



UNIVERSITY OF GOTHENBURG
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GOOD ACCOUNTING PRACTICE IN SERVICE CONTRACTS –
ACCORDING TO
THE SWEDISH SUPREME ADMINISTRATIVE COURT

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Authors:

VICTORIA LINDBERG

NATHALIE SUNDBERG

Supervisors:

ANNA KARIN PETTERSSON

EMMELI RUNESSON

Abstract

This thesis investigates what good accounting practice in terms of service contracts is according to the Supreme Administrative Court and whether the arguments in the grounds for the decisions still are sustainable compared to current standards. Furthermore, it investigates how the accounting solutions approved by the Supreme Administrative Court relate to the quality of information investors are provided with, which is of relevance since the precedents are used as guidance by firms and the Swedish Tax Agency. To analyze the legal cases an argumentation analysis is used. After analyzing the results from the argumentation analysis, some guidelines for what the court considered good accounting practice were observable. Firstly, expenditures for acquisition of future profitable contracts are allowed to be expensed immediately, even though revenue from the contracts is recognized as linear during the entire contract period. Secondly, recording of accruals of income is approved in cases when the future commitment has a greater as well as a limited extent. However, the court found that for recording accruals to be allowed, the amount must be material. Further, our conclusion is that the arguments in the Supreme Administrative Court's grounds for the decisions in each of the reviewed legal cases still are sustainable compared to current standards, with one exception where no conclusion could be made. In addition, half of the accounting solutions approved by the Supreme Administrative Court provide investors with high quality information in accordance with the definition of quality in this thesis. In the other cases, the approved accounting solutions are not providing investors with high quality information.

List of abbreviations

BFNAR	–	Bokföringsnämndens Allmänna Råd
FASB	–	Financial Accounting Standards Board
IAS	–	International Accounting Standards
IASB	–	International Accounting Standards Board
Prop.	–	Proposition
RR	–	Redovisningsrådets rekommendation
The Board	–	The Swedish Accounting Standards Board

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1. INTRODUCTION

This thesis investigates what good accounting practice in terms of service contracts is according to the Supreme Administrative Court ¹ and whether the arguments in the grounds for the decisions still are sustainable compared to current standards. Furthermore, it investigates how the accounting solutions approved by the Supreme Administrative Court relate to the quality of information investors are provided with. In this chapter background, problem statement, aim and scope of the study are presented.

1.1 Background

In Sweden, there is a strong connection between accounting and taxation of firms, concerning accruals of income and expenditure (Skatteverket 2010). According to the Income Tax Act² 14:2 (1999:1229), results must be reported on accrual basis³ and good accounting practice⁴ unless otherwise is specially provided by law. This is called “the connected field”⁵ and implies that if the firm follows good accounting practice the reported results will also be fiscally accepted (Skatteverket 2010). The definition of good accounting practice is not distinct, but is generally explained as existent practice in a qualitatively representative group of accountable persons⁶ as well as statements from normative organs (prop. 1995/96:10). According to the legislator, statements from normative organs shall not automatically be considered good accounting practice. Consequently, the meaning of this legal standard, as a final step, ought to be decided by court. Due to the connected field, different opinions about the content of good accounting practice therefore sometimes lead to a court procedure between the Swedish Tax Agency⁷ and the firm.

The number of adjudicated cases in the Supreme Administrative Court regarding accruals of income and expenditure and whether they comply with good accounting practice, shows that the importance of these issues has increased concerning taxation of firms (Norberg 2003). Norberg (2003) claims that the explanation is the Swedish Tax Agency’s increased attention to these issues as well as the change and progress in accounting due to the influence of international accounting standards. An issue that has been discussed since the 1970s is accruals of income and expenditure from service contracts and whether they comply with good accounting practice. The discussion started with the Supreme Administrative Court’s judicial decision in the Anticimex case from 1977. Other cases are Arvika Energi AB RÅ 1994 ref. 2, Karlshamn’s hamn AB RÅ 2003 not. 127 and Key Code Security AB RÅ 1999 ref. 32. The topic is once again up for discussion as a result of the Supreme Administrative Court’s judicial decision concerning the Tele2 case from the autumn of 2010 (Virin 2010).

According to international accounting standards, service contracts are defined as a contractual execution of an assignment during a given period (IAS 18 p. 4). Service contracts can last for one or

¹ Högsta Förvaltningsdomstolen.

² Inkomstskattelagen.

³ Bokföringsmässiga grunder, explanation in Appendix.

⁴ God redovisningssed. The term is used in the Nordic countries and is collected from Flower, J. (1994) *The regulation of financial reporting in the Nordic countries*, Fritzes.

⁵ Authors’ translation.

⁶ Redovisningsskyldiga.

⁷ Skatteverket.

more accounting periods. In perennial service contracts it is difficult to determine when revenues are realized due to the possibility of using three different approaches (Norberg 1999). In cases where the contract is concluded when payment is made, the revenue can be regarded as fully realized in connection with the payment. Another approach is to report revenue gradually during the contract period or at the completion of the contract, i.e. at the end of the contract period.

Characteristic problems regarding service contracts are, for instance, the uncertainty concerning what achievement is demanded by the contract, depending on whether the circumstances demanding action from the vendor will occur or not (SOU 2008:80). This complication concerns contracts resembled to insurance contracts and is the issue in RÅ 1999 ref. 32, the Key Code-case, which are part of the empirical material investigated in this study. In cases where there is no uncertainty whether the achievement must be carried out, another problem is estimating the extent of the achievement. This problem concerns, for example, season cards when the customer receives unlimited advantage of the service during a specific period.

Although the connection between accounting and taxation has advantages, a disadvantage is that there is a risk that the connection affects development of good accounting practice in a negative way, since changes to increase the quality of accounting are restrained if it causes earlier taxation (Skatteverket 2010). In a literature study, Artsberg (1996) argues that as long as there is a connection between accounting and taxation, it will impede the development of accounting. The motive is that in cases where the accounting raises the income the higher the taxation will get, which is not in accordance with the firm's objective. Since accounting practice leads the accounting development in Sweden, there will probably be an indirect tax influence on accounting practice if the tax rules will remain being built on accounting. The reason is the concern from firms to reduce taxes, which will be a factor in determining standards and legislation for accounting. As long as the connection between accounting and taxation remains, it will be difficult to introduce new accounting solutions which will hinder the development, and consequently the quality of accounting.

1.2 Problem statement

Good accounting practice has an essential impact on taxable income and is the basis for which period income and expenditure are allocated, due to the connected field of accounting and taxation in Sweden. Since accruals influence the tax amount, this issue can be described as a conflict of interest between firms and the Swedish Tax Agency. In those cases when the Swedish Tax Agency is of a different opinion about the solution than the firm, it can lead to a court procedure. Laws and standards are not detailed enough to clarify how every specific situation regarding service contracts shall be reported. It is in these cases up to the court to decide whether the solution complies with good accounting practice. Based on the fact that there have been legal cases in the Supreme Administrative Court concerning service contracts, our conjuncture is that it is a problem for service firms and the Swedish Tax Agency which period income and expenditure shall be allocated to in service contract reaching over several accounting periods. As mentioned in the background, characteristic problems regarding service contracts, which are concerned in legal cases, are the difficulties to estimate the extent of the achievement as well as the uncertainty concerning which achievement is demanded by the contract. The uncertainty concerning which achievement is demanded depends on whether the circumstances that require an achievement from the vendor will occur or not.

Good accounting practice is changeable and Kellgren (2003) claims that changes are seldom preceded by modifications in law or recommendations. According to Norberg (1999), it is essential to continuously reconsider what good accounting practice is in court, because of the incessant changes. A problem could be when the taxation shall follow good accounting practice and where there is an old judicial decision in the area. Consequently, a question is whether the earlier judicial decision shall be relevant or not, if applying the judicial decision would result in a conflict with good accounting practice.

Furthermore, Norberg (1999) points out that it is of relevance to make the legal position clear and that tax payers, the Swedish Tax Agency and the court must be updated and evaluate good accounting practice, due to the rapid changes. Moreover, Norberg (1999) argues that the value of judicial decisions are limited since there will always be new changes in good accounting practice when the judicial cases are finally completed. This is supported by Bjuvberg (2006) who argues that legal usage may be of importance for the determination of good accounting practice in particular cases, since the court's decision is supreme. However, Bjuvberg (2006) continues that a consequence of the dynamics of the legal standard is that particular decisions quickly lose their value of precedent. The Supreme Administrative Court's decisions are relevant only in a short-term perspective, due to the fact that a precedent is a ruling in a specific case as well as the dynamic feature of good accounting practice.

The problem regarding accruals of income and expenditure and whether they comply with good accounting practice affects every firm, due to the connected field of accounting and taxation. In order to legitimize this study, we must make the conjecture that all firms want their accounting solution to be accepted by the legal system and finally by the Supreme Administrative Court. It is in the Swedish Tax Agency's interest as well to have a clear view of what good accounting practice is in order to give other firms correct taxation. Since the legislator states that good accounting practice as a final step ought to be decided by a court, it is of relevance to find out what the Supreme Administrative Court has determined to be good accounting practice.

Concerning the above mentioned problem we want to investigate the following as research questions:

- *What is good accounting practice in terms of service contracts according to the Supreme Administrative Court?*

In order to answer what good accounting practice is, a necessity is to investigate what arguments have been of crucial relevance in the Supreme Administrative Court's grounds for the decisions concerning service contracts.

As mentioned above, the value of judicial decisions is limited since there will always be changes in good accounting practice when the outcomes of legal cases are finally decided. For instance, standards from the Swedish Accounting Council⁸ and the Swedish Accounting Standards Board⁹ (the Board) regarding service contracts have been released after the judgments of the legal cases concerning revenue from service contracts. In order to review the current value of the precedents

⁸ Redovisningsrådet, RR 11.

⁹ Bokföringsnämnden, BFNAR 2003:3.

concerning service contracts as well as to find out whether there are any deviations from existing accounting standards, we want to answer the following question:

- *Are the arguments in the Supreme Administrative Court's grounds for the decisions for the approved accounting solutions still sustainable compared to current standards?*

As claimed by Artsberg (1996), the connection between accounting and taxation affects the quality of accounting. According to Soderstrom and Sun (2007) the quality of accounting is indirectly affected by a country's legal system. When there is a conflict between a firm and the Swedish Tax Agency, it could then be a complication that the case is to be solved by the legal system and not by economists. Consequently, it is also of relevance to investigate how the judicial decisions relate to quality of accounting.

- *How do the accounting solutions approved by the Supreme Administrative Court relate to the quality¹⁰ of information investors are provided with?*

1.3 Aim of study

The aim of this study is therefore to give an answer to what good accounting practice is in terms of service contracts according to the Supreme Administrative Court as well as to find out whether the arguments in the court's grounds for the decisions still are sustainable compared to current standards. It is of importance for firms and the Swedish Tax Agency to be certain of what good accounting practice is, due to the connection between accounting and taxation, and whether the precedents still are relevant to use as guidance for taxation decisions. Additionally, the aim is to find out whether the judicial decisions support a qualitative solution or not, since the accounting solution in the precedent is used as guidance by firms and the Swedish Tax Agency.

1.4 Scope

Since it is the juridical person who is the tax subject all legal cases are about juridical persons. Consequently, a natural scope of this study is that it only concerns juridical persons. Furthermore, we only review cases from the Supreme Administrative Court since these legal cases are precedents. The reviewed legal cases concern service contracts in the connected field between accounting and taxation and not pure taxation issues that refer to chapter 17 in the Income Tax Act. Moreover, the Board elaborates a new regulation, which is the K-project. Due to that the entire K-project is not completed, finished part of the K-project is not either discussed in this study, since it would still not give a complete view of the K-project. Furthermore, IAS 18 Revenue is not discussed due to that the differences between IAS 18 and RR 11 do not have any impact on the studied area. Additionally, none of the firms in the legal cases are listed.

¹⁰ There are several definitions of the term quality. In this thesis information is considered qualitative if the information can be used for future earnings or revenue estimation in accordance with Su (2005), Dichev and Tang (2008), Dichev (2008) and Zhang (2005). We are aware that this definition does not cover the entire spectrum of qualitative information desired by investors and thereby the limitations of this definition.

1.5 Outline

Chapter 2 – Frame of reference

The chapter includes a description of good accounting practice, the hierarchy of legal sources and the connection between accounting and taxation. Furthermore, the Swedish regulation for service contracts and the IASB Framework is described followed by a literature review concerning accounting for service contracts and accounting solutions' influence on the quality of information.

Chapter 3 – Methodology

The chapter presents and motivates the method used through the thesis, including research approach, information and data gathering as well as data analysis. A discussion concerning the reliability and validity of the study concludes the chapter.

Chapter 4 – Empirics

Includes a description as well as an argumentation analysis of the legal cases from the Supreme Administrative Court concerning service contracts. The described judicial cases are Tele2 Sverige AB 1784-08, Karlshamn's hamn AB RÅ 2003 not. 127, Key Code Security AB RÅ 1999 ref 32, and Arvika Energi AB RÅ 1994 ref. 2. The chapter aims to provide insight into the argumentation in the legal cases.

Chapter 5 – Discussion

Provides a discussion of the results from the argumentation analysis. Firstly, the legal cases are analyzed from what the Supreme Administrative Court has considered good accounting practice. In addition, the arguments in the Supreme Administrative Court's grounds for the decisions are analyzed from the perspective of whether they are still sustainable compared to current standards. Secondly, the accounting solutions approved by the Supreme Administrative Court in the judicial decisions are analyzed in the perspective of quality.

Chapter 6 – Conclusion

This chapter aims to answer the stated research questions by making conclusions from the frame of reference, the empirics and the discussion chapter. The chapter is concluded with limitations of the study and suggestion for future research.

2. FRAME OF REFERENCE

The frame of reference includes a description of good accounting practice, the hierarchy of legal sources and the connection between accounting and taxation. Furthermore, the Swedish regulation for service contracts and the IASB Framework is described followed by a literature review concerning accounting for service contracts and accounting solutions' influence on the quality of information.

2.1 Good accounting practice

In Sweden annual reports must be established in accordance with the Annual Accounts Act¹¹ (1995:1554). The Annual Accounts Act is designed as a legislative framework, which means that the regulations need to be complemented to be applicable (Kellgren & Bjuvberg 2008). According to the Annual Accounts Act 2:2 (1995:1554), the annual report shall be prepared in accordance with good accounting practice which is determined by applied practice and normative organs (prop. 1995/96:10). Consequently, the function of good accounting practice is to supplement the legislation.

However, according to the legislator good accounting practice shall not only be defined as existent practice or statements from normative organs (prop. 1998/99:130). The legislator explains that good accounting practice shall be elaborated by an interpretation of accounting laws. The interpretations shall be based on the wording of the law prescriptions and from the prescriptions' purpose and general principles. Sometimes a traditional interpretation of the law is not enough and in these cases a complementary interpretation is required. This complementary interpretation shall be established in existent practice among accountable persons. However, existent practice is as mentioned not enough due to the required development in accounting as well as the difficulty to determine the content of practice. Good accounting practice needs to fulfill certain quality requirements to be able to complement the law. These quality requirements shall not only be determined by book-keeping and accounting aspects, but also fiscal aspects as well as the international development concerning accounting. The legislator states that the standardization within the European Union and International Accounting Standards Committee, today International Accounting Standards Board (IASB), is of certain importance. Normative organs have the function of filling out the laws when the interpretation is complicated. The legislator points out that this does not mean that every statement from these organs, even though it has a powerful impact, should be considered good accounting practice since this would be in conflict with the constitutional law. In other words, statements from normative organs are not mandatory. Therefore good accounting practice, as a final step, ought to be decided by a court.

2.2 Hierarchy of legal sources

Legal sources¹² are hierarchically classified and therefore it is significant to clarify the sources' diverse value as authority reasons a court must consider in its grounds for the decision. Constitutions, laws and established rights have highest priority followed by legislative history and precedents, doctrine and other legal sources like institutional recommendations (Peczenik 1995). Precedent is guidance for similar cases in the future and is a ruling in a specific case that becomes an authoritative pattern for court decisions. Institutional recommendations are for instance directions

¹¹ Årsredovisningslagen.

¹² Rättskälla.

from the Board. Courts are mandated to regard constitutions, laws and established rights as authority reasons in its decision making argumentation, while legislative history and precedents are not mandatory but *should* be regarded as authority reasons. Neither doctrine nor institutional recommendations mandatory but are *allowed* to be regarded as authority reasons in court decisions. Good accounting practice is part of established rights and is consequently higher up in the hierarchy than directives from the Board. Therefore a court is obligated to make decisions that comply with good accounting practice but not obligated to follow the complementary set of regulations as long as it has not been established as good accounting practice. Likewise, precedents are hierarchically superior to the complementary set of regulations if it not yet has been established as good accounting practice.

2.3 The connection between accounting and taxation

The connection between Swedish taxation and accounting goes back to 1928 and 1929 when Municipal Income Tax Act¹³ and the Book-keeping Act were established (Skatteverket 2010). The main parts of the connected field involve accruals of income and expenditure although it also includes valuation of liabilities and assets.

The Income Tax Act 14:2 (1999:1229) states that, in cases where there is no specific tax rule, results shall be estimated in accordance with accrual basis and income shall be recognized as revenues and expenditures as costs in the time period that is in accordance with good accounting practice. This is called *the material connection* of the connected field. Good accounting practice is an important term in the Income Tax Act 14:2. According to legal usage, good accounting practice has the same meaning in the Income Tax Act as in the Annual Accounts Act, but is however not defined in the tax law (Skatteverket 2010). In the Income Tax Act the expression is only used to determine the time period for taxation (Skatteverket 2010).

As previously mentioned, the Income Tax Act states that accruals shall be reported in accordance with the accounting as long as they comply with good accounting practice and do not conflict with any taxation rule (1999:1229). If there is more than one way of reporting accruals in accordance with good accounting practice, the tax payer is free to choose how to accrue (prop. 1999/2000:2 part 2). The tax authority is obliged to follow the chosen practice. At the same time the firm cannot change the accounting concept for taxation purpose, since both the firm and tax authority must follow the chosen concept. However, in cases where the firm has not followed good accounting practice, no part is bound by the accounting solution.

2.4 The Swedish regulation for service contracts

In Sweden, non-listed firms can according to BFNAR 2000:2 (p. 5) choose to apply the Board's general advice (BFNAR) or corresponding recommendation from the Swedish Accounting Council (RR). Regarding accounting for service contracts, this implicates that a non-listed firm can choose to apply either RR 11, which is based on IAS 18 Revenue, or BFNAR 2003:3, which in turn is based on RR 11. Private, smaller¹⁴ firms can today as an alternative choose to apply BFNAR 2008:1 (K2) instead of BFNAR 2003:3. BFNAR 2008:1 is beyond the scope of this study and is therefore not further described. Below is a description of the parts of RR 11 and BFNAR 2003:3 that is of relevance for the

¹³ Kommunalskattelagen.

¹⁴ Definition according to Annual Accounts Act 1:3.

thesis, starting with RR 11 due to that BFNAR 2003:3 is based on this recommendation. RR 11 and BFNAR 2003:3 do not need to be applied to immaterial entries (RR 11 and BFNAR 2000:2).

2.4.1 RR 11 Revenue

Initially, it is of importance to sort out whether there are any differences between accounting for juridical person and the consolidated accounts regarding service contracts, due to that it is the juridical person who is tax subject and all legal cases are consequently about juridical person. When it comes to accounting for juridical person, RR 11 p. 36 states that service contracts can be recognized in accordance with the special regulations in the Income Tax Act. These regulations are in the Income Tax Act chapter 17, which is not the issue concerned in the legal cases in this study. The legal cases concern chapter 14 of the Income Tax Act. According to RR 11, there is no difference in accounting for the issues in the legal cases in juridical person or in the consolidated accounts.

According to RR 11, a service contract is a contract where a firm accomplishes a service agreement within a specific time period lasting for one or several accounting periods (RR 11:4). Income from a service contract shall be recognized as revenue based on the degree of completion on the closing date when the economical outcome of the contract can be measured reliably. The outcome can be measured reliably when following four criteria are fulfilled (RR 11:20);

- The income can be measured in a reliable way.
- It is probable the seller of the service contract will receive economic benefits connected with the service.
- It is possible to decide the degree of completion at the closing date.
- Expenditures that have emerged during the period and expenditures still remaining to finish the service contract can be measured in a reliable way.

The method to recognize revenues in accordance with the degree of completion on the closing date is normally called the percentage of completion method (RR 11:21). The purpose with this method is to recognize revenue in the correct accounting period when the work is performed.

Income from a service contract is only allowed to be recognized when the benefits connected with the service are probable to be transferred to the vendor (RR 11:22). When the contract is established with the other part of the service contract, the vendor can normally make reliable estimations about the outcome that determines;

- Every parts' rights according to the service contract that will be provided and the amount that will be received.
- The payment the vendor will receive.
- The regulations for the economic agreement (RR 11:23).

It is possible to determine the degree of completion in a service contract in different ways, and the vendor shall use the method showing the degree in the most reliable way (RR 11:24). Different kind of assessments can be contained, depending on kind of service contracts, such as:

- Accomplished work according to investigations.
- Accomplished work on the closing date compared to the total level of work.
- The ratio between costs on the closing date and the total expected costs.

In cases where a service contract contains an undetermined number of activities, accruals of income shall be recorded linearly over the contract period, unless another method better reflects the degree of completion (RR 11:25). In cases with one more dominant activity, revenue shall be recognized when the most dominant part of the service contract is finished. In the beginning of a service contract, it can be uncertain or not reliable how the outcome will be (RR 11:27). Despite this, it can still be possible that the buyer will pay for expenditures of the period. In these cases recognized revenues must be limited to an amount that is equivalent with the expenditures the vendor expects to receive in payment from the buyer. Since the outcome is not reliable, no profit will be recognized. In cases where the outcome of a service contract cannot be estimated in a reliable way and it is not probable the buyer will pay for incurred expenditures, no revenue is recognized and incurred expenditures are recognized as costs (RR 11:28).

Service contracts can be priced in different ways, either as fixed-price, cost-plus contract or as a mix between them (RR 11 Appendix 2). With a service contract at fixed-price is a price already decided for the service. When the outcome of a service contract can be measured in a reliable way, income and expenditures that have originated from the service shall be recognized as revenues and costs in relation to the degree of completion on the closing date. How to measure the degree of completion is clarified above.

The cost-plus contract is calculated to the price per hour and estimated hours to finish the service (RR 11 Appendix 2). Normally the achievement is estimated by how much of the work that is finished. Finished but not yet invoiced work is accounted to invoice price and is recognized as revenue in the period the work is performed.

2.4.2 BFNAR 2003:3

There are few differences between accounting for juridical person and the consolidated accounts in BFNAR 2003:3. However, a difference is that the alternative method can be applied in the consolidated accounts as long as it is applied in the juridical person. Though, large¹⁵ corporate groups are not allowed to use this method. Further, the main method can be applied in the consolidated accounts even though the alternative method is applied in juridical person. These differences do not have any impact on the issue concerned in the legal cases, since the legal cases concern juridical person and consequently the discussion does not involve the consolidated accounts.

The definitions of a service contract in RR 11 and BFNAR 2003:3 are more or less the same. The definition in BFNAR 2003:3 is that; a service contract is a contracted service that shall be provided during a specific time period and can reach over one or several accounting periods. In BFNAR 2003:3, there is a main method and an alternative method for service contract accounting, which is in contrast to RR 11, where only one method is presented. The differences are presented below.

According to BFNAR 2003:3 (p. 24), income from a service contract shall be recognized as revenue only if it is probable that the economic benefits connected with the service contract will be received by the firm. The main method in BFNAR 2003:3 states that revenue from cost-plus contracts is the value of performed working hours and used material and the value shall be estimated from the

¹⁵ According to the definition in the Annual Accounts Act 1:3.

contracted price (p. 29). According to the alternative method, revenue from cost-plus contracts can be recognized when the invoice is created (p. 30).

Income from fixed-price contracts shall according to the main method be recognized as revenue based on the degree of completion at closing date (p. 31). The criteria for revenue recognition based on the degree of completion method in BFNAR 2003:3 correspond to the criteria in RR 11 p. 20. BFNAR 2003:3 p. 31 states that revenue shall be recognized when the economic benefits from the service contract probable will be received by the seller and when the income, degree of completion at closing date as well as emerged and remaining expenditures can be measured reliably. Furthermore, the criteria for a reliable measurement of the outcome in BFNAR 2003:3 p. 32 correspond to the criteria in RR 11:23, which are mentioned above. The degree of completion shall be measured in a reliable and consistent way (BFNAR 2003:3 p. 33). When the outcome cannot be reliably estimated, only the part corresponding to expected payments from the buyer shall be recognized as revenue (BFNAR 2003:3 p. 35). In correspondence with RR 11:25, shall income from a service contract that contains an undefined number of activities be recorded linearly over the period, unless another method better reflects the degree of completion (BFNAR 2003:3 p. 36). The alternative method implies that revenues from fixed-price contracts shall be recognized when the main part of the service is completed (p. 39).

Compilation of RR 11 and BFNAR 2003:3

	RR 11	BFNAR 2003:3
When shall the revenue be recognized?	When the outcome of a service contract carried out by a firm can be measured reliably, the income connected to the service shall be recognized as revenue based on degree of completion on the closing date (RR 11, p.20).	<p>Basic condition The income from a service shall be recognized as revenue only if it is probable that the future economic benefits connected with the service contract will be received by the firm (p.24).</p> <p>Cost-plus contract <i>Main method</i> – The firm’s revenue from the service is the value of the working hours and material used during the period (p.29). <i>Alternative method</i> – Some firms¹⁶ do not need to account the value of the working hours and material used during the period as revenue until the service is billed (p.30).</p> <p>Fixed-price contract <i>Main method</i> – The income related to a service shall be recognized as revenue based on degree of completion on the closing date when the above basic condition is fulfilled and when the firm reliably can measure the income, the degree of completion on the closing date and emerged and remaining expenditures (p.31.) <i>Alternative method</i> - Some firms¹⁷ are allowed to wait with recognizing income as revenue until the service is mainly completed (p.39).</p>

Table 1. Compilation of RR 11 and BFAR 2003:3. Own construction.

¹⁶ For more specific definition, cf. BFNAR 2003:3 p. 4.

¹⁷ For more specific definition, cf. BFNAR 2003:3 p. 4.

2.5 The IASB Framework

In cases when an issue is neither regulated in standards from the Board nor the Swedish Accounting Council, standards from IASB can be applied to solve the issue (BFNAR 2000:2). This implicates that the IASB Framework can be of importance in the argumentation in legal cases. The parts of the IASB Framework that is of relevance for the thesis, due to that they are discussed in the argumentation in the Tele2-case, is therefore described in this section.

The IASB Framework is created to provide a helpful guide for the creation of annual reports for users such as investors, accountants, auditors, firms etc. Even though the Framework to some extent is characterized by the statement sheet approach, it is dominated by the balance sheet-approach, which means the income statement numbers are determined by changes in the balance sheet. The Framework contains helpful definitions and criteria for when balance sheet and income statement shall be affected, which is presented below.

According to the IASB Framework, the definition of an asset is that it is a resource expected to bring economic future value to the firm and is a result of an occurred event (p. 49). The firm must be in control of the asset. The future economic value connected to assets emerges from an indirect or direct inflow of liquid assets (p. 53) and can be used in different ways, for example by producing a product or service the firm can sell, regulating a liability or as dividend (p. 55).

The Framework's definition of liability is that it is an existing obligation as a result of an occurred event, which is expected to result in outflows of resources, which includes economic benefits (p. 49). Characteristically for a liability is that the firm has a responsibility or obligation to act in a special way, an existing obligation, which normally is binding as a result of a contract (p. 60). The existing obligation emerges when the asset is delivered or a binding contract to purchase the asset is made (p. 61).

According to the IASB Framework, the term revenue is defined as an increase of the economic value in an accounting period as a result of payments or an increase of the value of assets. Revenue is also defined as a decrease of liability value that affects equity (p. 70). Cost is, on the other hand, defined as a decrease of the economic value under an accounting period as a result of disbursements or a decrease in the value of assets. Cost is also defined as an increase in liabilities that affects equity.

An entity does not only need to fulfill the above-mentioned definitions to be recognized in the balance sheet or the income statement. It also needs to be probable that the economic benefits connected to the entity will occur or leave the firm. In addition, it must be possible to measure the value of the entity in a reliable way (p. 82-83).

The IASB Framework has a balance sheet-based approach, but the matching concept¹⁸ is, however, briefly mentioned. According to the Framework, application of the matching concept is not supposed to lead to recognition of entities in the balance sheet that do not fulfill the definitions of assets or liabilities (p. 95). A discussion about the matching concept's influence on the quality of information follows further down in this chapter.

¹⁸ Explanation in Appendix.

2.6 Service contracts – from the literature’s point of view

We have conducted a literature review, which revealed that little is written about accounting for service contracts. Studies we found that are of relevance in this thesis, since they discuss issues concerned in the investigated legal cases, are as follows.

To recognize revenue from a service contract in accordance with the percentage of completion method, the income must be measured in a reliable way. A problem is the lack of definition of the term *reliable*. A suggestion made by Barlev (1995) is a probabilistic model. Barlev (1995) states that *“the earliest point for recognising revenues will correspond to the point where the probability that unexpected costs may nullify expected profits is quite low (less than 5%)”*. This method complies with the prudence concept. However, in order to use this model, access to previous data on cost deviations and properties of cost distribution is required, which is associated with increased expenditures.

According to Samuelson (1993) the accounting of advanced payments for services results in essential difficulties concerning the liability recognition. Samuelson (1993) makes the analysis from a FASB perspective, which is not the scope for this text. However, we find the overall ideas of interest for the thesis, since he analyzes some of the problems concerned in the legal cases. The main implication of the accounting of advanced payments for services is that the balance sheet includes deferred credits that overstate the probable future sacrifices entities would be required to make to fulfill their commitments, if it would be shown among liabilities. If shown in a separate category between liabilities and owners’ equity, the probable future sacrifices to fulfill commitments would be understated.

Further, Samuelson (1993) exemplifies cases where revenues shall be deferred. An example is when a retailer sells a product to deliver in the future. Since there is a risk that the buyer cancels the contract or that the seller is unable to deliver the product, revenues shall not be recognized immediately. There is also an obligation to in the future provide the buyer with the product, wherefore it shall be recognized as liabilities. As long as there is a risk for cancellation of the contract, the seller is prudent if the liability is equivalent to the amount on deposit. Another case is the case of rental. If money is received for future rental it shall first be recognized as deferred revenues, then revenues shall be recognized every month by the amount referring to the monthly fee. Samuelson (1993) further argues that revenues shall not be deferred in cases where there is a small or no risk that the customer can cancel the contract.

The difficulty in accounting of advanced payments for services emerges since the unearned revenue is shown as a not current deferred credit on the balance sheet (Samuelson 1993). When recognized like this, the liquidation of the firm is understated since the deferred revenue requires the use of fewer assets for fulfillment. Therefore, reliable and relevant measures of financial position necessitate relevant and reliable measures of liabilities. Relevant and reliable measures of liabilities are the probable sacrifice required to fulfill the commitment.

Samuelson (1993) claims that an appropriate criterion for revenue recognition is at the “critical event”, which would be either the time for rendering the service or, if customers pay in advance, the time for the inflow of resources that permanently, beyond any reasonable doubt, increase net assets. Other criteria that would need to be achieved are the ability to measure the sellers’ probable

sacrifices, the ability for the seller to perform the service, and the inability for the buyer to cancel the contract and receive a refund.

Samuelson (1993) concludes that if the value of the revenue of future service liabilities is not a reliable measure of sacrifices, deferral of the revenue will understate the liquidity position of a firm when the deferred revenue is included among liabilities. If deferred revenues are excluded from the liabilities on the other hand, the firms' liquidity position will be overstated.

2.7 The quality of information

As stated in the background, Artsberg (1996) claims the connection between accounting and taxation impedes the development of accounting and consequently the quality of accounting. To develop the discussion about quality we have found the following studies in this section of interest. Even though the articles are written from the perspective of investors in the capital market, they are of relevance in this thesis, since they discuss the problems concerned in the legal cases and how the accounting solutions relate to the quality of information provided to investors.

The significance of the previously mentioned matching concept is examined in recent studies concluding that matching of revenues and costs leads to better quality of accounting earnings (Dichev & Tang 2008; Su 2005). Su (2005) investigates the matching concept's smoothing effect on accounted earnings. By using a multinomial model to analyze the variance reduction effect of earnings under matching, Su (2005) states the application of matching leads to improved estimation of the firm's long-term profitability¹⁹. Income smoothing is in the study defined as the statistical variance reduction of earnings over a numerous accounting periods and leads to that the earnings in each accounting period of a firm are closer to the firm's long-term profitability. More specifically the study shows, when profits are made by the firm, postponing costs and matching them against later coming revenues leads to a variance reduction of accounting earnings, which makes earnings accounting closer to the long-term profitability. On the contrary, the matching of revenues and costs when the firm makes losses may have the opposite influence on the variance reduction on earnings, where direct recognition of the costs instead of matching against the related revenues gave a variance reduction effect. The general conclusion made by Su (2005) is that the matching concept as well as conservatism can enhance the estimation of the firm's long-term profitability. If the variance is reduced, earnings are closer to the long-term profitability and investors are thereby provided with more reliable information for decision-making. However, Su (2005) does not discuss whether the expenditures shall fulfill the definition of an asset according to IASB's conceptual framework.

The development towards a balance sheet-based model and the consequently declined impact of matching for earnings determination is criticized by Dichev and Tang (2008). Dichev and Tang (2008) find in their empirical study of the 1,000 largest U.S. firms over the last 40 years, support for the conclusions made by Su (2005). The result shows that poor matching²⁰ increases the volatility of earnings. Dichev and Tang (2008) state that the evolution towards the balance sheet-based model

¹⁹ The definition of long-term profitability in the study is all revenues minus all costs divided by the length of accounting periods.

²⁰ The definition of poor matching is a cost recognition technique that differs from perfect matching. Matching is considered perfect when all relevant costs are matched against the related revenue.

and poor matching has a negative effect on the quality²¹ of accounting earnings, since the information content of earnings, which is considered the main accounting number by investors (Graham, Harvey & Rajgopal 2005), has deteriorated. If earnings are matched, the volatility in earnings will only be economics-driven (Dichev & Tang 2008). Dichev and Tang (2008) suggest that the result implicates that matching affects the possibility to carry out earnings forecasting.

In an empirical study Dichev (2008) criticizes the balance sheet-based model advocated by IASB as well as FASB and argues that the possibility to estimate future earnings is impaired due to the balance sheet approach. The aim of accounting is to reveal business reality; therefore the used model must be able to picture the important features of the business model. With the income statement approach the aim is to record accruals correctly and by that show the time of economic accomplishment, in other words revenues, and related costs. Dichev (2008) claims most firms are value-adding in an income statement way, which means they advance costs to make revenue and earnings. Consequently, the matching concept and, not equally important, realization concept, are essential. The difference between the measured economic accomplishments and the costs that were given up to fulfill the accomplishments is a measure of the performance for a specific period. If there is a reliable economic link between expenditures and income, the income statement-based accounting must translate this link into costs and revenues. Dichev (2008) exemplifies this reasoning by explaining that if there is a link between research and development expenditures today and revenues in the future, the expenditures should be capitalized and expensed over the forthcoming periods. Although Dichev (2008) admits a consequence of the income statement approach is an uncertain content of assets and liabilities, the purpose is an accounting that as much as possible reflects the economic reality of the firm. The conclusion made by Dichev (2008) is that the matching and the realization concept better reflect business reality than the balance sheet-based model. The consequence of using the balance sheet-based model is that the possibility to estimate future earnings is impaired, due to revaluations assets.

Zhang (2005) investigates relevance, reliability and predictability of revenues in an empirical study on a sample of software firms that implemented Statement of Position 91-1 (SOP 91-1) in the 1990s. Before SOP 91-1 was implemented, software firms recognized revenues contrary to the realization concept, i.e. recognized revenue prior to the delivery of the product or the performance of the service. When SOP 91-1 was released, it stated revenue should be recognized along with the delivery of the product or proportionally over the service contract if collectibility is probable. Zhang (2005) finds that early revenue recognition improves the timeliness²² of the information and thus the relevance by capturing the underlying economic events. Although the mentioned study investigates a particular industry, we find the results relevant to this thesis due to the fact that providing customers service contracts is a significant source of revenue for software firms (Zhang 2005), and the problem of determining when performance is fulfilled should be the same even in software

²¹ Decreased volatility of earnings is in the study considered as increased quality (Dichev & Tang 2008). Dichev and Tang (2008) though clarify decreased volatility also can indicate decreased quality of earnings, since lower earnings volatility can be a sign of extreme smoothing and consequently lower quality. From that point of view, increased volatility indicates higher quality. However, Dichev and Tang (2008) argue this is not the case in this study and motivates it with the combination of the results of several studies that have shown a decline in earnings quality over time, and other studies that have documented an increase in earnings volatility.

²² Zhang (2005) uses FASB definition of timeliness, i.e. "*having information available to a decision maker before it loses its capacity to influence decisions*".

firms. Zhang (2005) also finds that early recognition of revenue reduces the extent to how well accounts receivable accruals map into future cash flow realizations, which is a sign of lower reliability of the accounting information. Furthermore, in accordance with SOP 91-1 revenue from service contracts shall be recognized proportionally during the period, which increases the predictability. If revenue instead is recognized early the predictability of reported revenue becomes lower. In conclusion, early revenue recognition leads to higher relevance of the reported revenue, but lowers the reliability and the predictability.

3. METHODOLOGY

This chapter presents the method used through the thesis, including research approach, information and data gathering as well as data analysis. A discussion concerning the reliability and validity of the study concludes the chapter.

3.1 Research approach

The aim of the thesis is to find out what good accounting practice in terms of service contracts is according to the Supreme Administrative Court and determine whether the arguments in the grounds for the decisions still are sustainable compared to current standards as well as discuss how the accounting solutions approved by the court relate to the quality of information investors are provided with through the accounting. Consequently, this is a qualitative study. Qualitative research is less strict compared to quantitative research, which increases the risk of losing information (Blumberg, Cooper & Schindler 2008). Problems of gathering qualitative information correctly make it harder to draw reliable conclusions. This is considered during the research process. This thesis is also a descriptive study (Blumberg et al. 2008) since we want to find out *what* the arguments are in the Supreme Administrative Court's judicial decisions and describe how well the arguments coincide with current standards. However, a problem with descriptive studies is the difficulty to explain why an event has occurred. To be able to fulfill the aim of this study, an argumentation analysis is applied.

It is of interest to study legal cases from the Supreme Administrative Court since they are precedent (Lehrberg 2001). According to Lehrberg (2001), court decisions show the true, applied law of society, since it is up to the court to decide how legislation shall be interpreted. Since precedents are ruling in a specific case, it is not probable that the exact same issue will be up for decision again in court. However, valuable precedents are adjudications where a question of principle has been straightened out in such a way that an overall standard can be generalized. Lehrberg (2001) claims courts' tendency to follow precedents is so significant, precedents practically constitute the most essential source of law with the exception of laws and constitutions.

3.2 Information gathering

In the thesis we use laws, standards and literature to answer the research questions. Relevant laws and standards for the thesis are the Annual Accounts Act, the Income Tax Act, RR 11 and BFNAR 2003:3. To enable us to answer the research questions, relevant peer reviewed articles are gathered mainly from science databases such as Business Source Premier and ScienceDirect, available at Gothenburg University Library. Key words used in the literature search are; *revenue, service contract, accrual, quality, matching principle, balance sheet approach*. The articles are chosen from the prerequisite that they concern the same issues as discussed in the legal cases, i.e. matching concept and accruals of income. Literature²³ is also gathered from FAR database²³ available at Gothenburg University Library as well.

3.3 Data gathering

We investigate all legal cases concerning good accounting practice in service contracts from the Supreme Administrative Court, which is gathered from the database Infotorg Juridik. The legal cases are chosen from the prerequisite that the issue concerned is good accounting practice in service

²³ Used key words: *God redovisningssed, tjänstekontrakt, periodisering*.

contracts²⁴. Legal cases that are described and analyzed are the Tele2-case 1784-08, Karlshamn's hamn AB RÅ 2003 not. 127, Key Code Security AB RÅ 1999 ref. 32 and Arvika Energi AB RÅ 1994 ref. 2. The common issue in the precedents concern accruals where the firm and the Swedish Tax Agency have different kinds of views about good accounting practice. The issue in the Tele2-case 1784-08 concerns whether the firm has the right to immediately make deductions for compensations given to selling agencies or if the expenditures shall be recognized as assets. In Karlshamn's hamn AB RÅ 2003 not. 127, the firm recorded linear accruals over a period of 50 years of a one-time payment and the court had to decide whether the accounting solution complied with good accounting practice. Key Code Security AB RÅ 1999 ref. 32 concerns whether accruals of income from service fees shall be recorded immediately or linearly over several accounting periods when the possibility for commitment is only about 2%. The issue in Arvika Energi AB RÅ 1994 ref. 2 is whether connection fees for future electricity distribution shall reduce the depreciation base of fixed assets or if they shall be recognized as revenues immediately or over several accounting periods. We have noticed that Karlshamn's hamn AB and Arvika Energi AB are municipal owned companies. However, we still find them relevant since the court does not mention that the accounting solutions are only approved solutions in municipal firms. The accounting solutions in the precedents are of value since they can be used as guidance for future issues for private-owned firms as well.

Some of the legal cases described in the empirics refer to RÅ 1977 ref. 13 and RÅ 1987 not. 533. These legal cases are not discussed in this study since they no longer have precedent value.

3.4 Data analysis

In this study Naess' (1959) method for argumentation analysis is used. This method is also used in Björk's (1988) dissertation²⁵, where he analyses the arguments from the Swedish Supreme Court in a specific verdict. The empirics in the dissertation consist of legal cases from the Supreme Court whose arguments are analyzed to answer the research questions, which is in conformity with this thesis. This method for argumentation analysis makes it possible to present the argumentation in the legal cases in a perspicuous way (Björk 1988). Björk (1988) argues that the task of the court is to determine whether a thesis is valid or not, by considering arguments pro or con the thesis, which is a very similar approach to Naess' (1959) method. Consequently, there is a resemblance between Naess' (1959) method and legal approach, which makes the method relevant to use in order to answer the research questions.

In Naess' (1959) method for argumentation analysis, a thesis²⁶ concerning the argumentation is formulated. To reduce vagueness at the assessment of the arguments the thesis should be formulated as definitely as possible (Naess 1959). Thereafter, the arguments are subdivided into arguments that support the thesis, *pro-arguments*, as well as not support the thesis, *contra-arguments*. The following denominations are used:

T = Thesis

P_n = Pro-argument

C_n = Contra-argument

²⁴ Used key words: God redovisningssed, tjänsteuppdrag/avtal/kontrakt, serviceuppdrag/avtal/kontrakt.

²⁵ Björk, S. (1988) *Högsta Domstolen argumenterar – En analys av argumenten i domskälen i det så kallade Kontrast U-målet*, Lunds Universitet.

²⁶ "Tes" is the term used by Björk, while Naess uses the expression "spetsformulering".

Arguments that directly support the thesis are called pro-arguments of the first order (Naess 1959). Arguments that support or do not support arguments of the first order are called arguments of the second order. Arguments that support a pro-argument of the first order are denominated *pro-pro-argument*, while arguments that undermine the pro-argument are called *contra-pro-argument*. Corresponding terms are used for contra-arguments. The argumentation is for example schematically illustrated as follows; $P_1C_1P_1$, which is deduced pro-argument number 1 for contra-argument number 1 for pro-argument number 1 that supports the thesis T. $P_1C_1P_1$ is a denomination for an argument that *supports* another argument that in turn is against a pro-argument, which is an argument that *supports* the *thesis*. Taking the explanation one step further, we provide an example.

T = All dandelions are yellow.

P_1 = I have never seen a dandelion of another color. (This argument supports the thesis, since if I have never seen a dandelion in another color, there are most probably no dandelions of another color.)

C_1P_1 = I have not seen every dandelion in the world. (This argument is a contra-argument to P_1 , since the argument P_1 is undermined by the fact that I have not seen every dandelion in the whole world.)

$P_1C_1P_1$ = I have never been outside my home town. (This argument supports C_1P_1 since if I have never been outside my home town, I cannot either have seen every dandelion in the world.)

C_1 = There is a kind of dandelion that is white. (This argument is against the thesis that all dandelions are yellow, since it claims that there is a white kind as well.)

P_1C_1 = The white dandelion grows in eastern Eurasia.

We have chosen to classify every argument that supports an argument of the first order as an argument of the second order, even if it independently supports the thesis. We believe it is beneficial to do this classification to get a clear view of the arguments' relationship to each other. To explain and clarify an argument's relation to the thesis, premises are used. Further, the Supreme Administrative Court's arguments are given their own denomination numbers even if the arguments are reminiscent of arguments that have already been raised by any of the parties. The reason for this is that despite that the content of the Supreme Administrative Court's arguments is the same, it may differ in wording from what has already been said. It would therefore be incorrect to refer to previous arguments although the meaning is largely the same.

In order to evaluate the thesis, the pro- and contra-arguments must be considered individually, and be weighed against each other. To establish whether an argument should be included in this overview, two things must be considered in accordance with Naess' method for argumentation (Naess 1959). Firstly, the argument must be *sustainable*, i.e. how certain it is that the argument expresses a sustainable statement. The sustainability of an argument is a measure of how reasonable it is to accept the argument. A sustainable argument cannot be argued against. In this study an argument is therefore considered sustainable if the argument cannot be argued against and

is supported by the law, standards and recommendations, accounting concepts, normative organs, practice or praxis.

Secondly, the argument must be *relevant*, i.e. how strongly the argument, provided it is sustainable, supports or not supports the thesis (Naess 1959). The relevance of an argument is a measure of how well the argument supports the thesis, antithesis or another argument. In this study an argument is considered relevant if it supports or does not support the thesis or another argument and in addition is supported by the law, standards and recommendations, accounting concepts, normative organs, practice or praxis. It is important to keep in mind that an argument can be sustainable even though it is not relevant for the stated thesis. In cases when an argument in the legal cases is sustainable without being relevant, it is not included in the argumentation analysis.

We have chosen to formulate the thesis in accordance with the judicial decisions. This approach is suitable due to that good accounting practice is the overall issue we investigate and the judicial decisions reveal whether the accounting solution complies with good accounting practice or not. If it according to the Supreme Administrative Court is good accounting practice to record accruals, the thesis is for example formulated as follows.

T = It is good accounting practice to record accruals.

The arguments that are taken into consideration in the argumentation analysis are only the arguments in the legal cases from the Supreme Administrative Court. Since the legal decisions from lower instances are not precedent, the argumentation is not of equal importance. However, exceptions are made if any part refers to a statement made in any of the courts below. Furthermore, to secure the content of an argument, the intention has been to translate the argument as closely to the original formulation as possible.

Björk (1988) combines Naess' method with a legal argumentation analysis and refers to Evers (1976)²⁷. Since Evers' legal argumentation analysis is more focused on the arguments' evidential value, we have instead decided to apply a legal dogmatic²⁸ approach to analyze the results of the court case argumentation.

The deficit of this method is its subjectivity. For instance, the arguments could be selected differently depending on how the thesis is formulated. Further, there is no objective truth which can answer the research questions and consequently the analysis and conclusions in this study are influenced and constructed by our subjective perception. However, the intention has been to pursue an objective approach during the research process.

It is also of importance to point out that all of the contra-arguments to the thesis do not necessarily conflict with good accounting practice. In the cases when the firms' solutions have been considered good accounting practice by the court, it does not mean that the Swedish Tax Agency's accounting solutions do not comply with good accounting practice. This is due to prop. 1999/2000:2 part 2 as

²⁷ Evers, J. (1976). *Argumentationsanalys för jurister*, Liber-Hermods AB.

²⁸ The base in legal dogmatics is the existing legal sources (Lehrberg 2001). The aim of this approach is to determine what legal rules there are and specify how they should be understood and applied. Furthermore, the aim is to find the general solution for a particular problem by using the legal sources. The result of legal dogmatics is for instance recommendations about how legal rules shall be applied.

well as RÅ 1999 ref. 32 that proclaim if good accounting practice allows for several accounting solutions, the solution made by the firm shall be the base for taxation. Since the thesis is formulated in accordance with the judicial decision, it means that it is formulated in accordance with the firms' solutions in these cases. The Swedish Tax Agency's arguments are contra-arguments to the thesis, but can as well be in accordance with good accounting practice.

To sum up, when formulating a thesis in accordance with what is suppose to be investigated, i.e. good accounting practice, the arguments that are of importance as well as not of importance for the judicial decision becomes visible. This implicates that arguments that do not concern good accounting practice are possible to sort out. In addition, the method makes it possible to identify the arguments that are of relevance to answer the research questions. This method enables us to clarify in the discussion and conclusion-chapters what arguments the Supreme Administrative Court has based its decision on. Thus, it enables us to discuss what arguments that are of importance as well as not of importance for the judicial decision. For example, the method makes it possible to systematically clarify what criteria are necessary or not necessary for the accounting to comply with good accounting practice.

3.5 Reliability and validity

The reliability describes how well the test measures what it measures, while the validity describes the extent to which a study measures what it intends to measure (Nationalencyklopedin, 2011-05-08). Ejvegård (2003) states that high reliability is characterized by achieving the same result if performing the same study again.

A limitation in the reliability of this study is the fact that it is based on few studies, which most likely has affected the outcome of the conclusions regarding how the accounting solutions approved by the Supreme Administrative Court relate to the quality of information investors are provided with. In addition, it is important to be aware that the arguments have been translated, which could have affected the original content. We have though tried to translate the arguments as closely as possible to the original formulation. However, since we have had access to the original formulations during the entire process the translation should not have affected the reliability. Having access to the original sources during the entire process increases the reliability since misunderstandings can be excluded. Additionally, the legal cases are texts from the court, which increases the trustworthiness.

This study has high validity from the perspective that the reviewed legal cases are precedents from the Supreme Administrative Court, which implicates high validity since good accounting practice as a final step is decided by a court (prop. 1995/96:10). There are many accounting solutions that can be considered good accounting practice, but the decision made by the Supreme Administrative Court can be seen as a certain solution. What the Supreme Administrative Court considers good accounting practice is precedent and therefore an accepted solution for future cases. From this perspective we consider that the study has high validity since we analyze the final decisions. However, a restriction in the validity is the definition of quality, which captures only a limited spectrum of qualitative information desired by investors. Since the concept of quality is complex, it is difficult to formulate a definition that covers the entire spectra and as well is possible to use in an investigation.

Moreover, a weakness concerning the validity in our study is regarding the Tele2-case. The arguments in the grounds for the decision are based on the arguments made by the Board, whose vague arguments did not qualify to be included in the argumentation analysis. Since the Supreme Administrative Court bases its decision on the vague argumentation from the Board, it consequently made it difficult for us to come to a specific conclusion about *why* the accounting solution is considered good accounting practice in the particular case.

4. EMPIRICS

This chapter includes a description as well as an argumentation analysis of the legal cases from the Supreme Administrative Court concerning service contracts. The described judicial cases are Tele2 Sverige AB 1784-08, Karlshamn's hamn AB RÅ 2003 not. 127, Key Code Security AB RÅ 1999 ref. 32 and Arvika Energi AB RÅ 1994 ref. 2. The appellees' claims as well as the grounds for the decisions from each instance are described, since it provides a better understanding for the grounds for the decisions in the Supreme Administrative Court. The legal cases are treated separately, i.e. after the description of each case, the argumentation analysis follows.

This table presents an overview of the issues concerned in the legal cases concerning service contract. In addition, the Supreme Administrative Court's judicial decisions are presented to help the reader to relate to the relevance of the judgments of the Administrative Court as well as the Administrative Court of Appeal.

<i>Firm</i>	<i>Issue</i>	<i>Taxation year</i>	<i>The Supreme Administrative Court's judicial decision</i>
<i>Tele2 Sverige AB 1784-08</i>	Has the firm the right to immediately make deductions for subsidies for cell phones provided to selling agencies or shall the expenditures be capitalized?	2004	It does not conflict with good accounting practice to expense subsidies for cell phones to selling agencies immediately.
<i>Karlshamn's hamn AB RÅ 2003 not. 127</i>	Can the firm record accruals of a one-time payment concerning commitments of future services for 50 years?	1991	It is good accounting practice to record accruals of a one-time payment during the contract period of 50 years.
<i>Key Code Security AB RÅ 1999 ref. 32</i>	Shall linear accruals of income be recorded for future services when the possibility for commitment is about 2%, or shall the revenues be recognized immediately?	1991	It does not conflict with good accounting practice to record accruals of income from service fees during the contract period.
<i>Arvika Energi AB RÅ 1994 ref. 2</i>	If a firm receives connection fees for future electricity distribution, can the firm reduce the depreciation base of fixed assets or shall they recognize the connection fees as revenues immediately or over several accounting periods?	1988	It is good accounting practice to recognize connection fees in the accounting period the payments are received.

Table 2. Overview of the legal cases. *Source of information: Tele2 Sverige AB 1784-08, RÅ 2003 not. 127 Karlshamn's hamn AB, RÅ 1999 ref. 32 Key Code Security AB and RÅ 1994 ref. 2 Arvika Energi AB.*

4.1 Tele2 Sverige AB 1784-08

Tele2 Sverige AB (Tele2) subsidizes the sale of cell phones to selling agents in the form of a provision in connection to the sales of the firm's telephone subscriptions to costumers. The customer is bound to the subscription for 12, 18 or 24 months, which guarantees a fixed monthly income for the firm

during these months. The expenditure for the provision is recognized immediately while the revenue is recognized over several taxation years, which means that the firm does not apply the matching concept. The question is whether the firm is allowed to recognize all the costs in the current accounting period and the revenues in later periods. The Swedish Tax Agency disagrees with the accounting solution and demands a raise of the taxable income. Tele2 appeals the Swedish Tax Agency's decision to the Administrative Court²⁹.

4.1.1 The Administrative Court

In the Administrative Court, Tele2 claims that the firm has always expensed the expenditures for customer acquisition immediately, since this have been good accounting practice according to the firm. There are no specific tax regulations for this kind of expenditures, so good accounting practice shall be used. In accordance with the judicial decision in RÅ 1999 ref. 32, the firm claims that if good accounting practice gives option for different kind of accruals, the taxation shall be based on the choice made by the firm. The firm also refers to practice, a survey made by Price Waterhouse Coopers.

The Swedish Tax Agency argues that good accounting practice in the current question is that costs during a specific accounting period should be matched against the revenues that are originated to the accounting period, the matching concept.

A statement, invoked by Tele2, is made by the professor of accounting and auditing Walter Schuster at the Stockholm School of Economics. Schuster is of the opinion that there are several possible accounting solutions. Schuster claims that the Swedish Tax Agency builds their argumentation on the matching concept, which can be compared to the income statement approach. In the income statement approach, revenues are recognized when they are realized. The expenditures are thereafter matched against the revenues and the balance sheet is a function of the amounts in the income statement. The problem is that the matching concept is given an exceptional position, which is not in accordance with modern accounting theory in IASB's Framework. Schuster claims that good accounting practice can be based on the income statement approach or balance sheet approach, which can give different results but both are accepted. The professor also argues that the firm has followed good accounting practice in accordance with current practice in the specific firm.

In the grounds for the decision the Administrative Court claims that the balance sheet approach is not prominent, neither in the Framework nor in the recommendations or statements from the Swedish Accounting Council, the Board and IASB. The Administrative Court also argues that accounting in accordance with the balance sheet approach does not accept direct recognition of expenditures for customer acquisition that will generate revenues in up to two years, as good accounting practice. Neither the fact that other firms in the same industry account in the same way nor the statement from Walter Schuster change the decision. In accordance with the argumentation above, the appeal is rejected since the Administrative Court finds the accounting not in accordance with good accounting practice. Tele2 appeals the Administrative Court's decision to the Administrative Court of Appeal³⁰.

²⁹ Förvaltningsrätten.

³⁰ Kammarrätten.

4.1.2 The Administrative Court of Appeal

The firm claims what has been said in the Administrative Court, and also adds that none of the statements from the Board or the Swedish Accounting Council in the judicial case RÅ 1998 not. 106 approve to the judgment from the Administrative Court. Tele2 claims that the Administrative Court misinterpreted the Framework and also disregarded the actual practice in the business. Moreover, Tele2 claims an essential caution shall be taken concerning preparatory work statements on good accounting practice since the expression in the law is unmodified.

The Swedish Tax Agency objects approval to the appeal, claiming what have been said earlier with addition that there is a clear connection between the costs and revenues, why the matching concept shall be applied. Furthermore, the Swedish Tax Agency claims that only accounting methods used by accountable persons in Sweden shall be concerned, when referring to practice.

The Administrative Court of Appeal is of another opinion than the Administrative Court concerning the matching concept, claiming that good accounting practice can involve other alternatives to the matching concept in the current case. Furthermore, the Administrative Court of Appeal argues that another case concerning another large firm in the same industry has used the same accounting method, something that has to be taken into account for the decision, since it can be seen as practice. In addition, the Administrative Court of Appeal refers to the statement from Schuster that it is not possible to say that Tele2's accounting is in conflict with good accounting practice, considering the balance sheet approach. Consequently, the Administrative Court of Appeal obviates the decision from the Administrative Court and the arguments from the Swedish Tax Agency, since the chosen accounting method cannot be found to be in conflict with good accounting practice. The Swedish Tax Agency appeals the Administrative Court of Appeal's decision to the Supreme Administrative Court.

4.1.3 The Supreme Administrative Court

The Swedish Tax Agency claims the Supreme Administrative Court changes the earlier judgment and raises the income for taxation. They still refer to the matching concept and that cost and revenues shall be recognized linear over the contract period.

The firm refers to the Administrative Court and the statement made by Schuster.

The Board is requested to make a statement and refers to a statement from IFRIC concerning a similar question. IFRIC stated:

"The question was whether the contracts should be treated as comprising two separately identifiable components, i.e. the sale of a telephone and the rendering of telecommunication services, as discussed in paragraph 13 of LAS 18 Revenue. Revenue would be attributed to each component; or the telephones should be treated as a cost of acquiring the new customer, with no revenue being attributed to them." (IFRIC's statement, Subscriber Acquisition Costs in the Telecommunications Industry)

However, IFRIC does not reach a consensus regarding the issue. The Board interprets IFRIC's statement that it is not clear how the subsidies of cell phones should be recognized in accordance with IAS. However, the Board's conclusion from IFRIC's statement is that it is not against good accounting practice to recognize the cost for provisions to selling agents immediately.

The Swedish Tax Agency claims that IFRIC do not supports the conclusion made by the Board. IFRIC did not handle the specific question and it was also stated in 2006, and the case concerns the taxation for 2004.

The firm claims that the Board's statement proves that the firm had the right to recognize the costs for the provisions for the cell phones immediately. That the question was made in 2006 does not change anything since IAS 18 has been more or less unchanged since 1995.

The Supreme Administrative Court argues that there are no specific tax regulations in this case. If there are different options concerning accruals in accordance with good accounting practice, taxation shall be based on the method chosen by the firm. Furthermore, the court refers to the Board's statement and IFRIC. The court continues that the case is a bit different from IFRIC, but states that the firm has not recognized the costs against good accounting practice. The appeal is therefore rejected.

4.1.4 Argumentation analysis

T: It is good accounting practice to expense subsidies of cell phones to selling agencies immediately while the revenue is recorded during one or several taxation years.

Tele2's argumentation:

P_1 = The matching concept does not have an exceptional position in accordance with modern accounting theory as interpreted in the Framework.

P_2P_1 = In recent years, the matching concept has been rejected more and more, and the importance of the balance sheet approach has increased according to IFRS.

P_2 = With the balance sheet approach, the fulfillment of the general definition of an asset is a necessary but not sufficient condition. The item must also fulfill certain criteria to be capitalized.

Premise to P_2 = It is generally accepted within accounting theory that there are two competing paradigms, income statement approach and balance sheet approach and that the IASB Framework and the entire set of recommendations contains elements of both .

P_3 = It is hard to determine a direct connection between two single factors such as provisions and fixed fees for a binding period.

P_1P_3 = The interaction between capacity costs and marginal costs for the operator and fixed and variable charges for the customer in the long and short term is complicated.

P_4 = An accounting in which an expenditure is recognized as an asset only because of the existence of a general connection of future income, may lead to the increased risk-taking that volume-based strategies often implicate being not fully reflected in the accounting.

Premise to P_4 = The firm can during a short time period prioritize volume increase on expense of gain. It is clear that this strategy is connected with a major endangerment.

P_5 = According to an alternative approach, the provisions are expenditures to receive future benefits and in strict meaning no asset.

P_1P_5 = The contracts are the asset. With such an approach the asset would consist in the future subscription income.

The Swedish Tax Agency's argumentation:

C_1 = The matching concept has for a long time been a concept to recognize income and expenditure at the right year. The concept in its traditional form means that revenues and costs that originate from the same transaction or event shall be recognized simultaneously.

Premise to C_1 = RR 11 p. 19 and BFAR 2003:3 p. 20 e.

C_2 = There is a clear connection between provision to the selling agency and the revenues that are received during the contract period by the fixed monthly charges.

P_1C_2 = Compensation to the selling agencies is a direct result of the firm signing a service contract with a customer.

C_3 = Income and expenditure relating to the agreement must be assessed collectively and based on the principles of accounting for service contracts.

P_1C_3 = Service incomes and service expenditures shall be recognized in the income statement in proportion with the degree of completion of the service.

Premise to P_1C_3 = According to RR 11 Revenues.

C_4 = The firm shall recognize income from the fixed monthly fees linearly over the contracting period.

C_5 = The expenditures meet the criteria to be recognized as an asset.

Premise to C_5 = The IASB Framework and its requirement for an entry to be recognized as an asset (p. 49 and 89).

The Board's argumentation:

The Board's argumentation does not meet the sustainability and relevance requirements in accordance with our method to be included in the argumentation analysis³¹.

The Supreme Administrative Court's argumentation:

P_6 = According to the Board it is not in conflict with good accounting practice to expense provision to selling agencies.

³¹ A comment regarding this sample loss is that the Board refers to a statement from IFRIC considering how a provider of telecommunications services should account for telephone handsets it supplies free of charge or at a reduced price to customers. IFRIC did not reach a consensus but did however make two alternatives visible, whereof one, quoting: "the telephones should be treated as a cost of acquiring the new customer, with no revenue being attributed to them" was in accordance with Tele2's accounting solution. According to our interpretation, the Board concluded from IFRIC's statement, that it is not in conflict with good accounting practice to expense subsidies to selling agencies immediately, since this solution was one of the alternatives stated by IFRIC. Cf. RÅ 1999 ref. 32 which states that if good accounting practice allows for different options regarding accruals, the taxation shall be based on the option selected by the firm.

4.2 Karlshamn's hamn AB RÅ 2003 not 127

The case concerns the municipality of Karlshamn that in the year of 1990 deeded a property including a site-leasehold right to Karlshamn's AB (KAB). The property also included several wharfs. In the year of 1990 an agreement between the municipality of Karlshamn, Karlshamn's harbor (the harbor) and KAB was signed. The agreement regulated payment and had a term of maturity of 50 years. Other terms of conditions specified in the agreement were that KAB should not pay harbor fees for products connected to KAB's business, and only a half fee for other products. The harbor kept the right to collect fees from ships during the agreement. KAB had to pay a one-time expenditure of 4,000,000 SEK to the harbor regarding concession of the wharfs and related fees. The municipality and the harbor agreed to fulfill commitments concerning ice breaking, maintaining of water pipes, assistance with towing etc. In the accounting, the harbor recognized 80,000 SEK as revenue, 1/50 of the total amount. The remaining amount was recognized as a liability. The Swedish Tax Agency disagrees with the accounting solution and demands immediate taxation of the liability. The harbor appeals the Swedish Tax Agency's decision to the Administrative Court.

4.2.1 The Administrative Court

The Administrative Court refers to the regulation in 41§ Municipal Income Tax Act that states that accrual basis shall be the base for taxation. Crucial for how the kind of single payment as in the case should be taxed is that revenue shall be recognized in accordance with good accounting practice. The court also obtains guidance from the Board's statements; BFN U 87:1³², BFN U 89:10 and BFN U 93:2. The Administrative Court concludes from these statements that compensation for services that are performed during a multi-year contract period, in accordance with good accounting practice shall be accrued over the period concerned. The court considers that accruals of the single payment comply with good accounting practice and consequently must be accepted at the taxation, due to the fact that the compensation concerns a commitment for a period of 50 years. The long time period is not reason enough for another assessment. The Administrative Court approves the harbor's appeal. The Swedish Tax Agency appeals the Administrative Court's decision to the Administrative Court of Appeal.

4.2.2 The Administrative Court of Appeal

The Swedish Tax Agency argues for the importance of when revenue is considered realized according to tax praxis as well as against the relevance of BFN U 87:1, BFN U 89:10 and BFN U 93:2 in the case. BFN U 87:1 was requested by the Supreme Administrative Court in the case RÅ 1987 not 533 and according to the Board, revenue is in that case considered gradually earned. However, the Swedish Tax Agency points out that the Supreme Administrative Court opposed the statement and decided the income should be taxed in connection to the payment, i.e. a verdict in direct contravention of the Board's statement. Moreover, the Swedish Tax Agency claims that the issue in the statement BFN U 89:10 was rather about annual billings and not about one-time payments. Hence, the mentioned statement has no relevance in this particular case. BFN U 93:2 in RÅ 1994 ref. 2 concerned an amount of revenue that was considered nonessential by the Supreme Administrative Court in relation to total revenues. Consequently, there was no need to try whether the achievement was fulfilled or not. Additionally, the Swedish Tax Agency argues that it is unclear in the verdict from the Administrative Court, what circumstances the assessment that determines whether the revenue has the required connection to future performance is based on, which is necessary for

³² The appendix provides a brief description of the Board's statements.

recording accruals of the income. The Swedish Tax Agency maintains that it is not evident that there is a connection between the income and future expenditures required by fiscal conditions and that the Administrative Court's decision is not in accordance with tax praxis.

The harbor argues on the other hand that there is a clear connection between the income and future performance and refers to previous correspondence in the case.

The Administrative Court of Appeal refers firstly to the regulation in 41§ Municipal Income Tax Act and that revenue recognition shall be the base for taxation unless it conflicts with good accounting practice or a specific tax rule. The Administrative Court of Appeal also refers to SOU 1983:47 about what is required for accruals regarding taxation. Firstly, it must be clear the income is an advance and not just described as an advance. Secondly, the number of financial and taxation years the income concerns must be able to be determined. To legitimize accruals of income from a taxation perspective, the income must implicate commitments that remain after the end of the taxation year. In addition, these commitments need to be specific enough to enable that the income can be proportioned in relation to these. Furthermore, the Administrative Court of Appeal refers to the Board's circular C 1985-05-20 that states income from service contracts that are to be performed during a following period shall be recognized continuously during the period or when the achievement is fulfilled. The court refers as well to RÅ 1987 not. 533 with the argumentation that future performances which the income regards must be clarified when it comes to extent and time of completion of the services. The Administrative Court of Appeal claims the services are continuously commitments for the harbor and the expenditures for these commitments are not dependent on the agreement between the parties. The payment is by the Administrative Court of Appeal considered as a compensation for loss of port charges³³ the harbor abstained from charging KAB. Thus, the Administrative Court of Appeal's opinion is that the harbor's achievements according to the contract do not include the services maintenance. In addition, the extent and time of completion are not clarified enough to enable accruals of the income during the contract period. The Administrative Court of Appeal approves the Swedish Tax Agency's appeal.

The harbor appeals the Administrative Court of Appeal's decision to the Supreme Administrative Court.

4.2.3 The Supreme Administrative Court

The Supreme Administrative Court requested a statement from the Board who claims the Book-keeping Act (1976:125) shall be applied in the case. The Book-keeping Act does not contain specific regulation about which period revenue shall be recognized and therefore, the Board answers the question from accounting concepts, complementary standard setting and legal usage. The Board claims the realization concept³⁴ determines when revenue shall be recognized, which implicates that revenue shall be recognized when the achievement is mainly accomplished. Furthermore, the Board refers to RR 11 Revenue that states, besides that revenue shall be recognized when the achievement is accomplished, when a service contract contains many undefined activities during a specific time period, accruals of income shall be linear over the contract period unless another method better reflects the extent to which the performances are accomplished. According to the contract, the harbor has a commitment towards KAB to ensure that the wharfs are available for the firm's

³³ Hamnavgifter.

³⁴ Explanation of the realization concept in the Appendix.

activities. The Board concludes that the case is a service contract containing an undefined number of activities during a specific time period and the income shall consequently be accrued during the contract period.

The Supreme Administrative Court refers to the above mentioned regulation in 41§ Municipal Income Tax Act. Moreover, the court points out if good accounting practice allows for several alternatives concerning accruals, the accounting solution chosen by the harbor shall be the base for taxation³⁵. Furthermore, the Supreme Administrative Court agrees to the Board's statement and that it is confirmed the harbor has a commitment to KAB to perform the services. The Supreme Administrative Court explains there is no reason for a different judgment and approves the harbor's appeal.

4.2.4 Argumentation analysis

T = It is good accounting practice to record linear accruals of a one-time payment for future commitment over 50 years.

In this case there are no contra-arguments, since the Swedish Tax Agency accepted the Board's statement in the Supreme Administrative Court. However, arguments concerning good accounting practice are still captured.

The harbor's argumentation:

P_1 = The link between the abstained revenue and the one-time payment, the link between the one-time payment and the deed of the wharfs as well as the harbor's commitment regarding the wharfs are clear and unambiguous.

Premise₁ to P_1 = It is practice in the industry that the harbor charges half harbor fee for goods handled over the wharf. The fees shall cover the harbor's expenses for maintenance, etc. and for interest and depreciation on capital invested.

Premise₂ to P_1 = Since the harbor has paid for the wharfs that are deeded to KAB with a site-leasehold right, there is a reason for the harbor to compensate for the abstained harbor fees. The harbor has in the contract completely abstained from the harbor fees for goods connected to KAB's ordinary business, and from half the fee for other goods. After negotiations KAB has agreed to pay 4000,000 SEK in a one-time payment to the harbor regarding the licensing of the wharfs and associated fees. The amount is based on assumptions about the size of the abstained fees according to the contract and expenses associated with the deed.

The Board's argumentation:

P_2 = What determines when a firm shall recognize revenue from a service contract is when the firm accomplishes the performance that it must fulfill according to the contract.

P_1P_2 = The actual payment has no particular relevance to the time at which revenue shall be recognized.

Premise₁ to P_1P_2 = Annual Accounts Act 2:4 (1995:1554).

³⁵ The Supreme Administrative Court refers to RÅ 1999 ref. 32.

$P_1P_1P_2$ = Crucial for when revenue shall be recognized is the so-called realization concept. It basically means that revenue is considered to be realized when the seller essentially has accomplished its performance according to the contract.

P_3 = In service contracts containing an undetermined number of activities during an agreed period of time, accruals of income should, for practical reasons, be linear during the contract time, unless some other method better shows the extent to which performance is carried out.

Premise₁ to P_3 = RR 11 Revenue.

P_1P_3 = It is established that the issue concerns a service contract in which an undetermined number of activities are to be carried out over a specified period.

$P_1P_1P_3$ = According to the contract, the harbor has, together with the municipality, a commitment to KAB that for 50 years ensure that the three wharfs are available for the activities pursued by KAB.

$P_2P_1P_3$ = The Board assumes that the harbor will be responsible for a significant part of the commitment and that the harbor's performance, therefore, is to accomplish such recurrent tasks as ice breaking, dredging and maintenance of cables, etc.

$C_1P_2P_1P_3$ = The contract does not reveal how the commitment shall be apportioned between the municipality and the harbor.

P_4 = There is no information that any part of the compensation regards performance connected to entering into the contract or to the payment.

The Supreme Administrative Court's argumentation:

P_5 = *The Board assumes* in its statement that the harbor will be responsible for a significant part of the commitment to KAB and the harbor's performance, therefore, is to accomplish such recurrent tasks as ice breaking, dredging and maintenance of cables, etc.

P_6 = *According to the Board* there is no information that any part of the compensation regards performance connected to entering into the contract or the payment.

4.3 Key Code Security AB RÅ 1999 ref. 32

The business of Key Code Security AB is to return lost keys to the owner. The firm provided a tag with a personal identification number, which should be attached to the customer's keys. If the keys were lost, the finder of the keys could simply put them in a mailbox. The keys were thereafter sent to the firm ABAB which Key Code AB had an agreement with, which used the numbers on the tag to identify the keys and thereafter sent them to the owner. Thus, the commitment made by the firm was to return the keys to the customer. At closing date the firm changed its accounting routines for the service fee from recognizing the revenue immediately to accommodating the revenue to each month during a twelve-month period. The issue was whether the firm was allowed to recognize parts of the service fees as revenues the next taxation year. Billed service fees were recorded as a liability of 5,688,113 SEK. The Swedish Tax Agency disagrees with the firm's accounting solution and demands an immediate taxation of the liability of 5,688,113 SEK, while deductions are granted for

future expenditures. Key Code Security AB appeals the Swedish Tax Agency's decision to the Administrative Court.

4.3.1 The Administrative Court

The Administrative Court's motivation in the adjudication is that the firm's commitment after the conclusion of the contract is to restore found keys in a limited number of cases. Paid service fee for the subscription can therefore not be viewed as an advance for a later achievement, since the statistics of numbers of lost keys are historically very low. Accruals of income cannot be recorded over the whole contract period due to the fact that the achievement is, according to the Administrative Court, already accomplished in the beginning of the contract. The firm's expenditures are as well mainly prior and in connection to the contract agreement. In the customer agreements it is stated that Key Code Security AB only is committed to one achievement; informing the customer as soon as the lost keys have been provided to ABAB, which is done by ABAB by returning the keys to the customer. Therefore Key Code has to make sure the customer's individual code is registered. Statistically a maximum of two per cent of the customers lose their keys, which means that the only thing the firm must accomplish for the vast majority of customers is the registration. The registration, which is necessary to guarantee the returning of the keys, is accomplished in the beginning of the contract. Moreover, the expenditures during the contract period can be measured reliably. The subscription fees are related to the number of registered customers and independent of the number of customers losing their keys.

The Administrative Court also discusses the meaning of accrual basis and good accounting practice in the regulation in 41§ Municipal Income Tax Act. The court refers to the realization concept and states that revenue is realized when the seller has fulfilled the achievements in combination with specific circumstances within the industry or the particular firm. Since the implication of the realization concept is not clear in this particular situation, the Administrative Court concludes that applied tax praxis becomes crucial for the meaning of the realization concept. Due to applied tax praxis, the income must include commitments that remain after the end of the taxation year and the content of the commitments must be clear enough to proportion the income in relation to the commitments. These conditions are not fulfilled in this case due to that the paid service fee cannot be viewed as an advance for a later achievement, since the historical statistics of numbers of lost keys as well as the expenditures related to the achievement are very low. Consequently, the Administrative Court claims that accruals of income cannot be recorded. The Administrative Court rejects the firm's appeal and Key Code Security AB appeals the Administrative Court's decision to the Administrative Court of Appeal.

4.3.2 The Administrative Court of Appeal

The Administrative Court of Appeal states that Key Code Security AB are not allowed to defer revenue recognition to another period than the year of billing. The Administrative Court of Appeal rejects the firm's appeal. Key Code Security AB appeals the Administrative Court of Appeal's decision to the Supreme Administrative Court.

4.3.3 The Supreme Administrative Court

The Supreme Administrative Court requested a statement from the Board who claim that the realization concept determines when revenue shall be recognized. According to the Board's statement, the realization concept implicates that revenue shall be recognized when the

achievement is mainly accomplished. The Board claims Key Code Security AB has not fulfilled its contractual achievements until the subscription time has expired, due to the firm being responsible for restoring lost keys to their customers during the entire contract period. The Board makes the comparison to insurance contracts which are completed gradually during the contract period. Revenue shall in those cases be recognized gradually provided that the economic outcome can be reliably estimated. The Board's opinion is that this criterion is fulfilled and that the solution to accrue income from the service fees over the contract period complies with good accounting practice.

Furthermore, the Supreme Administrative Court refers to the above-mentioned regulation in 41 § Municipal Income Tax Act which states that the firm's revenue recognition shall be the base for taxation unless it conflicts with good accounting practice or a specific tax rule. The court clarifies that there are no specific tax rules for the particular income. Moreover, the Supreme Administrative Court explains³⁶ that taxation shall be based on the solution chosen by the firm if good accounting practice allows for several alternatives.

Additionally, the Supreme Administrative Court refers to the Board's circular C 20/5 as well as statements U 87:1, U 89:6 and U 89:10, which imply income from service contracts that are to be performed during a following period shall be recognized continuously during the period or when the achievement as a whole is fulfilled. The court's conclusion is that Key Code Security AB fulfills the achievement gradually during the contract period and therefore approves the firm's accounting solution. In contrast to the Administrative Court and the Administrative Court of Appeal, the Supreme Administrative Court approves the firm's appeal.

4.3.4. Argumentation analysis

T = It is good accounting practice to record accruals of income from service fees for future commitment over several accounting periods.

Key Code's argumentation:

Key Code's argumentation does not qualify to be included in the argumentation analysis, since the arguments are not relevant in relation to the thesis T. The firm refers only to the Municipal Income Tax Act and that the Administrative Court of Appeal did not make an independent assessment of good accounting practice. For that reason Key Code's arguments are not addressed here.

The Swedish Tax Agency's argumentation:

C₁ = The income is to 98 percent realized in connection with billing.

C₁C₁ = The remaining risks are relatively small.

C₂C₁ = The remaining risks are measured reliably.

The Board's argumentation:

P₁ = Crucial for when to recognize revenue is the so-called realization concept. According to this concept revenue shall be recognized when the person who shall perform something essentially has completed the performance.

³⁶ The Supreme Administrative Court refers to referral to the Council in Legislation (Iagrådsremiss) September 3, 1998 with a proposal for the new Income Tax Act 14:2,4 and commentary on these sections, p. 162-164 and 165-167.

P_2 = The firm has not fulfilled its contractual performance until the subscription period has ended.

P_1P_2 = Throughout the period the firm is responsible in relation to their customers for bringing lost and found keys back to the customers.

P_3 = Revenue shall be recognized gradually provided that the financial outcome of the contract can be measured reliably.

P_1P_3 = This condition seems to be fulfilled.

P_2P_3 = It is a matter of a contract that in conformity with e.g. insurance contracts is accomplished gradually during the contract period.

The Supreme Administrative Court's argumentation:

P_4 = Compensation for services that are to be performed during a future period, shall be recognized as revenue either when the performance is entirely completed or continuous during the period.

Premise₁ to P_4 = The Board's circular C 20/5 and statements U 87:1, U 89:6 and U 89:10.

Premise₂ to P_4 = If good accounting practice allows for different options in terms of accruals the taxation shall be based on the accounting solution selected by the firm, according to referral to the Council on Legislation, September 3, 1998 with proposals for new Income Tax Act 14:2, 4 and commentary on these sections, p. 162-164 and 165-167.

P_5 = The service fees are payment for the firm's commitment to provide that found keys are returned to the customers.

P_6 = The firm fulfills this performance continuously during the contract period.

4.4 Arvika Energi AB RÅ 1994 ref. 2

Arvika Energi AB, who distributes electricity, was subject to a tax audit revealing that the firm had not recognized revenue from connection fees of 199,000 SEK. Instead the firm had reduced the depreciation base of the fixed assets with the corresponding amount. According to the Swedish Tax Agency the accounting does not comply with good accounting practice and cannot be accepted. The Swedish Tax Agency appeals the decision to the Administrative Court.

4.4.1 The Administrative Court

The Swedish Tax Agency argues that taxable income should be raised by the amount of 199,000 SEK, since the accounting solution is not in accordance with good accounting practice.

The firm is of another opinion and states that they have reduced the connection fees from the subscribers from the acquisition cost of the electricity distribution network. The remaining amount has thereafter been the base for depreciation on machinery and equipment. The costs the firm strays for the wiring network shall be handled in accordance with regulations for fixed assets, which means a depreciation time of five years. The consumer pays the fee once but with the right to consume electricity for all future. In the end a reduction is made of the costs connected to the connection fees during a five year period. According to the firm, it is not in accordance with neither good accounting practice or the matching concept to recognize the revenue immediately and divide the cost over a five-year period.

The Administrative Court accepts the appeal from the Swedish Tax Agency and states that income of business operation shall in accordance with the Municipal Income Tax Act comply with good accounting practice as long as it is not in conflict with another regulation in the act. There is no support to handle revenue from connection fees in a different way than other revenue. Therefore, the revenues shall be, in accordance with the Swedish Tax Agency's decision, by with 199,000 SEK for taxation. Arvika Energi AB appeals the decision made by the Administrative Court to the Administrative Court of Appeal.

4.4.2 The Administrative Court of Appeal

In the appeal, the Swedish Tax Agency adds that the amount raised taxation is too high and shall instead be reduced to 156,891 SEK, which corresponds to the accelerated depreciations.

The Administrative Court of Appeal rejects the appeal from Arvika Energi AB and states that the connection fees are taxable income for the firm which shall be reported for taxation. There is no support from law, in accordance with what has been stated in the Administrative Court, that revenues from connection fees shall be handled in a different way than other revenues. Reducing the cost of capital assets purchased during the year with subscribers' connection fees, has led to that some of the acquisition costs have been directly depreciated. In accordance with the Municipal Income Tax Act 29:3, deduction for acquisition of the current kind of capital assets can be accepted only through early depreciations. Consequently, the firm's accounting is in conflict with the Municipal Income Tax Act. The firm shall therefore be taxed for the connection fees in accordance with what has been said earlier, and therefore the depreciation base for capital assets shall be increased with the same amount. The Administrative Court of Appeal rejects the appeal from Arvika Energi AB. Arvika Energi AB appeals to the Supreme Administrative Court.

4.4.3 The Supreme Administrative Court

Arvika Energi AB claims the Supreme Administrative Court shall reduce the taxable income stated by the firm in the declaration of income. The firm continues to claim it is in accordance with good accounting practice to recognize the subscribers' connection fees in the current way. The connection fee is more or less a fee that gives the consumer the right to use the electricity for all future. It is therefore natural that the fee is considered to be a compensation for services the firm will provide in the future. The cost for the connection is in the context negligible. Since the connection fees essentially are compensation for future usage, there is no hesitation according to the firm that accruals of income should be recorded. The firm claims the used method is practical and did not bring any tax advantages to the firm.

The Swedish Tax Agency rejects and argues that it is not proved that the connection fees included compensation for electricity and other services the firm shall provide the consumers in the future. Further, the income is definitive for the firm. From the total revenues 1987, only 0.4 % is connection fees. The Swedish Tax Agency therefore claims that the "prerequisite of materiality"³⁷ is not achieved even if the connection fees shall be seen as compensation for future services.

The Board is requested by the Supreme Administrative Court to make a statement and argues that there is no praxis of accounting of connection fees, and there are also no accounting recommendations in the current area. It shall therefore be judged after general accounting

³⁷ Väsentlighetsrekvisitet (authors' translation).

recommendations. The connection fees lead to that the firm becomes the owner of the made investments and therefore, wiring network and other facilities shall be recognized as assets in the firm's accounting. The connection fees shall therefore be recognized as revenue for the firm. The time for recognition of the revenue is the time for billing the fee, if it is not certain that the billing considers future performances. It shall also be taken into account how much of the fee originates from connection and how much originates from future electricity and other services the firm has to deliver. The part of the bill that does not concern connection fees shall be recognized as deferred revenue.

The court states that the income of the business shall be reported on accrual basis, if it does not conflict with the Municipal Income Tax Act. It is undisputed that the firm for the current year has not reported accrued connection fees otherwise than by a reduction in the depreciation base of capital assets by an amount equivalent to received fees. This is not in accordance with good accounting practice and shall not be the base of taxation. When it comes to the question concerning whether a part of the received fees shall be recognized as deferred revenue or recognized as revenues during the current year, the court states that due to the small amount of 0.4 % of the total revenue of the firm, accruals shall not be reported. The Supreme Administrative Court judges that all the connection fees shall be recognized as revenues during the year and thereby confirms the judgment made by the Administrative Court of Appeal. The court rejects the appeal from Arvika Energi AB and approves the decision made by the Administrative Court of Appeal.

4.4.4 Argumentation analysis

T = It is good accounting practice to recognize subscribers' connection fees as revenue during the current accounting period instead of immediately reducing the depreciation base of fixed assets with the corresponding amount.

Arvika Energi's argumentation:

C_1 = The connection fee is essentially a fee that resulted in a right to use electricity for all future.

P_1C_1 = The connection fee is mainly compensation for future use.

P_2C_1 = The connection fees are compensation for services that the firm will provide to the subscribers.

$P_1P_2C_1$ = The connection itself and the cost for it is negligible in this context.

The Swedish Tax Agency's argumentation:

P_1 = The income is definitive for the firm.

P_1P_1 = There is no evidence that the connection fees include compensation for electricity and other services that the firm will provide to the subscriber in the future.

P_2 = The prerequisite of materiality is not achieved even if the connection fees as a whole would be seen as compensation for future services.

P_1P_2 = Of the total revenues for the accounting year 1987 only 0.4 per cent represented compensations for connection fees.

The Board's argumentation:

P₃ = Wiring network and other facilities shall be recognized as assets in the firm.

P₁P₃ = Although subscribers by connection fees contribute to the firm's financing of an investment, there is no reason to use, as acquisition value for the investment, another amount than the entire expenditure.

P₁P₁P₃ = The presence of connection fees does not mean that anyone else except the firm becomes the owner of the investments.

P₄ = Regarding the timing of revenue recognition, the general principle is that the billed amounts are recognized as revenue immediately.

C₁P₄ = Only if it is clear that the billing is for not totally completed services, there is a reason to postpone the time for the revenue recognition or recognize revenues gradually over a certain period.

P₅ = Insignificant amounts do not need to be accrued.

P₆ = Acquisition value of an electricity facility concerned in this case, is the firm's expenditures for the investment without reduction of received connection fees.

Premise to P₆ = It is this value that shall be depreciated according to the Book-keeping Act §15.

The Supreme Administrative Court's argumentation:

P₇ = Accrual of an insignificant part of the revenues should in a case such as the one concerned not be recorded (cf. the Board's statement).

P₁P₇ = Connection fees for the accounting year amounted to only about 0.4 percent of the firm's revenues for electricity during the year.

5. DISCUSSION

In this chapter the results from the argumentation analysis are discussed. Firstly, the legal cases are analyzed from what the Supreme Administrative Court has considered good accounting practice. In addition, the arguments in the Supreme Administrative Court's grounds for the decisions are analyzed from the perspective of whether they are still sustainable compared to current standards. Secondly, the accounting solutions approved by the Supreme Administrative Court in the judicial decisions are analyzed in the perspective of quality.

5.1 Good accounting practice

5.1.1 Tele2 Sverige AB 1784-08

An issue concerned in the Tele2-case is whether the firm is entitled to expense subsidies of cell phones to selling agents immediately, while the revenue from the subscriptions is recognized over several taxation years, or if the expenditures shall be matched against corresponding revenue.

The Supreme Administrative Court considers expensing subsidies to selling agencies immediately as good accounting practice. In the grounds for the decision, the court only refers to the Board's statement that expensing provision to selling agencies does not conflict with good accounting practice³⁸. The Board discusses a statement from IFRIC considering how a provider of telecommunications services shall account for telephone handsets it supplies free of charge or at a reduced price to customers. IFRIC did not reach a consensus but did however make two alternatives visible, whereof one is in accordance with Tele2's accounting solution. According to our interpretation, the Board concludes from IFRIC's statement, that it is not in conflict with good accounting practice to expense subsidies to selling agencies immediately. Consequently, application of the matching concept is not necessary for an accounting solution to be in accordance with good accounting practice as argued by the Swedish Tax Agency³⁹, even though revenue from the contract is recognized linearly over the contract period. Since none of the arguments claimed by the firm or the Swedish Tax Agency are commented on in the grounds for the decision, it is not possible to analyze the Supreme Administrative Court's position regarding these arguments. However, Tele2's argumentation mainly consists of the IASB Framework definition of assets and the criteria for recognition as well as that the matching concept does not have an exceptional position in accordance with modern accounting theory as interpreted in the Framework⁴⁰. According to the IASB Framework, expenditures are not allowed to be capitalized if they fail to fulfill the definition of an asset or the certain criteria for recognition (p. 49, 82-83). A connection between income and expenditure is not enough to be allowed to capitalize expenditures, since the matching concept has a subordinate position. However, as mentioned above, the court does not discuss whether the expenditures fulfill the definition of an asset or the criteria to be capitalized according to the IASB Framework.

Dichev (2008) argues against the accounting solution approved by the Supreme Administrative Court and claims that matching better reflects business reality than the balance sheet-based model and the consequence of using the balance sheet-based model is that the possibility to estimate future

³⁸ P₆

³⁹ C₁

⁴⁰ P₁, P₂, P₁, P₂

earnings is impaired. Further discussion about estimation of future earnings follows later in this chapter.

5.1.2 Karlshamn's hamn AB RÅ 2003 not. 127

In this legal case, the issue is whether Karlshamn's harbor is entitled to record accruals of income from a one-time payment during the contract period of 50 years or if the total amount of the payment shall be recognized as revenue during the taxation year concerned.

The Supreme Administrative Court considers recording linear accruals of a one-time payment for future commitment over 50 years as good accounting practice. In the grounds for the decision, the court refers to the Board's assumption that the harbor is responsible for a significant part of the commitment to KAB and that the harbor's performance consequently is to accomplish recurrent tasks considering maintenance⁴¹. The court also refers to the Board's statement that there is no information that any part of the compensation regards performance connected to entering into the contract or the payment⁴². Consequently, the court judges that since the commitment is not accomplished at time of taxation and since it is found clear that the payment only regards compensation for commitments in the future, the payment shall be accrued over 50 years. Thus, the prudence concept is of crucial relevance.

As the Board argues, the service contract consisted of an undetermined number of activities that are to be carried out over a specified period⁴³. According to RR 11 p. 25, as referred by the Board, accruals of income shall be linear during the contract period in service contracts that contains an undetermined number of activities during an agreed period of time, unless some other method better shows the extent to which performance is carried out⁴⁴. Since a price is already decided for the services in the case concerned, the contract can be defined as a service contract at a fixed price. The corresponding paragraph to RR 11:25 is in BFNAR 2003:3 p. 36, which states that in accordance with the main method, income from a fixed price service contract containing an undetermined number of activities shall be recognized linearly over the period.

Alternatively, the firm can choose to apply the alternative method for fixed price contracts which states that recognition of revenue can be deferred until the commitment is mainly accomplished (BFNAR 2003:3 p. 39). However, this kind of accounting solution in this particular case can be questioned, since recognizing revenue nearly 50 years after payment would be an expression for an extreme application of the prudence concept⁴⁵ and thereby conflict with the concept of a true and fair view. Since reasonable prudence and true and fair view are prescribed by law and stated in the Annual Accounts Act 2:3-4, they are mandatory to follow according to the hierarchy of legal sources (Peczenik 1995).

Compared to recognizing the one-time payment as revenue immediately, the Supreme Administrative Court's judicial decision may have support in the suggestion made by Barlev (1995) that the earliest point for recognition of revenues is when the probability that unexpected costs nullify expected profits is low (less than 5%). On the other hand, the judicial decision may be in

⁴¹ P₅

⁴² P₆

⁴³ P₁P₃

⁴⁴ P₃ and Premise₁ to P₃.

⁴⁵ Explanation of prudence concept in Appendix.

contrast to Barlev's (1995) suggestion if the probability that unexpected costs nullify expected profits is not yet low enough for revenue recognition. We are aware that Barlev (1995) made his suggestion from a FASB and an IASB-point of view with the purpose of defining the term *reliable*. However, our intention is to show a logic idea of when revenue shall be recognized.

The approved accounting solution in the Karlshamn's hamn-case, implicates that main parts of the payment are during the first part of the contract period recognized as a liability. Samuelson (1993) claims that a relevant and reliable measure of a liability is the probable sacrifice required to fulfill the commitment. In the Karlshamn's hamn-case it is difficult to make any comments about the probable sacrifice required to fulfill the commitment, since it would only be speculations. It is therefore difficult to assess whether the liability corresponds to the probable sacrifice required to fulfill the commitment.

5.1.3 Key Code Security AB RÅ 1999 ref. 32

The issue concerned in the Key Code-case is whether the firm has the right to record accruals of income from service fees over several accounting periods for the future commitment to return the keys to the customer, or if the income shall be recognized as revenue during the taxation year concerned.

The Supreme Administrative Court considers recording accruals of income from service fees over several accounting periods for future commitments as good accounting practice. In the grounds for the decision, the court argues that compensation for services that are to be performed during a future period, shall be recognized as revenue either when the performance is entirely completed or continuously during the period⁴⁶. An important premise to this argument is that if good accounting practice allows for different alternatives regarding accruals, the taxation shall be based on the accounting solution selected by the firm⁴⁷. This premise is important for the outcome of the decision, but is however not an argument for what good accounting practice is, since it only says that when the firm's accounting solution complies with good accounting practice, it shall be taxed in accordance with that solution. Moreover, the court clarifies that the service fees are payment for the commitment to provide the found keys to the customers⁴⁸. Since the firm fulfills this performance continuously during the contract period⁴⁹, it is considered good accounting practice to accrue the service fees over several accounting periods.

Although the Supreme Administrative Court does not directly, in the grounds for the decision, refer to the statement from the Board requested by the court, the judicial decision is in line with the statement. According to the Board's argumentation in the statement the contract is, in conformity with e.g. insurance contracts, accomplished gradually during the contract period and revenues shall therefore be recognized gradually provided that the financial outcome of the contract can be measured reliably⁵⁰. Further, the Board claims that the financial outcome of the contract can be measured reliably⁵¹. The Board's argumentation is supported by RR 11 p. 20 and BFNAR 2003:3 p.

⁴⁶ P₄

⁴⁷ According to referral to the Council on Legislation, September 3, 1998 with proposals for new Income Tax Act 14:2, 4 and commentary on these sections, p. 162-164 and 165-167. Premise₂ to P₄.

⁴⁸ P₅

⁴⁹ P₆

⁵⁰ P₂P₃ and P₃

⁵¹ P₁P₃

31, which state that revenue shall be recognized based on the degree of completion at closing date when the financial outcome can be measured reliably in accordance with a number of conditions.

As argued by the court, it is good accounting practice to accrue the service fees over several accounting periods, due to that the firm fulfills the performance continuously during the contract period⁵². As clarified above, this argumentation is supported by RR 11 p. 20 and BFNAR 2003:3 p. 31. It may as well be supported by RR 11 p. 25, which states that accruals of income shall be recorded linearly when the service contract contains an undetermined number of activities, and BFNAR 2003:3 p. 36, which is equivalent to RR 11 p. 25 for fixed-price contracts recognized in accordance with the main method. The court also argues that compensation for services that are to be performed during a future period, can be recognized as revenue when the performance is entirely completed⁵³. This argument is supported by the alternative method for fixed-price contracts in BFNAR 2003:3 (p. 39), which states that recognition of revenue can be deferred until the commitment is mainly accomplished. However, this argument did not control the outcome of the case.

A complexity in this legal case is illustrated in the Swedish Tax Agency's argumentation, which is that the income is to 98 percent realized in connection to billing and that the remaining risks are relatively small and are measured reliably⁵⁴. However, the Swedish Tax Agency's definition of "reliably" is not clear. Our interpretation of the judicial decision, that is in opposition to the Swedish Tax Agency's argumentation, is that, even in cases when the extent of the remaining commitment is limited as in this particular case, the application of the prudence concept is crucial.

The Swedish Tax Agency's accounting solution may have support in the suggestion made by Barlev (1995) that the earliest point for recognition of revenues is when the probability that unexpected costs nullify expected profits is low (less than 5%). However, Barlev (1995) only made a suggestion for *earliest* recognition of revenue and does not say anything about recognition after the earliest point. The Swedish Tax Agency's accounting solution has support in this idea that revenue can be recognized if the probability that unexpected costs would nullify expected profits is low in the firm. In addition, Barlev's (1995) suggestion may support the court's decision as well. If the probability that unexpected costs nullify expected profits is higher than 5%, revenue shall not be recognized immediately according to this idea.

The approved accounting solution in the Key Code-case, implicates that parts of the income are recognized as a liability. Samuelson (1993) claims that a relevant and reliable measure of a liability is the probable sacrifice required to fulfill the commitment. In the Key Code-case it is obvious that the probable sacrifice required to fulfill the commitment is less than the deferred revenue, since the probability as well as the expenditure for having to return any keys to the customers are low. Analyzed in accordance with Samuelson's (1993) suggestion, the revenue value of the future service liability is consequently not a reliable measure of probable sacrifice and in this case the revenue deferral understates the firm's liquidity position.

⁵² P₆

⁵³ P₄

⁵⁴ C₁, C₁C₁ and C₂C₁

Furthermore, Samuelson (1993) argues that if customers have paid in advance, a better time for revenue recognition than deferring the revenue would be at the critical event, referring to the time for the payment under specific criteria rather than the actual performance. Samuelson (1993) claims that the critical event should be the event that, beyond reasonable doubt increases the net assets permanently. Criteria that must be fulfilled to be certain that the net assets will increase are the ability to measure the seller's probable sacrifice, the ability for the seller to provide the service and the inability for the buyer to cancel the contract and receive a refund. In the Key Code-case, the critical event and thereby the time for revenue recognition would be the payment, if it beyond reasonable doubt increases net assets.

5.1.4 Arvika Energi AB RÅ 1994 ref. 2.

The issue in the Arvika Energi AB-case is that the firm had not recognized revenue from connection fees of 199,000 SEK, but had instead reduced the depreciation base of the fixed assets by the corresponding amount. The question concerned is whether the firm is allowed to reduce the depreciation base or if shall the firm recognize the connection fees as revenue immediately or over several accounting periods.

The Supreme Administrative Court considers, in accordance with the statement made by the Board⁵⁵, that accrual of an immaterial part of the revenues shall not be recorded, since the connection fees for the accounting year amounted to only 0.4 % of the firm's revenues for electricity during the year⁵⁶. Consequently, the firm shall recognize the entire amount as revenue immediately. Thereby, it is not good accounting practice to reduce the depreciation base with the connection fees or record accruals of an immaterial amount. According to the Board, wiring network and other facilities shall be recognized as assets in the firm⁵⁷ and although subscribers by the connection fees contribute to the investment, there is no reason to use another amount than the entire expenditure as acquisition value⁵⁸. This argument is not crucial for the judicial decision, since the court only mentions that the amount is not material to be accrued. It is therefore not clear how the outcome would be if the amount concerned was material. Taken the Karlshamn's hamn and Key Code-cases into consideration, it is most probably that accruals of income would be approved by the court, if it can be proved that there are future commitments in accordance with the argument made by the firm, i.e. that the connection fee is essentially a fee that results in a right to use electricity for all future⁵⁹.

As mentioned, the Supreme Administrative Court refers to the argumentation made by the Board that the amount, representing 0.4 % of the firm's total revenues, is an immaterial amount and shall not be recognized as deferred revenue. This argument has support in RR 11 which states that the recommendation does not have to be applied to immaterial entities. In addition, BFNAR 2000:2 (p.7) states that the general advice from the Board does not either have to be applied to immaterial entities, which implicates that BFNAR 2003:3 does not have to be followed in this particular case.

In the article from Samuelson (1993) there are examples of deferred revenues when a retailer sells a product to deliver in the future or rents paid in advance. As long as the product is not delivered, the

⁵⁵ P₅

⁵⁶ P₇ and P₁P₇

⁵⁷ P₃

⁵⁸ P₁P₃

⁵⁹ C₁

revenue shall be recognized as deferred revenue since the retailer has an obligation in the future. The rent paid in advance is to be recognized as deferred revenue. The advanced payment is then allocated to the corresponding periods. These examples can be applied to the Arvika Energi-case, since the issue is similar. If there was evidence that the firm had a future obligation to provide electricity for all future, the case might have been different, i.e. accruals of income might have been approved by the court. But in this particular case, the prerequisite of materiality would still not be fulfilled. As mentioned above, if customers have paid in advance a better time for revenue recognition would be at the critical event, i.e. the time for the payment under specific criteria instead of the actual performance (Samuelson 1993). The critical event should be the event that beyond reasonable doubt increases the net assets permanently, which in the Arvika Energi-case, would be the payment if it beyond reasonable doubt increases net assets. Criteria that must be fulfilled to be certain that the net assets will increase are the ability to measure the Arvika Energi's probable sacrifice and ability to provide the service as well as the inability for the buyer to cancel the contract.

5.1.5 The relevance of the precedents

To reconnect to the problem that legitimizes this study, i.e. that the value of judicial decisions are limited since there will always be new changes in good accounting practice when the judicial cases are finally completed (Norberg 1999). The Supreme Administrative Court's decisions are relevant only in a short-term perspective, due to the fact that precedent is a ruling in a specific case as well as the dynamic feature of good accounting practice (Bjuvberg 2006). From the previously discussion, the arguments in the Supreme Administrative Court's grounds for the decision for the approved accounting solution in each of the reviewed legal cases are still sustainable compared to current standards, with exception of the Tele2-case where no conclusion could be made, which are further clarified in the conclusions. This implicates that these precedents are still of relevance, since no conflict between them or the standards is found, which could otherwise be the case due to the age of the precedents (Norberg 1999), the dynamic feature of good accounting practice and that particular decisions as a consequence to the legal standard's dynamic quickly lose their value of precedent (Bjuvberg 2006).

5.2 The quality of information

In this section we keep the perspective of investors, even though we are aware of that the firms in the legal cases have other important stakeholders as well. This is due to that the articles this discussion is based on are written from the perspective of investors. It is of importance to clarify that the fact that Karlshamn's hamn AB and Arvika Energi AB are municipal firms, which implicates that they have other stakeholders of probably more importance than investors. However, we believe that the outcome in the Karlshamn's hamn and Arvika Energi -cases are still of importance even if they are municipal owned, since the court does not mention that the accounting solutions are only approved solutions in municipal firms. The accounting solutions in the precedents are of value since they can be used as guidance for future relating issues for other firms as well. Consequently, it is of relevance to analyze how the accounting solutions approved by the Supreme Administrative Court relate to the quality of information investors are provided with, even though these cases concern municipal firms. Moreover, to remind the reader the term quality is to be interpreted in accordance with the definition of quality according to this thesis as stated in the background.

5.2.1 Tele2 Sverige AB 1784-08

As previously mentioned, the Supreme Administrative Court considers expensing subsidies to selling agencies immediately as good accounting practice in the Tele2-case. Consequently, application of the matching concept is not necessary even though revenue from the contract is recognized linearly over the contract period.

Several studies claim that the matching concept is beneficial regarding the information provided investors. Su (2005) states that the matching concept enhances the estimation of the firm's long-term profitability. Since matching reduces the variance in earnings, earnings are closer to the long-term profitability and investors are thereby provided more reliable information for decision making. Further, Dichev and Tang (2008) show that poor matching increases the volatility of earnings. Consequently, the evolution towards the balance sheet-based model and poor matching has a negative effect on the quality of accounting earnings, since the information of earnings deteriorates, suggesting that matching affects the possibility to carry out earnings forecasting. In another study, Dichev (2008) argues that the matching concept better reflects business reality than the balance sheet-based model and the consequence of using the balance sheet-based model is that the possibility to estimate future earnings is impaired. Considering the quality of information provided investors for decision-making, these studies suggest that an application of the matching concept would be preferable. If the subsidies to selling agencies are matched against the corresponding revenue from the contract, investors are provided more qualitative information, since the possibility to estimate future earnings increases. However, as Dichev (2008) points out, capitalizing of expenditures leads to an uncertain content of assets. Capitalizing of the subsidies to selling agencies could therefore result in an uncertain content of assets. It can nevertheless be concluded that the court's judicial decision of expensing subsidies to selling agencies immediately as good accounting practice, is in contrast to what these studies suggest as qualitative information that investors are provided with.

5.2.2 Karlshamn's hamn AB RÅ 2003 not. 127 and Key Code Security AB RÅ 1999 ref. 32

In the Karlshamn's hamn-case, recording linear accruals of a one-time payment for future commitment over 50 years is considered good accounting practice by the Supreme Administrative Court. Further, in the Key Code-case, the Supreme Administrative Court judges accruals of income from service fees for future commitment over several accounting periods as good accounting practice.

Zhang (2005) finds that early revenue recognition improves the timeliness and thus the relevance of the information by capturing the underlying economic events. Considering the relevance of the information provided to investors for decision-making, the study suggests that recording linear accruals of a one-time payment for future commitment over 50 years as in Karlshamn's hamn as well as recording accruals of income from service fees for future commitment over several accounting periods as in the Key Code-case, are not preferable accounting solutions. According to Zhang's (2005) results, the one-time payment as well as the service fees should be recognized as revenues in the beginning of the service contracts to provide relevant information. However, if revenue is recognized early, the predictability of reported revenue becomes lower, while recognized proportionally the predictability increases (Zhang 2005), which implies that accruals of income as approved by the court are preferable. Zhang (2005) also finds that early recognition of revenue lowers the reliability of the accounting information, since the extent to how well accounts receivable

accruals map into future cash flow realizations is reduced. However, in the Karlshamn's hamn- and Key Code-cases, the cash flows precede the accruals and consequently early revenue recognition should not lead to lower reliability of the accounting information. To sum up, the Supreme Administrative Court's judicial decisions that recording linear accruals of a one-time payment for future commitment over 50 years as well as recording accruals of income from service fees for future commitment over several accounting periods are good accounting practice, provide investors with qualitative information for decision-making, since the predictability of reported revenue increases if revenue is recognized proportionally.

5.2.3 Arvika Energi AB RÅ 1994 ref. 2

Concerning the Arvika Energi-case, the Supreme Administrative Court regards recognition of subscribers' connection fees as revenue during the current accounting period as good accounting practice. The court concludes in the grounds for the decision that the connection fees for the accounting year amounted to only 0.4 percent of the revenues for electricity during the year. Thus, accruals of an immaterial part of the revenues shall in this case not be recorded. In the case, the accounting solution approved by the judicial decision is in conformity with the conclusion made by Zhang (2005), that early revenue recognition improves the timeliness and thus the relevance of the information. Early revenue recognition leads to lower reliability according to Zhang (2005). However, it is difficult to determine how early revenue affects the reliability in the Arvika Energi-case, since it does not reveal whether the customer can cancel the contract and receive a refund. Neither is it possible to determine the risk that customers fail to pay the invoice⁶⁰. As previously mentioned, the predictability of recognized revenue becomes lower if revenue is recognized early (Zhang 2005), which implicates that recording accruals are preferable. Consequently, recognizing revenue from connection fees during the taxation year concerned as in the Arvika Energi-case lowers the predictability of revenue. However, it can be questioned whether the amount in the Arvika Energi-case affects investors, since the amount is immaterial according to the Supreme Administrative Court's grounds for the decision.

⁶⁰ We assume that the service begins before the invoice is paid.

6. CONCLUSIONS, LIMITATIONS AND FUTURE RESEARCH

In this chapter we answer the stated research questions by drawing conclusions from the frame of reference, the empirics and the discussion chapter. The chapter is concluded with limitations of the study and suggestions for future research.

6.1 Conclusions

What is good accounting practice in terms of service contracts according to the Supreme Administrative Court?

Due to the fact that an appeal is normally only granted when a judicial decision could be of precedent-setting significance (Lehrberg 2001) the four legal cases include different issues and conditions. Consequently, it is difficult to come to a single conclusion about what good accounting practice is in service contracts. However, we have concluded some guidelines.

Since expenditures for acquisition of future profitable contracts are allowed to be expensed immediately, even though revenue from the contract is recognized linearly over the contract period, we can conclude that an application of the matching concept is not necessary for an accounting solution to be in accordance with good accounting practice. This shall not be interpreted as though that an application of the matching concept does not comply with good accounting practice. We cannot come to any conclusion why the subsidies to selling agencies are allowed to be expensed immediately, e.g. due to failure to be capitalized in accordance with the definition of assets and the certain criteria for capitalization in the IASB Framework, since this is not discussed by the court. In the grounds for the decision, the court only refers to the Board's statement that expensing subsidies to selling agencies does not conflict with good accounting practice. Our conclusion of this fact is that a statement from the Board has a powerful impact on the judicial decision for what good accounting practice is, which is in accordance with prop. 1998/99:130. This powerful impact can be questioned, since it in this case leads to that the circumstances to why expensing subsidies immediately is good accounting practice still are unclear.

Accruals of income are a major issue in the legal cases concerning service contracts. A general conclusion from the results is that it is in accordance with good accounting practice to record accruals of income when the firm still has a commitment to fulfill in the future, i.e. after time of taxation. The extent of the commitment regarding time and future expenditures can be of different magnitude, since the court approved accruals regarding a major commitment reaching over 50 years as well as a commitment of a limited extent where almost no expenditures were left to pay. In addition, it is of significance that the payment only regards compensation for commitments in the future. Finally, we come to the conclusion that it is not in accordance with good accounting practice to reduce the depreciation base of fixed assets by the amount corresponding to received income. Additionally, recording accruals in accordance with good accounting practice demands a material amount. If this criterion is not satisfied, immediate revenue recognition must be made. Accruals of income of an immaterial amount do not comply with good accounting practice.

Are the arguments in the Supreme Administrative Court's grounds for the decisions for the approved accounting solutions still sustainable compared to current standards?

The arguments in the Supreme Administrative Court's grounds for the decision for the approved accounting solution in each of the reviewed legal cases, with the exception of the Tele2-case where no conclusion could be drawn, are still sustainable compared to current standards. This can be concluded through following comparison. An argument for recording accruals is that the performance is to accomplish recurrent tasks during a specific period. This argument is supported by RR 11 p. 25 as well as the main method for fixed price contracts in BFNAR 2003:3 p. 36, which state that accruals of income shall be recorded linearly during the contract period in service contracts that contains an undetermined number of activities during an agreed period of time. The argument that the compensation shall be recognized as revenue continuously during the period may as well be supported by RR 11 p. 25 and BFNAR 2003:3 p. 36. Additionally it is supported by RR 11 p. 20 and the main method for fixed price contracts in BFNAR 2003:3 p. 31. Finally, the argument in the grounds for the decision that the amount is not material to be accrued is in accordance with BFNAR 2000:2 (p. 7) and RR 11.

From these conclusions we suggest that these precedents are still of relevance, since no conflict between them or the standards is found, which could otherwise be the case due to the age of the precedents (Norberg 1999), the dynamic feature of good accounting practice and that particular decisions as a consequence of the legal standard's dynamic feature quickly lose their value of precedent (Bjuvberg 2006).

The arguments in the Supreme Administrative Court's grounds for the decision in the Tele2-case are not comprehensive, since the court only states that expensing subsidies to selling agencies does not, according to the Board's statement, conflict with good accounting practice. Since the court does not discuss why the accounting solution does not conflict with good accounting practice, it is consequently not possible to come to a conclusion whether the arguments in the grounds for the decision for the approved accounting solution still are sustainable compared to current standards.

How do the accounting solutions approved by the Supreme Administrative Court relate to the quality⁶¹ of information investors are provided with?

It can be concluded that two of the accounting solutions⁶² approved by the Supreme Administrative Court, provide investors with qualitative information, since the accounting solutions are in accordance with Zhang's (2005) conclusion that if revenue is recognized early, the predictability of reported revenue becomes lower, while recognized proportionally the predictability increases. This implies that accruals of income as approved by the court provide investors with more qualitative information, though at the expense of the relevance of the information.

In the other two cases⁶³, the approved accounting solutions do not provide investors with qualitative information according to the reviewed studies. Since Su (2005), Dichev and Tang (2008), Dichev (2008) show that matching increases the possibility to estimate future earnings, it can be concluded that the court's judicial decision that expensing subsidies to selling agencies immediately is good accounting practice, is in contrast to what these studies suggest as qualitative information provided

⁶¹ In this thesis information is considered qualitative if the information can be used for future earnings or revenue estimation.

⁶² Karlshamn's hamn and Key Code.

⁶³ Tele2 and Arvika Energi.

to investors. The studies suggest that the expenditures instead shall be matched against the corresponding revenue from the contract to provide investors with more qualitative information, since the possibility to estimate future earnings increases.

Zhang's (2005) conclusion that the predictability of reported revenue becomes lower if revenue is recognized early, implicates that recognizing revenue from connection fees during a concerned taxation year provides investors with less qualitative information. To comply with Zhang's (2005) conclusion, the connection fees should be accrued over several accounting periods. Thus, as mentioned in the discussion chapter, it can be questioned whether the amount in the case affects investors, since it is immaterial according to the court's grounds for the decision.

6.2 Limitations

To provide an ethical point of view, we want to clarify the limitations of this study. It is important to make clear that in three of the legal cases; Karlshamn's hamn AB RÅ 2003 not. 127, Key Code Security AB RÅ 1999 ref. 32 and Tele2 Sverige AB 1784-08, it is only possible to identify what good accounting practice is. No conclusions can be made about what is not good accounting practice. In these cases, the firms' accounting solutions were considered good accounting practice according to the Supreme Administrative Court. If good accounting practice allows for several different alternatives, taxation shall be based on the solution chosen by the firm, due to prop. 1999/2000:2 part 2 as well as RÅ 1999 ref. 32. This implicates that if the firms had chosen the Swedish Tax Agency's accounting solution, it could as well had been considered good accounting practice by the court, i.e. it is not possible to draw the conclusion that the Swedish Tax Agency's accounting solution is not good accounting practice.

A weakness in our study is regarding the Tele2-case, where the arguments by the Supreme Administrative Court were vague and only referred to the Board's argumentation, which did not qualified to be included in the argumentation analysis. Consequently it was difficult to come to a specific conclusion about what good accounting practice constituted in the particular case.

We are also aware of the fact that the conclusions regarding the quality of information investors are provided with are based on few studies, which most likely has affected the outcome. Further, we are aware that there are several definitions of the term quality and that the definition in this thesis does not cover the entire spectrum of qualitative information desired by investors.

6.3 Future research

During the process of this study, we have found that the general supply of research concerning service contracts is limited. With this study, we have answered what good accounting practice in service contracts is according to the Swedish Supreme Administrative Court. To follow up this study, it would be interesting to investigate what good accounting practice in service contracts is by investigating annual reports and thereby the practice of service contracts. This is of importance, since the legislator explains that good accounting practice is existing practice in a qualitatively representative group of accountable persons, except from statements from normative organs (prop. 1995/96:10). During the processing of the data, we found that practice was discussed by the firms in a very limited way, the Swedish Tax Agency as well as the courts. By investigating practice, a comparison concerning good accounting practice in service contracts between praxis and practice is enabled.

Another possible future research is to investigate whether the arguments in the Supreme Administrative Court's grounds for the decisions still are sustainable compared to the K-project, when this is completed. This is of interest since the K-project will be of essential importance in the future.

Appendix

Statements from the Board

BFN U 87:1 concerns when a firm sells a product with a warranty included, where the question is how to recognize revenues from the sale of the warranty service in the accounting period.

BFN U 87:9 concerns how to estimate the cost for consultant services when recognizing provision for follow-up reserves.

BFN U 89:6 concerns cases where there are different stages in delivering. The question is when a started contract shall be recognized in the results and how to account started but not yet finished contracts.

BFN U 89:10 concerns service contracts reaching over several accounting periods where the firm receives a fixed amount and has an obligation to repair trucks for a contracted period. Since it is unknown how many service hours will be spent on services, the question is how many revenues shall be recognized of the amount during the accounting period.

Accounting concepts

Accrual basis: Revenues and costs connected to the accounting period shall be recognized in the annual report, even though receipts and disbursements have or have not been made. What decides the period is when the business transaction is made, not when it is regulated liquidly (Thorell 1996; RedR 1).

Prudence concept: Concerns two aspects (Westermarck 1998; RedR 1). On the closing date, only certain or realized revenues can be recognized (realization concept). Also, all predictable risks and possible losses that have occurred during this accounting year or earlier shall be taken into account, even if they are realized after the accounting year has ended, but before the annual report is created. Value changes shall as well be taken into account regardless of whether the firm is making profits or losses. In uncertain cases, a lower valuation shall be made of assets and a higher valuation of liabilities. Only certain revenues can be recognized in the income statement. Normally revenues are certain in connection to delivery and billing, with a condition that the delivery will give the right to payment. The valuation shall be made with reasonable prudence, but without going too far (Thorell 1996; RedR 1). If the carefulness goes too far it can cause a conflict with the true and fair view of the result.

Matching concept: Expenditures are recognized in the income statement based on the connection between the cost and corresponding specific revenue (Westermarck 1998).

Realization concept: Revenues shall be recognized in the income statement when they are certain (Thorell 1996).

Glossary

Accountable person	–	Redovisningsskyldig
Accrual basis	–	Bokföringsmässiga grunder
Annual Accounts Act	–	Årsredovisningslagen
Book-keeping Act	–	Bokföringslagen
Constitutional decision	–	Författningsbestämmelse
Cost-plus contract	–	Uppdrag på löpande räkning
Degree of completion	–	Färdigställandegraden
Good accounting practice	–	God redovisningssed
Income Tax Act	–	Inkomstskattelagen
Municipal Income Tax Act	–	Kommunalskattelagen
Preparatory work	–	Förarbete
Prerequisite of materiality	–	Väsentlighetsrekvisit
Percentage of completion method	–	Succesiv vinstavräkning
Source of law	–	Rättskälla
The Administrative Court	–	Förvaltningsrätten
The Administrative Court of Appeal	–	Kammarrätten
The Swedish Accounting Council	–	Redovisningsrådet
The Supreme Administrative Court	–	Högsta Förvaltningsdomstolen
The Swedish Accounting Standards Board	–	Bokföringsnämnden
The Swedish Tax Agency	–	Skatteverket

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