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Goodwill
– **A Controversial Accounting Issue in**
“the New Economy”.

Different angles of reflection on a current topic
in the Swedish IT sector.

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ABSTRACT

The New Economy is a new arena in business life where IT (Information Technology) companies act. The IT sector in Sweden grew immensely during the end of the 1990s. That growth was possible through numerous acquisitions. The market's valuations of the new prosperous enterprises in this young sector were extremely high.

Through a row of highly priced acquisitions, huge goodwill items emerged in most IT companies. Profitability was not a core issue and the future seemed bright to most actors. Share prices fell dramatically during 2000 and IT companies had to write down goodwill in a drastic way in the annual reports.

In this thesis different aspects of accounting for goodwill in the annual reports covering the year 2000 for 29 Swedish IT and Internet companies are presented. A close-up on two companies, HiQ and TietoEnator, provides a deeper insight in our study. Different concepts of goodwill are looked into. Accounting rules and regulations dealing with goodwill in specific and with intangibles in general are presented both from a national and an international outlook.

Key words: The New Economy, The Swedish IT sector, Acquisitions, Goodwill, International Accounting Regulations.

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1. INTRODUCTION

1.1 Background

What is the IT sector?

The rapid development and change in the IT (Information Technology) sector and the growing number of services connected to IT are factors that make it difficult to clearly define the IT sector. One of the more frequently used definitions of the IT sector is that it consists of partly the industrial sectors that manufacture computers and telecom equipment, and partly the service sectors working with software, support, consulting, sales and so forth concerning computers and IT solutions.¹

In September 1998 the OECD Committee for Information, Computer and Communication Policy established a definition of what the IT sector should include. The sectors included according to the OECD definition can be divided in two main categories, namely the production of hardware and the production of IT services.²

Information technology and its fast spread are regarded by many as a key factor in the development of what is called the New Economy. This expression, “the New Economy”, can be regarded both as a name for the IT sector and as a description of the type of development on a macroeconomic level which is characterised by economic growth, increasing employment and low inflation.³ The perhaps controversial expression “the New Economy” is discussed further in a separate part of our thesis.

¹ Det nya näringslivet, p 30.

² Ds 2000:68, IT – an Engine for Growth, pp34-35.

³ Ibid.

The IT Sector in Sweden – a Remarkable Development.

Sweden today is considered to be one of the leading IT (Information Technology) countries in the world. In February 2001, the analysis company IDC, ranked Sweden as the world's leading IT country, (considering the age of IT,) for the second year in a row, closely followed by countries like Norway, Finland, the United States and Denmark.⁴ Sweden has a relatively well developed IT infrastructure and there is a high level of proficiency in IT at user level. Many Swedish companies are in the forefront in the age of information technology.

During the period 1993-1999 the IT sector represented roughly 25 % of the total GNP growth in Sweden. In 1999 the export from the IT sector amounted to 19 % of the total Swedish export. The gross export from the Swedish IT sector was by then e.g. higher than the export from the total Swedish forest industry.⁵

Share prices for many Swedish IT companies reached an all time high. In one article published in the Swedish business paper "Dagens Industri" in August 1999⁶ a financial analyst from Swedbank presented his opinions about the high share prices in the Internet sector and if he considered the Internet companies to be overvalued. He meant that no facts really supported the high price level. The investor's valuation base for a number of companies was expectations about a persistent high yield and growth. Risks considering an emerging competition were often neglected.

Organic Growth Versus Acquisition Strategy

One significant factor in the very fast growing IT sector was the speed with which many IT companies grew through a number of acquisitions. It was considered a great advantage to build sizeable companies through acquisitions

⁴ Det nya näringslivet, p 27.

⁵ Ibid., pp 30-31.

⁶ Linnala, 1999-08-28

rather than growing by the companies' own operative business. The market had total confidence in the potential of companies that had acquisitions strategies. The base for valuation of the acquired companies was market price (or share price), which in many cases resulted in enormous goodwill items in the accounts of the acquiring companies. A majority of the acquisitions were made when share prices were eight or nine times as high as they were at the end of year 2000. For a number of the acquiring companies, one crucial condition of making growth possible, was to pay for the acquisitions by issuing new shares in their own highly valued companies.⁷

Goodwill in the IT Business - Paying Too Much for Too Little?

During year 2000 the positive development for most Swedish IT companies changed into a dramatic turn downwards, share prices fell considerably and many companies were facing severe problems. One of the problems that management and auditors had to face was the valuation of goodwill in the annual reports for year 2000. A number of the fast growing companies had to make immense lump sum write-down of goodwill at the time of year end closing. Swedish listed IT companies made a total loss of about 7 billion SEK in the year 2000. In 1999 the total profit for listed companies in the sector amounted to around 1.5 billion SEK.⁸

What is Goodwill? – The Debate in Sweden.

The development of the Swedish IT companies during the last few years, makes it obvious that there is often a clear discrepancy between on the one hand the book value of assets and liabilities in a specific company and on the other hand the market value of the same company. One example of this is when an acquisition results in a goodwill item of high value in a group's accounts. It is

⁷ Hedensjö, 2001-02-28, pp 4-5,

⁸ Ibid.

clear that the market value or acquisition price contains a compensation for values or assets that are not recognisable in the balance sheet.

This fact raises the question whether annual reports or group accounts prepared in accordance with traditional accounting principles in a “correct” way reflect the value of a company or not. According to Swedish legislation goodwill has to be amortised, a fact that of course has an effect on the income accounted for.

Opponents of the accounting principles used today mean that goodwill is something that belongs to “the Old Economy” and is not applicable to knowledge-intensive companies in “the New Economy”. Some consider the surplus value, which traditionally has been referred to as goodwill, as intellectual capital and they argue consequently that goodwill does not exist. Other critics suggest that goodwill or intellectual capital is the only asset in many knowledge-intensive companies and they find it bizarre to amortise this only asset before it will generate income. Others mean that accounting for goodwill and above all amortisation of goodwill, will make it harder for IT companies to develop and reduce their future dividend capacity.

On the other side we find those in favour of today’s accounting principles. The defenders argue that goodwill is an investment like any other investment and consequently with that should be amortised. The importance of open disclosure in balance sheet and income statement is crucial for the ability to outsiders in judging the management’s capacity to integrate acquired companies.

Another point of reference is that the problem does not really have to do with goodwill, but with the, unrealistic pricing, during the last few years of shares in IT companies. In spite of losses, share prices reached new heights. The defenders of the accounting principles of today, point out that the aim of annual reports is not to currently provide a reflection of the market value of a specific company. The importance of extensive disclosure, not only in balance sheet and income statement focusing on human capital, is pointed out.⁹

⁹ Knutsson, 2000, pp 12-13

During the last few years, the arena for information technology companies have changed drastically. The use of information technology have, during the last few decades, gone from being a narrow path only for a few users, mainly for national security only, to a broad highway for millions of users. This great growth has brought a new kind of companies, the so called IT-companies.

When times were good, the "goodwill issue" was of great concern, since the industrialised world uses different ways to amortise these items. In USA, where FASB rules, 40 years is maximum, in Europe (IASB) 20 years, and in Sweden a maximum of 20 years is accepted in certain circumstances. This became great worry when the "bubble" burst and focus started to change from high share prices to the worry of small if not nonexisting profits, and goodwill items that would have to be amortised with profits that were planned to occur but didn't.

The depreciation of assets, tangibles and intangibles, is to be done in consideration of every asset's life length. If this is not possible, the 10 year depreciation is recommended in Sweden.

For Framfab, one of many Swedish IT-companies, the burden of amortisation of goodwill has been heavy at the same time as earnings have been low. Framfab is only one example of an IT-company that is struggling to survive. Another examples from the sector are HiQ (which we examine in our thesis), one of the few that have gone through the "hard years" almost unharmed. Tieto-Enator, the second company in our research that we look at more deeply, have had other ideas about mergers and acquisitions. For these three, the future looks quite different and the acquired goodwill has a large part in their future possibilities.

IT-companies are knowledge-based companies and this category has been defined by Karl-Erik Sveiby in his book "Kunskapsflödet" (in English; The Flow of Knowledge). He says¹⁰ (author's translation) that knowledge companies often

¹⁰ Sveiby, 1995, pp 16-17

consist of competent, highly educated personnel that often solves complex problems that vary from case to case. The production in these companies have been shown by Arbetsgruppen Konrad¹¹ and is categorized like this: not standardised, creative, highly dependent on the individual, and often gives complex solutions. Sveiby gives some examples of knowledge companies; advertising companies, law firms, accounting firms, and IT-companies.

In our work, we will focus on IT-companies and their handling of goodwill. This item in accounting has been highly discussed and focused on lately among these companies. The burden of amortisation of goodwill has been hard to handle since expected earnings do not meet expectations. The different ways of handling goodwill in the Annual Reports will be discussed and analysed in this thesis.

1.2 Problem Analysis

In this part of our thesis we declare why we want to conduct this study. In order to do that, we have to describe the main issue of our work.

Is traditional accounting regulation applicable on companies in "the New Economy", where growth through acquisitions was believed a key success factor superior to organic growth?

In order to highlight this area of accounting, we extended our study by describing how Swedish IT-companies handled purchased goodwill in their Annual Reports covering year 2000.

¹¹ Arbetsgruppen Konrad, 1989, p 10

In order to visualise this issue we have decided to study the topic from the following angles of approach:

- What are the different definitions of goodwill and intangibles?
- What regulations are applicable concerning accounting for goodwill, on both national and international levels?
- In what environment do the chosen companies act, and how does this affect the practice of accounting for goodwill?

1.3 Purpose

The purpose with this thesis is to study Swedish IT-companies' Annual Reports covering 2000 and focusing on the treatment of goodwill. Our aim is to see if their strategies have affected them concerning amortisation of goodwill and if accounting rules are applicable. To visualise this we find it necessary to give a background concerning the rules and regulations dealing with goodwill. An international outlook on accounting regulation is also presented. The IT-sector differs from traditional business life. Therefore we add a brief description of the sector and study the factors that are significant to "the New Economy". Two companies have been analysed more thoroughly which has brought a deeper insight to our study.

1.4 Scope and Limitations

Scope

This thesis is written to those interested in goodwill handling and accounting regulation in the Swedish IT sector during year 2000. To enhance the understanding of the topic, we find it necessary to give a wider picture including business environment connected to this area. A case study on two selected companies will supply a more extended knowledge.

The thesis is designated primarily to business administration students and students within commercial law with an interest in accounting and accounting rules.

Limitation

There was an intense debate about the treatment of the enormous goodwill items in the Swedish IT sector in the end of year 2000 and in the beginning of year 2001. Newspapers and magazines covering the business world published quite a number of articles on this subject. This raised our interest to take a deeper look into the theme goodwill in the IT sector. Our thesis will focus on how Swedish IT companies accounted for goodwill and amortisation of goodwill in the annual reports reflecting income year 2000. This gives one of the limitations:

We would like to point out that our assignment concentrates on external accounting. Internal accounting offers a higher degree of freedom in the choice of principals and is not subject to regulation on a national or international basis.¹² The impact of goodwill on key-ratios is reflected on in chapter 5. Choosing companies gives another limitation: *Selecting the companies referred to as “IT and Internet Companies” according to a classification established by the Swedish business magazine “Affärsvärlden” of 2001-07-20.* We consider this grouping to be well established and frequently referred to.

To get a broad picture of our topic we have looked into the annual reports reflecting income year 2000 of all the selected companies classified as IT and Internet Companies by Affärsvärlden in July 2001. To get a deeper insight in how companies discussed the issues concerning goodwill, we have carried out two case studies. In Chapter 5 we present HiQ and TietoEnator, two IT companies with a more positive development during this year than many of their competitors have had.

We find the theoretical framework regarding intangible assets important as a base for a describing accounting regulations concerning goodwill. To get a more

¹² Knutsson, 2000

comprehensive background to what goodwill is and how it is accounted for, we decided to deal with intangibles in a wider context in Chapter 3.

When discussing goodwill we have a third limitation:

To discuss purchased goodwill and issues connected hereto. The reason for this is that acquired goodwill is in focus due to the growth through acquisitions in the IT sector. Still, it may be worth to mention that there is a debate about goodwill created inside companies going on and the possibilities to get intangible assets capitalised are discussed. We exclude this debate in our thesis in favour of a logical focus.

The debate concerning how to account for goodwill is definitely not a national phenomenon. Immense changes of regulations covering this field are taking place in the United States and will probably have an impact on international standard setters outside the United States.

It is noteworthy that standards set by IASB (International Accounting Standards Board) are growing in importance internationally. The active work by the EU Commission in supporting IASB's work is one example of this. There are suggestions to make IASB's standards regarding group accounting compulsory for listed companies in Europe. To a small country like Sweden the growing internationalisation of accounting standards is important and will make it easier for Swedish companies to establish abroad and to be listed on foreign stock exchanges.¹³ More about international standards as regards the goodwill issue is presented in chapter 3.

¹³ Knutsson, 2000, pp 31-32

1.5 Outline

Chapter 1 Introduction
Presentation of Our Issue and the Focus of the Research

Chapter 2 Methodology
The Work Securing the Quality of the Thesis

Chapter 3 Accounting for tangible / intangible assets
Establishing the Framework for Accounting for Goodwill

Chapter 4 Goodwill – a part of ”the New Economy”
Influence by External Forces on the Accounting for Goodwill

Chapter 5 The Internet sector – overview
The Selected IT Companies in focus

Chapter 6 Company close-up
HiQ and TietoEnator

Chapter 7 Analysis

Chapter 8 Conclusions and Reflections

2. METHODOLOGY

In this chapter we present the way we have chosen to secure the information collected and analysed.

Importance of Methodology

Various methodological approaches can be used when conducting research. The main purpose for this is to legitimate the information used and to ensure the accuracy of sources. The chosen research approach will be presented, as well as the scientific approach and the research design. Also, we will present the data collection process and also discuss the quality of our research, and how we work to present the data as precise as possible.

We acknowledge that when conducting research activities, it is of outermost importance to see to that methodological issues are ensured. It is also important, therefore, to combine the main issue of the thesis with this.

2.1 Research Approach

The choice of research approach depends heavily on the degree of precision on which the original research question can be formulated, and how much knowledge that exists in the area of the chosen subject. One way of discussing the research approaches is to use Patel & Davidsson (1994) that state 3 characteristics:

- (1) Exploratory
- (2) Descriptive
- (3) Hypothesis testing

Exploratory

When information is insufficient, the study becomes exploratory. The main purpose with exploratory studies is to collect as much knowledge about a certain problem area as possible. This designates that the problem is analysed from a number of different points of view. This type of study often provides a basis for further research.

Descriptive

In a descriptive study, only the essential aspects of the phenomenon are looked upon. The descriptions of these aspects are detailed and fundamental.

Hypothesis testing

This method is used where information is extensive enough to form new theories. The researcher collects and makes hypotheses that will be tested in the empirical world and which will result in acceptance or rejection.

Chosen approach

The main issue for our thesis work was presented in chapter one. As explained, we aim to study whether traditional accounting seems to be applicable to companies that take part in “the New Economy” and are growing mainly through acquisitions. Huge goodwill items were created in many Swedish IT companies during the end of the 1990s. We will explore and describe how 29 companies in this sector handled goodwill in their annual reports covering year 2000.

In order to be able to describe our findings in the Annual Reports in a way as correct as possible, we find it important to present facts that give the frames of reference to the reality in which the Swedish IT companies act. In that way, we may also be able to try to describe not only how goodwill was accounted for in the annual reports of the 29 companies, but also why it was handled in a specific way in accordance to certain given conditions. These companies are dependent on environmental factors like accounting regulations, international influences and

interests from different groups of stakeholders. We find it important to describe the interaction between the different parties involved in the course of events surrounding the Swedish Internet companies as a background to our issue.

In order to understand how the Swedish Internet companies use and discuss accounting for goodwill, we have conducted an exploratory research of the Annual Reports as well as literature covering the fields of accounting regulations dealing with intangibles, specifically in goodwill. In connection we have explored literature on the harmonisation process.

Since the topic of our thesis needs to be looked upon from different perspectives, both the exploratory and the descriptive approach is suitable and chosen for our study.

2.2 *Positivistic and Hermeneutic Perspective*

”Today we have two main scientific directions; the positivistic and the hermeneutic perspective. The former is based on the idea on knowledge as ideal, and the other is related knowledge”¹⁴

The differences are visualised below¹⁵:

	Positivistic	Hermeneutic
Scientific ideal	Testing Observing	Interpreting
	Objecifying	Subjectifying
	Neutral of value	Neutral of value
Vision of reality	Mecanisms of systems	Objectives on life
	Laws of causal connection	Explanations of causal connection
		Legitimations

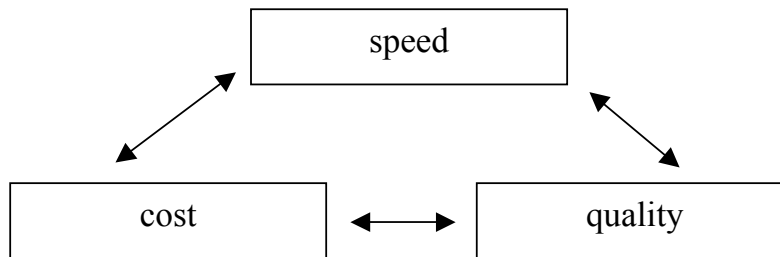
¹⁴ Eriksson, Widersheim-Paul, 1998, p 201

¹⁵ Ibid, 1998, p 233

2.3 Quantitative or Qualitative

When doing scientific research one can choose between two types of data when collecting information. One way is to choose quantitative (often called hard information) like earnings in dollars, number of sold units and so on. The other, qualitative data can be exemplified with soft data like function, or how a service unit is valued by customers. A lot of data lies somewhere in between these two, like measuring pollution in a lake; one is units of poisoning in water, and the other its effect on life around the lake.

Furthermore, when collecting data the researcher has to weigh between three variables:



Source: Eriksson, Widersheim-Paul, s 65

The double arrows between the variables indicate that a researcher must always weigh in, that in research, quality often brings higher costs, and a fast investigation can bring down quality.

When collecting data, we have tried to collect the best data available, considering the three variables. Should we have had unlimited cash and time, the research could have been done in another way, but our work has been conducted with point of reference to the actual conditions.

2.4 Research Design

We will present the three main ways to form a theory. Kam (1990) discusses two of these, the inductive and the deductive approach. The deductive approach can be described as when a theory concerning the chosen subject exists and a hypothesis is formed from this former theory. The research examines whether the existing theories are combined with reality by making observations to these existing theories. The opposite is the inductive approach where the research follows earlier explorations. The researcher is primarily conducting observations in the reality. From this a conclusion is drawn, and a theory is formulated. Also the abductive approach is presented by Alvesson & Sköldberg (1994) where the researcher uses a combination of the above approaches and from this creates an analysis of the empirical findings, together with previous theories.

On the subject we have chosen, we have found no other research, as far as the IT sector year 2000. One explanation is that the chosen information is rather new. Concerning the regulations we have used the information that comes from regulators and voices from the debate around the issue. An established practice among auditors and business administration in the chosen companies are present. We have chosen not to examine a theory since we want to visualise our problem rather than prove a point. We want to show an overall picture of our problem.

2.5 Data Collection

Collecting data for the thesis is of outermost importance to the relevance of the outcome of the problem solving. Eriksson and Wiedersheim (1997) guide on methods to conduct this important task. The chosen alternative depends on which method that produces the best answers relevant to our problem. In our thesis, a blend of primary data and secondary data have proved to be the best.

Primary data is information that is collected for the first time. It can be collected by two methods; experimental or non-experimental research. The advantage with

primary data is that it can be adapted for the purpose of the specific theme. The disadvantage is that it can be costly to collect.

Secondary data is information that exists already, like statistics, literature, material of law and electronic sources which all contribute to form a wider perspective and are of course essential for this thesis. The purpose of this cannot exactly match the "new" research. This kind of information can be divided into internal or external data. Internal data can be data collected within a company, and external data can for example be books or articles that are available for the public¹⁶.

We started with gathering the Annual Reports from the Affärsvärlden Index for Internet consultants and looking into them. We also searched for literature and articles on the Internet and in the library at Handelshögskolan. Also, reading business magazines daily gave us fresh information on how our problem was handled during the time we conducted the research. Also, contact with an auditor has led to data and material relevant to the subject.

We also searched for material concerning the rules and regulations concerning intangibles, which includes the core of our work, purchased goodwill.

With the ambition to provide a deeper insight into how the accounting issues concerning purchased goodwill were discussed inside a number of the IT companies in our selection, we aimed to conduct a small number of case studies. After studying how the companies had discussed goodwill in their annual reports concerning year 2000 and after literature studies connected to this ("Tendenser I börsbolagens årsredovisningar 2000") we became interested in some companies, that seemed to discuss goodwill in a more extensive way than the average company did.

One of these was Turnit that provided a more thorough discussion concerning its thoughts around goodwill. We tried several times both by mail and phone to be

¹⁶ Kinnear & Taylor, 1996, p 139

able to meet the CFO for an interview, but unfortunately the CFO considered herself too busy.

WM-data was another company that was subject to our interest for an interview. The ground for our interest in WM-data was again the fact that the company had rather comprehensive thoughts disclosed around the goodwill issue. Unfortunately to us WM-data has just appointed a new CFO, who did not participate in the work with annual report concerning year 2000. Due to that he claimed that he could not assist us in our thesis work.

We had better success in our efforts to meet the CFO at HiQ, which is another company with more profound discussions in its disclosure concerning goodwill. We had the opportunity to conduct an interview in Stockholm with Anna Jennehov, the CFO. The result from this is presented in chapter six.

We contacted TietoEnator, which we found interesting as an opposite pole to HiQ. TietoEnator is a considerably bigger company in terms of turnover, more international and with a more intense acquisitive strategy. We were successful in getting contact with Ms Lemström at Shareholders' and Public Reporting at the Finnish head office. We conducted an interview over e-mail, since we did not have the possibility to go to Finland. TietoEnator is listed both in Stockholm and in Finland. We are aware of the fact that the head office follow Finnish regulations concerning goodwill accounting, which we point out further in our thesis.

In chapter six we describe the results from our the interviews with HiQ and TietoEnator and the facts that affected our efforts to conduct interviews with other companies. We are convinced that the current negative market situation and the difficult financial positions for most IT companies in Sweden have had a major impact on the willingness to discuss perhaps controversial issues regarding accounting for goodwill.

The most common mistake when conducting interviews is that the purpose is not

clearly stated to the respondent. This can cause an uncertainty in the data collected and lowers the legitimacy of the outcome. We have prepared for the interview by talking to the respondents beforehand and explaining both purpose and subject of our thesis to them.

2.6 Quality of Research

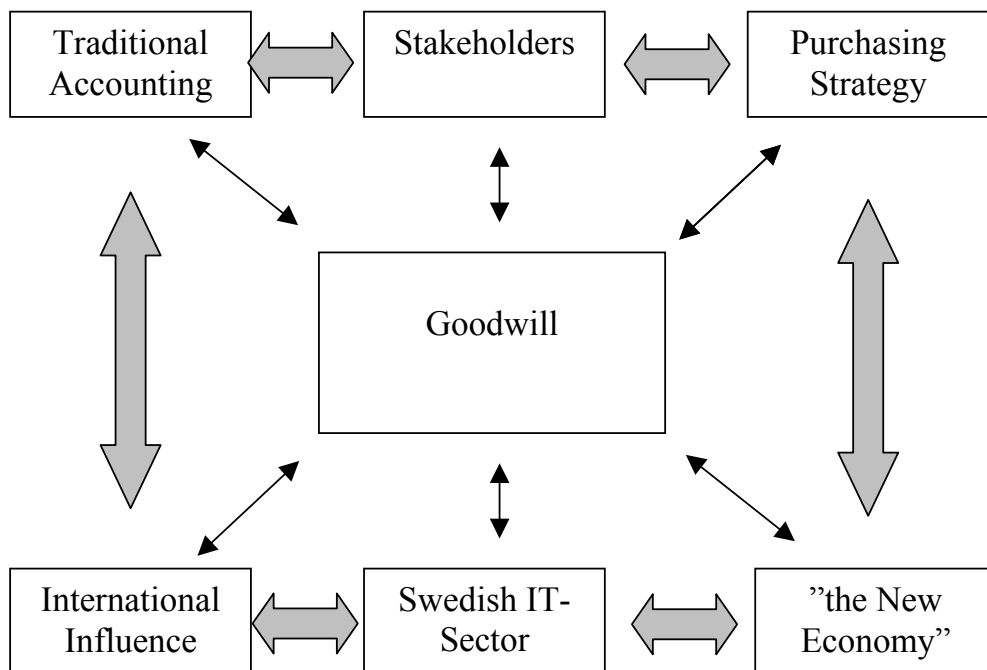
When the scientific value of a reports is discussed, the concepts of validity and reliability are frequently used. Validity is defined as the absence of systematic errors of measurement. Validity is divided into two sub-groups; internal and external validity. Internal validity handles the question whether the authors in the research measure what is supposed to be measured. External validity on the other hand regulates the relationship between what was measured and the reality. Reliability is defined as the absence of random errors in the research. A research with high reliability is not affected by the person conducting the measuring. That is, the individuals that conduct the research do not affect the outcome.

In our research, we have used sources that as far as we know, are reliable. Articles, books and other sources of information are questioned and valued from our knowledge base concerning who wrote it, the purpose forwriting it and to whom it was written to. The respondents from the selected companies have of course answered with politically correct answers, and we are aware of this fact. The external voice might not be the one that works internally, but this fact is known to us. The answers by the respondents are weighed together with our knowledge of the company and our ambition has been to handle the information from an objective standpoint. Naturally, our ambition throughout the work with this thesis has been to handle all information with objectivity.

Planning the thesis:

When looking into this subject, we have chosen to discuss the topic all through the work. This is to show different angles on a subject. Some may argue that we should have put all data on for example goodwill in one chapter but then we would have lost the peripheral picture we want to show.

Our figure aims to illustrate how we consider different concepts and forces to have an impact on goodwill on their own, as well as interact with other factors. This is why we have chosen to describe goodwill from different perspectives through this thesis.



3. Rules and Regulation on Intangible Assets

In this chapter we establish the framework for how the regulation handles goodwill, which is an intangible asset, and how the different power bodies decide, interact and react.

3.1 Goodwill and Accounting Regulations.

3.1.1 Introduction

Accounting for intangibles has been a question of growing importance. There are several factors behind this development: the increase of international mergers and acquisitions, the speed of technological change, the impact of Information Technology, the major expansion of the service sector and a tremendous growth of the international financial markets. Consequently of this, questions about how companies should account for intangibles like goodwill have raised interest in many countries. The interest of accounting regulations in this area is international and issues should therefore not be solved entirely on a national basis.¹⁷ In spite of this, regulations dealing with accounting for goodwill have been an area where international differences are notable. According to recent changes in regulations dealing with goodwill and other intangibles, differences between FASB (Financial Accounting Standards Board) in USA and recommendations issued by IASB (International Accounting Standards Board, and formerly known as IASC) will even widen the gap between the two frames of regulations. We will discuss this topic more thoroughly further on in this chapter.

A useful background to a discussion about different methods of accounting for goodwill may be given by a brief look at the conceptual issues underlying financial statements. The aim of financial statements is to provide a wide range

¹⁷ Radebaugh and Gray, 1997

of stakeholders information that is useful for decision-making and to hold management accountable for the company's resources. The information given must be relevant, reliable, comparable and understandable. Recognition is a central concept dealing with the reporting of assets in the balance sheet. To fulfil this, expectations of future economic benefits as well as a reliable measurement of the assets are required. In connection with this it is important to judge the uncertainty of future economic outcome with prudence. "The purpose of the balance sheet is to provide an indication of the financial strength of a company in a way that should help users to judge the ability of the company to meet its obligations."¹⁸ By this follows the central question whether the balance sheet should reflect the purchase cost of an asset, its value in economic terms, or both. From the perspective of the stock market research indicates the fact that all publicly available information very fast have reflections in share prices. Research indicates that what really has an impact on share prices is not the actual accounting methods chosen for the treatment of intangibles, but the disclosure about the intangibles and how they have been accounted for. Full disclosure of relevant information about the nature and the treatment of the intangible assets is important. Disclosure in this area should include qualitative information and quantitative non-financial information.¹⁹

3.1.2 Goodwill – the Concept.

We have decided to discuss purchased goodwill, that is goodwill which may arise in connection to an acquisition or merger, depending on which method of accounting that is used. Goodwill that is created within a company (sv: upparbetad goodwill) does not appear in the companies accounting unless a transaction like an acquisition or merger takes place. When discussing goodwill in connection to the Swedish IT-sector further on in our thesis, our focus consequently is on purchased goodwill.

¹⁸Radebaugh and Gray, 1997, p 269

¹⁹ Ibid., 1997, p 270-271

There are several ways to explain what goodwill is. Goodwill is a residual that might appear when using acquisition accounting. Technically goodwill is the difference between the price for the acquired shares in a company and the value of the identifiable assets and liabilities.

Put in another way goodwill can be referred to as the excess of the purchase price for a company over the fair value of the net assets acquired by the buying one. Goodwill in this situation is often referred to as purchased goodwill. Goodwill can only arise in situations where purchase accounting is applied. Goodwill can also be explained as “a premium paid to reflect the future earning capacity of the acquisition”.²⁰

Considering the pooling-of-interest method goodwill is of no matter, since the nominal value of the shares issued and not the market value is recognised.

A third way to account for a merger is to use the equity method, which may be used in case of consolidation of associated companies.

Situations may occur when goodwill is negative, that is when the purchase price is less than the fair value of the assets acquired.

3.1.3 Goodwill - Accounting Methods

There are several methods used internationally for the accounting of goodwill, but three main approaches can be crystallised:²¹

1. Immediate write-off of the cost of goodwill against shareholders' equity. Proponents of this method base their viewpoint on thoughts that purchased goodwill is not an asset for the aim of financial statements. Further, they mean that it is not possible to separate goodwill from the valuation of a business as a whole. Another argument used is that goodwill is not used up like other productive resources. Another factor pointed out

²⁰ Radebaugh and Gray, 1997, p 271

²¹ Ibid, pp 272-274

is that the true value of goodwill is not corresponding to the price paid on the acquisition date. Instead the true value will be influenced by economic factors and by changed perception from investors. This method of accounting for goodwill is allowed in countries like Germany, Switzerland, the United Kingdom and within the European Union.

2. Capitalise goodwill as an asset with systematic amortisation. The advocates of this method suggest that goodwill is an asset representing the value of economic benefits in the future. Since the value of goodwill will be used up in the same way as other resources in a company, it should be amortised systematically against earnings. Otherwise the future earnings would be overstated and misleading because it would be a mistake to include all costs caused to generate those earnings. The time period for systematic amortisation of goodwill differs in a striking way between countries. The time span embraces maximum periods from five (Japan) to forty years (the United States and Canada for example). In Sweden the maximum period is twenty years. Most countries specify that the time period for amortisation should be based on the concept of useful economic life without giving notice of a specific maximum time period.

3. Capitalise goodwill as an asset without amortisation. The arguments for using this procedure are based on the opinion that goodwill should be capitalised because of the expected future economic benefits that has been given valuable consideration. When a business is successful the value of goodwill is maintained and amortisation is therefore not motivated. This method of accounting for goodwill is permitted only in a few countries, for example in Switzerland.

3.1.4 An International Outlook

3.1.4.1 The U.S.A – FASB

The two methods of accounting for business combinations, Purchase Method and Pooling of Interest have been generally accepted in practice since 1945.

According to the American standard purchased goodwill shall be capitalised as an asset with amortisation. Goodwill is allowed to be amortised over an extended period that must not exceed forty years, which in comparison with most other countries is very liberal. In practice, an amortisation period between five and ten years is most common. Large companies making important acquisitions often use up to forty years.²²

Immense changes in the regulations concerning the accounting for goodwill and other intangibles issued by FASB (Financial Accounting Standards Board) are taking place. FASB is the American body corresponding to the Swedish body Redovisningsrådet. FASB has recently published two new standards, FAS 141 and FAS 142. There has been an intense debate in the USA about these changes, since they will drastically change the regulations concerning how to account for goodwill.

FAS 141 - Business Combinations, which will replace APB 16.

This standard appoints for a compulsory application of the purchase method when a merger has taken place. This means that the pooling of interests method therefore no longer is applicable. The pooling of interest method has been widely used by companies growing by acquisitions in USA. This has been the case for a number of companies in the new economy, where most of the assets cannot be attributed to hard assets.²³ The well-known Internet equipment maker Cisco has frequently used this accounting model rather than purchase accounting, since

²² Radebaugh and Gray, 1997, p 273

²³ Powell, 2001, www.eLibrary.com

pooling does not require the buyer to record goodwill.²⁴ The new standard, FAS 141, will come into force for mergers that take place after June 30 2001, or later.²⁵

FAS 142 – Goodwill and Other Intangible Assets, Replacing APB 17.

According to FAS 142, goodwill and some other intangible assets will be considered to have a constant economic life in contrast to APB 17, according to which intangible assets are supposed to have a limited economic life. At every reporting occasion companies are obliged to test whether the intangible assets still are considered to have a constant economic life. In case of establishing the fact that one intangible is considered not to have a constant economic life any more, amortisation should be carried out for the rest of its useful life. Furthermore, the possible need of a write-down should be tested on a yearly basis or more often in case of an indication of a write-down requirement.²⁶ The evaluation of goodwill established at the date for acquisition should be allocated to distinct “Reporting Units”. In this connection a “Reporting Unit” may be a company, a line of business or a department. This new standard will come into force 1 January 2002, but is already applicable for goodwill acquired from June 30. 2001.²⁷ One effect of FAS 142 may be that there will be larger fluctuations in a company’s net profit for a year since the write-down requirement will occur irregular and with varying amounts.

3.1.4.2 Goodwill Accounting According to IASB (former IASC).

IAS 22.

A restructuring of IASC (International Accounting Standards Committee) has resulted in the creation of IASB (International Accounting Standards Board). IASB is an independent accounting standard-setter based in London. The Board

²⁴ Kahn, 2001-09-07., www.eLibrary.com

²⁵ FAR INFO 12/2001, p 5

²⁶ Rankin Johansson, pp 14-18

²⁷ FAR INFO 12/2001, p 5

Members originate from nine countries and co-operate with national accounting standard setters. The aim of IASB is to develop global accounting standards of high quality around the world.²⁸

IAS 22 (International Accounting Standard 22) Business Combinations became effective for annual financial statements for periods beginning on or after 1 January 1995. In 1998 the IAS 22 was revised and this new version became operative for annual financial statements covering periods on or after 1 July 1999.

The essence of IAS 22 may be summed up in the following way:

An acquisition is defined as a business combination in which one of the enterprises obtains control over the net assets and operations of another enterprise in exchange for the transfer of assets, incurrence of a liability or issue of equity. The acquired assets and liabilities should be included in the consolidated financial statements at fair value. The difference between the cost of the purchase and the fair value of the net assets is recognised as goodwill.

The most important change in the revised IAS 22 is the fact that the absolute maximum useful life of goodwill, 20 years, can be exceeded in rare cases.²⁹ This may be used when there is persuasive evidence that the useful life of goodwill will be a specific period longer than twenty years. According to the amortisation requirements in IAS 38, Intangible Assets, an enterprise should amortise the goodwill over its estimated useful life. If there is persuasive evidence that the useful life will exceed twenty years the enterprise should amortise the goodwill over its estimated useful life.

The goodwill value should be tested for impairment on an annual basis in accordance with IAS 36, Impairment of Assets. IAS 22 applies for disclosure of the factors that are of significant importance in determining the useful life of

²⁸ www.iasb.org 2001-10-26.

²⁹ Rundfelt, 1998, p 241

goodwill. An enterprise is not permitted to assign an infinite useful life of goodwill.

IAS 38, Intangible Assets.

IAS 38 came in force for annual financial statements covering periods beginning on or after 1 July 1999. This standard deals with the whole spectrum of intangible assets. In the case of a business combination, that is considered to be an acquisition, IAS 38 builds on IAS 22. The reason for this is “to emphasise that if an intangible asset does not meet both the definition and the criteria for the recognition for an intangible asset, the expenditure for this item (included in the cost of acquisition) is to be defined as goodwill rather than an intangible asset”

³⁰

³⁰ www.iasb.com, 2001-10-27

The requirements for amortisation of goodwill in IAS 22 are consistent of those of IAS 38 .

3.1.5 Differences between FASB Regulations and IASB Regulations.

FAS 142's new attempt meaning that an acquired unit should be considered as an integrated part of the new group lacks equivalence according to IASB's standards. Due to IASB's standards there is no possibility to allocate goodwill to Reporting Units attributed to the acquiring party.³¹

In accordance with IAS 38 the opinion of IASB is that all intangible assets, including goodwill, have limited economic life. As mentioned above, FAS 142 identifies some kinds of intangibles to have a limited economic life and some, like goodwill, to have a constant economic life.³²

FAS 142 does not require a permanent decrease of value to demand a write-down of goodwill or of some other intangible assets. The new regulation is definitely much more severe than the old one. It is enough that a diminution of value is established to force a company to write down the intangible in question. This is a consequence of the new rule meaning that some intangibles have a constant economic life. It should be pointed out that according to FASB there is no requirement for the diminution of value to be permanent. As soon as a depreciation is a fact, a write-down must be done. This is not the fact according to IASB, which requires a permanent decrease in value.³³

3.1.6 The European Union (EU) - The Seventh Council Directive on Consolidated Accounts.

³¹ Rankin Johansson, 2001, pp 14-18

³² Ibid.

³³ Ibid.

The European Union, EU, plays a central role in the international work dealing with standard setting in the field of financial accounting. One important aim with the standard setting work within EU is to bring the accounting standards of different European countries to reach harmonisation and to be standardised, meaning that all member states within EU share identical accounting standards. The aim with this is to bring the nations closer to the idea of one market within the EU.

The Seventh Council Directive on consolidated accounts (83/349/EEC of 13 June 1983) is implemented in the national laws of all EC member countries as a part of the harmonisation process of accounting in Europe. The Seventh Directive is an extension of the Fourth Council Directive (July 1978), which deals with the accounts of single companies. The Seventh Directive extends the requirements of the Fourth Directive by giving the regulations on consolidated accounts of groups. The Seventh Directive is considered to be a compromise between the practices used in the different member countries, since the variety of methods in use was very broad in several countries. Concerning the question of goodwill, the Seventh Directive permits three alternative methods: Immediate write-off against reserves, capitalisation and subsequent write-off over up to five years, or capitalisation and write-off over a period longer than five years but not exceeding economic life (Fourth Directive, Article 37). Member states are allowed to choose one or more of these alternatives in their national legislation.³⁴

A general accepted accounting standard is to account for goodwill as an asset. Still, regulations set by EU permits goodwill to be directly written down against shareholder's equity. The time period used for depreciation of goodwill is an area where disparity is more obvious. In Great Britain and in France there is a general acceptance of depreciation over a time period beyond twenty years. British and French companies also have a possibility to choose not to depreciate. This is the case when a company can prove that the actual value of goodwill exceeds the book value.³⁵

³⁴ Thorell and Whittington, 1994, pp 215-239

³⁵ Rundfelt, 2000, p 125

3.1.7 Sweden

3.1.7.1 A Retrospect of Swedish Regulation.

The first explicit regulation of how to account for goodwill appeared in the Companies Act of 1944 (1944 års Aktieförlagslag). In the mid 1970's the legislation was transferred to the Accounting Act (Bokföringslag 1976). In this way the legislation should be applicable not only to limited companies. At the same time the possibility to amortise goodwill over a time period longer than ten years was stopped. Earlier the regulation had permitted a longer period of amortisation in case of specific circumstances. Simultaneously, FAR (Swedish Institute of Authorised Public Accountants) recommended that a goodwill value recorded in the consolidated balance sheet should be amortised according to common grounds, that otherwise are applicable for amortisation of goodwill. The amortisation should charge the consolidated income statement. ("avskrivnas enligt de grunder, som eljest gäller för avskrivning av goodwill och avskrivningen belasta koncernens rörelseresultat.").³⁶

The regulation regarding a maximum time period of amortisation of ten years was in practice often neglected by Swedish companies. FAR's Accounting Committee recommended in 1987 that goodwill on consolidation may be amortised for a longer period than ten years in special cases. In 1991 Redovisningsrådet, RR, (the Swedish Financial Accounting Standards Council) published a new recommendation applying for accounting of goodwill on consolidation as an asset. The amortisation period was limited to ten years with a possibility of extension to an absolute maximum of twenty years.

³⁶ Nilsson, 1998, p 5-6

3.1.7.2 *The Current Legal Situation in Sweden.*

Årsredovisningslagen (1995:1554) (ÅRL)

In accordance with chapter 4, section 2 of Årsredovisningslagen (The Accounting Act) purchased goodwill may be accounted for as an intangible asset. Section 4, chapter 4 deals with rules concerning amortisation of fixed assets. The amortisation period for fixed assets is stated to be five years, but a longer amortisation period is allowed when economic life is indicated and made probable to be more than five years.

Section 5, chapter 4 in ÅRL deals with rules concerning write-down of fixed assets including goodwill. It is stated that a write-down is allowed when the diminution of value is established to be permanent.

Chapter 7 deals with regulations concerning group accounts. Section 22, Chapter 7 points out the treatment of purchased goodwill and refers to the sections of chapter 5 described above.³⁷

The Swedish Accounting Regulations for goodwill are set in compliance with IASB. The Swedish standard setter is *Redovisningsrådet* (The Swedish Financial Accounting Standards Council) (RR). During 1999 Redovisningsrådet (The Swedish Financial Accounting standards Council) started working on a renewal of the paragraph RR 1:96, dealing with consolidation principles. One of the topics concerned the amortisation period of goodwill. According to RR 1: 96 the main rule about the maximum depreciation period for goodwill was 20 years. The model for the Swedish regulations, IAS 22, allows an extension of that time limit only in extraordinary cases. According to the regulations in force in Sweden today, the maximum period for amortisation of goodwill is twenty years. A renewal of Standard RR 1.00 will be adopted in Sweden and applicable to financial years starting from 1 January 2002 .

³⁷ FARs Samlingsvolym 2001

One main difference between RR1:96 and RR1.00 is that the reversed recommendation comments on intangible assets in wide and not only on trade marks as in RR 1:96.³⁸

According to the new recommendation from Redovisningsrådet the maximum amortisation period is 20 years. Provided that the time of use can be shown to be longer than 20 years there is a possibility in exceptional cases for a lengthening of the amortisation period. In cases where the goodwill item is clearly connected to an identifiable asset or group of assets with a time of use exceeding twenty years it may be reasonable to suppose that it will provide for financial benefits to the acquirer for a time period longer than twenty years. However, there are no examples of this given in the recommendation. The amortisation period for goodwill must be considered to have a large impact on the net profit / loss on a yearly basis for many companies. A maximum amortisation period of twenty or forty years, which so far is possible for example in the United States, can dramatically influence the level of a company's net profit.

According to RR 17, Write-downs, an asset should be written down when the recovery value (sw: återvinningsvärde) is below the book value. Recovery value refers to the highest of the net realisable value and value of use (sw: nyttjandevärde). This recommendation is also applicable to intangible assets.

³⁸ Rundfelt, 2000, p 123

3.2 Accounting Concepts

As well as laws and regulation, accounting is ruled by some concepts which are legislated but subject to personal translation by the users. This translation is regulated amongst the accountants around the world through their trade committees.

3.2.1 True and Fair View

The concept of true and fair view has its origin in the Anglo-Saxon tradition. It provides companies an option to interpret or relinquish laws and recommendations that are considered to be too formal and old-fashioned. The main purpose with this principle is to keep accounting theory up-to-date.

The True and Fair View was introduced in Sweden through the Swedish Annual Accounts Act which was enforced in 1996. According to this, the companies shall give a true and fair view of its financial health and its yearly earnings.

Swedish policymakers have accepted the true and fair view as they continuously work to adapt to the standards of the European Union. In the EU fourth company amendment, this principle is accepted and decided upon.

The prudence principle, which sometimes can be in conflict with the true and fair view, is an integrated part in Swedish regulation. This concept sometimes brings extensive supplements which can be included in the Annual Report.

The practice is that Swedish policy makers interpret the "true and fair view" as meaning compliance with existing laws.³⁹

³⁹ Dahlin, 1998, p 162

3.2.2 The Prudence Concept

This concept can shortly be explained⁴⁰ as the concept of making provision for all actual and probable liabilities only including assets as incoming resources when they are definitely realisable.

Revenue and profits are not anticipated but are recognised by inclusion in the profit and loss account only when realised in the form of cash or other assets where cash realisation can be expressed with reasonable certainty. Provision is made for all known liabilities (expenses and losses) whether the amount is known with reasonable certainty or is a best estimate in the light of the information available.

3.3 Intangible Assets

3.3.1 Identification of Intangibles

In order to identify and describe the specific nature of an intangible asset, it may be helpful to understand what an intangible asset is not. The distinction between a tangible asset and an intangible may clarify what an intangible asset is. The essential difference between tangible and intangible assets are⁴¹:

1. The value of a tangible asset is created by its tangible nature.
2. The value of an intangible asset is created by its intangible nature.

The visual and corporeal elements of a tangible asset give it its value together with the flows from its physical features. This means that a tangible asset should have physical existence and substantial form, it should be capable of being seen and touched. A tangible asset should be perceptible to the touch.

⁴⁰ www.asb.org , 2001-10-12

⁴¹ Reilly and Schweihs, 1999, p 383

One of the conditions for the existence of an intangible asset is a tangible proof of the intangible. These evidence of the existence of an intangible asset may for example be in the form of documentation, diskettes, files, forms and agreements. These tangible proofs prove the existence of the intangible asset and is of great importance for the creation of the value of the intangible asset. Without without the tangible manifestation, the existence of the intangible asset is not proven.

The value of an intangible asset can be visualised in parts:

1. arises from the property rights linked to the ownership of the intangible asset.
2. the value originates from intangible factors such as rarity, competitive edge, high profitability, great market share, and a long life.

3.3.2 Coexistence between Tangible/Intangible

The relationship between tangible and intangible assets is not seldom rather tight. There is often the requirement of tangible assets in order to completely realise the value of an intangible asset. One illustration of this is the need of computer hardware (tangible asset) for exploiting *the positive attributes* of computer software (intangible asset) in an effective way.

Often tangible assets are like machinery, equipment and monetary assets necessary to commercialise intangible assets like goodwill, trademarks, patents and so forth. However, it is of great importance to note that intangible assets do represent a value of their own. The owner of an intangible asset does not necessarily have to own the tangible asset that is used to exploit the value of a specific intangible. The owner of an intangible asset can realise the value of the intangible asset by using tangible assets without actually owning the tangible assets. Through the combination of tangible assets and intangible assets, the owner of the tangible asset has a possibility to create a value of new intangible assets such as customer relations, brand value and goodwill. An important point in the discussion about the nature of intangible assets is that intangible assets have an individual value separate and distinct from tangible assets.

3.3.4 Common Categories of Intangible Assets

Individual intangible assets are generally categorised by economists and appraisers into distinct groups. The purpose of this is for general asset identification and classification. The categorisation is often done into groups of intangible assets with similar valuation methods. Goodwill-related intangible assets can describe one category including for example institutional goodwill, professional practice goodwill, personal goodwill of a professional and general business going-concern value.

It is worth noticing that one individual intangible asset can be included into more than one category depending on the views of the specific analyst. One analyst may for example classify the employment agreement of an executive as a contract-related intangible asset, while another analyst prefers to refer to the group comprehending human capital-related intangible assets. It is worth noticing that the classification of different intangible assets does not affect the answers to crucial questions like: What is the value of a specific intangible asset? What is the expected remaining useful life? These questions must be considered closely connected to our research work about the valuation of goodwill in the IT-business.

3.4 The Annual Report

3.4.1 The Company Annual Report

The Annual Report has a long history. The present way to produce the report is annually, showing numbers from January to December (another, so called split financial year exist, and is used among some companies). This is to enhance the comparability of the report, to make it easier for the readers and the analysts, to state ground for taxation and so on.

The Annual Report is a package of statements presented in narrative form, as well as numerical, in content. It tells shareholders and other interested parties

what has been happening during the last 12 months, or since the last report was presented. The three main accounting statements are the balance sheet (presenting the year-end position of the company), the profit and loss account (showing if the company has been successful or not in the sense of creating wealth for the shareholders), and the cash flow statement (showing the flow of the liquidity position for the year). In Sweden an additional director's report is compulsory (förvaltningsberättelsen). The Annual Report is form bound through legislation and through practice. Most companies include in the "package" a free presentation of the company and its goals etc.

3.4.2 Purpose of Accounts

Around the world, different rules have had different purposes. The world is in a harmonization process concerning accounting, and Sweden have had influences from all parts of the world, and so our accounting tradition is a mix many of them.

3.4.2 Information aimed at certain readers

The information given from different companies are often aimed at a certain reader. It may be investors, banks, shareholders, auditors and other parties. It is important to know this when reading financial reports critically. This was discussed in the two reports that we will view shortly below:

The Trueblood Report was issued in the USA in 1973. The legitimacy of a financial report is that it is bound to follow rules and regulations in. The Trueblood Report was on the objectives of financial statements and identified many such objectives. Some key ones are quoted below:

”

- (1) The basic objective of financial statements is to provide information useful for making economic decisions.
- (2) An objective of financial statements is to supply information useful to investors and creditors for predicting, comparing, and evaluating

potential cash flows to them in terms of amount, timing and related uncertainty.

- (3) An objective of financial statements is to supply information useful in judging management's ability to utilize enterprise resources effectively in achieving the primary enterprise goal.⁴²

A similar document published at about the same time in the United Kingdom was "The Corporate report". This was a discussion paper published by the Accounting Standards Steering Committee in 1975. The basic approach of the document was that "corporate reports should seek to satisfy the information needs of users. These seven user groups were:

- (1) the equity investor group
- (2) the loan creditor group
- (3) the employee group
- (4) the analyst-adviser group
- (5) the business contact group
- (6) the governmental sphere
- (7) the public sector

The different groups have some equal and some different needs of information. They have also different views on facts in some cases.

⁴² The Trueblood Report, 1973

4. Goodwill - a Part of “the New Economy”

In this fourth chapter we present definitions of, and present chosen parts from the debate around goodwill. The debate also concerns the new ways to conduct business in “the new economy” which is why we also present the idea of this concept.

”If the science of accounting has a final frontier then perhaps accounting for intangible assets lies on it. The subject is a matter of great current concern and is creating an increasing tension between the standard makers and those who prepare and use accounts”⁴³

”The basic position of traditional accounting is that intangible assets have a value which appears out of the blue and is equally likely to disappear in the same way. The combination of a lack of transactional evidence for the existence of most intangibles and the volatile nature of their valuation leads this tradition to a virtual total exclusion of such assets from the accounting records. In the real commercial world, those managing large companies find that the name of their product and the reputation of their business in the market are very substantial, often dominant, factors in their ability to earn profits. To them it seems as if these assets represent such a major part of the position of the business that it is impossible to justify their omission from statements purporting to show that position”.⁴⁴

Such a tension must eventually lead to a resolution of some kind. On the one hand, the present view of the standard maker might prevail. If so the business and investment world will see traditional company reports as being increasingly irrelevant to their decision-making processes. On the other hand, the business view will prevail and some method will be found to report the ethereal as well as the corporation dimension of the business’s position. No such solution is likely

⁴³ Brockington, 1996, p 5

⁴⁴ Ibid.

to be fully satisfactory unless it meets the legitimate concerns represented by both points of view.”⁴⁵

4.1. Interpretations of Goodwill

“ I can’t define it, but I know it when I see it.”⁴⁶

The quotation above said by U.S. Supreme Court Justice William J Brenner may be used when it comes to defining what goodwill really is.

The identification and quantification of goodwill intangibles are important issues of any valuation of a business when using an asset-based valuation approach. The definition of what goodwill is differs from analyst to analyst and therefore there is no universally accepted definition of goodwill.

The different interpretations of goodwill may be divided into two main groups, namely accounting interpretations and economics interpretations. Both groups generally agree on the factors that create goodwill and the types of situations when goodwill arises.

To the accountants, the value of goodwill often represents the total value of the business enterprise, which in an acquisition transaction is represented by the actual purchase price for the business, less the fair market value of the business tangible real property and tangible personal property.

Goodwill that a business enterprise develops is seldom recorded on the financial statements of the business. Purchased goodwill is recorded by the corporate acquirer after the acquisition of a business. This is only the case when the acquisition qualifies under the purchase accounting rules (compared to the pooling of interest accounting rules).

⁴⁵ Brockington, 1996

⁴⁶ Reilly and Schweihs, 1999

Economists on the other hand define the intangible asset goodwill as the capitalisation of all of the economic income from a business enterprise that cannot be associated with any other asset, tangible or intangible, of the business. In most situations of evaluation of goodwill concepts from both the accountants and the economists point of view are included.⁴⁷

4.1.2 Components of Goodwill

Three principal components of goodwill can be recognised. The components can be considered as the aspects that cause goodwill or the rationale behind the existence of goodwill in certain situations:

1. Going-Concern Value Element of Goodwill:

This component includes the existence of assets in place and ready to use. Value is created through the fact that all elements of a business enterprise are physically and functionally assembled. Elements referred to are capital, equipment, employees and management. A well functioning organisation of the elements create value and some of that value can generate a goodwill intangible.

2. Subsistence of a surplus of economic income. “The excess economic component relates directly to the concept of goodwill as the value of a business (or other economic unit) that cannot be assigned to any of the other tangible assets or identified intangible assets of the business.”⁴⁸

3. The expectations of future events that are not directly related to the activities in the business in the current situation. Examples of this component are the expectations from investors regarding future mergers and acquisitions, future products or services, future clients or customers and so forth. The component of expectations is directly connected to the concept of goodwill, which here may reflect the current value of future assets that are not yet in existence on the day of

⁴⁷ Reilly and Schweihs, 1999, p 383

⁴⁸ Ibid.

valuation. “Investors (and owners) assign a goodwill value to a business if they expect net present value of the income associated with the future events to be positive.”⁴⁹

4.1.3 Different Sets of Goodwill

Different sets of circumstances may have an impact on the identification and the ownership of goodwill.

1. Institutional goodwill relates to the goodwill of an industrial or commercial business enterprise. The goodwill is in this case considered to be a result from the collective operations of the enterprise.

2. Professional practice goodwill, which relates to goodwill in a professional practice, for example in consulting firms. The professional practice goodwill can be divided into the practitioner component and the business component. The first component is the goodwill created by the skills and the name of the individual human professional in the specific business area, for example a lawyer or a CPA. The business component on the other hand can be illustrated by goodwill created by the reputation, the longevity, assembled assets and so forth of the institutional practice. It is important to notice that the identification into different categories depending on different circumstances in which the goodwill comes into existence should not have an influence on the valuation of goodwill.⁵⁰

4.1.4 Valuation Methods for Goodwill

Cost approach, market approach and income approach are all relevant methods for valuation and economic analysing of goodwill intangibles. The most commonly used are the income approach methods, while market approach methods are not used that frequent. Least commonly used are the cost approach methods.

⁴⁹ Reilly and Schweih, 1999

⁵⁰ Ibid., 1999, page 382

Three regularly used income approach methods are:

1. Residual from business enterprise value method.

The residual from business enterprise value method values goodwill in the following way: Overall business enterprise value less the value of financial assets less the value of tangible assets and less the value of identified intangible assets, equals the intangible value in the nature of goodwill. More than one method regarding valuation of going concern business entities are often used to develop supporting confirmation to the valuation concluded. Another often used method within the first group is the discounted cash flow method. This method is founded on the condition of the fact that the value of the business enterprise is the present value of the future economic income to be derived by the stakeholders of the business.⁵¹

2. Capitalised excess economic income method. The capitalised excess economic income method involves the quantification and capitalisation of any excess economic income earned. The technique is based on the estimation of an amount of regular or normal income that can be expected from investors. Estimations of industry average rates of return on investments are often used in connection to this method.

3. Present value of future economic events method. Present value of future economic events method involves estimations of expected future mergers, acquisitions, product lines and so forth. To form a complete analysis of future economic events must be considered to be a very complicated assignment. This method is considered to be one of the most correct methods to value a company's goodwill but is also looked upon as difficult to use since the uncertainty of long-term economic events is a factor of great impact.⁵²

⁵¹ Reilly and Schweih, 1999, p 388

⁵² Ibid., p 391

It is important to notice that all three methods are founded on the perception of goodwill representing the potential of economic benefit in the future.

4.1.5 Self-Generated Goodwill / Purchased Goodwill

It is important to distinguish between self-generated and purchased goodwill, since it is only the latter that can be accounted for in traditional reports. The “new” economy discusses this frequently since in-house brands are not valued on the financial reports, although taken in consideration in alternative reports such as valuing the market price / share price.

4.1.6 Goodwill –Great Subject to Discussion

Goodwill has been/is an important issue in the context of any discussion on intangible assets. As early as 1929 the Economist described goodwill as a “master valuation account”. The journalist who wrote this meant that all of the cash flows of the business can be identified with specific assets or groups of assets. Those that could not be allocated could be explained by the existence of goodwill which in this sense derives from the synergy that is achieved when a particular company’s assets are operated together by a particular management in a particular situation.⁵³

4.2 The New Economy – How Old Is New?

When describing the essence of the new economy, speed, connectivity and the growth of intangible value are three central themes. Speed can be explained as: “Every aspect of business and the connected organisation operates and changes in real time”.⁵⁴ Connectivity can be described in the following way: “ Everything is becoming electronically connected to everything else: products, people,

⁵³ Brockington, 1996, p 119

⁵⁴ Davis and Meyer, C, 1998, p 5

companies, countries, everything.”⁵⁵ In this connection one clarification of intangibles is: “ Every offer has both tangible and intangible economic value. The intangible is growing faster.”⁵⁶ The increasing value of intangibles can be traced to information and relationships, which are things hard to see and measure.

The concept “new” is connected with something that has existed or been known only for a short time. New refers to something different from what has been before, something that is not yet explored. To get involved in what is new has for a long time been regarded as a condition for success in business life. The high speed in the new economy implies new actors to take part of what is new. The uniqueness of what is new then gets harder to call attention to and “new” transforms into “old”. “The *new* new thing” is a context created by IT-entrepreneur Jim Clark, who started Netscape and Silicon Graphics. “ The new new thing is a notion that is poised to be taken seriously in the marketplace. It’s the idea that is a tiny push away from general acceptance and, when it gets that push, will change the world “. ⁵⁷

Internet must be considered to be the most dominant technology in the new economy. The new economy and the internet companies have attracted a vast interest from mass media, the public, shareholders and business men. Network society, information age and the new economy are all concepts describing a new unbounded world where there seems to be a constant flow of knowledge, information and of course capital. The global flow of capital links technology, information, pictures, sounds, and symbols, together creating new traditions in business life. New traditions and new social principals are created. The internet business companies created new hopes for the future with help from the new technology and the new kind of enterprises were made into symbols for a new way of doing business. A highly technological society characterised by speed and flexibility was the arena for the entrepreneur, who may have (had) a label of

⁵⁵ Davis and Meyer, C, 1998, p 5

⁵⁶ Ibid.

⁵⁷ Strannegård and Friberg, 2001, p 30

heroism in the new economy. The internet companies were highly respected when the public faith in them was strong. When later the expectations from stakeholders could not be met, the fall was very steep for most internet companies.⁵⁸

About two and a half years ago a study was started at “Centre for Advanced Studies in Leadership” at Handelshögskolan in Stockholm with the title “Ledarskap och organisering i Internetföretag”(Leadership and organisation in Internet companies). The study aimed to focus on how the new technologies have an impact on the society and on the way people work and live. To describe the sector, the study was made from the inside of a Swedish company in the internet world. The working name of that company in the study was “Quickcompany” – a term which describes one of the characteristics in this line of business, where “quick” and “action” are keywords. A French philosopher, Paul Virilio, claims that acceleration is the fundamental principal around which the modern world is organised. He means that every innovation that brings about an acceleration of speed also will create a corresponding crash. “Quickcompany” lost 90 % of its stock value between spring 1999 and autumn 2000, a period of acid tests for many companies in this line of business. 20 % of the employees in “Quickcompany” lost their jobs over a period of five months.⁵⁹ This dramatic development was typical for Swedish Internet companies during the period of time mentioned.

Companies acting in the network society are often organised in a rather non-hierarchic way. The organisations change so fast that organisational charts often do not exist, perhaps also because of the lack of time. The average age of employees in the internet business has so far been low in comparison with more traditional business lines. In the book⁶⁰ about the study mentioned above, was noted that the average age of the employees was 29 years, the majority had worked in the company for less than one year and the average time of

⁵⁸ Strannegård and Friberg, 2001

⁵⁹ Ibid. pp 51-52.

⁶⁰ Ibid.

employment was six months.

Another characteristic of the new economy is the important role knowledge plays. Knowledge has been described as the most important factor of input and result in the modern economy. Production is more and more immaterial and knowledge-intense companies are focused on research about the new society.⁶¹

During the last decades business people have started to focus on flow and change rather than on stock and stasis. The income statement grew in importance as an indicator of the value of an enterprise showing the flow of activity and transactions over a period of time, compared to the balance sheet showing the balances of a specific date. Future accumulation of value can be considered to be more closely related to income than to assets. Evaluation and pricing of companies started to connect rather to the income that may be generated than to the net worth according to the balance sheet. The interest in future prospects are often of a larger interest to analysts than the current performance of a company and investors search for promises of growth. These facts have been most apparent on Wall Street, where the evaluations of firms are reflected in their share prices. The prices are yielding market capitalisation that for many firms far exceed their book values.⁶²

Capital in the traditional sense often refers to plants and production equipment. New forms of capital have become of great importance when evaluating a company. In the last years intellectual, human and structural capital have been in focus.

⁶¹ Strannegård & Friberg, 2001, p 84.

⁶² Davis and Meyer, 1998, p185-186

5. The Internet Sector

Starting with chapter 5, we present our empirical findings. This will continue through chapter 6 by looking more closely into specific companies.

In this chapter, we first look at the industry of IT, and secondly we look at data from the companies within this industry chosen from the Affärsvärldens index.⁶³

5.1 Brief History of the Sector

Although the Internet's history started in the 1950's as a military strategy weapon, it came into worldwide use in the 1970's when the universities got permission to use parts of it. From the 1980's it has grown rapidly. This new media brought a new kind of work, the computer science trade. During the 1990's the companies that had this computer science knowhow were called Internet companies, or IT companies, from IT – Information Technology.

As the computers became household appliances, producers such as IBM, Apple, Compaq and others have seen skyrocketing sales figures, and followers have been established on the market. Also, the companies that made programs for the hardware, so called software producers started to evolve. Microsoft and Adobe are some, and in Sweden we have Hogia, SPCS and other.

As English has been established as the major computer science and IT language the borders have not been any problems for computer companies to establish branches around the world. Sweden has a long tradition as a leading force in technological branches, such as telephones (Ericsson) and the Swedish steel industry. It is not easy to explain why Sweden (and Finland) have positioned themselves in the front borders among large countries such as the USA. Swedish schools started early with language lessons in English. A large part of the population can therefore use this the new technology language.

⁶³ www.afv.se 2001-07-20

Either way, it is a fact that Swedish companies have taken an impressive part in the IT-technology sector.

As the market for software and hardware grew, many saw the forecoming need of adapting the traditional industry to the new technology, and the internet consultant companies evolved from this.

When new markets occur, such as the IT-consultant market, one strategy is to gain great market shares and with this control the market. This is one reason why Swedish IT-companies have acquired each other and have been rapidly introduced around the world. As companies grow through acquisitions, the intangible asset's account grow. This cost can be amortised against earnings or financed by stock emissions.

As the market fell in the end of the 1990's, the IT consultants found themselves with great amortisation costs and low earnings at the same time when financiers ran to traditional sectors. The earnings plan was not realised as fast as expected. Many plans were simply overstated.

5.2 Why has IT / "the New Economy" Grown So Fast?

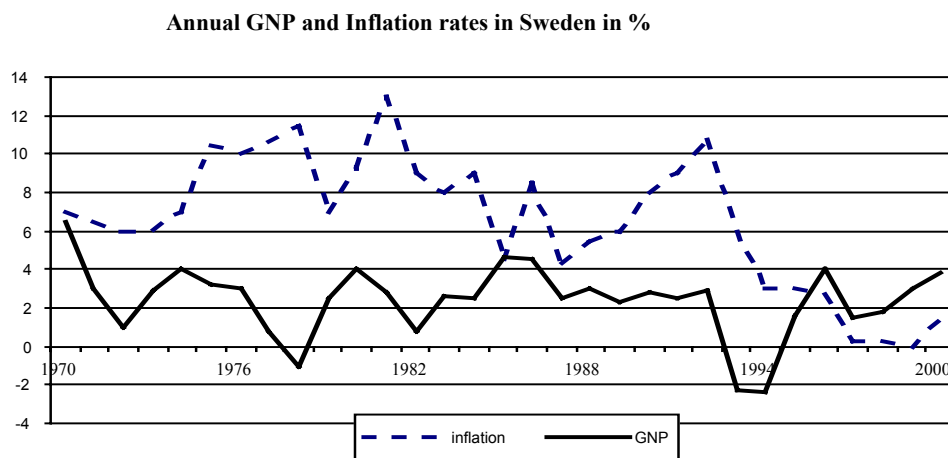
Information technology is today linked with WAP (wireless application protocol), broadband and so on. The New Economy is a combination of a variety of changes of which some of the most important are:

- a new basis technology – IT
- new deregulated global markets
- immaterial values grow in importance
- new ways of organising companies
- new economic policies and low inflation
- new attitudes and values among people globally

The changes discussed above are some of the reasons for the speed with which this "new economy" have grown. Also, investors are acting on a more global basis and this is "creating" more capital for this new industry. The last few years skyrocketing stock prices have laid ground for investment interest among all groups in a society, from bankers and rich people to ordinary employees through mutual funds. This picture have changed during year 2001, when many IT-companies suffer from badwill and bad earnings and stockprices fall. Today the new companies have to fight hard for the investors capital.

5.3 A Swedish Outlook on the IT Sector

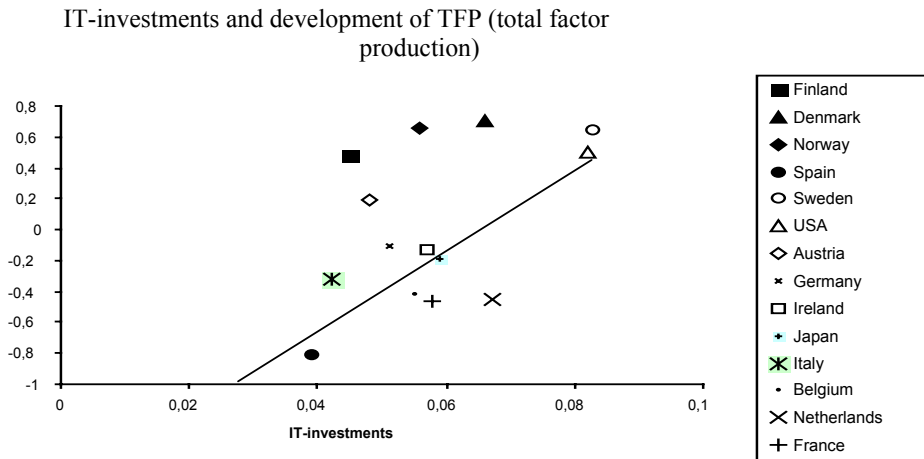
The development of GNP and inflation rate in Sweden are visualised below:



Source: Den nya ekonomin, Hårda data om den nya ekonomin, page 17

As can be seen above, a break in the trend appears in the 1990s. While the inflation rate historically has been higher than the GNP growth, the opposite has been a fact since 1993. Sweden has evolved from a stagnating economy with inflationary problems to an economy with growth and in comparison with European countries, rather low inflation. It is not statistically proved that growth have been steered by IT-investments or by any specific factor. But it is probably one influential sector during these years. It may then be interesting to look at IT-

investments and the growth of TFP (Total Factor Production) to see if any relation can be seen between these two.



Source: OECD

Note: TFP refer to the change between median of 1980-90 and median between 1995-98. IT investments are taken from expenditures from ICT.

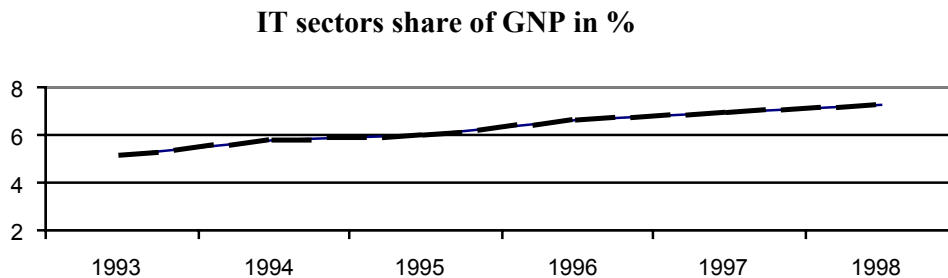
The above chart visualizes that a connection between the two factors can be seen. A study from the Näringsdepartementet (Ministry of Industry, Employment and Communications) in Sweden concludes that one third of the growth of the trade and industry can be connected to the IT industry.

The IT sector or, the new economy, is difficult to distinguish in a national focus. It is rooted in the society on many levels. We will try to look at various themes:

- its size
- its investments
- development of companies
- new demands at the labour market
- a deregulated, global financial market

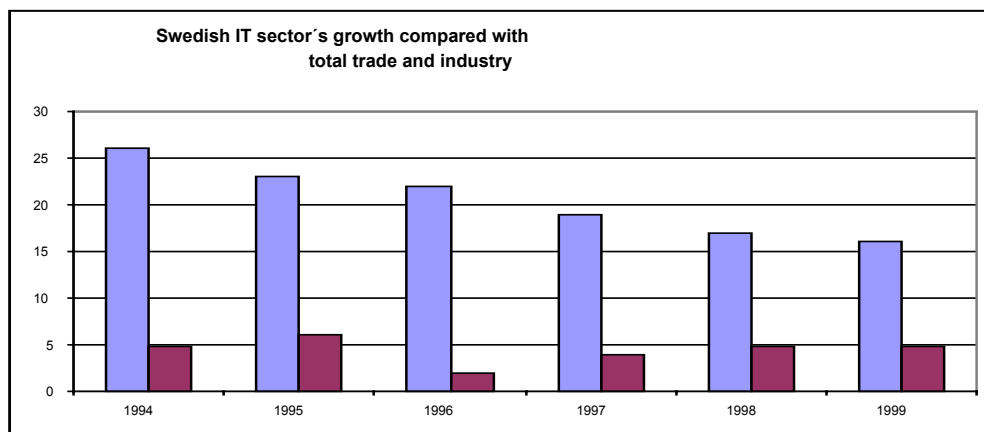
Size

The most used definition of the IT-sector is the producers of computers and mobile telecom, as well as the service companies doing the support, the software, consulting, sales and so on. With this definition the IT sector stood for 7% of the GNP and 5% of the employment in Sweden in 1996⁶⁴. This sector is larger than in many other countries. The IT industry's share of GNP is showed in the chart below.



Source: Näringsdepartementet

The importance of the IT sector is shown even more by the fact that it stands for 25% of the growth of the GNP in Sweden between 1993-1999, as indicated below:

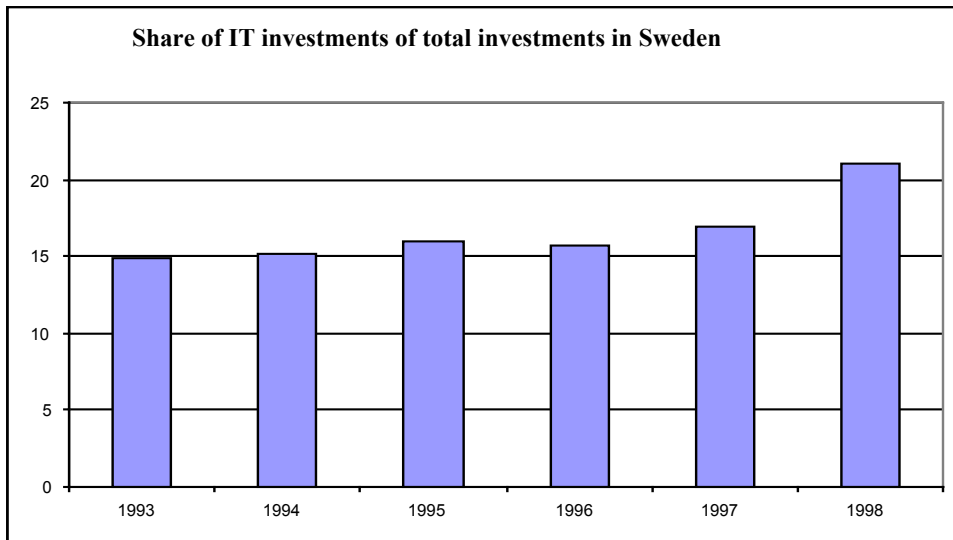


Source: Näringsdepartementet 2000

Investments

⁶⁴ Näringsdepartementet, 2001-11-10

Also, the IT investments share of total investments can make the picture even more clear:



Source: SCB nationalräkenskaperna.

Development of Companies

The number of companies in the IT-sector has grown rapidly. In 1993 Sweden had approximately 13,000 companies in the sector. In 1999 it had grown to almost 25,000. Mainly the growth was in database hosts and "other" IT companies but also the system and program consultants have grown in numbers.

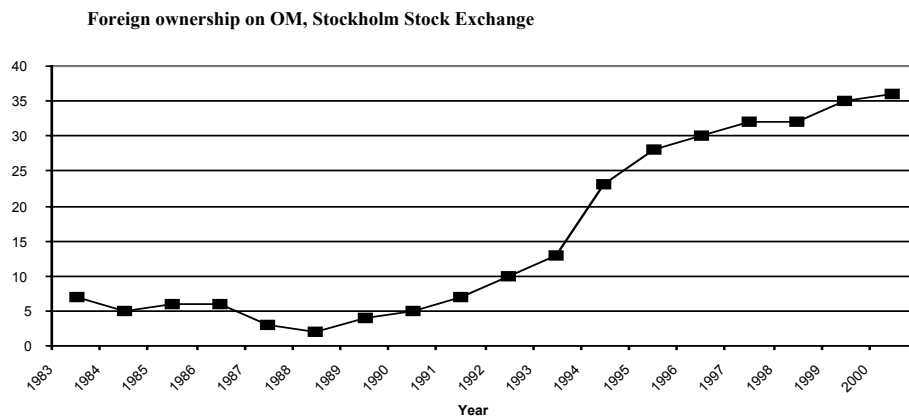
New Demands on the Labour Market

In this new sector, the demand for well-educated staff have grown. Also the way of keeping high performing personnel with option programmes, bonuses and other are not frequent in many other sectors. Employees have been more movable in this sector, why efforts to keep them are made. They are not easy to replace since almost no unemployment was to be found in the sector's workforce, which is not the case today.

A Deregulated Global Financial Market

A higher demand for a well working financial operation. The new sector has been looking for investors and a growing numbers of introductions on the stock market have taken place. The connection between a well organized and functioning stock market and investments in the IT sector has been strong. In general, countries with large stock markets have generally higher IT investments.

The IT companies share of new capital through new introductions to OM Stockholmsbörsen have increased during the last years and measured up to 45% in 1999. This is seen as one indicator pointing to the fact that the economy is changing. Another indicator is the increasing foreign capital that was invested in Swedish IT-companies:



Source: Hårda data om den nya ekonomin, 2000

During 2000-2001 the above graph has plummeted. The investors are running to traditional industries because of the falling stock prices and bad reports from the companies in the IT industry. The foreign ownership in the industry has not yet been seen in measures, but a major fall is expected.

5.4 An Overview of the Selected Companies from Index from Affärsvärlden

5.4.1 Amortisation Periods

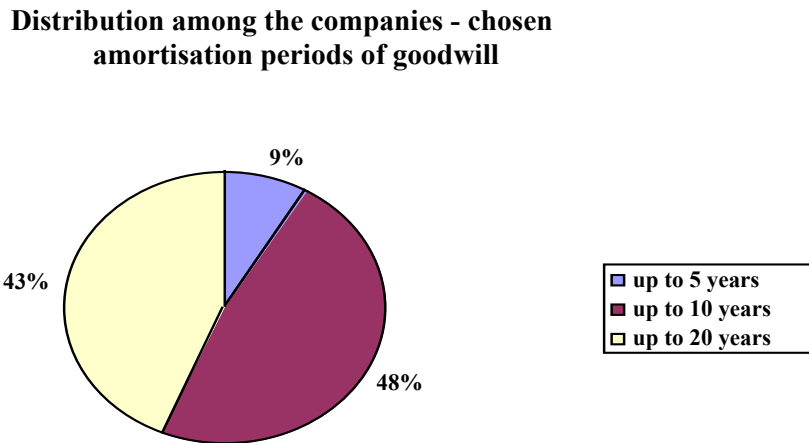
The companies in our study are listed below. The amortisation period of goodwill is presented in parenthesis. The data is collected from their Annual Reports:

<i>1. Adcore</i>	<i>(5-20)</i>	<i>26 Teleca B/sigma</i>	<i>(5 to 20)</i>
<i>2 Adera B</i>	<i>(3 to 10)</i>	<i>27 Tietoenator</i>	<i>(3-20, finska</i>
<i>3 Alfaskop</i>	<i>(*)</i>		<i>regler)</i>
<i>5 Cell Network</i>	<i>(10 to 20)</i>	<i>28 Turnit B</i>	<i>(20)</i>
<i>6 Cyber Com</i>	<i>(more than 5)</i>	<i>29 WM-data B</i>	<i>(0 to 20)</i>
<i>7 Dimension</i>	<i>(5)</i>		
<i>8 Enea</i>	<i>(10)</i>		
<i>9 Framfab</i>	<i>(10)</i>		
<i>10 Frontec B</i>	<i>(10 to 20)</i>		
<i>11 HIQ</i>	<i>(5 and 10)</i>		
<i>12 Icon</i>	<i>(3 to 5)</i>		
<i>13 IMS Data</i>	<i>(10)</i>		
<i>14 Kipling</i>	<i>(10 to 20)</i>		
<i>15 Know It</i>	<i>(10)</i>		
<i>16 Mind</i>	<i>(5 to 10)</i>		
<i>17 Modul 1</i>	<i>(5 to 10)</i>		
<i>18 Mogul.com</i>	<i>(3 to 5)</i>		
<i>19. MSC B</i>	<i>(5)</i>		
<i>20. Novotek B</i>	<i>(5 to 10)</i>		
<i>21Proact</i>	<i>(5 to 10)</i>		
<i>22 Pronyx</i>	<i>(5 to 10)</i>		
<i>23 Resco B</i>	<i>(10 to 20)</i>		
<i>24 RKS B</i>	<i>(10 to 20)</i>		
<i>25 Softronic</i>	<i>(5 to 20)</i>		

*Alfaskop filed for bankruptcy during the fall of 2001. They will not be analyzed in this report.

One question that may be asked is why the amortisation periods differ among the companies. They act on the same market, seek the same customers and deals and the market is free. We will firstly discuss three groups of chosen amortisation periods; firstly 0 to 10, secondly 10 to 20, and finally more than 20 years.

5.4.2 Chart Showing Chosen Amortisation Periods of Goodwill:



5.4.3 The Past Year – One Page Summary in the Annual Reports

In the Annual Report most companies show the year that passed in a summary. On this page, most companies in our research present "good numbers" (meaning; telling mostly the good news, leaving out the other kind).

Many companies changed board members during the year 2000. Most common presented is if the company changed CEO (Chief Executive Officer). Of the 29 companies in our research, 12 presented a new CEO in the Annual Report.

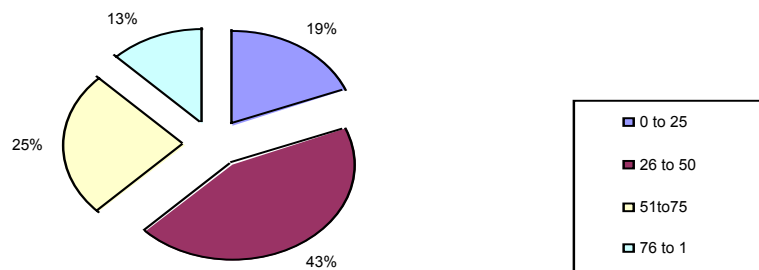
New contracts are noted, or if a certain success have taken place in some of the branches, or overall success on a certain product. No losses are discussed.

Also, key ratios are presented. From the researched companies, all present key ratios without regarding the goodwill posts. Those that do not present key ratios are for example Cell Network which have great problems with showing “good” numbers. They argue that their ”work” will pay off soon. This is probably meant to calm investors and to start the search for capital needed to survive. At the same time, sales of branches or acquisitions (which increases the post) are shown in the information. It may seem rather unorthodox to chose to exclude the goodwill in one ratio, presenting new increases on the goodwill item, as is the case.

5.4.4 Earnings among the Companies

Among the 29 companies only 13 (44,8%) show black figures from operations⁶⁵. Among studied companies that show losses from operations (before financial income and expenses) the goodwill item is distributed accordingly:

Goodwill compared to Equity among companies with negative operative earnings in percentage

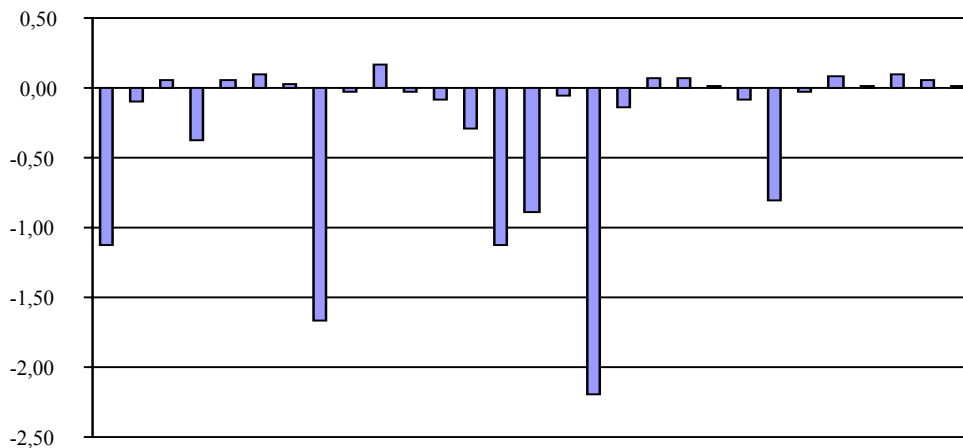


Source: Annual Reports from 2000

⁶⁵ Annual Reports 2000

Among companies where earnings are low, or as here, negative; the goodwill items are a heavy burden. This means that neither the acquired companies or the parent company are earning any means for handling the present. This gives way to a very heated debate on whether goodwill should be written off immediately when it seems that its value is questionable (mentioned in chapter 3) like planned implementations on regulation on goodwill in the USA. We would like to make some more comparisons on the companies that suffer from negative earnings:

Earnings / Turnover Year 2000



Source: Annual Reports 2000

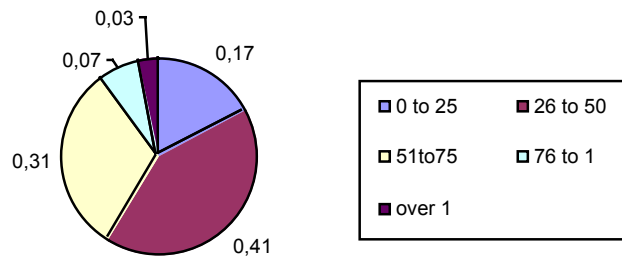
*The earnings / turnover represent the companies presented in the beginning of this chapter, in that order from Adcore at the extreme left to VM-data at the furthest to the right.

In the industry analysed, the year 2000 was a very odd year. For most years during the 1990s the industry had very good earnings. It looked ahead and did not save for the downfall that the new millenium brought. It could simply not be seen in any horizon (said IT-people, analysts, creditors and other).

Looking at goodwill and equity among all companies:

Below chart shows the ratio between goodwill and equity. This is interesting when knowing that the equity is the item paying for goodwill write-downs. The data is divided into groups of 0-25% and so on.

Goodwill / Equity

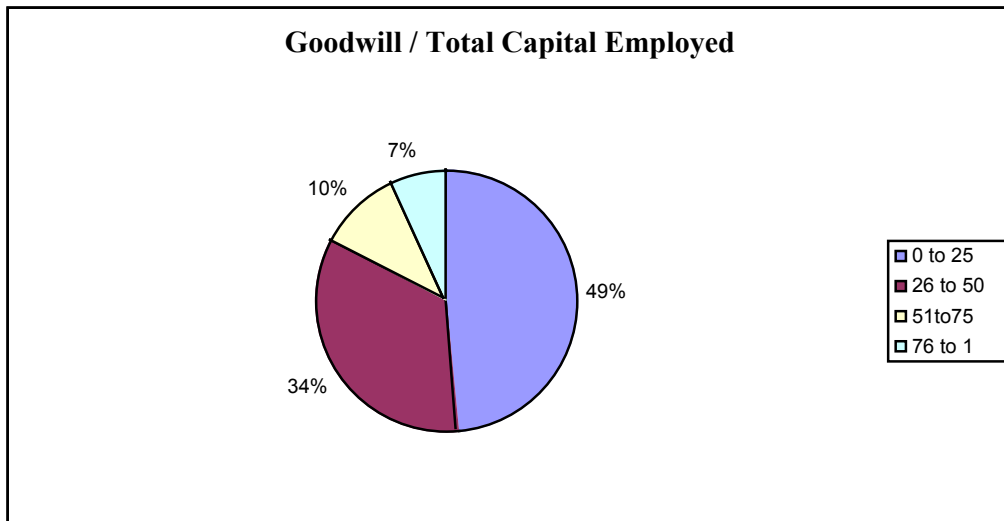


Source: Annual Reports from 2000

Most companies have, during the years with the trend towards acquisition before organic growth, got large goodwill items. Note that the major part of the studied companies has close to a 50 percentage of the owner's equity in goodwill. Should we look at the companies that have between a 35 to a 65 percentage, the share of the material would be that 66% would fit into this group. Turnit is the company that has a group of its own at the "over 1"- grouping. Their goodwill is larger than the owner's equity and this is a warning signal for certain.

Noteworthy is that TietoEnator is among those below 25%. They use Finnish Accounting rules and when Tieto and Enator merged, the acquisition method was not used, and therefore the goodwill post became zero from this merger. The pooling of interest method could not have been used in Sweden. Discussion about this is presented shortly in the end of this chapter.

Looking at Goodwill in relation with Total Capital Employed :



Source: Annual Reports from 2000

With the above chart one sees, when also keeping the former in mind, the share of the goodwill item, and also how the acquisitions have been financed. Of course, the share of goodwill is less when looking at total capital employed, but it shows that the equity is vulnerable to goodwill write-downs. It is a fact that if goodwill write-downs, or fear of them, take a large part of the equity, the banks and other creditors will not be very open to new funds, which might create hard times when liquidity is low, even for a short period of time.

Besides the fact that writedown of goodwill hits the equity, equally it also lowers the profit. In the year 2000 a company could fill up with new capital by issuing new stock, but in 2001 the market is cold when it comes to investing in the sector. At the same time, many companies are in need of capital to survive.

5.4.5. General Impression of the Studied Annual Reports

The numbers presented in the Annual Reports are as seen above not very optimistic. Many companies show numbers excluding goodwill items, meaning it has nothing to do with operations. The goodwill item will eventually have to be

amortised in full. Regulators are planning different ways to handle goodwill. An immediate write-down will break most of the companies, since they have neither money nor great profits to pay for it. Buying expensive IT companies, searching for size, and selling them for almost nothing, have not been a good deal for the industry. Very few companies have searched for organic growth before growth through mainly acquisitions.

5.4.6 Regulation Used

Swedish companies act in a global, wireless world. How they have handled the goodwill issue in this context, is the question. Since they are based in Sweden, the RR's recommendations should guide them. It is legislated in Companies Act (ABL) how to act when global. It is clear; only Swedish rules apply, if it resides in Sweden.

The goodwill items descend from acquisitions not only within Sweden. Sweden has had a rather cautious approach to the amortisation of goodwill, as seen in the earlier chapters have stated.

We have looked upon information concerning how companies handle their goodwill. Not all go along with Swedish rules, and in these cases they often follow US standards because the USA have the most lenient rules on this issue. This will change, also as stated in earlier chapter.

Many companies disclose that they amortise goodwill in 10 to 20 years. This information is found in the Annual Report. Many, also, use different amortisation periods, but we have chosen the year that represents the bulk of their goodwill item. Also, the acquisitions are mainly the intangible assets that are amortised for the most extended time periods.

5.5 Key Ratios – How Can the Company Use them in Order to Show the "Right" Numbers?

In terms of accounting, goodwill is normally looked upon as an investment like other investments in the sense that it represents an expenditure that probably will bring the company future income. This is the case no matter whether the purchased goodwill is paid for in cash or with own shares. The future earnings are supposed to arise from the subsidiary that was bought and/or from synergies. According to Swedish regulations goodwill has a limited economic life and should therefore be subject to straight-line amortisation over the time period representing its economic life, not longer than 20 years. (In exceptional cases this time limit can be extended according to new regulatory work; see Chapter 3).

Financial analysts sometimes ignore goodwill and amortisation of goodwill. This approach is justified by the fact that it is the task for every financial analyst to evaluate the total value of goodwill in the entire business group at every point of time with reference to forecasts made concerning the expected future earnings of the group. Evaluations that are based on future cash flows are not influenced by the treatment of goodwill.⁶⁶

The way goodwill is handled in a company's accounts has of course an impact on the key ratios. The issues around how goodwill is dealt with are therefore in many aspects controversial, not only for the financial analysts but also for top management. The ground for the problems is the valuation of goodwill and how it is amortised. The effect of amortisation of goodwill on the profit is the most important issue to most people involved.⁶⁷

⁶⁶ Finansanalytikernas rekommendationer 2001, p 84

⁶⁷ Finansanalytikernas rekommendationer 2001, pp 87-88

5.5.1 Looking at Key Ratios and Income Measures in Connection to Goodwill

When goodwill is eliminated in an analysis the impact mainly occurs when looking at earnings ratios, which may lead to misleading conclusions. Above all key-ratios including shareholder's equity are effected when goodwill is eliminated.

We would like to present some key ratios and income measures that we find important in connection with the discussion about the impact of goodwill on a company's earnings.

Earnings per share and EBITDA.

In case of a big acquisition with a large goodwill value involved, the result often is that the key ratio Earnings per share, decreases, at least temporary. This may be considered as an odd effect in cases when the acquisition is regarded as a good investment. One income measure often used nowadays is EBITDA (Earnings Before Interest Taxes Depreciation and Amortisation of goodwill). When using EBITDA instead of earnings per share the effect of goodwill is spirited away. One cannot claim that one of these indicators is more correct than the other, but it is important to be aware of the fact that when using EBITDA, the effects of acquisitions and the demand for an increasing earning capacity will be neglected. The importance of taking goodwill in consideration is pointed out by Peter Malmqvist, analyst at Aragon Kapitalförvaltning, in an article in Dagens Nyheter 1999.⁶⁸ He means, that when analysing companies that continuously grow through acquisitions, it is essential to consider a cost for that growth when presenting a forecast about the company. It is reasonable to assume that this cost will be at least equal to the cost for acquisitions historically. Unfortunately this is a fact that is often forgotten by analysts, according to Malmqvist. His approach is therefore that by yearly amortisation of goodwill negative surprises will be avoided. Another argument in favour of recognising the costs of goodwill is that in cases of large acquisitions risk exposure is more immediate since large acquisitions are harder to carry out than small ones. Problems with getting the

⁶⁸ Nachemson-Ekwall , 1999-11-14

new organisation to work smoothly and the fact that the positive effects of co-ordination will be harder to achieve when a large acquisition are important issues to take in account when analysing a company.

P/E ratio and PERA

P/E ratio (Price Earnings Ratio) or PER is one way to describe the evaluation of a company and is one of the most commonly used key-ratios when estimating a company's value. The P/E ratio expresses the market value per share divided with earnings per share and is often used for comparisons of companies.

To make comparisons easier between companies where one company has grown through acquisition and the other organically, PERA or Price Earnings Ratio adjusted for Amortisation of goodwill, can be used. PERA expresses the market value per share divided with earnings per share with reversed amortisation of goodwill. PERA is not yet very commonly applied in Sweden, but is more frequently adopted in the rest of Europe.⁶⁹

As discussed above, analysts work with goodwill in different ways. It is therefore desirable that companies disclose goodwill openly in the balance sheet and in the income statement. Large amounts of goodwill and amortisation of these should also be accounted for in notes per subsidiary. This procedure makes it easier to everyone to evaluate the fairness of the goodwill value and its amortisation.

5.5.2 An Example on Key Ratios in Connection to an Acquisition

Accounting with or without goodwill will give different pictures of a company. We will try to visualise one outcome by presenting an example given by the Finansanalytikernas Förening⁷⁰ :

⁶⁹ Finansanalytikernas rekommendationer 2001, p 31

⁷⁰ Finansanalytikernas rekommendationer 2001, p 93

The Internet Sector

M acquires all shares in D for 1000 mSEK. Payment is done with shares in M. Both companies and the newly founded. Corporation's earnings and asset reports look like this:

	M	D	M+D	Ad-justm	Non-cash issue	Cash acquisition
Sales	5400	1800	7200		7200	7200
Op. Costs	-4960	-1620	-6580		-6580	-6580
Am. goodwill				-30	-30	-30
Op. Profit	440	180	620	-30	590	590
Finances	-120	-40	-160		-160	-260
Result bef fin	320	140	460	-30	430	330
Tax	-120	-40	-160		-160	-130
Net profit	200	100	300	-30	270	200
Op. Capital	2400	800	3200	+600	3800	3800
Net debt	1200	400	1600		1600	2600
Equity	1200	400	1600	+600	2200	1200
Rate of return on equity	17	25	19		12	17
Rate of return on op. Capital	18	23	19		16	16
Solidity op capital	50	50			58	32
No of shares, million	30	20	50		50	30
Share rate	18	23	19		50	50
Stock value total	1500	1000	2500		2500	1500
Earnings/share	6,67	5	6		5,40	6,67
P/e	7,5	10	8,3		9,3	7,5

The Internet Sector

Equity / share	40	20	32		44	40
Stock price/equity %	125	250	156		114	125
Total value	2700	1400	4100		4100	4100
EV/EVBIT	6,1	7,8	6,6		6,9	6,9
Op value/ book value %	113	175	128		108	108

D has an equity of 400. In the first column we present the numbers of both companies. In the third, an addition of numbers before consolidation adjustments. These additions match the result that would have been if the companies had used the pooling-of-interest method. The key ratios that are drawn from them are a weighed average from both companies' ratios before goodwill and used as basis for the discussion about how goodwill accounting affects key ratios.

In the first, paying with own shares, M pays the deal with 20 million shares at a rate of 50 SEK. In the second, where cash is used, a loan of 10% interest is financing the acquisition. No hidden values lie in D's assets or liabilities and therefore the goodwill value is 600 million SEK (=mSEK). We presume that stock prices remain like before the acquisition.

No-cash-issue:

M owns before the purchase 30 million shares at a stock price of 50 SEK. The purchase is paid with 20 million SEK which increases the corporations (= the group of company M+D) equity with 20 times stock price 50 = 1000 million SEK to 2200 mSEK. The latter figure consists of the parent company's equity before the acquisitions, 1200 mSEK, the subsidiary's equity of 400 mSEK, and goodwill of 600 mSEK.

The value of the goodwill is also included in the corporation's working capital (equity + net debt) which means 600 mSEK larger than the sum of both companies.

Whether goodwill affects the corporation's profit depends on the amortisation plan for the item. In this case the purchase is said to be of strategic interest and a period of 20 years is chosen. The corporation's annual amortisation is then 30 mSEK. Goodwill amortisation is not tax deductible.

The corporation's key ratios differ from the companies accordingly:

* The Rate of Return on equity decreases from 19 to 12 depending on a) the goodwill item increases total equity and b) the amortisation lowers the profit.

* The earnings per share decreases from 6 SEK to 5,40 because amortisation of goodwill. If D had higher or lower profit per share than M this would have affected the profit per share in the new corporation accordingly. The decrease of earnings also increases the P/e ratio from 8,3 to 9,3.

* Equity per share rises from 32 to 44 SEK per share because the value of the goodwill item brings the market price (stock price) to a level of 114% instead of 156% of the equity.

* The corporation's market price is the sum of both M and D's market value plus net debt. Since earnings are lower the EV/EVBIT rises somewhat.

* The relation between the market value of the corporation and its book value decreases from 128 to 108 percentage because of the goodwill item.

* The solidity on working capital rises from 50% to 58% depending on the fact that the goodwill value is financed with own shares (equity).

Paying with cash – scenario

In the last column is shown the ratios in case M would acquire D with cash. This is financed with a loan with an interest rate of 10%. The corporation's financial costs increases with 100 mSEK which lowers the net profit with 70 mSEK after 30 % tax. The working capital is not affected but the net debt increases with 1000 mSEK and the equity is accordingly lowered by this.

When comparing the ratios from the sum of both companies we find (col 3) these differences:

* The earning capacity on working capital as well as the key ratios based on the market value of the corporation (EV/EVBIT which is market value / book value) remain the same like the example with no-cash issue. These key ratios depend on the financing.

* The earnings ratio on equity is not affected strongly. It becomes 17% compared to 19 in the 3rd column. In this case it is the same as M's ratio since D's profit cover just about the goodwill amortisations and the financial cost of the purchase (interest). The earnings improve compared to the no-cash case which was 12.

* The profit per share is 6,67 compared to 6. This is because the number of shares is lower, by 20 million shares. The increased financial costs and the amortisation of goodwill do not add up to more than 5 mSEK if calculated on these shares. This sums up to that the P/e ratio decreases from 8,3 to 7,5.

* Since the corporation's equity is not affected by the purchase, the equity per share as well as stock price / equity the same as the parent company's before the acquisition. These key ratios are then lower than those in column 3.

5.6 Key Ratios and Income Measures in the Chosen Companies

Looking at key ratios and income measures, we have found that most companies in our chosen population prefer to present them excluding goodwill. The goodwill issue is discussed by the board and CEO among strategies.

Looking at Cell Network (example below) shows that almost all key ratios and income measures where increase is good, are lower in the year of 2000, and the opposite regarding key ratios where low rates are good.

Cell Network

Turnover 1999; 1210 mSEK to 2000: 905 a decrease with 305mSEK (= 25 %)

Ebita 1999: 62,3 2000: 88,6

Solidity decreases from 67% 1999 to 44% in 2000

EBITDA increases from 6,4% 1999 to 11% in 2000

The four large IT-companies Framfab, Icon, Cell and Adcore made write-downs close to 6 billion SEK during 2000. In spite of these efforts their goodwill items are still huge and considered "bombs" by analysts⁷¹ and are a threat to the equity items. This influenced all key ratios. Some analysts prefer to calculate without goodwill, looking upon them as one-time-costs that will affect profit only one year, and therefore are not significant for the analysis, only notable.

The "trend" among the mentioned companies last year was write-downs, or write-offs, of goodwill and it is not strange to assume that this will continue during 2001.

The largest amount considering write-downs among the companies was done by Icon Medialab. Amortisations according to plan was 667 mSEK and the addition on write-down was 1,6 billion SEK. After this, Icon still has goodwill items of 462 mSEK.

⁷¹ Linnala, 2001-03-06

Framfab was another company that cut a total of 1,8 billion SEK from the goodwill. At the end of the year 2000 the goodwill item was still large enough to wipe out 57% of the equity.

Cell Network only made write-downs of 270 mSEK in 2000, but had at the end of the year goodwill items of 880 mSEK. Should all have been written down, the owner's capital would be very small, only around 25 mSEK.

The stock price of Icon Medialab around the end of 2000 was: 14 SEK and in november 2001 it was bought and sold around 3,50 SEK.

The stock price of Framfab around the end of 2000: 13 SEK and in November 2001 the price is approximately 0,75 SEK.

It is safe to comment that the goodwill items are an even greater threat to the company in november 2001 than at the end of year 2000.

Adcore made write-downs of 1,4 billion SEK which was around 50% of the goodwill item amount.

Among other IT-companies in the chosen population Know IT stands out. In the annual report the company doesn't specify the goodwill item, but at the latest check the intangibles was 182 mSEK, which is 50 mSEK more than the equity, which tells us that the item is of significance to the stakeholders.

A total of nine of the 30 IT-consultants⁷² (one of the 30 had filed for bankruptcy when we "took" the list as research population) had goodwill that measured up to more than 50% of the equity. The median value for the whole industry (including program companies and hardware sales companies) as a whole is that goodwill measures up to around 44% of the equity.

When looking at the write-downs one question is how it was financed.

⁷² Linnala, 2001-03-06

In the year of 2000 many internetconsultants (our population; i.e.c ompanies in our research) had during the last 5 years made acquisitions at inflated high prices which could not stand against the hard times of sharply decreasing stock prices and when the stock market's interest left them. The result was great goodwill write-downs and in many cases the "holes" in equity were covered by issuing a considerable number of new shares.⁷³

All companies in our survey are often in the media such as analyses in business magazines. The articles lately have a more critical focus than one year ago. The business is changing again, and it is changing rapidly.

How do the companies view their future?

Most companies view the coming year as very important. Many struggle with earnings but most of the companies plan to improve their market shares and to improve earnings. Some of the ways to improve numbers are reorganising, letting go of personnel, and writing down intangibles (goodwill). Few give promises for the operative part of the company. Also, many point out that they want to widen the customer stock into the traditional industries such as forestry, defence, government and so on.

⁷³ Linnala, 2001-03-06

5.7 Differences between Swedish and Finnish Accounting Regulation Affected Merger Discussions for Tieto-Enator⁷⁴

It should be noted that differences exist between the two countries in which Tieto-Enator conducts business mainly, i.e. Sweden and Finland. This has influenced the way this company has chosen to merge. During the year 2000 Tieto-Enator has gone through share transitions that would have resulted in addition of 305 million Euro, should the deal have been accounted for according to Swedish regulation. With the estimated life of 10 years this would have added 16 million Euros in amortisation cost every year, and the total of 289 million Euros in intangibles for the year 2000. Also, the merger between Tieto and Enator 1999 should have, if accounted for in Sweden, added 687 million Euros in intangibles, with the forthcoming of amortisation as life of estimated 20 years the annual amortisation would add up to 38 million Euros.

Also TietoEnator has associated companies in which it holds items (intressebolag) per post in proportion to its shares. In the report these posts have been added into one. This used way to consolidate is not valid due to Swedish regulation where equity method is called for. This shows in the profit and loss account, but as far as share in net profit no difference occurs for the mentioned companies. The Finnish regulations made the merger possible.

This is one way of looking into how using different countries regulation can "change" a company's intangible item. The burden of amortisation would with knowledge of the present earnings have been too heavy, if not impossible, to bear for the corporation.

⁷⁴ Annual Report, TietoEnator,2000 , p. 47

6. COMPANY CLOSE-UP

We have chosen two companies in the IT-sector for a deeper study in this sixth chapter. This we do to get a better understanding of the handling of goodwill in the IT-sector, which we began discussing in the 5th chapter.

The prerequisites of our study of the IT sector have changed in an obvious way during the second half of 2001. The sector is going downhill, which has made our possibilities to get a deeper contact with companies for a case study more difficult. In a situation like that it may be understandable that some companies do not prioritise to take time for interviews dealing with a hush period.

We also experienced that companies did not actually have time to meet us, which may have to do with the fact that the number of employees in a number of IT companies has decreased substantially during this year. We tried at several occasions to arrange a meeting with the CFO of Turnit, one of the companies from our selection. The CFO was eagerly working with an interim statement and had unfortunately not the time to participate. In the end of October this year Turnit announced a very negative forecast concerning the result on an annual basis. Turnit explained the negative development as a consequence of a market characterised by uncertainty, instability and increasing competition.⁷⁵

We were interested in a meeting with the CFO of WM-data and made several attempts both by mail and phone to achieve this. WM-data has a new CFO, who did not participate during the work with the annual report covering year 2000 and has no prior experience from the IT sector. Due to that he felt that he could not help us. Some weeks later we met the headlines in the press telling us that WM-data had to decrease the number of employees in its core business in Sweden with about 900 persons, i.e. 12 % of the total number employees.⁷⁶

⁷⁵ Press release Turnit 2001-10-25

⁷⁶ Svensson, 2001-11-09

Among the companies we contacted, few were interested in discussing goodwill. Only those that did not fear the subject, agreed to see us. We feel that if we had contacted the persons at more lucrative periods, the issue would have been more easy to research and discuss.

6.1 HiQ International AB

6.1.1 The Reasons for Choosing HiQ for a Case Study.

2001 can so far be characterised as a dramatic year for Swedish IT companies. Huge financial problems have caused a vast number of consultants notice to quit and the market for IT consultants has diminished. During the second half of 2001 the immediate risk of bankruptcy has increased for a number of Swedish IT companies.⁷⁷ Well aware of this fact we decided to contact a company that swam against the stream and decided to make a case study of HiQ, a company which differs from many of its competitors in being a *profitable* IT company. The possibility for us to get information of high quality and of interest for our thesis formed our judgement in choosing a company without a severe financial problems.

HiQ is a Swedish IT Company, which partly differs from most of its competitors in Sweden. How? HiQ does not mainly put an interest in the magic of growing through acquisitions. They do not firstly focus on being “big” but on keeping up a high quality.

During the superheat period in the history of IT Companies, HiQ had perhaps an air of caution in comparison to competitors that grew very fast through acquisitions.

⁷⁷ www.Afv.se/bors 2001-11-10

6.1.2 HiQ - A Brief Historic Background.

HiQ started as HiQ Approve in Arboga, Sweden in 1995. Simulation Technology was the base of the company's operations. The Swedish national defence was the customer and the simulation technology developed was used in JAS Aircrafts. The same year, HiQ Data started in Stockholm with a focus on the private sector and with the task of broadening the operations while maintaining a particular focus on the telecom business line. In 1998, the name of the parent company was changed from Statyetten Konsult AB to HiQ International AB and two subsidiaries were started. In 1999, HiQ International was listed on the OM Stockholm Stock Exchange. In 2000, new subsidiaries in Denmark and Gothenburg were started through acquisitions and the same year a subsidiary was founded in Finland.^{78, 79}

6.1.3 HiQ of Today.

In short HiQHiQ works with *communication*.⁸⁰

HiQ is an IT- and management consulting firm focusing on high technology in the areas telecom, mobility and simulation technology. 70 % of the operations consists of systems development and development of embedded systems. The remaining 30 % consists of management consulting. In the annual report 2000-12-31 the turnover was divided in the following segments:⁸¹

Telecom Suppliers 37 % (e.g. Ericsson, Nokia, Cisco)

Telecom Operators 26 % (e.g. Telia, Telenordia, Sonera Utfors)

Defence 18 % (e.g. Swedish Defence Material Administration and Ericsson Microwave)

Finance 8 % (e.g. Nordea and OM)

⁷⁸ www.HiQ.se 2001-10-29

⁷⁹ Jennehov, 2001-11-06

⁸⁰ Ibid.

⁸¹ HiQ Annual Report 2001, p 18

Other 7 % (e.g. ICA and Aftonbladet)

Vehicles 4 % (e.g. Volvo and Saab Automobile)

During the last years business activities are widened into new fields like medicine and utilities.

HiQ has more than 400 employees and a turnover of more than 400 Mkr.

Most of HiQ's consultants are highly educated (87 % of the employees are university graduates) and have a solid professional experience (57 % of the employees have 6 - 20 years of experience in their line of business).⁸² They work with advanced technology in long term relations with customers, who are end users.

In order to maintain a high level of profitability and quality, HiQ points out important tools like recruitment of highly skilled consultants, a high degree of chargeable time and control of the level of the average pricing.⁸³

The market situation for Swedish IT companies is described by Anna Jennehov as increasingly cautious among customers. Also big customers are definitely more prudent in their procurement of services.

Growth

HiQ's vision is to be the best consulting company in the fields telecom and mobility in Europe with a base in the Nordic countries. This fact does not necessarily mean to be the biggest consulting firm. HiQ focuses on high quality, which also is what the name stands for. The vision has an impact on how the company has grown: HiQ's growth is mainly organic but a few acquisitions have been carried out. In year 2000 HiQ acquired a company in Denmark and one in Gothenburg, Sweden. Both acquired companies are profitable and their businesses easily pay off the acquired goodwill. Scandinavia is the most important market for HiQ and businesses are also run in Norway and Finland. In total the group consists of seven subsidiaries and employs more than Scandinavia is a very interesting centre for companies in their business line.

⁸² HiQ Annual Report 2001, p 27.

⁸³ Jennehov, 2001-11-06

Although organic growth is the most important way to get bigger, HiQ is not overall negative to acquiring companies, but companies in question must be profitable, have an excellent circle of customers and fit in to the business ideas of HiQ's.

6.1.4 Interview with Anna Jennehov, CFO

During our meeting with Anna Jennehov, CFO, we discussed the management's thoughts around HiQ'S goodwill item.

In the year 2000 total net investments of HiQ amounted to 115,7 Mkr of which investments in goodwill was 103.4 Mkr. HiQ WISE in Denmark and HiQ Open in Gothenburg were acquired. The two new subsidiaries were consolidated from 1 May 2000 and goodwill is amortised over a period of 10 years. During the financial year 2000 no write-down of goodwill is done in HiQ.

According to Anna Jennehov, goodwill is considered to be "an investment like any other investments in the company" (en investering som alla andra investeringar i företaget.)

Anna Jennehov pointed out that the aim of running the business is of course to manage the company according to the going concern assumption. This is why it is of great importance that the acquired companies are profitable. The companies acquired by HiQ during 2000 are profitable, growth and margins show a positive development and they both pay off the acquired goodwill.⁸⁴

The management has an open dialogue with HiQ's auditors about how to handle goodwill. The management's viewpoint about amortisation of goodwill over a period of ten years is in total conformity with the auditor's opinion.

The negative impact of goodwill on traditional key-ratios and how this may influence the choice of which key-ratios to disclose were briefly discussed. After acquiring companies margin before goodwill is more frequently used. The

⁸⁴ Jennehov, 2001-11-06

orientation towards the result of the business is more clear and relevant when disclosing margin before the impact of goodwill, according to Anna Jennehov.

6.2 TietoEnator

6.2.1 The Reasons for Choosing TietoEnator for a Case Study.

Our second case study describes TietoEnator , which in comparison to HiQ is bigger and more internationally established. In line with its size, there have been a number of mergers and acquisitions over the years, so the context of purchased goodwill is something quite familiar to the company. One thing in common with HiQ is the fact that TietoEnator has had a more positive development during the last year than the rest of the IT companies our study concerns. We believe that this is one of the reasons why these two companies are more positive and alert in responding to our contact with them. Many other IT and Internet Companies have an extremely difficult situation right now, why our attempts to involve them in our study is not given priority.

TietoEnator has its head office in Esbo, Finland and are listed both at the Helsinki and the Stockholm Stock Exchanges. We find it contributing to our study to include the thoughts around goodwill and standard setting in the IT business from a more international company. Unfortunately we did not have the possibility to visit our contact person, Susanne Lemström, who works with issues concerning Shareholders' and Public Reporting at the Finnish Head Office. Instead she has taken part in our study by using e-mail and telephone.

6.2.2. TietoEnator - A brief Historic Background.

TietoEnator is the result of a merger in 1999 between the Finnish company Tieto and the Swedish Company Enator. This business transaction was received with a lot of attention and was of course followed by the press. Some considered it questionable weather the deal really was a merger or not in fact an acquisition through which Tieto acquired Enator. In the press⁸⁵.⁸⁶ it was pointed out that the

⁸⁵ Hallsenius, 99-03-04

⁸⁶ Wallén, M, 99-03-09

deal was not between two equivalent partners. Enator's owners would only control about 31% of the shares in the new group and the total market value was estimated to 7.8 billion SEK for Enator and 18,2 billion SEK for Tieto. The Finnish consolidation principles were more liberal than the Swedish and the pooling of interest method was approved to be used. By this followed that a goodwill item of five billion SEK never occurred in the group accounts.

Tieto started its business operations in Finland under the name Tietotehdas Oy in 1968 . During the company's first years IT systems were developed and maintained mainly for Union Bank of Finland and its customers, and for a small number of forest industry companies.

Tieto's customer base grew in the following decades and during the 1990s the company experienced a rapid growth through a number of acquisitions and alliances.

In 1995 a Swedish listed company, Celsius AB, merged its IT-related operations and the Enator Group was created. This group was formed by a merger of three separate IT-related subgroups, namely Telub, Enator and Dialog. In 1996 Adedata was acquired and the new group, Enator, was listed on the Stockholm Stock Exchange. By the end of the nineties a number of acquisitions were carried out in Sweden and in other European countries.

6.2.2 TietoEnator of Today.

TietoEnator has operations in 19 countries and employs more than 10.000 people, of which about 3000 in Sweden. The group is a leading supplier of value-added services with a turnover of about 1.1 billion Euro. TietoEnator offers for example systems development, integration, operation and support, product development services, management consulting. The group's customers act in business lines like bank and finance, the public sector, forest and energy

industry and telecommunications.⁸⁷

Growth

TietoEnator's growth targets are said to be achieved through a combination of organic growth and acquisitions. The base for growth is in ready-made solutions is world wide and in partnership in the Nordic countries as well as in continental

Europe

We asked Susanne Lemström to describe TietoEnator's strategy concerning growth and if any adjustments of this strategy had been carried out in consequence to a more difficult market situation for IT companies. The annual growth target is 20 % : 10% through acquisitions and 10 % organically. The operating profit (EBIT) is targeted to be above 10 %. No adjustments of its growth strategies were established.

Goodwill

Concerning goodwill, TietoEnator uses an amortisation period of five years. In case of a more strategic acquisition, goodwill is amortised over a period of ten years. The parent company is Finnish, so local regulations are used.

No write-down of goodwill is made.

One of our questions to TietoEnator concerned how the dialogue with the auditors about the goodwill issue looks like and if the attitudes toward these issues differed and in what way. The management's opinion concerning the goodwill issue is in accordance with the auditors' point of view and no specific comments were made in connection to the answer.

In connection to the questions directly dealing with goodwill, we asked about the opinion concerning how goodwill affected the choice of key-ratios. TietoEnator discloses earnings per share, both by including and by excluding goodwill. Susanne Lemström had the impression that financial analysts have focused more

⁸⁷ Lemström, 2001-11-08.

and more on results before the impact of goodwill.⁸⁸

Finally our respondent shared her views on the ongoing debate about goodwill in the IT sector. According to her point of reference the resistance to apply the pooling of interest method has a negative effect on acquisitions or even stops them in many cases. Large amounts of goodwill occur in connection to acquisitions of IT companies and this will effect non restricted earnings and further restrict profit distribution in the parent company. Susanne Lemström poses the question about what will happen when they will have to prepare financial statements in accordance to IAS. Due to that scenario goodwill must be allocated to the line of business level. Companies must then make an impairment test on an annual basis, which according to Lemström's opinion will be very difficult to achieve.⁸⁹

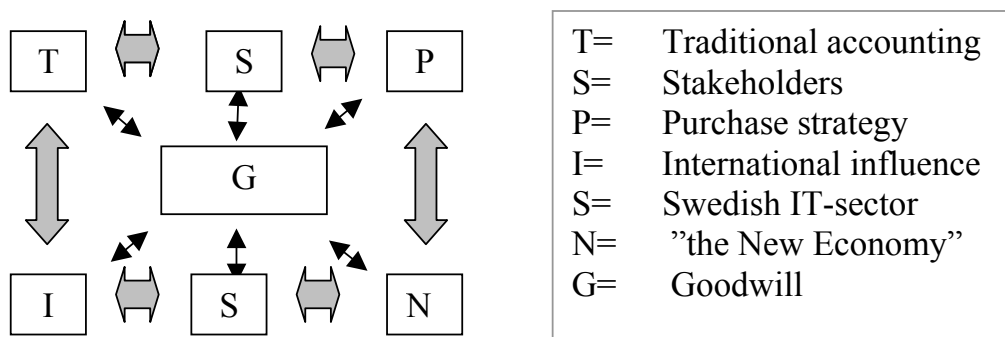
⁸⁸ Lemström, 2001-11-08.

⁸⁹ Lemström, 2001-11-08.

7. ANALYSIS

Our analysis will be based upon the seven topics presented in chapter 2., which we find have an important impact on the IT-sector and goodwill accounting. These concepts have had an important role when collecting data and therefore they will be the foundation for this analysis.

Figure in mini format :



The concept of goodwill as well as the accounting treatment of goodwill must be regarded as areas full of nuances and interpretations, not least from an international perspective, and could therefore be described from different perspectives.

Intangible assets may be difficult to recognise and therefore complicated to clearly define. There are also difficulties involved when forming an opinion on the economic life of assets of this category. The value of intangible assets can be said to lie in future economic benefits such as cost savings or increased future earnings. In general it must be considered a harder issue to identify benefits assigned to an intangible asset than to a tangible one.

Due to the remarkable development in the IT sector, it seems that accounting issues dealing with intangible assets in large and goodwill in specific are of current interest in the Swedish and in the international accounting debate. This

attention is noticeable not only from the regulators point of view but also from actors in business life. IT companies and other knowledge intense companies in “the New Economy” often act in an international environment and it seems therefore seemslogic that accounting regulations are created to fit an emerging international market.

External Accounting Information – Basis for Financial Decision Making.

To analyse the aims of external accounting and the fact for whom the information is presented must be considered a base for demands raised on accounting regulations and the design of framework for external accounting provided by companies.

External accounting, including the annual report, is one very important way for a company to communicate with its stakeholders. Different kinds of stakeholders are interested in different kinds of information. Owners, investors, analysts, the public, government and creditors represent groups of stakeholders that have various interests in financial information provided by a company. The information given will be important as a ground for financial decision-making in order to buy or sell shares in a specific company, to provide a company with credits and for giving a correct picture of a company’s financial position to customers and suppliers. Another important use of the external accounting is the possibility to control in what way legal regulation is followed and to what extent stakeholders’ interest is taken care of.

In chapter 3 we discussed two basic concepts concerning accounting, namely the concept of a true and fair view and the prudence concept. External information provided in annual reports in specific and external accounting in general is of utter importance as a mean for the company to get the stakeholders’ trust in its business. To inspire confidence in a company and in its financial information is a crucial task for management and for the company’s auditors. To disclose correct financial information must be considered a prerequisite for survival in the long run for a company.

The need of information to assess a company's possible profitability or to evaluate future cash flow is fundamental for most stakeholders. One objective of external accounting must be to enhance the possibility for sound financial decision making for all interested parties.

One way to secure the quality of external accounting information and to provide adequate information to different kinds of stakeholders is to set accounting standards. The standard setting work is important both on a national and on an international basis although development of accounting standard setting during the last few decades implies that this field more and more is a matter of international harmonisation. To increase the credibility of accounting information and to reduce differences between companies in what is externally presented are perhaps the most important objects for standard setting work.

A Renewal of International Standards on Accounting for Intangible Assets.

FASB

In the United States FASB (Financial Accounting Standards Board) has changed the rules radically for the purchase method of accounting. Rather than amortising goodwill to income, companies will now have to review goodwill for impairment. According to American accounting standards purchased goodwill shall be capitalised as an asset. Prior to the recent, important adjustments of the American regulations, goodwill was approved to be amortised over a period which must not exceed forty years, which in comparison with most other countries was extremely liberal.

One reaction to the new rules by FASB may be that there will be negative reactions from the market when an impairment is done in comparison to the prior scheduled amortisation charges. Does an impairment signal bad news about the company and future results? The new regulation FAS 142 does not require a *permanent* decrease of value to demand a write-down of goodwill or of some

other intangible assets, wherefore it might be hard to follow the development and position of a company as regards this area.

Another very important change of the American regulations concerning goodwill is the compulsory application of the purchase method in case of a merger in accordance to FAS 141. By this follows that that the pooling of interests method no longer will be applicable. The pooling of interest method has been widely used by companies growing by mergers. This new accounting regulation by FASB, will probably have a restrictive influence on growth strategies in American business life. The frequent use of this accounting model rather than purchase accounting, has its explanation in the fact that the pooling of interest method does not require the buyer to record goodwill and by this follows that no amortisation of goodwill will charge earnings.

IASB

In the long run there are efforts to make standards set by IASB applicable on group accounting in all member countries within EU. In a very long-range perspective there are international efforts to achieve a set of uniform accounting regulations that may be accepted on stock exchanges worldwide. Meanwhile, we have to look at international differences in accounting standards setting.

In IAS 22, (International Accounting Standard 22) the international standard setter IASB, (International Accounting Standards Board), states its recommendations dealing with business combinations. The current version of IAS 22 has been operative for annual financial statements covering periods on or after 1 July 1999. According to IASB, acquired assets and liabilities should be included in the consolidated financial statements at fair value. The difference between the cost of the purchase and the fair value of the net assets is recognised as goodwill. One central change in the revised IAS 22 is the fact that the absolute maximum useful life of goodwill, 20 years, can be exceeded in rare cases.

The amortisation requirements regarding goodwill are stated in IAS 38, Intangible Assets. In accordance to this standard, a company should amortise

goodwill over a period reflecting its useful life. In case of persuasive evidence providing that the useful life will exceed twenty years, goodwill should be amortised over its estimated useful life. The amortisation period should reflect the expected time span over which future benefits, for example a stream of income, may occur.

IAS 38 is founded on the assumption that it is rather unlikely that the useful life of intangible assets may exceed twenty years. *Persuasive* evidence of facts pointing at a useful life exceeding the twenty year limit, must be looked upon as a rather harsh formulation of the requirement to fulfil this criteria.

Swedish Accounting Regulation on Intangible Assets: A matter of Cross-Border Regulatory Work.

When describing the renewal of Swedish accounting regulations in the field of intangible assets, it is obvious that the international influence on the national standard setting is crucial. This development must be considered very important to Swedish companies since the possibilities to establish abroad and to be quoted on stock exchanges abroad will increase. Sweden is a small country and as such it seems even more vital to adapt to international development in the area of accounting. To Sweden and Swedish companies it will probably be a matter of increasing importance to actively take part in the international standard setting work in organisations like EU and IASB. In this way there is a possibility to get Swedish views on accounting regulatory work met.

One example of this is the in recently revised Standard RR 1.00, that has its prototype in IAS 22.

IAS 22, allows, as described above, an extension of that time limit only in extraordinary cases. According to the new recommendation from Redovisningsrådet in Sweden, the maximum amortisation period will continue to be 20 years, but provided that the time of use can be shown to exceed 20 years

there is a possibility *in exceptional cases* for a lengthening of the amortisation period.

A renewal of Standard RR 1.00 will be adopted in Sweden and applicable to financial years starting from 1 January 2002 .

According to chapter 4, section 2 of Årsredovisningslagen (The Accounting Act) in Sweden, purchased goodwill may be accounted for as an intangible asset. In the light of the emerging number of acquisitions in business life, purchased goodwill will probably be an issue of rising importance not only for companies in the IT sector but also for companies in more traditional lines of business.

“The New Economy”

The increasing value of intangibles may be traced to information and relationships, which are things hard to see and measure. Products, people, companies and countries can be connected electronically.

Capital in the traditional meaning often refers to plants and production equipment. New forms of capital have become of great importance when valuing a company. In the last years intellectual, human and structural capital have been in focus. These are factors that can be referred to as components of the concept “the New Economy”.

Traditional accounting systems can be regarded as focused on transactions and historical costs. There are opponents to this traditional accounting system asking whether accounting for companies in “the New Economy” may need a new set of measurements to give another perspective on a company’s result and financial position. During the last decades business people have started to focus more on flow and change. Information provided in the income statement showing the flow of transactions over a period of time grew in importance in comparison to the balance sheet showing the balances of a specific date.

One characteristic of companies taking part of “the New Economy” is the speed in growth. Growth through acquisitions was an every day phenomenon to many actors.

It is obvious that in companies acting in “the New Economy” during the last few years, there has been a major discrepancy between the book value of a company’s assets and liabilities and the market value of that company’s shares. This can be reflected in the emergence of huge goodwill items in connection to acquisitions.

Business Focus

A number of acquisitions in the Swedish IT sector were financed by the acquirer through issuing new shares and using the new shares as payment for the acquired company. The emergence of purchased goodwill is not affected by this way of financing an acquisition. Investments of this type are accounted for in the same way no matter in what form the payment of the shares is made.

It is interesting to notice that those Swedish IT companies that followed a more traditional and cautious way of acting during the end of the 1990s have handled the bad times for the sector in a better way than others. This is exemplified with HiQ, one of the companies we have presented in a close-up. HiQ preferred to grow primarily organic but did also acquire companies provided that they were profitable. One important factor when acquiring a company, according to HiQ, is that the acquired company must have ability to pay off the goodwill acquired in connection to the transaction. The other company that this thesis describes in a close-up, TietoEnator, is an example of a company choosing a blend of the two strategys, the purchasing strategy and the pooling of interest strategy. At the time of the merger between Finnish-based Tieto and Swedish-based Enator, the pooling of interest method was of utmost importance for both companies. The purchase method would have brought goodwill to large amounts, and the companies themselves say that it is not clear whether the deal would have taken

place should the chosen method not have been possible. The purchase method would have been too expensive to carry forward.

The issues around goodwill items that occurred during year 2000 had from our point of view to do with acquisitive business strategies with focus on high-speed expansion together with the neglect of profitability. The market's pricing of companies in the IT sector seems to have been too optimistic. The potential problems concerning the ticking bombs hidden in huge goodwill items seemed to have been neglected or perhaps not even understood by many.

The fact that the business is "new", and that many of the spokespersons from it considers current accounting regulations unfit for their purposes and business is well-known. The values in the industry is not believed to be seen in traditional reports. The companies try to explain these values in their own way, in the Annual Reports. The comparability between chosen ways to present each company's values are subjective and differ greatly.

The industry during the year 2000 suffered. Their market values (i.e. stock prices) had fallen from great sizes to almost nothing. The earnings had not met expectations, and the investors were becoming skittish. This can be explained in from the fact that investors did not offer new capital to the industry, which was considered overvalued. The demand for product and services that the industry provided, did not increase but decrease. The "big" pioneers, Framfab, Cell Network and Icon Medialab had great difficulties not only in coping, but actually in surviving. It was a fact that earnings did not meet expectations, or to put it more clearly, did not even cover the costs of the same companies. This picture was seen all through the industry.

The goodwill item was from the beginning not really discussed. When the business faced the downfall this item became more focused upon. It was suddenly a grave threat to the companies. The amortisation could easily be explained when the purchased companies were considered valuable, but that was not possible when the purchases, and also the whole corporation had lost maybe

90 % of its market value. As a part of a cleansing, and according to regulations concerning goodwill, the companies were forced to make huge write-downs in order to seem responsible, and legal, to the market. Some companies still can not do “proper” write-downs since the cost would throw them into bankruptcy. The industry has made write-downs of almost 6 billion SEK, but this is not enough and this picture will probably remain for the IT-industry for some years.

Sweden was an early actor in the Internet business, as well as the USA, Finland and others. Early entrance can be successful. It can also be hazardous since new markets are set on unsteady ground and laws and regulation have not adapted. Regulation try to keep up, but the industry’s economic prerequisites change with the moodswings of the business life.

From the Annual Reports different conclusions can be drawn. The hard times are visible in the reports, both in comments and in numbers. The way the companies present themselves in the Annual Report have changed. The vision of great expectations and bright future has been changed to explanations on how to survive. Many companies, of which Hiq is one, show charts on the upgoing demand for their services, and present the names of well-known customers from traditional industries, like car manufacturing, medical companies, and defence. The “boring” traditional industries are at present used to bring security to the shareholders. Many IT companies try to diverse from having a few large customers from telecom, internet, and mobility to diversifying into many fields. The strategy of having customers from several industries may be used to calm down the influence of business life and to spread the risks of one industry having difficulties and cutting down on buying IT services and IT products.

Looking at key ratios and income measures, the companies have changed the way they present themselves. Today, the outcome is lower when calculating key ratios and other measures than those from earlier years. Instead strengths are presented mostly in facts of diversifying into new markets, reorganizing and writing down goodwill. Understanding key ratios and income measures is of utmost importance for readers of economic information from this industry, since it is not easy to compare reports directly. It is clear that key ratios presented are

chosen with care so that they show one side of the company. Today the IT sector present rather traditional key ratios and measures compared to the ones that was presented when the industry was on a high. The soft assets were considered and valued as the “gold reserve” in the company and these items explained what the goodwill item really consisted of. This is also discussed above.

Purchasing Strategy – Good or Bad?

In many new markets, size is considered a great advantage. This is one of the reasons for choosing a purchasing strategy. In the industry we are looking at, the largest companies were considered strongest by the market, and their purchasing strategies were applauded. The large companies had great influence in the business life as well and they were considered winners by the market, since early establishment on a new market was considered great key success factors. Investors from all over the world handed for example Framfab money to get a lead position in the race towards market shares and lead position, sizewise. Also, early entrance in other markets other than the Scandinavian was considered a future key success factor. Note that in almost no discussions the issues of earnings or goodwill amortisation were seen as problems.

The industry was new, and wanted to seem separate from the old, traditional industries, and the concept “the New Economy” was founded. No old ways could be used to understand this the new way to conduct business. The new men and women that lead the way had not much in common with the old ways, they said.

History in economics contain the introduction of new markets. In new markets, size has been set equal great market shares. So, here the old and the new agree.

The different ways to purchase or to merge with companies in order to grow and to gain synergy effects differ. Those companies that did grow organically and had a restrictive purchase strategy, like HIQ, were considered boring by the

investors in the beginning. Today the picture is different. HIQ is considered reliable and strong.

The market is not always consistent. From the beginning the purchasing strategy was applauded, in the end it was rejected.

The IT Sector in the Near Future

What will happen in the future? As said before, many companies talk of *diversifying* as strategy. This means they will try to expand the customer groups from mostly mobile and telecom industry to more traditional sectors. To turn to government with its healthcare, defence, schools and other's are examples of this strategy. Also forestry, medical industries and other smaller business are focused upon. Many companies are forced to sell their subsidiaries in order to get petty cash to survive until the down period sets off upwards. This is often done with large deficits when looking at purchase price and sale price, but it brings survival for some time.

Also, the industry has to make large *write-downs* on their remaining (still huge amounts) goodwill items. Some of the companies do not seem to be able to afford this, and if regulation would force them, they would have to file for bankruptcy.

8. CONCLUSIONS AND REFLECTIONS

8.1 Conclusion

We now return to the basis of this research, the main issue:

Is traditional accounting regulation applicable on companies in "the New Economy" where growth through acquisitions was believed a key success factor superior to organic growth?

General Conclusion

The international debate concerning goodwill and other types of intangible assets includes the topic that accounting regulations in force may fail in the attempts to give the correct picture of the value of, in particular, knowledge intense companies. There may be pressures for extended disclosure concerning goodwill in financial statements in the future to avoid negative reactions from the market. A higher degree of transparency may have a positive effect on the stock market and may lead to better evaluations of companies.

Underlying facts concerning position and result of a company can be highlighted in notes. Open disclosure and additional information concerning goodwill and other intangibles in notes, can to a large extent complete the picture presented in the income statement and balance sheet. No limits are set regarding voluntary disclosure, but understandably enough companies may hesitate to disclose too much when taking competitive considerations.

The question of credibility must be considered crucial to most companies acting in the Swedish IT sector during the last few years. The importance of adequate external accounting information must be highlighted. Companies in this sector of Swedish business life could be characterised by explicit acquisitive growth strategies during a brief period, by which followed vast goodwill items in annual accounts covering year 2000.

From the material we have presented in this thesis it is clear that according to Swedish regulations purchased goodwill should be regarded an asset, and accordingly recognised in the balance sheet and amortised over its economic life.

To consider the purchase price for goodwill from another point of departure than is done with tangible assets, does not seem correct concerning whether to amortise goodwill or not. The value of purchased goodwill is subject to amortisation reflecting the fact that the value probably declines over time.

Accounting issues concerning goodwill and other intangibles are of current interest in large international standard setting bodies. According to recent regulatory work presented by FASB in the United States, the economic life of goodwill and certain other intangibles will be considered constant. In consequence of this, no amortisation according to plan shall be carried out. Instead, companies will have to test whether there is a requirement for a write-down of goodwill and other intangibles on at least a yearly basis.

This new regulation will probably affect IASB to take actions in the same direction. If not, there will be considerable differences between companies applying accounting recommendations according to IASB and others using standards provided by FASB. These diversities will result in enhanced difficulties in comparing and analysing companies on the international arena.

The opinions of stakeholders like shareholders, analysts, employees, government and others will have to be considered for evaluating new ideas for regulation. The industry has not, so far, been quiet about what does not fit into this “the new

economy”, like regulation on accounting and other, although the debate is less heated today. It is also important to know that the persons that lead these new companies are not from the same groups that built the industrialized world. The ingeneurs and the business people have a new group to consider when ruling the business life: the young, verbal, bold computerized generation. This new group does not play by the old rules and the reason for this is that they are pioneers in a new business (that does not have its like at present).

The IT sector in Sweden has the following set of rules to follow: the Swedish rules, regulations and recommendations. All the companies in our research population differ when applying these sets on their own accounting, although all keep within “limits”. The evaluation of goodwill seems to differ vastly between the companies, and so does the size of their goodwill items. Many have made vast write-downs but not all seem to have written off enough. Should the European regulators and therewith Swedish regulators, follow the American rules with the impairment test, many will have problems with handling this without risking the company. But for the year 2000, the write-downs were huge, and at the same time few companies showed positive operative earnings.

So to answer shortly, the accounting rules are maybe not directly applicable to ”the New Economy”, as far as the industry itself wishes to see it. But since the market does not seem sure about how to regulate the new values, the traditional ways must stay.

8.2 Suggestions for Further Investigation Connected to Our Field of Research.

We consider it very interesting to conduct a study of the Swedish IT sector in about a year or two from now. The reason for this is the actual threat against survival for numerous IT companies. At present about twenty Swedish IT companies are in the danger-zone to empty their cash and bank within a period of about six months⁹⁰. In fact, a number of the businesses in the sector are facing bankruptcy. What will the sector look like in a year? Which companies are the survivors and why? What did their acquisition strategies look like?

Another field of interest is the new set of regulations by FASB, FAS 141 and FAS 142, concerning goodwill. What impact will the new regulatory work dealing with goodwill have on business life in the United States? How will the new regulation affect the inclination to business acquisitions when the possibility to use the pooling of interest method has vanished?

Closely connected to this is the question whether FAS 141 and FAS 142 will have an impact on the regulatory work conducted by IASB and EU? In what direction will that work move?

⁹⁰ Leijonhufvud, 2001-11-15

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APPENDIX 1.

The Magazine Affärsvärlden's website at 2001-07-20

The IT-consultant index of 29 companies

Explanation:

60 IT 6010 IT-and internet consultants

Consultant companies that provide IT and internet solutions

6020 Software

Software producers

6030 Computer distributors and sales

producers of computers and accessories, and datastorage.

Companies that sell or distribute computer hardware.

6010

1 Adcore

2 Adera B

3 Alfaskop

4 AU-System

5 Cell Network

6 Cyber Com

7 Dimension

8 Enea

9 Framfab

10 Frontec B

11 HIQ

12 Icon

13 IMS Data

14 Kipling

15 Know It

16 Mind

17 Modul 1

18 Mogul.com

MSC B

19 Novotek B

21Proact

22 Pronyx

23 Resco B

24 RKS B

25 Softronic

26 Teleca B

27 Tietoenator SDB

28 Turnit B

29WM-data

APPENDIX 2

Questions for HiQ Interview 2001-11-06

(The interview was done in Swedish, and has been translated for the thesis)

- 2 Ask Anna Jennehov to introduce herself. Education, age, earlier work experience and so on
- 3 Give information on the fact that we have studied the Annual Report
- 4 Addition concerning acquisitions (in Swedish: förvärv).
- 5 Have changes in the industry brought any change in their strategies?
- 6 Adaptation to the industry?
- 7 Ask for a description on acquired value (in Swedish Annual Reports Hiq parts between goodwill and acquired value (=affärsvärde) item is one part, the affärsvärde is another, which we want to understand)
- 8 Acquired business value is amortised in 5 years, goodwill in 10 ?
- 9 Why haven't they put acq. Business value in the goodwill item?
- 10 Hur redovisar ni goodwill (för HiQ menar vi även ingår förvärvat affärsvärde)?
- 11 Amortisations?
- 12 Is there within HIQ discussions on whether you would like the regulation on goodwill to be different? If so, how?

Key Ratio Focus

- 1 Has the goodwill item influenced the presented key ratios in the Annual Report?
- 2 Profit with dilution? Warrants?
- 3 Foreign owners (=56%), positive or negative in these bad times?
- 4 Mostly, reading the Annual Report, the owners are security brokerage companies. Do they have a long term commitment? Discuss.
- 5 Comments on the Cash Flow Analysis?

- 6 HIQ's customers come from telecom (37%) industry (ericsson, nokia, motorola) and telecom operators (27%) (banverket, netcom, sonera. Also Internet companies. The business cycle for these industries are at a downfall. How does their austerity plans in your operations?
- 7 Finance and Defence industries, are they markets you want to expand on, in order to dilute threats from down periods in specific industries?
- 8 In the Annual Report 2000 no write-downs on goodwill was to be found. Is this still the case? If write-downs have been made, were they not known by the end of the year?

Additional Questions

- 1 How does Hiq cope with the weak business cycle that is reality for the IT-industry?
- 2 Notation 36, "investments that can be said strengthened the capacity is low compared with those which have kept the same, explain please.
- 3 In your strategies you talk about growing organically and at the same time "goal is to be leading consultant in Europe regarding telecom and mobility". How is this possible without acquisitions (organic growth)? How does HIQ respond to that today, competitors are cheap to buy and HIQ have cash and bank balances.....?
- 4 They act in Norway and Finland, have the focus stayed European or is it Scandinavian?
- 5 Long term financial goals is organic growth of 30% and an operative margin of 15%? Are they realistic today?
- 6 Långsiktiga finansiella mål org tillväxt på 30% och rörelsemarg om minst 15%.
- 7 Has the fact that many of the operators in the market have great problems and are letting personnel go, and at the same time that the market for consultants
- 8 Have the events during the year changed your view on acquisition strategies? (framfab almost filed for 11, frontec, icon, ms2 and others have great problems...)

In General on the Industry – A Reality Check?

- 1 Many IT-companies have heavy goodwill items. Discuss.

Appendix

- 2 The debate on goodwill has been brought forward mainly from companies with acquiring strategy (in stead of organic growth) and who have paid mainly with stock in "inflated" prices.Discuss.
- 3 Have the communication with the auditors changed?
- 4 Has the control of goodwill changed?
- 5 Do you (AJ) that the big downfall within the industry could have been avoided?
- 6 How important do You consider that the "big" voices in the industry, Birgersson and Stael von Holstein have been? Has HIQ acted in another way? Have they shown a misleading picture?
- 7 Has globalisation brought uniformity to handling intangibles and goodwill?
- 8 Today the differences grow between IASB and FASB (Europe and USA). Will this bring difficulties in accounting, knowing that Hiq have owners from both regions?

APPENDIX 3

Mail questions to TietoEnator translated from Swedish.

As an introduction we would like you to give a short description of the company concerning size, geographical spread of business activities, aim and direction of business activities, type of customers, a description of the owners and the profile of the employees.

1. Please describe the strategy/strategies of TietoEnator concerning growth. We are interested in the strategies until now concerning acquisitions, organic growth, geographical markets and so forth.
2. In the light of the changing market situation for your line of business: Is there a change in the growth strategy of TietoEnator concerning the future? If this is the case – in what way/ways has it changed?
3. Please describe how goodwill is handled/accounted for within TietoEnator. What time period is used for amortisation? How have discussions dealing with the concept of goodwill been conducted? Which regulatory work do you refer to concerning your handling of goodwill?
4. Why is (are) this (these) method/s chosen?
5. Are any impairments of goodwill carried out? Where appropriate - For what reason?
6. Is a dialogue conducted with your company's auditors concerning the handling of goodwill? What does the dialogue look like? Is there a conformity between the auditors' point of view and the company's opinion on this subject? If not – in which areas are discrepancies?
7. Key-ratios : When deciding what key-ratios to disclose in the Annual Report, do you take the effect of goodwill in consideration? How has this influenced you and which choices have been made?
8. Has your opinion on how goodwill affects key-ratios changed over time? We are referring to the turbulent development for your line of business during the last few years.
9. Do you have any opinions on the goodwill debate that has been going on concerning companies in your field of business?

