither treats the foreign exchange translation (RR8), that can arise from consolidation of foreign daughter companies, or the account of associated companies (RR13) (Falkman, 2001). Furthermore, it does not treat the transactions between companies under common control (RR1:00).

The recommendation RR 1:00 shall be applied when establishing a group account. It states that the parent company shall establish the group account; it is only under certain circumstances that a parent company does not have to do this. The circumstances are listed in the ÅRL (7 kap, 2§, 3§). Moreover, the recommendation states which daughter companies that shall be included in the account and that the parent and daughter company must use the same financial year. It also states that the account shall be done according to uniform accounting principles. Furthermore, the recommendation shows how to account for a minority interest, how to eliminate transactions between companies included in the consolidation and how to account for the own capital of the group of companies (RR1:00).

A major part of the recommendation describes different ways of making an acquisition or a merger and how to account for it. The acquisitions and mergers have different

economical meaning; therefore, these differences shall be reflected in the account. Normally, a company shall use the purchase method when it acquires another company. According to ÅRL (7 kap. 24§), the equity method shall be used if the business of the daughter company differs from the rest of the business to such an extent that using the purchase method would be inconsistent with the demand for a true and fair view. Moreover, the recommendation states that the pooling method shall be used when there is a merger (RR1:00).

The RR 1:00 also lists what kind of information has to be included in the group account, for example, information about goodwill and acquisitions during the last year. It also includes the rules which shall be used when there is a transitional period between different accounting recommendations. Finally, the recommendation includes several appendices. For example, one appendix shows how to account for the daughter company's own capital according to the purchase method. Furthermore, it includes comparisons between RR 1:00 and IAS 22 and IAS 27 (RR1:00).

### 4.3 Goodwill

Even if the assumption is that the assets of the daughter company are fairly valued, the value of the assets can be overestimated. An overestimated value occurs when the parent company is willing to pay more for the shares of the daughter company than the true value of the net assets. The parent company pays the higher value because it expects extra high profits in the future by acquiring the daughter company. The intangible asset that gives the extra high profits in the future is called *goodwill*. Goodwill is calculated as follows (Lönnqvist, 2002):

$$\begin{array}{l}
 + \text{ The price that the mother company pays for the shares} \\
 - \text{ The market value of the net assets in the balance sheet of the daughter company} \\
 \hline
 = \text{ Overestimated value (Goodwill)}
 \end{array}$$

Directly after the acquisition the following assets will be included in the group account (Lönnqvist, 2002):

- The assets of the parent company, excluding the shares of the daughter company
- The assets of the daughter company
- Goodwill of the daughter company

Together, these assets make the assets of the group of companies (Lönnqvist, 2002). According to RR 1:00, goodwill only appears when there is an acquisition (purchase method, equity method), hence, there can not be any goodwill when there is a merger of companies (pooling method).

#### 4.3.1 Depreciations

According to the assumption that goodwill will bring future profits, it is easy to realise that the goodwill must be *depreciated* during the time when the profits become reality. The depreciation, (also called amortisation of intangible assets) of goodwill shall be accounted for as a cost in the group account. Since neither of the parent or daughter company accounts separately for goodwill, neither of these companies will account for the depreciation on goodwill. Consequently, the depreciation of the group account will be greater than the sum of the separate companies' depreciation, which leads to a lower result for the group account than the sum of the results of the included companies

(Lönnqvist, 2002). Likewise, the RR 1:00 states that goodwill should be valued as the acquisition value minus the accumulated depreciation and eventual write-downs, and accounted for in the group balance sheet.

#### **4.3.2 Negative Goodwill**

If the acquisition value is less than the true value of the acquired part of the acquired company's net assets, it should be accounted for *negative goodwill*. Negative goodwill can arise if the assets have been overestimated or if the debts have been underestimated (RR 1:00). According to group accounting negative goodwill is a kind of discount on the shares. The discount is supposed to cover the future expenses that, for example, a restructuring can lead to (Lönnqvist, 2002).

## 5 Empirical Data

*This chapter includes a summary of the IASB Exposure Draft 3 on Business Combinations. Furthermore, the differences between different accounting regulations are pointed out. This section also includes a summary of the interviews.*

### 5.2 Differences between the RR 1:00 and the IAS 22 and 27

Although the RR 1:00 is a translation of the IAS 22 and 27, there are differences between the RR 1:00 “Group Accounting” and the IAS 22 “Business Combinations” and the IAS 27 “Consolidated Financial Statements and Accounting for Investments in Subsidiaries”. The differences are due to Swedish law and they will henceforth be divided into the following categories (appendix 3, RR 1:00, FAR, 2002):

- differences between the RR 1:00 and the recommendation text in the IAS 22 and the IAS 27;
- differences between the RR 1:00 and the explanatory text in the IAS 22 and the IAS 27;
- paragraphs in the RR 1:00 that are without parallels in the IAS 22 and/or the IAS 27.

#### 5.2.1 Differences Between the RR 1:00 and the Recommendation Text in the IAS 22 and IAS 27

- IAS 22 (p. 64) states that negative goodwill shall be accounted for as a deduction item on the asset side of the balance sheet. The RR 1:00 (p. 73) states that negative goodwill shall be accounted for as a provision (ÅRL 7 kap. 22§).
- IAS 22 (p. 79) states that according to the pooling method, the accounted value for shares in a daughter company shall be eliminated against what has been added to share capital at the time of issuance of own shares. The RR 1:00 states that the accounted value for the shares of the daughter company shall be eliminated to the consolidated own capital, firstly to the daughter company’s own capital and secondly to the group of companies’ restricted and free share capital (ÅRL 7 kap. 23§).
- IAS 27 (p. 7) states that a parent company that as a whole, or almost as a whole, is owned by another parent company does not have to establish a group accounting under certain circumstances. One condition for this is that a permission for not establishing a group account is obtained from the minority. There is a reference to the ÅRL (7kap. 2§) in the RR 1:00 (p. 5), which allows more exceptions to the demand for establishing a group account than there is in the IAS. One restriction in the ÅRL that does not exist in the IAS is that the parent company which establishes the group account shall be located within the European Economic Area (EEA).
- The IAS 27 (p. 32a) states a few demands for information concerning a significant daughter company. The RR 1:00 (p. 91) states the same demand for information but it concerns all daughter companies. By reason of this, an agreement with the ÅRL (7 kap. 16§) is attained.



### 5.2.2 Differences Between the RR 1:00 and the Explanatory Text in the IAS 22 and IAS 27

- IAS 22 (p. 13) treats in a particular part accounting for so called reverse acquisitions. According to the Årsredovisningslagen (ÅRL) (1 kap. 4§), a company that owns more than half of the votes in another juridical person is the parent company. The parent company shall, according to the ÅRL (7 kap. 1§), establish a group account. No exception from this is stated. Therefore, the ÅRL probably will prevent accounting according to the IAS 22 (p. 13). For this reason, there is nothing corresponding to the IAS 22 (p. 13) in the RR 1:00.
- IAS 27 (p. 14) does not allow that acquired daughter companies (i.e. not cases of merger), are taken up in the group account by any other method than the purchase method. The RR 1:00 (p. 29) has been adjusted to the ÅRL (7 kap. 24§), which demands that acquired daughter companies under certain circumstances, shall be taken up in the group account according to the equity method.
- IAS 22 (p. 84 and p. 85) concerns certain questions that affect accounting of postponed tax, referring to the IAS 12, Income Taxes. These questions are treated in Redovisningsrådet's recommendation number 9, Income taxes.

### 5.2.3 Paragraphs in the RR 1:00 that are Without Parallels in the IAS 22 and/or IAS 27

There are some items in the RR 1:00 that have no equivalence in the IAS 22 and the IAS 27. Several of the items are a consequence of Swedish rules concerning restrictions of dividends and with that the connected division of share capital in free and restricted capital ( p.14-18, 83, 88-90). Item number 9, which treats separate accounting principles for the group of companies and the annual report of the parent company, has no correspondence in the IAS 22 or the IAS 27.

## 5.3 Possible Future Changes in the Regulation

The EU has now decided to use the IAS from 2005. Meanwhile, the IAS regulation itself is evolving. Regarding business combinations, the IASB has been working on a project since July 2001. The objective of this project is improved quality as well as international convergence on this area. The project has two phases. Phase I has recently resulted in an Exposure Draft, ED 3 on Business Combinations, a proposed IFRS which is intended to replace the current IAS 22. There is also an IASB project that might amend or supplement IAS 27. But it has not yet resulted in an exposure draft or interpretation. In September 2002, the IASB and the FASB signed a Memorandum of Understanding, where they agreed to work together toward convergence of global accounting ([www.iasb.org.uk](http://www.iasb.org.uk)). This might also lead to changes in the present IAS standards.

### 5.3.1 The IASB Exposure Draft 3 on Business Combinations

One of the most important features in the ED 3 is that the *pooling method* is proposed to be prohibited and thus that all business combinations would be accounted for using the purchase method. The reason for this proposed change is that financial analysts and other users have claimed that allowing two different methods impairs the comparability of financial statements, especially as the two methods do give quite different results. Another reason mentioned by the IASB is the fact that the pooling method has been abandoned in Australia, Canada and the United States (ED 3).

Other major changes concern *goodwill*. Goodwill acquired in a business combination should not be amortised as according to the IAS 22 today, but instead tested for impairment annually, or even more frequently, if indicated by special events or circumstances. Negative goodwill is proposed to be recognised as a gain immediately in the income statement (ED 3).

There are also proposed changes about restructuring provisions. Cost expected to be incurred as a result of the business combination to restructure the activities of the acquired entity or the acquirer, would be treated as post-combination expenses. The only exception to this would be if the acquired company has an existing liability for restructuring its activities at the acquisition date (ED 3)

Today, under the IAS 22 there are two different alternatives to measure acquired identifiable net assets initially. But in the ED 3, it has been considered that the permission to account for similar transactions in different ways impairs the usefulness of the information for the users. It is therefore proposed that identifiable assets, as well as liabilities and contingent liabilities, would be measured at *fair value*. Moreover, there are proposed changes on, for example, reverse acquisitions and a proposition to recognise acquired intangible items as assets separately from goodwill, if they meet the definition of an asset (ED 3).

### **5.3.2 Phase II of the Project on Business Combinations**

The phase II of this project is intended to result in amendments to the IFRS on Business Combinations being developed under phase I. Phase II is a joint project between the IASB and the FASB who will work to eliminate the remaining differences in the application of the purchase method between their two systems. Another important issue in this phase is the development of a *fresh start method*. This method would be used in cases of business combinations involving entities under common control. The view is that a new entity emerges as a result of a business combination, and therefore the assets and liabilities of *each* of the combining entities should be valued at fair value (www.iasc.org.uk).

### **5.3.3 The Co-operation between the IASB and the FASB**

The IASB and the FASB have announced that they are undertaking a co-operation in order to work toward convergence between the IAS system and US GAAP. They have confirmed their intentions in a Memorandum of Understanding, “The Norwalk Agreement” dated September 18, 2002 (www.iasc.org.uk). First the two Boards will undertake a short-term project in order to remove a variety of individual differences between US GAAP and the IAS. This will be done during 2003 and will mostly concentrate on “unnecessary” differences, i.e. uncontroversial issues. The resulting changes in the IAS will be in force before 2005 and therefore will have to be applied by the EU companies when they change to the IAS accounting. (The Norwalk Agreement, www.iasc.org.uk, Balans 2002:12). Moreover, the two Boards have agreed on further work in the form of projects, to remove other differences between the IAS and US GAAP that will remain at January 1, 2005. (The Norwalk Agreement)

## 5.4 Interviews

As the interviewees wish their specific answers to be anonymous, we have chosen to summarize the answers obtained in the three interviews and divided them into different sections. The summary is organized according to the answers that we find most relevant when answering the questions of this thesis.

### 5.4.1 The Future of the Swedish Redovisningsrådet and the RR 1:00

One of the interviewees believes that the Swedish Redovisningsrådet (RR) and the recommendation RR 1:00 on Group Accounting will disappear. The respondent argues that the companies will have to follow the IAS directly without interference from the RR. Also, he says that the reason for the RR's probable disappearance is that its purpose will be gone after the conversion to the IAS in 2005. Furthermore, he believes that the RR already has stopped producing new statements. Moreover, now that the standards are becoming official, the RR will not need to translate the IAS into Swedish as translation is an EU obligation. According to an interviewee, all the differences between the IAS and the Swedish accounting recommendations will be eliminated. Also, this interviewee says that the changes in the IAS will bring with it changes in the Swedish Årsredovisningslagen (ÅRL). The ÅRL is only a translation of the EU directives and the EU Directives are changing which, in turn, will result in changes in the ÅRL.

### 5.4.2 The EU Acceptance of the New Recommendations

One of the interviewees does not believe that the IASB will really come up with a standard that is not in accordance with the EU directives because the EU is the main user at the moment. Furthermore, this interviewee says that he is sure that the EU will check all the new recommendations. Also, this same interviewee believes that the EU will try to have an influence on the standard-setting-process. Although, he does not see this as a problem, he thinks that the EU already seems to accept a lot, and basically, they have already made a choice in saying the following: for public companies on the consolidated level we can have a totally different type of accounting and financial reporting than we have in smaller companies or the legal entities.

### 5.4.3 Negative Goodwill

One of the interviewees does not believe that the accounting for negative goodwill will change in terms of the valuation of negative goodwill. He says that it is the presentation on the balance sheet that differs. According to this interviewee, these differences will have to change so that the RR 1:00 corresponds to the IAS 22 and 27, unless the IASB comes out with a new standard in the mean-time.

### 5.4.4 Using Other Accounting Principles in the Consolidated Reports

According to one of the interviewees, the possibility for using other accounting principles in the consolidated reports will probably continue to exist. He says that the government has initiated a commission that will look at it and issue a report in the summer of 2003. If it is prohibited to use other accounting principles in consolidated reports, he says that there would be differences between the financial reports and the tax accounting in the parent company. The Commission will look at other possible problems concerning this area, but this is not believed to be a problem, at least not for the listed companies, because they can handle it. In smaller companies it might be more of a problem to prepare financial statements according to several different accounting principles.

### **5.4.5 Conservatism/Prudence when Adapting the IAS**

According to one interviewee, there has been a development from conservatism to other ways of thinking in Sweden for a long time. The IAS is influential in this area as well. The public companies on the consolidated level have already moved away from conservatism, basically. An interviewee says that, probably, conservatism is a stronger accounting principle for small, non-listed companies, but whether that will change or not is still open for debate.

### **5.4.6 The True and Fair View**

According to one interviewee, the true and fair view is defined in many different ways in different countries. He claims that the development towards showing the economic value creation has already happened for large Swedish and European companies. These large companies moved towards this because that is what the stock market wants. He does not think that the IAS will conversion will change that perspective. The whole development with the IASB being integrated into the EU regulatory framework is a part of the larger development. The interviewee says that there are other developments, too, like the increasing importance of stock market and the European government which believes that there is a need for European companies to change the way that they do financial reporting. That is the driving force. Furthermore, according to an interviewee, it is his opinion that the EU Commission saw the IAS as a good tool to reach this objective, i.e. the IAS is the tool, not the driving force. If you look at the underlying logic of the IAS, he explains, one can see that they are very different from the traditional European laws. The US GAAP standards with less detail: that is the IAS. Moreover, in US GAAP, it is very clear that the purpose of financial reporting is to provide information for investors, so that they can make decisions. Furthermore according to one interviewee, one will also need the economic picture. Another interviewee also says that the IAS, to a great extent, is an intelligent tool when really trying to present a true and fair economic meaning of business transactions. On the other hand, this interviewee says that this can lead to a few untraditional effects. He believes that the Swedish Årsredovisningslagen is more explanatory and open, providing more information.

### **5.4.7 Effects on Swedish Companies**

One of the interviewees believes that there will be mostly positive effects for listed companies in Sweden. For example, it will be easier to explain to outside investors what their businesses are doing. Outside investors will, in turn, tend to rely more on financial statements of the listed Swedish companies. He also says that the IAS is widespread over the world so when investors speculate in Swedish listed companies, knowing that the financial statements are prepared according to IAS will give the investors some comfort that the numbers are reliable. Another interviewee also believes that the IAS will bring a better transparency and conformity for financial statements of all countries. This is believed to be true especially for the countries that are active in an international market – not just local capital markets. Both interviewees believe that the short-term negative effects are that if there are changes to be implemented in the companies' own internal reporting, that will be a cost to the companies. There will also be a one-time cost setting up the accounting system, for example, including the need for education of accountants, journalists, analysts, investors, etc. Everything is more complex and it demands more of the performers and users. Another interviewee does not see the adaptation to the IAS as having positive or negative effects. Instead he argues that the

adaptation to the IAS is necessary because large international companies are dependent on international investors, who in turn demand international rules (IAS). He says that one has to take the rough with the smooth.

Moreover, one interviewee believes that you will obtain accounting harmonisation internationally at the expense of having more divergence nationally. He says that he thinks that this will happen all over Europe. This will mean that you will have more difficulties when comparing companies inside Sweden than before, but the interest groups that read the financial reports are quite different for listed and non-listed companies. Therefore, the interviewee does not think of this as significant problem. On the other hand, it could be a problem for those people who are interested in both types of companies, for example creditors. But probably, the interviewee says, they will develop the expertise to make comparisons. It will be easier for investors. But he also says that IAS some extent already has happened because many French and German companies already use the IAS. And, of course, many listed companies already use the IAS in Sweden. The interviewee definitely believes that the adaptation to the IAS is positive for the investors. He says that what has been seen as the biggest problem in accounting diversity is the difference between US GAAP and the IAS and the requirements of the SEC to follow US GAAP.

#### **5.4.8 The Co-operation Between the FASB and the IASB**

One of the interviewees believes that the prospects of the co-operation between the FASB and the IASB are very good, because the organisations very recently issued an exposure draft. He explains additionally that it is very likely that these new rules on business combinations, the final IASB standard, will be similar to the FASB standard, which means that using the pooling method will end and there will be no goodwill amortisation. The FASB argues that there is never a pooling of interest taking place in reality, and therefore, they have banned the method in June 2001. Now, all such business combinations are acquisitions according to the FASB. The IASB has said that that they find true mergers (to be accounted for as poolings of interest) as very unusual, but such combinations might happen. In that case, a new type of accounting for mergers that is not just like the pooling method but rather, as the IASB calls it, “the fresh start method” would be required. In simple terms this means that you revalue all assets and liabilities in both companies, once they merge. According to the acquisition method you revalue assets and liabilities of only one company, the acquired company. In the fresh start method, you revalue everything as it were a new company. The interviewee believes that the new rules will be quite similar to the American rules.

Another interviewee says that banning the pooling method will be a shame for companies which are meant to use this method. But the method was put to a wrong use and therefore it did not work. That is why it seems to be disappearing. The interviewee also says that it is also a question of how you account for a business in the best way. He believes that, today, the purchase method in combination with no amortisation of goodwill, and instead the impairment test of goodwill is a good solution for these problems. A third interviewee says the question when banning the pooling method is whether it always gives a “true and fair” view. Sometimes, pooling can be good as an accounting procedure.

### **5.4.9 US GAAP Instead of the IAS**

One of the interviewees does not think that it would be possible for the EU to adapt the US GAAP rules instead of the IAS, because for the FASB, of course, their task is to react to developments in the US and develop rules that are needed in the US business environment. However, the FASB is co-operating more and more nowadays with the IASB.

When we asked the interviewee if he believes that the US ever will change to the IAS, he said that due to the co-operation between the FASB and the IASB, the organisations will probably make sure when issuing a new recommendation, that the other party has a similar one. The interviewee believes that the FASB and the IASB will gradually become more and more similar, and also they are going to develop all their standards by comparing which organisation has the newest ones. Thereafter, they will try to merge the different standards. The interviewee believes that the big question is the SEC. After the Enron scandal, the SEC, under the leadership of the now former SEC chairman, Harvey Pitt, has been more in favour of harmonising the US GAAP and the IAS.

## 6 Analysis and Conclusions

*In this chapter we will analyse our empirical data and theory and out of this draw conclusions. Characteristics that we have found of special interest, regarding the question and purpose of the study are pointed out. We also present our overall reflections and conclusions. These are based on the theory and empirical data. Suggestions for future studies are also included in this chapter.*

### 6.1 The Effects on the Regulation of Swedish Group Accounting

Presently, we have seen that there are differences between the RR 1:00 and the IAS 22 and 27 in some respects. For example there are differences regarding so-called reverse acquisitions and exceptions from the obligation to establish a group account (see section 5.1). The question arises whether these differences still will be in force after the EU:s change to the IAS in 2005, as expressed in an EC Regulation. When the EU decides if all/which of the IAS will become part of the EU system, these will also be published as a Regulation (Balans 2002:12). We believe that all the IAS will be accepted, as the desirable positive effects would be diminished if exceptions would start to be made. Considering the EC legal system (the supremacy of EC law and characteristics of Regulations) and that all the IAS will be part of the EC legislation as a Regulation, it appears that there will be a legal obligation for listed companies to follow the IAS directly instead of RR 1:00. Consequently, the above-mentioned differences between the RR 1:00 and the IAS 22 and 27 will not be possible to keep for Swedish group accounting for listed companies.

It is also important, that the current IAS are not permanent and unchangeable documents. In concrete terms, the area of the RR 1:00 and the corresponding IAS 22 and 27, is already subject to changes, through the IASB ED 3 on Business Combinations. We see some of the proposed changes, such as the banning of the pooling method and the changes regarding goodwill, as likely to be accepted, as this has already happened elsewhere. For example, the pooling method has already been banned in the US (FAS 141) and also due to the co-operation between the IASB and the FASB this ban on the pooling method is likely to happen in the EU as well. The accepted changes might then come into force before 2005 (Balans 2002:12). Moreover, there is the second phase of the IASB project on business combinations, which certainly will deliver other possibilities for changes in this area. And future co-operation between the IASB and the FASB might lead to further changes.

It is possible that the option to use different accounting principles in the financial reports of the group of companies and in those of the parent company (p.9 RR 1:00) will be enlarged in the future. There is a Swedish commission, working on this question among others, that will issue a report during the summer of 2003 (the statement of one of the interviewees). We believe that such a change is possible. The whole problem is also related to the strong connection between tax and financial reporting that still exists in Sweden, which no longer is the case in many other accounting systems. If differences in financial reporting at the consolidated level and parent company level are not allowed, there will have to be differences between financial reporting and tax accounting in the parent company.

The change-over to the IAS has also brought proposed changes in the EU Directives and in the Årsredovisningslagen (DS 2002:42). We see no reasons for that these would not be accepted. The EU Directives have to be changed to agree with the IAS, and there is a strong will to adapt to the system. As a consequence of changes in the EU directives, the ÅRL has to be changed because of the supremacy of EC law (cases 6/64 Costa v. Enel, 106/77 Simmenthal).

**Conclusion:** The Swedish accounting regulation for listed companies will change in 2005. The IAS will be applied instead of the RR 1:00. Consequently, there will be minor changes caused by the current differences between the RR 1:00 and the IAS 22 and 27. Moreover, it is likely that there will be some quite important changes in the IAS until 2005, thus leading to further changes for Swedish accounting as well. The ÅRL, will also be modified in order to be in harmony with the EU/IAS system. Furthermore, even after 2005, we can expect other changes in the IAS, i.e. even in Swedish accounting regulation. But all this concerns only listed companies on the consolidated level (Regulation 1606/2002)

### **6.1.1 Reflections on the Changes in Swedish Group Accounting Regulation**

Today, there are not any radical changes, based on the differences between the RR 1:00 and the IAS 22 and 27, that will occur in 2005 in the area of the RR 1:00. It seems as if the RR would have accepted practically everything in the IAS 22 and 27, but the ÅRL has forced them to other solutions on some points. Nevertheless, the changes of the IAS 22 that are proposed in the IASB ED 3 are more important, if accepted.

#### **6.1.1.1 Pooling vs. Merger**

There really are very few, if any, true mergers, and the method has been misused (FAS 141 and the opinion of one of the interviewees). Practically the two merging companies are rarely of the same size, but it is often desirable to call their joining a merger, also for psychological reasons.

We consider the ban of the pooling method a good decision. On the other hand, there should be an alternative for situations of true merger, where the acquired and acquiring company cannot be distinguished. We will see what the work on the so-called fresh start method (phase II of the IASB project on business combinations) will result in.

#### **6.1.1.2 Negative Goodwill**

Regarding the proposed changes on negative goodwill, we believe that they are not bad, which is also the opinion of one of the interviewees. Goodwill amortisation that has been and still is used, does not really tell so much about a company. Some consider goodwill not being an asset at all. Even when not taking this view, it cannot be neglected that it is a very special kind of asset (it is only the difference between certain figures in an acquisition).

Therefore, we believe that the system of amortisation is not suitable for goodwill. The impairment test might, if properly applied, give signals of for example a decline in a business. This will be good for the transparency and for the users/market. On the other hand, it seems as if such evaluations will be hard to make for the companies, and consequently, there could be room for discretion.



### **6.1.2 The Future of the Swedish Redovisningsrådet**

One of the interviewees mentioned that today, the future of RR may be said to be uncertain. By 2005, all listed companies will be obliged to follow the IAS and the IAS will be a part of the EU legal system. Thus, as laws they will be translated into all EU languages. That is the rule (Bernitz, 1996).

We have not found anything that would indicate an exception in this case. Perhaps it seems irrational with all this extra work, when there already are great parts of the texts translated. But it is important to remember that this is the situation in Sweden, but not in many other Member States. Although, the RR today is mostly transforming the IAS into the Swedish recommendations or revising earlier recommendations in order to adapt them to the IAS, there is some space for the RR to depart from the IAS and make special Swedish solutions. This will no longer be possible from 2005 (due to the principle of supremacy of EC law). Consequently, it seems as if the RR no longer will have a meaningful task to fulfil.

### **6.1.3 Other Reflections Regarding EU:s Change to the IAS**

There seems to be quite a consensus in the EU that the change to the IAS is both a necessary and a good step. For example, the Parliament accepted it by great majority (Balans 2002:12). Nevertheless, the EU has kept the possibility to “check” all the future IAS, as the EU is going to come out with a Regulation to accept each newly issued IAS (Balans 2002:12). The EU has not by the decision to use the IAS from 2005 automatically accepted all new or changed standards. We do not see any reason that this will change. Thus, the EU has not really given away any power and that is certainly the way the EU wants it. On the other hand, we do not believe that, in the future, standards will be issued that the EU is not ready to accept. Firstly, the EU certainly will have some influence on the standard-setting process. Secondly, from the part of the IASB itself it is also important to have a good relationship with the EU now becoming the main user.

The EU:s decision to change to the IAS should first be seen as a step towards further harmonisation within the EU. Today, harmonisation is worked on in almost every area (Steiner, Woods, 2000). In order to create, for example, the common market, more is needed than a formal guarantee of free flow of goods, labour and capital. Accounting is one such “invisible” barrier to a true common market, but therefore it is also a tool. Today, with so many accounting systems in the different Member States, Europe is possibly disadvantaged in comparison to, for example, the US. The harmonisation of accounting is a step towards a true common market, which in turn – it is considered – creates better opportunities for the European companies and is good for the economy in Europe.

For the EU, there was also another important motive: the changing world, the increasing importance of the stock market and investors, etc. (Blake/Lunt, 2001). As US accounting generally has a more “liberal” (less conservative or prudent) view, it is often remarked that US companies often have been able to show better figures, which has disadvantaged the European companies. Such a more “liberal” accounting, as well as the movement towards the “true and fair view” and emphasis on matching instead of prudence, seems to be a trend in accounting. The IAS conversion is believed to be in agreement with this trend (the view of one of the interviewees).

However, to create a totally new accounting system, where all the different traditions of the member states are synthesised, would be a long and costly process, perhaps even impossible. The IAS already are there, so why create something completely new? Moreover, the IAS system is by definition “impartial”, which politically must have been an argument in its favour for finding a set of international accounting standards which all EU Member States could adopt.

## **6.2 Possible Long-Term and Short-Term Effects for Swedish Companies**

According to the interviewees, the most important positive effect for Swedish companies seems to be that they will be in a better position to attract foreign investors. It is obvious that an investor is reluctant to invest in a company if he is not able to evaluate the company sufficiently because of different accounting than he is used to and knows. In many cases, the investor could be suspicious of possible “hidden” negative information. The IAS are not only a kind of a “quality mark”, but will, when used all over Europe, become probably the most important accounting system of the world together with the US GAAP. Regarding European investors, this IAS conversion will suddenly give them the ability to more easily understand financial reports of listed companies of the EU Member States, as well as the financial reports of companies in their home country. Regarding the investors outside the EU, many of them are likely to understand the IAS system being used by so many important companies. Also, the IAS system already is rather widespread in the world ([www.iasc.org.uk](http://www.iasc.org.uk)), which means that many investors already have been in contact with the IAS. These investors, in turn, will more easily understand the financial reports of companies that used to apply other accounting standards.

We believe that another positive effect for Swedish companies is that the group reports will be easier to prepare for companies who have subsidiaries in other EU member States. Today, allowing for various differences permitted by the EU Directives, different accounting in different states causes the companies extra work and costs. Naturally, this lack of a same set of standards can be seen as an accounting impediment to mergers and acquisitions, vis a vis companies in other EU Member States, even if this is not one of the most important impediments.

It should also be easier for Swedish companies to register on foreign stock exchanges. Today, all states in Europe mutually accept each other’s accounting as long as they follow the EU Directives (Van Hulle, 1996). But there might be a difference regarding other stock exchanges, which might more easily accept the IAS than the Swedish accounting principles. However, the most important issue here is whether the SEC sooner or later, as we see it, will allow companies listed on the US stock exchanges, to use the IAS without reconciliation to US GAAP (see section 6.1.8). This would naturally be very good for Swedish companies, making it easier and less costly for those already established there as well as for those who wish to be listed on US stock exchanges.

Applying the theories of Blake and Lunt (2001), the change to IAS will make it easier for investors to evaluate companies. The same has naturally to be true for the companies themselves. Following the IAS conversion, it will become easier for companies to

evaluate their competitors. The figures in the financial reports from other companies using the IAS will permit comparison directly with the figures of the company. Consequently, such financial statement comparisons will lead to less extra expense and may give more reliable results. On the other hand, the use of the same set of accounting standards makes it easier for all actors: a company itself will also be more easily evaluated by others and therefore, this is also a negative effect.

The most important negative effect will be the extra costs when implementing the new system. Also, it is likely that the change to the IAS in many cases will lead to changes of the internal system of a company. Moreover, the staff working with financial reporting will need education, training, etc. According to the interviewees, certain external groups will also be more affected than others, such as auditors, analysts and journalists. Furthermore, the IAS system is more complex than the current Swedish system, which also will lead to higher costs, both for users and those preparing the reports. This factor of higher cost is not only connected to the transition to a new system.

For auditors, creditors and others who will need to know both systems (the IAS for the public companies and the “Swedish” rules for the rest) this will also lead to extra costs (the opinion of one of the interviewees) for education and training for staying up-to-date in these two systems.

**Conclusion:** Considering all these aspects, we believe that the change to the IAS, principally is positive for Swedish companies, at least in the long run. Practically, on the negative side there are mainly costs that arise from the implementation of a new system and maintenance of two systems. Here, it should not be forgotten that, however, the Swedish accounting today is very similar to the IAS already, although it does not have the official “IAS” label. Also, on the positive side we have all the mentioned various possibilities for Swedish companies in gaining or increasing their access to debt and equity markets, world-wide. And as the Swedish industry is highly international, Sweden is one of the countries that could be especially favoured by the IAS conversion ([www.redovisningsradet.se](http://www.redovisningsradet.se)). On the other hand, the use of the same set of accounting standards makes it easier for all actors: a company itself will also be more easily evaluated by others and therefore, this is also a negative effect.

### **6.2.1 Possible Problems and Uncertainties from the Conversion to the IAS**

An interesting question is, of course, how similar the accounting in different Member States actually will be. It is one thing is to have identical rules and something else to use and interpret them exactly the same way. Considering the important differences in accounting traditions that we have within the Union (see section 3.3), it is unlikely that the application could be 100% the same all over Europe.

Another problem could be that we now will get different accounting principles within the Member States as smaller companies still will be using the same national rules as today (EC Regulation No 1606/2002). We will get harmonisation on the international level, at the expense of the national level. But is that so much of a problem? From the user’s perspective, i.e. the argument about the investors and the stock market, it does not really seem to be a problem, as the two types of companies (public and non-public) do have generally different interest groups (the opinion of one of the interviewees). For

example, we believe that someone who is interested in buying shares in a public company is probably not the same person who would economically help start up a family business, etc. Viewed from the “European Common Market” argument, it is clear that the theory of one common market is not only about investors and the stock market. However, we believe that it is possible that the Swedish legislator, and most of his EU counterparts, will give all companies the option to use the IAS. In reality this will mean that most of the larger non-public companies, who could be interesting to the same investors as the public ones, will use the IAS, as they could feel disadvantaged if they did not. The same will probably be true for companies who have or wish to have business contacts with the rest of the EU and perceive the use of their (national) accounting as a handicap.

The problem of the two systems does not seem to be such an important issue. Perhaps there could also be some worries that the smaller companies who will not use the IAS from 2005 will be a little “forgotten”, that not enough rules will be produced in order to help them with their accounting. We do not think that this will happen. We consider it to be a good decision to limit the compulsory use of the IAS to consolidated reports for public companies. The system is far too complicated and costly to be used by all the small companies as well. The problems and costs such companies would experience could be very harmful for them, and cannot be said to be balanced by the positive effects of an absolute harmonisation. One negative thing though, is that for companies using national standards, it will be even more costly to get listed, as the change to IAS in financial reporting requires a lot of time, education of the staff etc. On the other hand, we doubt that this would really prevent any companies from getting listed.

### **6.3 The IASB/FASB Harmonisation Agreement**

Below the surface, the IAS conversion perhaps, to some extent, is about power. The EU is afraid of letting the US dominate too much in the area of setting accounting standards (Balans 2002:4). If the EU had not moved toward greater harmonization in accounting, more and more European companies would probably have started using the US GAAP instead, and also would have been encouraged by the fact that for US stock exchange listing, the SEC today, practically, only accepts reports according to the US accounting rules (The European Accounting Review 2002:1). Consequently, a creation of a common accounting system within the EU was important also from this point of view. One accounting system used by companies all over Europe is a stronger set of rules and could at least have the potential to be able to “compete” with the US GAAP. Even from this point of view, the choice to use the IAS appears to have been “good”; it is not only a European system but the IASB is also, as said, by definition an international rule-maker. This, undoubtedly, makes the system stronger than if there was a totally new EU system created. Moreover, by choosing the IAS, the EU, as one of the main users, hopes, of course, to have more influence on the IASB (European Accounting Review 2002:1).

Although the EU seems to fear accounting and rule-setting domination by the US, the question is, whether the US accounting has not somewhat “slipped in the back door”. The IASB is dominated by members from the US and the UK ([www.iasc.org.uk](http://www.iasc.org.uk)), thus countries of the common-law tradition. Moreover, the co-operation between the IASB and the FASB is likely to make the US influence more direct. On the other hand, as one of the interviewees mentioned, it is important to remember that the accounting systems in the EU member states are so different, that some of them stand closer to US GAAP

than to some of the others. It could also be said that the global trend in accounting today – through the power of the stock market, US economy, etc – rather is Anglo-American than continental European. Therefore, it is not that easy to point out the change to the IAS solely as a reason for US influence.

### **6.3.1 The Co-operation Between the IASB and the FASB**

An interesting question is how the co-operation between the IASB and the FASB will develop and why it actually was brought about now. From the American perspective, the accounting scandals (Enron, Worldcom etc.) during 2002 might have contributed to a willingness to co-operate with the IASB. Following these scandals, it has been discussed whether a more principles-based accounting could have prevented such distorted accounting results. It was realised that there are weaknesses in US accounting as well (stated at a Seminar about Enron). A key issue is here the SEC. According to one of the interviewees, the now former SEC chairman, Harvey Pitt, is quite positive toward the IAS.

**Conclusion:** According to what has been mentioned previously, and as it equally seems to be in the EU /IASB interest, we believe that there are good chances that the co-operation between the IASB and the FASB, at least to some extent, will be successful. We believe so, even if a memorandum of understanding is not legally binding to higher extent than the attempt to achieve the objectives through further negotiations. But we do not think that one of the systems clearly will abandon their rules and change to the other. In the case of, for example, the EU changing directly to US GAAP, there are firstly institutional problems: how can the FASB react to accounting problems outside the US, when it actually is a national actor? How would enforcement be done? And from both sides such a change seems to be unrealistic because of a certain “pride”. Therefore, we believe that the two institutions will continue to co-operate in the present way, both “equal”, and that the two systems over time will become quite similar to each other. Thus, we believe that the IAS will be affected by US accounting in the future as well.

We believe that the SEC, in the not very remote future, will need to fully accept the IAS, especially since the IAS now will be used by many important companies (i.e. European companies), and as the co-operation between the FASB and the IASB will reduce the differences between these accounting systems.

### **6.3.2 A Movement Towards Global Accounting**

The change to the IAS by the EU in 2005 might also affect accounting in non-EU-states. For example, it is likely that some of the candidate states will choose to start implementing the IAS as well. But this issue is not really in the scope of this study.

All these harmonisation developments, which in one or other way are connected with the change to the IAS in the EU, show that there is a movement towards global accounting. The EU has, through the decision to change to the IAS, contributed to that. Thus the IASB has gained forces, which in turn, certainly, has contributed to the already mentioned co-operation between the IASB and the FASB. When these two major systems, at least partly, are merging it is, undoubtedly, both an historical and an important step towards global accounting

## **6.4 Suggestions for Future Studies**

The accounting harmonisation in the EU is a much debated subject today and the adaptation to the IAS in 2005 has led to many questions. The EU has issued a Regulation which requires an application of the International Accounting Standards (IAS) from 1 January 2005 for all listed companies in the Union. Therefore, we think that it would be interesting to study how Swedish group accounting and Swedish companies really will be affected. We also find it interesting to study to what extent the EU:s accounting will become more homogeneous. Moreover, it would be of great interest to study how the European countries that are not members of the EU have been affected by the harmonisation of the Member States.

As part of a continuing effort to bring about convergence of global accounting standards, the FASB and the IASB have decided to co-operate. It would be interesting to study how this co-operation has developed and if/how it has affected accounting in the EU. For example, if it has become easier for EU companies to become listed on stock exchanges in the US

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## Appendix

### Interviews

#### Questionnaire for Personal Interview

- Could you please tell us a little about your background (education, previous work experience, position and title of today etc)?
- What do you believe will be the main changes in Swedish accounting regarding groups, as a result of the change to the IAS in the EU by 2005?
- There seems to be great uncertainty and disagreement among Swedish accounting experts about what is going to happen with RR 1 as a result of the change to the IAS. Do you believe that the recommendation will disappear/ change/not change at all? And why?
- Do you believe that the change to the IAS will bring with it changes in Årsredovisningslagen (the Swedish Accounting Act)? (e.g., differences between the RR1 and the IAS 22 that are caused by Årsredovisningslagen)
- Do you believe that the equity method in Swedish accounting will disappear? (there is no such alternative according to IAS 22 today) Why or why not?
- Do you believe that the accounting on negative goodwill will change? If so, how?
- Do you believe that the Swedish way of dividing equity capital into "free" and "restricted" and the connected rules in the Swedish Companies' Act regarding dividends will be affected by the change to the IAS? If so, in what way?
- Do you believe that the possibility in Sweden today of using other accounting principles in consolidated reports will disappear? (see p 9 in RR 1) If so, why?
- Do you believe that the "caution principle" will become less important through the change to the IAS? Why or why not?
- Do you believe that the change to the IAS will make Swedish accounting better fulfil the requirement of "true and fair view"? If so, how? If not, why not?
- In what ways do you believe that Swedish companies will be affected by EU: s change to the IAS by 2005? (positive and negative effects)
- In what ways do you believe that the comparability between listed and non-listed Swedish companies will be affected? (Is that something that you find important?) And the comparability between listed companies in Europe? (Will that really give such positive effects as is said?)

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- What are your ideas about the newly announced co-operation between the IASB and the FASB regarding groups? (especially the purchase method)? Is such a co-operation good and do you believe that there are any prospects that it will be successful?
  - Do you believe that it would have been better if the EU would have decided to adapt to the US GAAP instead of the IAS? Why? And would that be possible at all?
  - Do you think that the USA ever will change to the IAS?

### **E-mail Questions to Experts**

1. What positive and negative effects do you believe that the adaptation to the IAS in 2005 will have on Swedish companies? Why?
2. How do you believe that the co-operation between the FASB and the IASB will affect Swedish group accounting and Swedish companies?
3. What advantages and disadvantages do you think there are concerning the development towards the purchase method being the only one permitted?