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SCHOOL OF BUSINESS, ECONOMICS AND LAW

Master Degree Project in Accounting

To Choose an Appropriate Accounting Framework
A study about accounting choices in real estate companies

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Abstract

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Title: To choose an appropriate accounting framework - A study about accounting choices in real estate companies

Background and problem: In Sweden there is an ongoing project to reform the regulatory accounting framework, as a result, there will be four different frameworks, namely K1 - K4. The main framework for non-listed companies is the K3 framework, at the same time, 97 percent of the Swedish companies have the possibility to follow either the K2 framework or the K3 framework. In other words, the companies will have to make the choice to adopt either the rules-based K2 framework or the principles-based K3 framework. One industry where this accounting choice will have a significant effect on the accounting practice is within the real estate industry.

Purpose: The aim with the study is to investigate the incentives behind the choice of following either the K2 framework or the K3 framework in a real estate company. More specific, the study will include an investigation of the reasoning behind accounting choices by integrating different perspectives.

Scope of research: The choice between the K2 framework and the K3 framework affects some industries more than others, thus, it would be more interesting to undertake an investigation between companies within the same industry instead of doing a comparison between companies in different industries. Therefore, the focus of this study will be on the real estate industry.

Method: The aim with the study is to create an understanding of why real estate companies engages in certain accounting choices, thus, it is suitable to use a qualitative approach when conducting the study. In order to provide a detailed answer of the research question interviews were conducted.

Analysis and Conclusions: The empirical findings indicate that all of the real estate companies in the study consider to adopt the K3 framework. An interesting aspect regarding the empirical findings was whether the companies had underlying legal entities or not. For a company with underlying legal entities, the choice to adopt the K3 framework could mainly be explained by the costs and benefits associated with the accounting choice since it would not be feasible to mix the principles-based K3 framework and the rules-based K2 framework within a real estate corporate group. On the other hand, for a company without underlying legal entities, the adoption of the K3 framework could mainly be explained by the importance to be viewed as legitimate.

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Chapter 1 - Introduction

The first part of the introduction gives an overview of the development of the Swedish accounting framework incorporating the ongoing K-project. This constitutes the basis for the following problem discussion as well as the research question. Thereafter, the purpose of the study is presented as well as the scope of the research. Furthermore, the benefits of the thesis are presented and finally the disposition of the thesis is provided.

1.1 Background

During the last decades, the financial accounting practices have continuously been developed due to a changing external environment. As a result, the need for a flexible accounting reporting system emerged. The need for an amendment arose early due to the emergence of multinational corporations, which resulted in the beginning of a harmonizing process with an attempt to standardize the regulatory framework of accounting on a global level. This international standardization is driven by the International Accounting Standards Board (IASB) and the aim is that the accounting framework should be applied by all nations. The standards developed by the IASB are known as International Accounting Standards (IAS) as well as International Financial Reporting Standards (IFRS) and derives mostly from the standards issued by the Financial Accounting Standards Board (FASB), which is based on the American Generally Accepted Accounting Principles (US GAAP) (Smith, 2006).

When it became known that the IFRS should be introduced, the Swedish Accounting Standards Board (BFN) decided to reform the Swedish accounting framework. The process to reform the regulatory framework started in 2004 and consisted of a project to create a new Swedish accounting framework, the so called K-project. This project aims to create relevant regulatory frameworks that should be used when establishing an annual financial statement and an annual report in non-listed companies. The K-project includes four different categories of companies, namely, K1, K2, K3 and K4 (Bokföringsnämnden A, 2012) The main framework for non-listed companies is the comprehensive general advice K3. The K3 framework is based on International Financial Reporting Standards for Small and Medium-sized Enterprises (IFRS for SMEs) which is a simplification of IFRS (Drefeldt & Törning, 2012). The Swedish Accounting Standards Boards aims to implement the K3 framework in the financial year starting after 31 December 2013. This implies that from the beginning of the year 2014 all non-listed companies that fulfil the definition of a large company according to the Annual Accounts Act¹ need to follow the K3 framework. Companies that do not fulfil the definition of a large company have the possibility to follow either the rules-based K2

¹ A company that fulfils more than one of following requirements is defined as a large company:

- The amount of employees exceeds 50 persons
- The balance sheet total exceeds 40 MSEK
- The turnover exceeds 80 MSEK

A small company is a company that does not fulfil the definition of a large company (1 kap. 3 § ÅRL).

framework or the principles-based K3 framework (Bokföringsnämnden A, 2012). On the other hand, the parent company in a larger corporate group has to follow the K3 framework whereas the parent company in a smaller corporate group has the possibility to choose between the regulatory frameworks (PWC, 2012). The definition of a large corporate group is the same as for a large company (Bolagsverket, 2012). However, it is important to point out that the vast majority of the Swedish companies, namely 97 percent, are considered as smaller companies and thus have the possibility to follow either the K2 framework or the K3 framework (Balans B, 2012).

Traditionally, the Swedish Accounting Standards Board as well as the Swedish Financial Accounting Standards Council (RFR) have provided complementary standard setting regarding how companies should prepare the financial statements. In the current situation non-listed companies have the possibility to either choose to apply the standards issued by the Swedish Accounting Standards Board or the corresponding standards issued by the Swedish Financial Accounting Standards Council. These regulatory frameworks are principles-based just as the K3 framework, which means that if applying these regulatory frameworks the change to follow the K3 framework will not be so extensive. However, smaller non-listed companies do also have the possibility to follow the rules-based K2 framework (Bokföringsnämnden A, 2012). Furthermore, the companies that are going to follow the K3 framework needs to consider the effect of the implementation already in the beginning of 2013 since these companies ought to report recalculated comparative figures according to the K3 framework (PWC, 2012).

The effect of the choice between the K2 framework and the K3 framework will vary depending on the industry. One industry where the effect might concern many companies is within the real estate industry. The reason for this is that a real estate company can be divided into several different legal entities, which in turn can be considered to fulfil the definition of a small company. Another important issue within the real estate industry, that is associated with the choice between K2 and K3, regards whether to apply component depreciation or not. When following the K3 framework the company needs to engage in component depreciation, which will have a significant effect on the accounting practice. Moreover, in connection to the choice between K2 and K3, the company will also have to decide whether to disclose the market value of the real estates or not (Deloitte, 2012). On the other hand, the choice between the two accounting frameworks can also have other effects that do not strictly concern the accounting practice. For instance, the choice between the K2 framework and K3 framework might also have an indirect effect on the company's contractual agreements with external parties such as credit institutions (KPMG, 2013).

1.2 Problem discussion

In the current situation, the non-listed companies in Sweden have the opportunity to choose various complementary standard settings based on different accounting areas. However, when the K-project is fully implemented this will no longer be the case. Instead the companies have

to follow one of the K-frameworks. Since 97 percent of the Swedish companies will have the possibility to follow either the K2 framework or the K3 framework, the vast majority of companies in Sweden have to make a choice concerning which of these two frameworks to adopt. In other words, the companies will have to make the choice to adopt either a rules-based framework or a principles-based framework. Hence, the choice between the K2 framework and the K3 framework will imply numerous changes in the accounting practice. The effects will be evident within the real estate industry where the companies need to decide whether to choose to apply component depreciation or not as well as to disclose the market value of the real estates or not. Consequently, it would be interesting to investigate the underlying incentives for a number of real estate companies to use either one of the two frameworks.

1.3 Research question

Based on the fact that a choice between the rules-based K2 framework and the principles-based K3 framework will imply numerous changes in the accounting practices it would be interesting to investigate the incentives behind this choice. Since the effect of the choice between the two accounting frameworks will be evident in the real estate industry, the investigation will concern different accounting choices in a number of real estate companies. Given the above background and discussion the proposed research question is as follows:

What are the underlying incentives for a real estate company to follow either the K2 framework or the K3 framework?

1.4 Research purpose

The aim with the study is to investigate the incentives behind the choice of following either the K2 framework or the K3 framework in a real estate company. In other words, the study will include an investigation of the reasoning behind accounting choices by integrating different perspectives. The purpose is therefore to conduct a study where the advantages or disadvantages with either following the K2 framework or the K3 framework will be investigated.

1.5 Scope

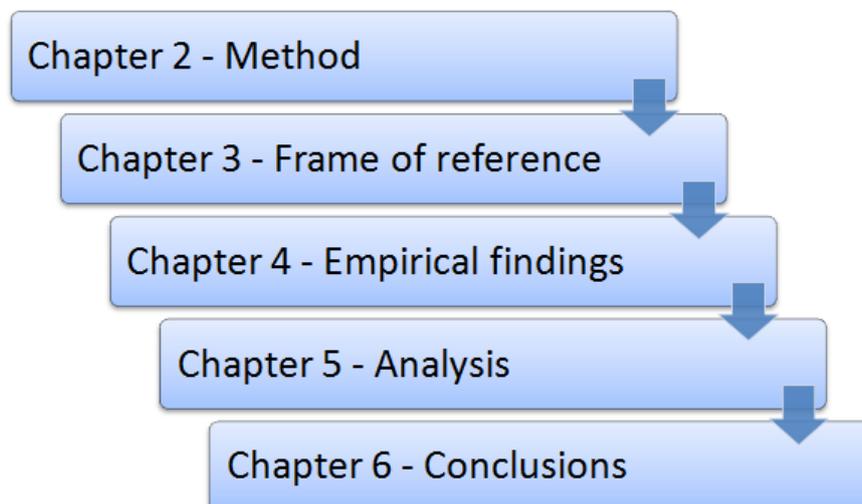
The aim with the study is to investigate the underlying incentives for choosing either the K2 framework or the K3 framework. Since the choice between the two frameworks affects some industries more than others, it would be more interesting to undertake an investigation between companies within the same industry instead of doing a comparison between companies in different industries. Therefore, the focus of this study will be on a specific industry. As mentioned earlier, one industry where some major changes will be evident and where the choice between the K2 framework and the K3 framework is critical is within the real estate industry. Therefore, it would be interesting to conduct a study of a number of

Swedish non-listed real estate companies and investigate the underlying incentives to adopt either one of the regulatory frameworks.

1.6 Benefits of the thesis

The study will investigate incentives for either choosing to follow the K2 framework or the K3 framework within the real estate industry. Thus, the study will contribute to the research area concerning accounting choices. More specific, different perspectives will be used in an attempt to explain the reasoning behind different accounting choices associated with the K2 framework and the K3 framework. In other words, the results from the study will strengthen the various theories' applicability regarding accounting choices. In a broader perspective, the results from the study could be important for various companies, trade organizations as well as other actors within the real estate industry. Furthermore, the results could also be interesting for various Audit Bureaus as well as Accounting Standard Setters. The reasoning for this is that the results maps important factors to take into consideration regarding what the choice between the K2 framework and the K3 framework within the real estate industry will imply in practice. Consequently, the study will contribute to an enhanced understanding of which incentives that are determinant for a real estate company regarding the choice between the K2 framework and the K3 framework.

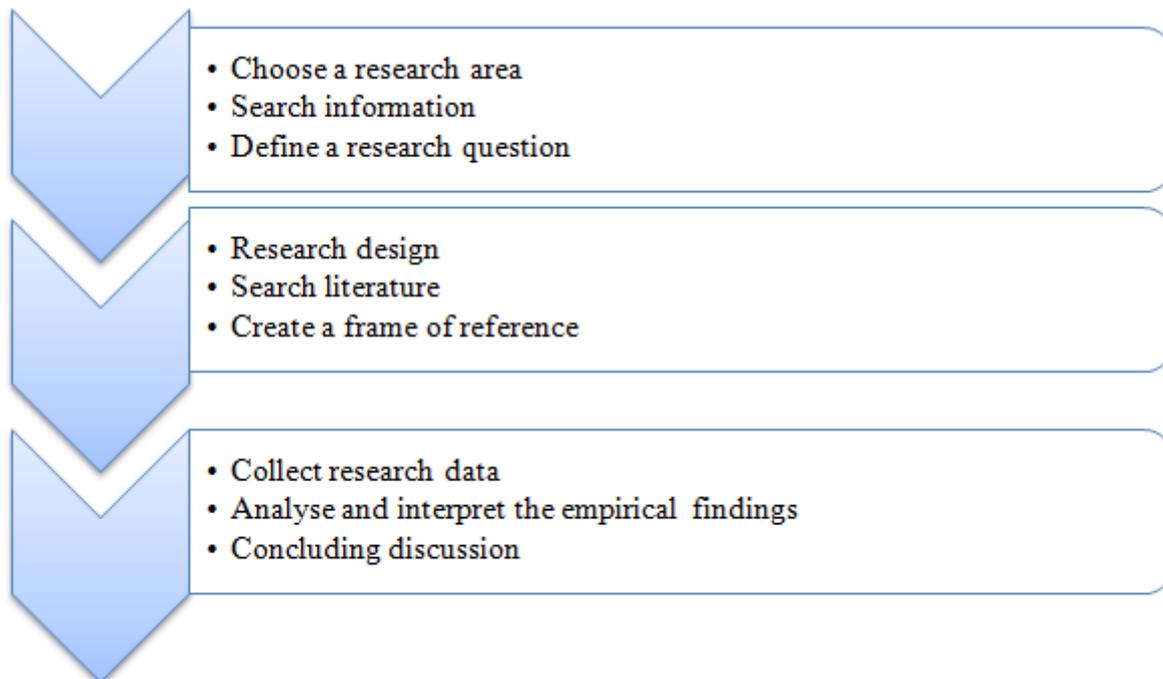
1.7 Disposition



Chapter 2 - Method

In the first part of the method, the research process as well as the methodology is presented. Thereafter, a literature review regarding the different perspectives used in the frame of reference is provided. The next part constitutes the way the data were collected and analysed, which incorporates the selection of sample, preparation for interviews as well as the approach concerning interviews. Furthermore, the sources of which the collected data derives from is critically reviewed. Finally, a discussion regarding the credibility of the study is provided, thus incorporating an argumentation of the reliability and validity associated with the study.

2.1 Research process



This study has the aim to investigate why a number of real estate companies choose to follow either the K2 framework or the K3 framework. The process with the study began with deciding upon a research area. Thereafter, information about the chosen research area was collected in order to be able to define a research question. The next step in the process was to decide on how to conduct the study. In other words, a research design were developed incorporating different methods that could provide an answer to the research question. Subsequently, literature was searched in order to create a frame of reference containing possible explanatory theories of the phenomena. The next step in the process was to collect empirical data about the phenomena. When the process with collecting the empirical data was

done different aspects presented in the theoretical framework were used in order to explain the incentives for the real estate companies in the study to choose an appropriate accounting framework. Finally, a concluding discussion with the aim to summarize the results of the study was provided.

2.2 Research methodology

The focus of this study is on a specific industry, namely the real estate industry. The aim of the study is to make an in-depth investigation by analysing possible incentives for the management in the real estate companies to follow the K2 framework or the K3 framework, thus, the study will mainly undertake an analytical approach. However, the study will also be characterised by a descriptive approach since the real estate companies' current practice will be described to a certain extent. Since the purpose of the study is to create an understanding of why real estate companies engages in certain accounting choices, it is suitable to use a qualitative approach when conducting the study.

2.3 Literature review

Initially, the frame of reference gives an overview of the development of the Swedish accounting framework, K-project as well as the real estate industry in order to create an understanding of the choices the managers faces. Considering that the purpose of the study is to investigate the incentives behind the choice of either following the K2 framework or the K3 framework, it is important to be aware of what this choice between a rules-based framework and a principles-based framework will imply. Therefore, the main features within these two frameworks are presented. Thereafter, the accounting choice theory including different aspects of the decision-making process is presented. The accounting choice theory incorporates both an internal perspective and an external perspective. The internal perspective regards the managerial interests whereas the external perspective refers to the perceptions and expectations of the stakeholders. In other words, the combination of these two perspectives is considered to explain why the management in the real estate companies engages in different accounting choices and in turn accounting practices. Additionally, the so called internal and external perspectives are characterised by features that are associated with different theories within the financial accounting, mainly, the positive accounting theory and the legitimacy theory. Moreover, there are some advantages or disadvantages associated with the different accounting choices, hence, it is appropriate to complement with the aspect regarding cost and benefit in accounting. Consequently, all of the literature presented in the frame of reference is in some way associated with different accounting choices.

2.4 Data collection

To be able to describe the reasoning behind the accounting choices in the various real estate companies and thus be able to answer the research question, different methods for collecting data were used. Only primary sources were used in the study. The reason for this is that the

collection of primary data is not as restricting as the collection of secondary data. The primary sources used in the study include data obtained from different websites, annual reports, books as well as articles. Furthermore, in order to develop an in-depth understanding of the topic, interviews with various real estate companies were also conducted. As a result, by integrating different methods for collecting data, a more holistic view of the study is created.

2.4.1 Selection of sample

The choice between the K2 framework and the K3 framework concerns Swedish smaller non-listed companies. Therefore, the appropriate sample to use in the study is Swedish non-listed real estate companies that do not fulfil the definition of a large company. In turn, the aim with the sample selection was that the sample should incorporate various real estate companies with different characteristics regarding juridical composition. More specific, the sample should consist of real estate companies that have the following characteristics;

- Family-owned company
- Owned by a listed company
- Owned by a municipality

- Part of a large corporate group
- Part of a small corporate group
- Not part of a corporate group

This compilation was chosen in order to investigate if the different characteristics of a real estate company will affect the choice of accounting practice and in turn the choice of an accounting regulatory framework. However, many real estate companies are structured in the way that a corporate group consists of several parent companies with both large and small underlying legal entities. If it is a large corporate group, the parent company as well as the underlying larger legal entities will be obligated to follow the K3 framework. On the other hand, the underlying smaller legal entities within the corporate group still have the possibility to choose whether to follow the K2 framework or the K3 framework. As a result, this motivates an investigation of the incentives behind the accounting choice for these underlying smaller legal entities. Consequently, four different Swedish real estate companies were chosen based on the juridical composition as well as the corporate structure. These companies are Eklandia Fastighets AB, Ivar Kjellberg Fastighets AB, Stena Fastigheter AB and Tranemobostäder AB.

Eklandia Fastighets AB is owned by the listed company Castellum, thus, Eklandia is a part of a large corporate group. Ivar Kjellberg Fastighets AB is a family-owned company situated within a large corporate group. However, this corporate group can be considered as relatively small in this study. Stena Fastigheter AB is family-owned company and part of a large

corporate group that consists of different business segments. Tranemobostäder AB is owned by the municipality of Tranemo and is not part of a corporate group.

When choosing the companies the thought was that the underlying smaller legal entities would be able to undertake a decision to follow either the K2 framework or the K3 framework. However, as the interviews were conducted, the study took an unexpected turn. The empirical findings indicated that the underlying smaller legal entities within a corporate group do not choose independently what framework to adopt since the company is characterised by a view that takes into account the whole corporate group and not a legal entity separately. Thus, only one of the companies in the selection of sample has the opportunity to choose between the K2 framework and the K3 framework independently. Nevertheless, the sample was not changed since it was interesting that the findings from the real estate companies with underlying smaller legal entities were strikingly similar. Moreover, it was also interesting to investigate one other company where the accounting choice is not influenced by a corporate group view. Even though, the characteristic regarding whether a company had underlying smaller legal entities or not was not a part of the selection of sample in the beginning of the study, it turned out to be an important characteristic concerning the incentives behind the choice to adopt either the K2 framework or the K3 framework. As a result, the sample was divided on the following characteristics;

	Eklandia Fastighets AB	Ivar Kjellberg Fastighets AB	Stena Fastigheter AB	Tranemobostäder AB
Family-owned company		X	X	
Owned by a listed company	X			
Owned by a municipality				X
Part of a large corporate group	X		X	
Part of a small corporate group		X		
Not part of a corporate group				X
Has underlying legal entities	X	X	X	
No underlying legal entities				X

2.4.2 Preparation for interviews

As a preparation for each interview, it was necessary to collect information regarding the companies' vision and business philosophy, the operation and business activities as well as the long-term strategy. The required information was obtained from the companies' websites as well as annual reports. Furthermore, some additional information was also collected through the companies' annual reports. More specific, the information concerned different investments conducted, if the company engages in sale of real estates as well as if the company discloses the market value of the real estates or/and the adjusted equity/assets ratio. Additionally, the companies' financial statements were also examined and it was mainly to look at the turnover, the capital structure as well as the size of the assets. Moreover, it was also important to stay updated about the development of the K-project, especially the K2 framework and the K3 framework. Therefore, information from various websites connected to trade organizations as well as Audit Bureaus were gathered.

2.4.3 Interviews

The purpose with conducting interviews was to provide a detailed answer of the research question. Face to face interviews were conducted since it enables more developed answers as well as it can create trust with the respondent (Quinlan, 2011). Another way of receiving more detailed answers was by the use of a semi-structured interview, which consisted mostly of open questions since it allows follow-up questions. Moreover, in order to get as developed answers as possible an interview guide was send in beforehand to the respondent. To avoid ambiguous answers from the respondents, the interview guide was standardized. Since the purpose with the study is to investigate the underlying incentives for choosing an appropriate framework and at the same time map the accounting choices within a company, the respondents were chosen based on their job title. In other words, the CFOs on each company were interviewed. Furthermore, the interview was recorded as well as it was transcribed.

The empirical findings were solely based on the material deriving from the interviews. Firstly, different headings were chosen based on the questions in the interview guide, namely strategy, stakeholders as well as the choice between the K2 framework and the K3 framework. Thereafter, the material from the interviews was divided based on these different headings. For instance, information regarding the real estate companies' different relations with banks as well as the tenants was allocated to the heading concerning stakeholders.

2.5 Method for analysis

The aim with the analysis was to create a nuanced answer of the research question. Therefore, in the analysis the different possible explaining aspects mentioned in the frame of reference were used in order to explain the incentives behind the accounting choice. However, initially in the analysis, the section about the companies different strategies located in the chapter of the empirical findings were analysed in order to create a general overview of the companies'

business activities. Thereafter, the other sections within the empirical findings, namely stakeholders as well as the choice between the K2 framework and the K3 framework, were linked to the different aspects mentioned in the frame of reference. To exemplify this, the aspect regarding principles-based and rules-based accounting could be linked to the information regarding the choice between the K2 framework and the K3 framework. The reasoning for this could be that the management in the company might have incentives to choose either the rules-based K2 framework or the principles-based K3 framework. Another example regards the accounting choices. For instance, the positive accounting theory could be linked to the choice between the K2 framework and the K3 framework since there might be incentives to adopt either one of the frameworks based on the managerial self-interest. On the other hand, the legitimacy theory could be linked to the section concerning stakeholders since the incentives to adopt either one of the frameworks might be associated with the fact that the companies want to be viewed as legitimate in the eyes of potential stakeholders. Finally, the cost and benefit in accounting could be linked to the choice between the K2 framework and the K3 framework since there might be different trade-offs for the companies to take into consideration depending on which framework to adopt.

The empirical findings indicates that one specific characteristic is important regarding the underlying incentives behind the choice to follow either the K2 framework or the K3 framework, namely, whether the real estate company has any underlying legal entities or not. Eklandia, Ivar Kjellberg and Stena have underlying legal entities, and their answers regarding the incentives behind what framework to adopt in their smaller legal entities were strikingly similar. On the other hand, Tranemobostäder does not have any underlying legal entities and thus the company's choice of an appropriate accounting framework is based on other incentives. As a result, the analysis was structured in a way that each possible explanatory aspect was used firstly in order to explain the incentives for the companies with underlying legal entities and thereafter to explain the incentives for a company without underlying legal entities.

2.6 Criticism of the sources

The frame of reference is mainly based on peer reviewed academic articles regarding the different theories presented. The frame of reference does also contain information about the K-project and the real estate industry, which are mainly based on books and electronic sources. The information about the K-project that derives from electronic sources, for instance different websites, is provided by Swedish Standard Setters as well as Audit Bureaus and can therefore be considered as a valid source of information. On the other hand, it is important to point out that the primary data obtained from the various real estate companies' websites and annual reports can be somewhat biased. Therefore, it was granted to have a critical standpoint when analysing the information. However, the data in the financial statements is presented by the use of explicit accounting rules whereas one can assume that the numbers and figures are not manipulated to a larger extent.

2.7 Credibility

In order for the study to obtain credibility it is important to consider the reliability and the validity regarding the chosen research methods. Reliability regards if the study is conducted several times with the same result every time, on the other hand, the study is characterised by high validity if it measures what it is intended to measure (Collis & Hussey, 2009).

2.7.1 Reliability

The study can be conducted again with the aim to achieve the same results regarding the evidence and conclusions. For instance, if another person would conduct the same study and interview the same real estate companies with the use of the same interview guide, the results would be about the same. The reasoning for this is that ambiguity was avoided in the preparation of the interview guide as well as the fact that the real estate companies' attitudes towards the K-project are based on carefully considered arguments. Moreover, the primary data retrieved from electronic sources can be obtained by everyone and will not change. However, it is important to take into consideration the fact that the information can be interpreted in different ways due to previous knowledge and experience. Although, the study can still be considered to have high reliability.

2.7.2 Validity

The chosen research methods can be regarded as in line with the aim of the study and the research question, hence, the study can be considered to measure what is intended to measure since it provides answers to the research question. Moreover, the interview guide was sent in beforehand to the respondents in order to ensure that the different concepts was interpreted in the same way as well as to enable carefully prepared answers. Furthermore, the interviews were recorded and transcribed so that the answers would not be misinterpreted. As a result, this increases the validity of the study.

Chapter 3 - Frame of reference

The first part of the frame of reference gives an historical overview of the Swedish accounting framework. The second part gives a presentation of the K-project including the development as well as the differences between the various regulatory frameworks. Thereafter, the real estate industry is presented, which first gives a general overview of the industry as well as the importance of a relation with credit institutions. Furthermore, the real estate industry provides an understanding of why it is important with the capital structure in a company. In the next part, different aspects that might be able to explain the choice between the K2 framework and the K3 framework is presented. These aspects are: principles-based versus rules-based, accounting choices including positive accounting theory and legitimacy theory as well as cost and benefit in accounting.

3.1 Swedish accounting framework

The development of the different regulatory frameworks within the accounting has been rapidly changing during the last decades due to a changing financial world. In turn, the Swedish accounting regulation has been adjusted towards the law of the European Union as well as it has been influenced by international accounting standards. The underlying reason behind this adoption is IASB's idea of a harmonized regulatory accounting framework, which means that all companies should use the same accounting principles to the extent it is possible. In Sweden, there are mainly two organizations that have contributed to the development of Generally Accepted Accounting Principles (GAAP) for the companies that operates in Sweden, namely the Swedish Accounting Standards Board and the Swedish Financial Accounting Standards Council (Broberg, 2010). These standard setters are issuing complementary rules that constitute guidance on how to use the Annual Accounts Act. However, it should be noted that even if it is called complementary rules it is still the main source of information for the accountants. The Annual Accountants Act constitutes a frame and the task of the complementary rules is to create a more detailed substance to that frame (Edenhammar & Thorell, 2009).

Historically, the Swedish complementary rules were issued by auditing organizations. However, 20 years ago, the Swedish Financial Accounting Standards Council started to give out complementary rules for Swedish listed companies (Edenhammar & Thorell, 2009). Much of the work conducted by the Swedish Financial Accounting Standards Council consisted of translation of the standards issued by the IASB, of which 90 percent were pure translations. Additionally, since 2005 all Swedish listed companies follow IFRS when establishing a consolidated financial statement (Smith, 2006). On the other hand, the complementary rules for non-listed companies in Sweden are issued by the Swedish Accounting Standards Board. Traditionally the Swedish Accounting Standards Board was giving so called general advices concerning how the rules for listed companies should be used in the non-listed companies. However, when it became known for the Swedish Accounting Standards Board that the IFRS were to be introduced, the Swedish Accounting Standards Board stopped adapting

complementary rules for the non-listed companies based on the complementary rules for listed companies. The reason for this was that IFRS was perceived to be too extensive to be adapted to the non-listed companies. Instead, in 2004 the Swedish Accounting Standards Board decided to reform the Swedish accounting rules concerning non-listed companies. (Edenhammar & Thorell, 2009).

3.2 K-project

The Swedish Accounting Standards Board is the main decision-making body regarding the accounting in non-listed companies. The principal work conducted by this Board is characterised by the adjustment of the international accounting standards by formulating a complementary standard setting known as recommendations for the non-listed companies. The standards issued by the Swedish Accounting Standards Board are mostly a simplified version of the rules that applies for the listed companies. As a result, the non-listed companies can still choose to apply a more advanced accounting principle, however, this possibility has led to a more comprehensive regulatory framework for the smaller companies. Consequently, the disclosed information that the non-listed companies provide has been harder to interpret and understand. Therefore, the Swedish Accounting Standards Board decided to amend the regulatory framework since it was not considered as adequate as well as with the light of the international development of standards (Bokföringsnämnden B, 2012).

Additionally, there was an on-going debate about the current regulatory framework which implied that the accounting system was complicated to comprehend. It is mainly the smaller companies that have complained due to the fact that the current accounting framework requires much knowledge and a well-developed administrative system, which can be seen as an unnecessary requirement for smaller companies that do not have to report information to the same extent as the larger companies. Therefore, the Swedish Accounting Standards Board decided to reform the Swedish accounting framework in order to adjust the regulation so that it fits the conditions of different types and sizes of companies. This reform is known as the K-project and includes four different categories of regulatory frameworks. The purpose is to facilitate for the companies by assembling all the accounting principles in one regulatory framework for each category (Broberg, 2010).

The K-project includes four different categories of companies, namely, K1, K2, K3 and K4. It is important to note that each of the K-frameworks should be used as a whole and a combination of for instance the K2 and the K3 framework is therefore not allowed (Drefeldt & Törning, 2012). The K1 framework (BFNAR 2006:1, 2010:1) is applied by sole proprietorship, general partnership as well as non-profit organizations and requires a simplified version of an annual financial statement. The K2 framework (BFNAR 2008:1, BFNAR 2009:1) requires a simplified annual report and is used by smaller companies and smaller financial associations. The K3 framework (BFNAR 2012:1) is an on-going project which will mainly be based on IFRS for SMEs and is applied by larger companies when

establishing an annual report and consolidated financial statements. The K4 framework is applied by listed companies and requires usage of full IFRS (Bokföringsnämnden A, 2012).

In Sweden, the main framework for non-listed companies is the comprehensive general advice K3. The K3 framework is based on IFRS for SMEs which is a simplification of IFRS. The IFRS for SMEs is a framework for non-listed companies, and it was issued in 2009 by the IASB. However it is important to note that there are differences between the K3 framework and IFRS for SMEs. For instance the K3 framework is more simplified than IFRS for SMEs and moreover the K3 framework has also been influenced by the Annual Accounts Act (Drefeldt & Törning, 2012). It has been, and it is still possible for non-listed companies to combine complementary rules issued by the Swedish Financial Accounting Standards Council concerning for instance tangible assets and general advices from the Swedish Accounting Standards Board concerning for instance leasing. Thus it has been, and still is possible to use different complementary rules for different subject areas within the accounting practices. However, when all the K-frameworks have been put into place by 2013/2014, this will no longer be the case. Hence, the management in the company has to follow one of the four K-frameworks (Bokföringsnämnden B, 2012).

In December 2012, the Swedish Accounting Standards board issued a general advice concerning a possible shift between the K2 and the K3 framework. This general advice implies that the management in a company always has the opportunity to change from the K2 framework to the K3 framework. However, on the other hand, the management in the company does only have the opportunity to change from the K3 framework to the K2 framework if the company has certain reasons to do so. Approximately 97 percent of all companies in Sweden have the possibility to follow either the K2 or the K3 framework. Since the K3 is the main framework, most companies are supposed to follow this framework. However, due to the new general advice, the management in companies that otherwise might had chosen K3 might instead decide to follow the K2 framework in order to be on the safe side even though the company might have stakeholders that require a higher disclosure level. Due to the fact that the management in the companies might have incentives to choose to follow K2 instead of K3, the Swedish Auditors Ordinance (FAR) has advised against the decision made by the Swedish Accounting Standards Board (Balans B, 2012).

3.2.1 Differences between the K2- and the K3 framework

It is important to point out that the K2 framework is more simplified than the K3 framework. The main difference recognised between the two frameworks is that the K3 framework is principles-based which means that the accountants has to rely more on their own judgments, whereas the K2 framework is rules-based and thus rather tell the accountants exactly what to do. Therefore, the K2 framework is more of a standardised regulatory framework and does not require all of the fundamental accounting principles. To exemplify this, for instance, concerning the accrual concept, the K2 framework does not demand incomes and expenditures to be periodized if each of them is below 5000 SEK. Moreover, the K2 framework does not require that expenditures which the company has every year to be

periodized if they do not vary with more than 20 percent between the years and if each year is charged with an annual expenditure (Drefeldt & Törning, 2012).

In general, the K2 framework does not allow different items of smaller value to be reported as one item in the balance sheet. For instance, the items machinery and equipment has to be reported separately. Consequently, tangible assets such as land, plant, building, building accessories and incremental expenses is considered as separate units and should be reported as such. In K2 it is not allowed to use component depreciation which is a requirement when following the K3 framework. Moreover, the K2 framework contains standardised rules concerning depreciation of tangible assets. For instance, in K2 it is allowed to make depreciation with the same amount every year. Furthermore, in K2 the depreciation period regarding machinery and equipment is 5 years, improvement expenses pertaining from another real estate are depreciated over 10 years and plants are depreciated over 20 years. Buildings are depreciated in accordance with the general advice issued by the Swedish fiscal authorities (SKV A 2005:05). Concerning, intangible assets, the K2 framework does not allow internally generated intangible assets in the balance sheet (Drefeldt & Törning, 2012).

In the K2 framework the income statement is somewhat simplified in comparison to the K3 framework and hence does not include all items that can be found when using the K3 framework. For instance, in K2 it is not allowed to report deferred tax. Furthermore, it is only allowed to use an income statement that is divided by nature whereas in the K3 framework an income statement divided by function is also allowed. Moreover, according to the K2 framework it is only allowed to report leasing agreements in the income statement, in other words it is not allowed to report financial leasing since it is not allowed to capitalize assets that the company does not own. Concerning the fact that the Annual Account Act does not demand smaller companies to prepare a cash flow statement, it is therefore not required in the K2 framework. Likewise, only disclosures that are required by smaller companies is considered when preparing the financial report according to the K2 framework. On the other hand, the K3 framework requires more disclosures in contrast to the K2 framework, for instance, the disclosure of the market value is required in the K3 framework (Drefeldt & Törning, 2012).

3.2.2 Previous research

The Swedish Accounting Standards Board aims to reform the Swedish accounting framework. As mentioned above, this reform is called the K-project and the aim is to facilitate the accounting so that it fits the conditions regarding different types and sizes of companies. This could be considered to be in line with previous studies concerning differential reporting which takes into account that smaller and larger companies are in need of different accounting regulations. Moreover, previous studies regarding financial reporting for SMEs within Europe indicates that there are arguments both in favour for differential reporting as well as arguments against differential reporting. The arguments recognised in favour for differential reporting are mainly that it is more costly and time consuming to establish financial reports in accordance with a regulatory framework that is not suitable for the company. In other words,

it is more costly to follow an accounting framework that requires more than what actually might be necessary since the stakeholders might have different information requirements depending on if it is a small or a large company. On the other hand, the main argument against differential reporting regards the fact that it is contradictory concerning IASB's aim to harmonize the international accounting, hence, differential reporting might have an impact on comparability among companies (Evans et. al, 2005). Furthermore, the advantages and disadvantages recognised with differential reporting can be associated with the aforementioned argumentation to choose either the K2 framework or the K3 framework. For instance, for a small company which stakeholders might not have a large information need, an adoption of the K2 framework could be more suitable. However, the comparability might be affected if SMEs within the same industry follows different regulatory frameworks.

3.3 Real estate industry

There are several ways to define a building depending on who ought to do it. The reason for this is that the building has a different purpose for various parties. For instance, for a tenant the building serves as a home, for the investor it is an investment and for a real estate manager it is a property. On the other hand, the building might solely be seen as a character of the town. Thus, the definition of a building is in the eye of the beholder (Torfason, Lundqvist & Polesie, 2011). Since the definition of a building can vary depending on who is making the definition, similarly, the value of a building can also vary depending on who is making the valuation. Consequently, the economic value of a building is dependent on various actors, with different perceptions and ability to influence, within the society. These actors are mainly authorities, owners, tenants and lenders. For instance, authorities decide over the societal structure which in turn affects the economic value of a building in terms of the location. On the other hand, the economic value of a building is also dependent upon the future cash flow it can generate. (Bengtsson & Polesie, 1998).

In general, the real estate industry can be divided into four different categories. Two different types of real estate can be recognised, namely commercial premises and residences. In turn, these can be associated with construction and/or managing. Traditionally, real estate companies were operating in all of the four categories, meaning that they both were engaged in the construction of the properties as well as the management of the properties. However, there is an ongoing trend towards increased specialisation, in other words, the focus of the real estate companies has shifted and they are instead engaging in one of these categories, namely management of properties. On the other hand, the real estate companies usually choose to only manage either residences or commercial premises. Additionally, it is important to point out that the investments made by the real estate companies are to a large extent dependent on loans from banks or other lenders. In turn, these credit institutions ability to lend capital depends on the economic situation in the society (Lundkvist, Polesie & Torfason, 2011).

<i>Type of activity</i>	Manage		
	Construct		
		Residences	Commercial premises
		<i>Type of real estate</i>	

A real estate is constructed with the aim to stand at the same place for several years. However, the characteristics of the real estate might change over time. As mentioned earlier, various actors define the building in different ways as well as the value of the building might vary depending on the actor. For instance, one stakeholder might be interested in the *book value* since it is used in the calculation of different financial ratios as well as the management in the company might be interested in the book value in connection with a possible sale of a real estate. On the other hand, another stakeholder might be interested in the *market value* since it reflects the possible purchase price of a real estate. Additionally, the *new-construction cost* indicates a limitation of the market value since it decides the cost of the construction of a similar real estate. Another factor that is important to take into consideration is the *location price* since similar real estates might have different values depending on the location. Consequently, there are different approaches that an actor might undertake in order to determine the value of a building (Bengtsson & Polesie, 1998).

3.3.1 Component depreciation

When the management in a company acquires a fixed tangible asset, they also need to decide the useful life of the asset over which the cost of the asset should be allocated. The depreciable amount should be divided systematically over the period that the company intends to use the asset. However, an asset might consist of various components with different useful life and even though it is acquired as a whole, it might be necessary to divide the asset by its components. Thus, when making the depreciation of the asset it might be appropriate to use component depreciation so that each component are depreciated separately over its own useful life. When making component depreciation, the management in the company does not have to expenditure the cost when buying a new component. However, if the management in the company does not use component depreciation the price of a new component will be treated as an expenditure in the income statement. Thus if the management in the company uses component depreciation, the costs in the income statement will be more evenly distributed compared to if component depreciation is not used. As a result, the usage of

component depreciation could indicate a more accurate view of the asset's depletion (Marton et. al, 2010).

As mentioned earlier, according to the K2 framework, a company is not allowed to use component depreciation. On the other hand, one difference between following the K2 framework and the K3 framework is that the K3 framework demands that if a fixed tangible asset can be divided in different significant components and the useful life of these components differs essentially from each other, component depreciation should be made. However, the decision regarding what components that should be considered to be significant might sometimes be hard to make. One industry in which this might be hard is in the real estate industry. Therefore, a request to issue a guidance regarding how to divide the components of a real estate was made. (Balans A, 2012) As an answer to this request, Fastighetsägarna Sverige (2012) and SABO, trade organizations within the real estate industry, issued a guidance regarding what components in a real estate to regard as significant. These components were following;

- (1) Land
- (2) Plant
- (3) Building - and machinery equipment
- (4) Frame
- (5) Roof
- (6) Facade
- (7) Inner surface
- (8) Installations
- (9) Tenant improvements

3.3.2 Real estate industry and credit institutions

Real estate companies are in many cases dependent on credit institutions regarding constructions and acquisitions of buildings. However, in order to receive a loan, a real estate company needs to be financially strong, meaning that the company needs to be solvent and have an acceptable capital structure. For instance, in order to obtain a loan for a construction project, a requirement is that the company is able to finance at least 15-30 % of the expenses arising from the construction project by its own means. The requirement is still applicable regardless the guarantee. Consequently, the requirements for loan receiving have become stricter. The reason for these stricter requirements derives from the financial crisis in the beginning of 1990, which in turn was based on several events during the second half of 1980. More specific, in 1985 a decision was made that gave the banks the possibility to lend money without restrictions. As a result, the demand and supply on loans increased, which had a large impact on the real estate market where the demand on real estates also increased. Moreover, the increased demand resulted in a higher price on the real estates. The end of 1980 was characterised by a change of trend mostly due to a tax reform that had an effect on the real estate market. For instance, the tax reform lead to decreased subventions on residences, which

in turn increased the need for loan. However, simultaneously the loans became more expensive due to the decreased inflation that the tax reform caused. As a result, the demand on real estates decreased as well as the price. On the other hand, during 1993 a turning point could be recognised where the economic situation started to improve (Bengtsson & Polesie, 1998).

3.3.3 Capital structure

In order for a company to be able to survive and thus preserve the concept of a going concern, the potential of growth is essential. However, a company's ability to grow is dependent on its access to capital, which in turn depends on the company's performance and financial strength. More specific, if a company wants to attract investors it is important for the company to increase the profitability. Furthermore, if a company has much equity in relation to its debts the company is concerned to be more creditworthy. The relation between debt and equity can be measured by either the equity/assets ratio or the debt/equity ratio, which indicates the degree of solvency. It is important to point out that the increase in debt needs to be proportional to the increase in equity, in order to maintain the balance between these items and in turn maintain the financial solidity. Explained in another way, the equity/assets ratio also shows how the company's assets are financed, that is, either by debt or equity (Johansson & Runsten, 2005).

On the other hand, the financial solidity could also measure the company's solvency in the long-run as well as it is an indication of the company's ability to withstand losses. The reason for this is that the losses are deducted from the equity, which in turn can threaten the company's survival. Therefore, the higher financial solidity a company has, the greater is the ability to survive losses. Moreover, another argument for having a high financial solidity is that the bank will otherwise demand a higher interest rate or be reluctant to give a loan in the first place, which might affect the potential growth of the company (BAS, 2010).

3.4 Principles-based versus Rules-based

The historical development of the industrial countries is mainly characterised by two different accounting traditions, namely the Continental tradition and the Anglo-Saxon tradition. These two accounting traditions are based on various traditions within the civil law. The continental civil law tradition originates from the Roman law and is based on a legalistic perspective, which means that the rules situated within this tradition are strongly associated with written rules and constitutions. On the other hand, the Anglo-Saxon civil law tradition derives from medieval traditions in England and is to a small extent based on written rules. Instead, the Anglo-Saxon tradition is characterised by customary law or case law that is complemented with precedents from a judicial assembly or a court (Smith, 2006).

A contributing factor to that these two accounting traditions have developed in different directions is mainly the differences in the provision of finance and existing legal systems in the various countries. Within the continental tradition, the state, banks and family had an influential effect on the owner structure. Consequently the countries within this tradition have been characterised by a credit-oriented perspective. On the other hand, the Anglo-Saxon tradition can be associated with a more shareholder-oriented view since the providers of finance have mainly been investors due to the diffusion of listed companies. These two civil law traditions are also recognized as code law countries and common law countries, which refers to the different legal systems within the various countries. As mentioned earlier, the continental civil law tradition or the so called code law countries is characterised by written rules that are established to give guidance in all situations and is situated in the company law. The Anglo-Saxon civil law tradition or the nations known as common law countries is associated with a legal system based on accounting rules that derives from case by case and is developed by professional organizations and private standard setter (Alexander et. al, 2011).

From these two different civil law accounting traditions, the concepts of rules-based and principles-based perspective on accounting emerged. The rules-based framework relies on the fact that good accounting is associated with accounting that corresponds with the written law, which is in line with the continental tradition. On the other hand, the principles-based framework is based on the accounting principle of a true and fair representation of the reality where the underlying definition is constructed by professional accounting bodies, which goes hand in hand with the Anglo-Saxon tradition (Smith, 2006).

The difference between the rules-based accounting framework and the principles-based accounting framework is mainly that written rules can be seen as an obstacle in a financial world that is characterised by complexity and can be seen as changing continuously. On the other hand, the opportunity for the management in the company to choose accounting methods, based on their value judgment that specifically reflects the nature of the company's economic transactions, can be considered as essential in a changing environment (Maines et. al, 2003). Given the characteristics of the standards issued by IASB, mainly IAS and IFRS, the management in the company is given the opportunity to interpret the standard and apply the content of it based on its own expert judgment, consequently, the standards acts more as guidance and there is given a lot of space for interpretation. In other words, the accounting choice made by the management in the company is legitimate as long as it does not contradict the principles recognized in the standard, in turn, this is in line with the principles-based system of reporting. On the other hand, the rules-based accounting framework is mainly associated with specific criteria, examples, implementation guidance, scope and restrictions as well as limitations (Carmona & Trombetta, 2008). Arguably, the rules-based approach can be seen as the reporting system that fits in all situations, thus, ignoring company specific problems, whereas, the principles-based approach takes the uniqueness of each company into consideration (Alexander & Jermakowicz, 2006).

3.5 Accounting choices

The nature of accounting theory is based on the concepts of explanation and prediction. The accounting theory has the objective to explain why the management in the company chooses to apply certain accounting methods over others as well as it predict the attributes associated with the choice of a certain accounting method. The management in a company faces different accounting choices on a daily basis, therefore, accounting theory is essential in order to explain the underlying incentives of the managerial behaviour regarding accounting choices. For instance, the different accounting choices can be associated with depreciation methods, valuation issues as well as amount of disclosures (Watts & Zimmerman, 1986). Consequently, accounting choices are based on the managers' intentions to achieve a certain outcome. However, there is various economic factors that influences the managerial behaviour in the decision-making process, namely, contractual arrangements such as compensation plans as well as debt covenants. This perspective is often referred to as the efficient contracting perspective and aims to avoid the agency costs associated with contracting parties. For instance, an attempt to align the incentives of several parties might reduce agency costs. At the same time, there can be conflicting goals among the contracting parties concerning the accounting choices undertaken by the managers (Fields, Lys & Vincent, 2001). On the other hand, the contracting costs are considered to derive from voluntary accounting choices, whereas mandatory accounting choices are referred to as monitoring costs. More specific, the decision-making process can also be affected by political forces, thus resulting in a mandatory accounting choice (Holthausen & Leftwich, 1983).

Since the financial world is characterised by complexity and a continuously changing environment, there is a need for different perspectives in order to explain an accounting phenomena (Watts & Zimmerman, 1986). In other words, the economic aspect needs to be complemented with a sociological perspective including social factors that might influence the decision-making process. It is therefore important to take into consideration other parties with personal relations to the company in contrast to those with formal contracts. It is also important to point out that a stakeholder might both have a formal and an informal relation with the company at the same time. A socio-economic perspective explains the various accounting choices undertaken by the management in the company by integrating social and economic variables, thus, engaging in a more holistic view. Hence, the socio-economic view does also take into account how the company is viewed in the eyes of different stakeholders. Consequently, the socio-economic approach can be associated with the legitimacy theory (Mangos & Lewis, 1995).

3.5.1 Positive accounting theory

The development of positive accounting theory is mainly based on the principal-agency theory and rest on the assumption about individual self-interest. As a result, there is assumed to be a contractual relationship between the management in the company and the shareholders. For instance, the managers can be seen as the agents of the shareholders and

incentives are used in order to motivate the agent's decision-making process. In turn, this contractual relationship is based on the assumption of economic rationality that characterises the managers as well as the shareholders. Furthermore, the positive accounting theory is also influenced by the neoclassical economic model, meaning that the role of the costs and benefits of information needs to be taken into consideration as well as the fact that the management in the company needs to be provided with incentives that motivates the pursue of satisfying the shareholders interest instead of their own (Ryan et. al, 2002).

The positive accounting theory examines the underlying reasons behind the adoption of different accounting practices. The theory also explains the managers incentives to influence accounting standard setting as well as it gives an understanding of why the management in the company supports or opposes different accounting standards. As mentioned earlier, the main assumption that the positive accounting theory is based on concerns the managerial self-interest, which is assumed to be in line with the organization's expected future wealth as well as the shareholders' interests and expectations. There are mainly five factors that could be seen as motivating incentives for the managers, namely taxes, regulatory procedures, political costs, information production costs and management compensation plans (Watts & Zimmerman, 1978). Furthermore, it is assumed that the accounting method choice has a positive effect on the organization's value (Watts & Zimmerman, 1990).

The positive accounting theory provides an understanding of why the management in the company chooses to use various accounting practices and gives an explanation to why the managers might engage in earnings management or income smoothing as well as voluntary disclosures (Ryan et. al, 2002). However, by engaging in lobbying activities the management in the company directly considers their own interest whereas the interest of the shareholders is only accounted for indirectly. Arguably, the assumption about the managerial self-interest can be seen as an underlying explanation behind this kind of behaviour (Watts & Zimmerman, 1978). There is also some criticism associated with the positive accounting theory, mainly that the theory does not consider a broader perspective. For instance, the main assumption about the managerial self-interest can be considered as far too simple. It is argued that the reality is characterised by complexity and consequently, other interests need to be taken into account as well (Boland & Gordon, 1992).

3.5.2 Legitimacy theory

The legitimacy theory is based on the assumption that companies do not have any inherent right to resources or to exist (Deegan, 2002). Since the company by itself is not assumed to have any inherent right to gain resources and to exist, the management in the company has to make certain actions in order to convince the society that the company deserves the recognition to exist and to gain resources. In other words, the permission to exist and gain resources is to be viewed as legitimate in the eyes of the society. This leads to another underlying assumption of the legitimacy theory, namely that there is a relationship and interdependence between the economics, the society and the politics. Finally the legitimacy theory assumes that the groups' constituting the society are homogenous.

In order for the company to be viewed as legitimate in the eyes of the society, the expectations and perceptions regarding the actions taken by the management in the company should be in line with the actual actions taken by the management in the company to the greatest extent possible. Since the expectations and the perceptions of the society is changing over time, it might be hard for the company to always act exactly as the society wishes. In order to gain legitimacy the management in the company can choose to adopt different strategies and tactics (O'Donovan, 2002). What strategies and tactics that are appropriate to use depends on if the management aims to establish, maintain, extend or defend the legitimacy of the company in the eyes of society. For instance, in the early stages of the company lifecycle it is important for the organization to be approved in the eyes of the society in order to gain resources. Thus it is important for the management to make the company legitimate in the eyes of the society, in other words to establish legitimacy. Strategies appropriate in order to establish legitimacy is to for instance meeting its requirements and at the same time being profitable enough (Tilling & Tilt, 2010).

If the management succeeds in establishing legitimacy it is important that this legitimacy is maintained. As mentioned above, the expectations and the perceptions of the society is changing over time. Thus, in order for the company to maintain the established legitimacy the management in the company needs to be responsive. To be able to be responsive it is important for the management in the company to already be aware of possible future challenges and developments. However, it is not enough to be responsive and change if the perceptions of the society change. The management in the company also has to make sure that the society is aware of the changes. Therefore disclosure of information is an important issue (Tilling & Tilt, 2010).

To establish and to maintain legitimacy can be argued to be more or less necessary for all companies. However, depending on the company's strategy it might also be relevant to extending legitimacy. For instance in order to successfully enter a new market the management in the company needs to convince the society that the company is something special in relation to the already established companies in that market. Hence, the management needs to take actions above what is expected from the company. Moreover another issue that not appear to all companies is to being hit by a critical event. An example of this might be to be targeted by a non-governmental organization. In such situations it is important for the management in the company to take actions in order to defend the legitimacy of the company. These actions might include attempts to adapt the organization to what is required, but it can also be to attempting to change the perceptions of the public. More controversial actions in order to defend the legitimacy of the company is to use manipulation and misrepresentation (Tilling & Tilt, 2010).

3.6 Cost and Benefit in Accounting

In most situations a decision has to be made concerning what actions to make. In order to decide which action is the most appropriate one to choose a trade-off needs to be made between the costs and the benefits associated with the actions in the particular situation. Therefore, the trade-off between cost and benefit can, when broadly speaking, be defined as an analysis of a choice between different alternatives of actions where the consequences need to be evaluated in order to achieve the most beneficial alternative. In other words, The concept of Cost-Benefit Analysis (CBA) is based on the assessment of the pros and cons associated with different courses of actions. For instance, when the management in the company needs to evaluate various investment alternatives it needs to take into consideration the costs and benefits associated with the investment. More specific, the management in the company needs to evaluate the expenditures and revenues that derive from the investment alternatives in order to be able to choose which alternative that is the most beneficial (Boardman et. al, 2011).

Generally, the trade-off between cost and benefit is a dilemma/challenge that the management in the company might face. Hence, there is no specific approach that can be applied concerning how to make the trade-off between the costs and benefits associated with the choice of different alternatives. This is evident when the management in a company is preparing its financial statement. For instance, the management needs to decide an appropriate amount of information to disclose to its stakeholders. When deciding the appropriate amount of disclosed information a trade-off needs to be made between the costs of preparing the disclosed information and the benefits of disclosing it. In other words, how useful and relevant is the information for the stakeholders, and an even more important question, do the stakeholders comprehend and understand the content of the disclosed information? (Marton et. al, 2010).

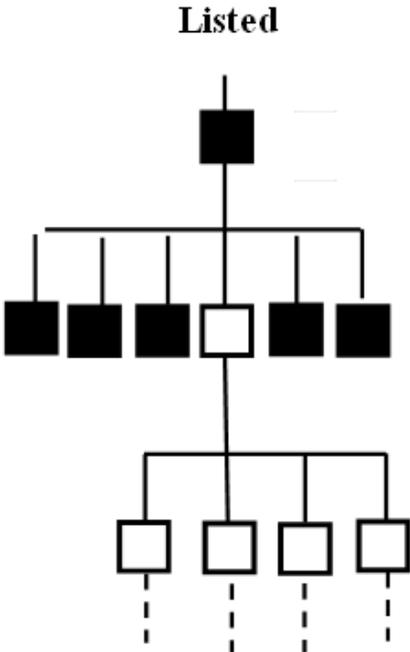
Chapter 4 - Empirical findings

The empirical findings derives solely from interviews with the CFOs in four real estate companies, namely Eklandia Fastighets AB, Ivar Kjellberg Fastighets AB, Stena Fastigheter AB and Tranemobostäder AB. For each company, initially an overview of the company's business and organizational structure is presented. Additionally, the figure provided are somewhat simplified and solely aims to illustrate the interrelation between the legal entities within the corporate group. Thereafter, information regarding the company's strategy and stakeholders is provided. Finally, the incentives to follow either the K2 framework or the K3 framework are presented. However, it is important to point out that the real estate companies' incentives provided for adopting either the K2 framework or the K3 framework are only on a preliminary basis, hence, the decision within the real estate companies concerning which framework to adopt is not yet final.

4.1 Eklandia Fastighets AB

Castellum is one of the largest listed real estate companies that exist in Sweden. The company's real estate portfolio consists mainly of commercial premises for office, retail, warehouse and industrial purposes. Castellum has chosen to divide the corporate group into six underlying companies which are located regionally. In turn, these companies independently own and manage the real estates. Eklandia Fastighets AB is a real estate company within Castellum and operates mainly in Gothenburg. In turn, Eklandia is a parent company with both smaller and larger underlying legal entities that form underlying corporate groups.

Castellum Corporate Group



4.1.1 Strategy

Eklandia aims to be the leading real estate company in Gothenburg regarding commercial premises. In other words, the company strives to be the first choice for its tenants. The purpose with the business is to construct, acquire, develop, own and manage real estates in a long-term perspective. In order to fulfil this purpose, the company needs to engage in certain investments. In connection to the investments, the company needs to generate a certain return. Furthermore, sale of real estates is also a part of the long-term strategy since Eklandia should have a certain equity/assets ratio due to a requirement from its parent company. On the other hand, it is considered to be more beneficial to acquire a real estate with the aim to make improvements to the extent it is possible, and then sell the real estate. In other words, it is more interesting to have a real estate with potential to enhancements than to have a matured real estate.

4.1.2 Stakeholders

The different stakeholders recognised are mainly the tenants which have their business in the commercial premises, the suppliers which ensures that the real estates are provided with the necessary equipment. There is also the municipal authority which decides the infrastructure as well as decides the time frame concerning approval of constructions. Moreover, it is also important to take into consideration the owners as well as credit institutions. For instance, Eklandia does not have a direct contact with the banks since it is Castellum that is responsible for the negotiation. In this way, the possibility to receive better terms and conditions increases. As a result, all financing goes through the parent company, which thereby also has the possibility to regulate Eklandia's growth. However, in order for Castellum to be able to receive a loan, the banks needs to obtain information about Eklandia since its real estates constitutes securities. On the other hand, the tenants are considered as the most important stakeholder. The company aims to have a long-term relation to their tenants. Therefore, it is important to establish a close relationship, which means that the company should be able to satisfy the tenant's requirements. Furthermore, the company arranges social activities for their tenants as well as provides the tenants with questionnaires in order to capture the level of satisfaction.

4.1.3 The choice between the K2 framework and the K3 framework

Eklandia is the parent company in an underlying corporate group within Castellum and is thereby obliged to adopt the K3 framework. However, it is still possible for the smaller legal entities within Eklandia to choose the K2 framework. On the other hand, Eklandia cannot have different regulatory frameworks within the corporate group since the organisation uses an integrated system concerning monitoring of revenues as well as costs. In other words, the company is characterised by a view that incorporates the whole corporate group and not a legal entity separately. Therefore, Eklandia considers adopting the K3 framework consistently

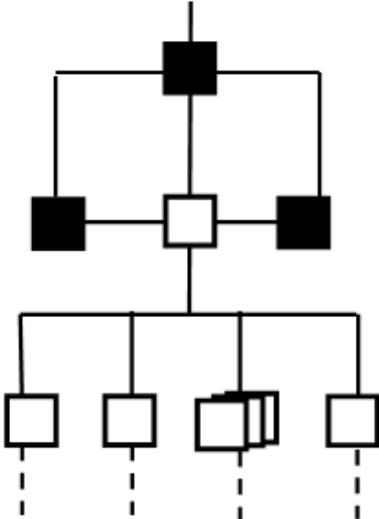
throughout the corporate group. Moreover, since Castellum is a listed company and applies IFRS, Eklandia has prepared financial statements in accordance with IFRS to be able to deliver to the parent company. These financial figures delivered to the parent company are considered important, especially the market value. A possible adoption of the K3 framework will require disclosure of the market value, hence, this transition will not imply any extensive changes for Eklandia since the company already calculates as well as reports the market value. However, a problematic area within the K3 framework will be the use of component depreciation since it is characterised by complexity in terms of personal judgements. For instance, it is difficult to decide the different components a real estate consists of as well as it is problematic to decide the useful life of these components. In turn, the use of component depreciation will imply more work. Furthermore, the depreciation is not relevant in the operational management since the company emphasises the net operating profit in connection to the market value. The net operating profit is calculated before depreciation, thus, the depreciation method does not have an impact at the operational management.

4.2 Ivar Kjellberg Fastighets AB

Ivar Kjellberg AB was founded by Ivar J. Kjellberg and is a family-owned company. The corporate group consists of two main business categories, namely, real estate and construction. There is also a business category that involves ongoing projects. Furthermore, Ivar Kjellberg Fastighets AB comprises several smaller and larger legal entities that form underlying corporate groups. The real estate company operates mainly in Gothenburg and the real estate portfolio incorporates residences to 80 percent and the remaining 20 percent constitutes commercial premises. Moreover, Ivar Kjellberg Fastighets AB also owns 50 percent of Aranäs AB, which is a real estate company that operates in Kungsbacka.

Ivar Kjellberg Corporate Group

Family-owned



4.2.1 Strategy

Ivar Kjellberg aims to be perceived as one of the leading real estate companies within the industry. The company's strategy is to own and manage real estates in a long-term perspective. Thus, investments to maintain or expand the real estate portfolio are considered as a part of this strategy. The profitability is an important factor to take into consideration when conducting investments to maintain or expand the real estate portfolio. However, when engaging in these types of investments, the aim is to construct a building that is characterised by high quality and durability. Consequently, the profitability might not always be maximized. Thus, long-term owning and managing of the real estates is central for the company. This also reflects the sale of real estates which is relatively low. The company does not often sell their real estates since the aim is to increase the management volume. On the other hand, when the company actually engages in sale of real estates, it usually regards odd pieces that do not really fit within the real estate portfolio.

4.2.2 Stakeholders

The stakeholders are mainly the owners and credit institutions. The owners are to a great extent active in the company and therefore well informed about the business activities. Moreover, the company has also established a good relation with creditors since the investments is mostly financed through bank loans, which in turn requires close contact and good dialogue with the banks. On the other hand, even though the company is not public and the disclosure requirements are not that extensive, it still discloses information about the adjusted equity/assets ratio in the annual report. Furthermore, the company also describes that there is a difference between the book value and the market value, which is a result of the surplus value of its real estates. As a result, the stakeholders become aware of that the company is characterised by stability as well as it has a relatively high amount of equity. From an economic perspective, the main stakeholders are the aforementioned owners and credit institutions, however, satisfied tenants are also an important stakeholder to take into consideration in a long-term perspective. The company is keen to attend to their tenants needs and requirements, which is reflected by the awards the company has obtained concerning customer satisfaction in Sweden.

4.2.3 The choice between the K2 framework and the K3 framework

The company reports consolidated financial statements in Ivar Kjellberg AB and Ivar Kjellberg Fastighets AB, which requires the use of the K3 framework. Consequently, in the parent companies as well as the underlying larger legal entities there is no choice of which framework to adopt since they are obligated to follow the K3 framework. On the other hand, within the corporate group there are several underlying smaller legal entities that still has the choice to apply the K2 framework or the K3 framework. As a result, the question remains how to report for these underlying smaller legal entities in the corporate group. The choice

between the K2 framework and the K3 framework for the smaller legal entities has not been explicitly decided, however, the management in the company has a clear picture of which direction to follow. The company wants to make the reporting in the underlying smaller legal entities as simple as possible, in this case it can be preferable to use the K2 framework. At the same time, there are also some disadvantages recognised with the K2 framework. The company believes that there are certain limitations with the regulatory framework and that it does not reflect the actual business to its full extent. Moreover, since the financial statements of the underlying legal entities still have to be a part of the consolidated financial statements, it can be considered as complicated to use two different kinds of regulatory frameworks. As a result, it is more likely to use the K3 framework throughout the whole corporate group in order to make it as simple as possible. It is important to point out that a possible transition to the K3 framework will imply a lot of administrative work at the beginning, however, when this work has been conducted as well as the new practices has been established and put into place, the reporting system will run smoothly.

The major differences that an adoption of the K3 framework will imply are mainly, disclosure of the market value as well as the use of component depreciation. Regarding the disclosure of the market value, this will not be an extensive change for the company since it already does internal calculations of the market value of their real estates. As mentioned earlier, the company discloses information about the adjusted equity/assets ratio which is based on the market value. However, the company will have to develop the information concerning the market value and the surplus value of the real estates in the annual report. On the other hand, the company will have to look into how to use component depreciation. For instance, the K3 framework does not describe how to divide an asset into different components, the regulatory framework acts more like guidance in that sense. Therefore, the company needs to decide how to make this separation. At the same time, it is important to point out that the company looks at other important financial figures such as the net operating profit in relation to the investments as well as in relation to the market value. Overall, the choice of regulatory framework lacks importance in the context regarding operational management. On the other hand, it is still important to be able to attract stakeholders and be viewed as a potentially stable company. Consequently, the external reporting and how the company represents itself is essential.

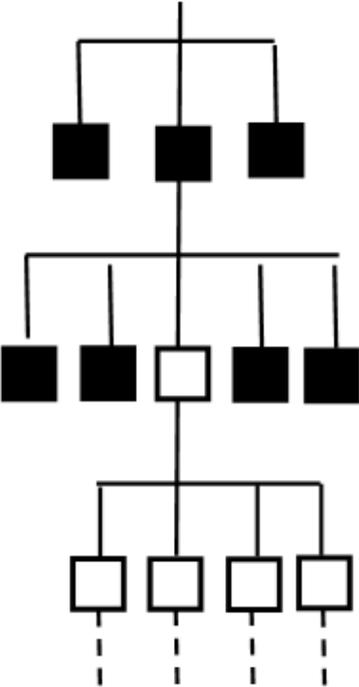
4.3 Stena Fastigheter AB

Stena was founded by Sten A. Olsson and is a family-owned company. There are three pillars in the corporate group, namely Stena AB, Stena Metall AB and Stena Sessan AB. These companies constitute *Stena Sfären* and consist of different business segments that are mainly associated with shipping, management of real estates and recycling. Stena Fastigheter AB, situated within Stena AB, is one of the largest privately-owned real estate companies in Sweden. The company consists of both smaller and larger underlying legal entities that operate mainly in Gothenburg, Stockholm and Malmö. The distribution between residences and commercial premises are 80 percent respectively 20 percent. Moreover, the company also

comprises Stena Realty B.V. which is a foreign real estate company that solely encompasses commercial premises. At the same time, Stena Fastigheter AB manages the family's private real estates, which constitutes the company Josefina.

Stena Corporate Group

Family-owned



4.3.1 Strategy

Stena Fastigheter AB aims to be one of the leading real estate companies in Sweden, which means that the company aims to be the tenants' first choice regarding rental of a residence or a commercial premise. In order to strive for achieving this aim, Stena Fastigheter AB focuses on developing attractive residences and commercial premises within Gothenburg, Stockholm and Malmö. The purpose is to manage real estates in a long-term perspective. Furthermore, the focus has been on developing existing real estates as well as engaging in new construction. When conducting these kinds of investments, mainly two factors are taken into consideration, namely, the need to make the investment and the return on the investment. Moreover, the company also engages in sale of real estates which can be considered as a part of the strategy to manage on a long-term basis. A reason to engage in sale of real estates can be based on the fact that there are real estates that do not fit within the company's real estate portfolio. It is important to point out that the sale of real estates solely concerns a small part of the company's real estate portfolio and at the same time, new investments is conducted to expand the real estate portfolio.

4.3.2 Stakeholders

The main stakeholders can be recognised as the owners, credit institutions, tenants, personnel, suppliers, the state as well as other real estate companies. The media can also be considered as an important stakeholder since Stena is a large company. The company is keen about their relation to their different stakeholders. For instance, in order to maintain a good relationship with the banks, the company invites representatives from the banks to an annual gathering with representatives from the company. At this gathering, the banks are able to get an insight about the business as well as obtain information about important occurrences during the previous year. Furthermore, the company discloses information about the market value in the annual report. Consequently, stakeholders such as credit institutions have the opportunity to calculate the adjusted equity/asset ratio. It is also important to point out that the company does calculations of the adjusted equity/asset ratio, however, it is only used internally in connection with Board material.

The company uses a concept called *Relationsförvaltning* which is a registered trademark. The concept aims to develop living environments where the tenants are satisfied and stays longer. The concept involves different social projects and activities in collaboration with the state, school and different associations. For instance, the company arranges soccer camps and swimming schools, establishes libraries in laundry areas, constructs fitness centres etc. Moreover, the tenants have the opportunity to self manage their neighbourhood, which contributes to a greater commitment. The purpose is to create a stable environment with decreased disturbance and where the company can engage in an open dialogue with the tenants. As a result, the tenants' life quality increases which in turn leads to fewer resettlements.

4.3.3 The choice between the K2 framework and the K3 framework

The choice between the K2 framework and the K3 framework is still a relatively new topic and Stena Fastigheter AB has not made a final decision yet. The parent company within the corporate group is obligated to follow the K3 framework. Furthermore, the corporate group constitutes several legal entities where almost half of them is considered as larger companies and will therefore not be able to choose the K2 framework. However, the underlying smaller legal entities still have the possibility to choose either the K2 framework or the K3 framework. Since the parent company as well as the underlying larger legal entities will have to follow the K3 framework, consequently, all of the legal entities within the corporate group considers to adopt K3 framework. The use of the K2 framework within the smaller legal entities would have implied too many adjustments when preparing the consolidated financial statements according to the K3 framework. Therefore, it is considered as an easier alternative to use the K3 framework throughout the whole corporate group, even though some of the legal entities are not required to do so. Moreover, an advantage with using the K3 framework in all of the legal entities within the corporate group is that the framework is more flexible compared to the K2 framework. In other words, the K2 framework is too regulated and does

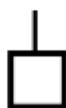
not reflect the business activities in an accurate way. Furthermore, an advantage with the K2 framework is that the disclosure level is not that high as in contrast to the K3 framework. On the other hand, an area within the K3 framework that can be considered as difficult to handle is the use of component depreciation. In practice, the component depreciation will imply more administrative work for the company, which will not add more value for the stakeholder since the depreciation method is not that relevant in the context. Instead, a factor that is interesting to look at is the net operating profit in relation to the market value.

4.4 Tranemobostäder AB

Tranemobostäder AB is a real estate company that is owned by the municipality of Tranemo. The company's real estate portfolio is spread over 13 different locations and consists mainly of residences but also some commercial premises. Tranemobostäder is a small real estate company with no underlying legal entities and thus not part of a corporate group. On the other hand, the company is part of a network with four other similar real estate companies. In this network, the companies act as a support to each other and have the opportunity to collaborate regarding certain problematic issues. The network creates an integrated platform with increased competence, which can be seen as comforting for the real estate companies.

Tranemobostäder

Owned by a Municipality



4.4.1 Strategy

Tranemobostäder aims to own and manage real estates in a long-term perspective. The purpose with the business is that the company shall offer a safe and comfortable residential area as well as create a good social community and integration within the living environment. At the same time, the company shall also acquire and construct properties as well as engage in sale of real estates. In order to fulfil this purpose, Tranemobostäder has to conduct certain investments. When making investments, there are mainly two factors that are important to take into consideration, namely, the demand and the profitability. For instance, if there is a large maintenance need, the company prioritizes the improvement that increases the useful life of the real estate. In other words, the company does the maintenance that results in more revenues or less costs in the future. In turn, more capital can be spent on other investments.

Tranemobostäder also gains financial resources by engaging in sale of real estates. However, since the company is owned by the municipality of Tranemo it has to follow the owner directives established by the municipal council, which incorporates decisions about disposal of assets. Tranemobostäder is owned by the municipality with the purpose to constitute a

political instrument, thus, the company shall contribute to an attractive supply of residences in connection to the demand. Since there are vacancies in the smaller surrounding areas, the company has on a strategic level identified real estates that are appropriate to sell, which has been approved by the municipal council. On the other hand, if the company decides to sell real estates that is not in line with the decisions undertaken within the municipality, then the company needs to present a new proposal for the municipal council. Consequently, the municipality decides in which areas Tranemobostäder has the possibility to sell real estates.

4.4.2 Stakeholders

The main stakeholder recognised within Tranemobostäder is the tenants. In order to make the tenants satisfied, the company emphasises on maintaining an environment characterised by high quality. This incorporates both the standard of the residences as well as the outdoor environment. Furthermore, it is also important to create a good social community among the tenants. In turn, the company organizes different arrangements. On the other hand, the municipality of Tranemo is also an important stakeholder, both since the municipality is the owner as well as it acts as a guarantee regarding loans. For instance, the fact that Tranemobostäder has a municipal guarantee enables for the company to borrow through *Kommuninvest Sverige AB*. In general, the company does not have any gatherings with credit institutions, instead the company solely presents the financial statements.

4.4.3 The choice between the K2 framework and the K3 framework

Tranemobostäder considers following the K3 framework even though the company is not required to do so since it is a small company without underlying legal entities. The advantages with the K3 framework are mainly the use of component depreciation. For instance, the company has a large maintenance need and the use of component depreciation might enable a planned treatment which will have a positive effect on the result. In other words, the use of component depreciation gives the company a possibility to activate maintenance costs, which will not affect the result to the same extent. Furthermore, the K3 framework is more flexible in contrast to the K2 framework. For instance, by adopting the K2 framework the company is only allowed to use an income statement divided by nature. Since the real estate industry is characterised by using an income statement divided by function, a comparison between the company and other real estate companies would not be possible. On the other hand, the K3 framework requires more competence and resources. The company will have to implement new administrative systems as well as disclose the market value of the real estates. In the current situation, there are no established internal practices considering the calculation of the market value. In general, there are not many accounting practices that are in line with the K3 framework. Consequently, a possible transition to the K3 framework will imply tremendously work. Moreover, it is important to point out that the choice between the K2 framework and the K3 framework is not affected by the municipal owner. In other words, the reasoning behind the choice is based on the interest of the company since it would have to do these changes anyway due to that it is important considering the operational management.

Chapter 5 - Analysis

The analysis aims to create an understanding of why real estate companies engage in certain accounting choices. In the first part of the analysis, the empirical findings regarding the companies' strategy is analysed. In the second part of the analysis an attempt to explain the underlying incentives for the real estate companies to choose either the K2 framework or the K3 framework is provided. Aspects that will be taken into consideration in order to understand these incentives are: principles-based versus rules-based, positive accounting theory and legitimacy theory as well as cost and benefit in accounting. In the third part, the aim with the K-project is discussed and finally a reflection to summarize the accounting choice is provided.

5.1 Strategy

In general, the real estate companies' strategy is to manage and own real estates in a long-term perspective. This strategy incorporates the aim to have real estates that are characterised by high quality. In order to fulfil this purpose, the companies need to conduct investments to be able to enhance the quality of their real estate portfolio. Determining factors to take into consideration regarding investments to expand the real estate portfolio alternatively to increase the quality of the real estates by improvements are all quite similar within the companies. For instance, vital criteria for conducting investments are the profitability as well as the demand and the maintenance need. However, profitability is not always prioritized since the focus is to have high quality. Although, it still has to be feasible to conduct the investments. On the other hand, the real estate industry is characterised by capital intensity and to be able to conduct these investments the real estate companies are dependent on financial resources. One way to receive capital to conduct investments is by engaging in sale of real estates. This might be seen as a short-term strategy, however, Eklandia, Stena and Tranemobostäder does engage in sale of real estates which is a part of their long-term strategy.

5.2 To choose an appropriate accounting framework

In this section, different aspects will be used in order to explain the incentives for the real estate companies to choose either the K2 framework or the K3 framework. Initially, the accounting traditions associated with the regulatory frameworks will be described in order to point out the difference between the two frameworks. Moreover, the underlying incentives behind the choice to either follow the K2 framework or the K3 framework can be explained by the positive accounting theory and the legitimacy theory since these theories are based on assumptions that might explain different accounting choices. Furthermore, the cost and benefit in accounting can be considered as a tool to explain the trade-off associated with the incentives behind the accounting choice.

5.2.1. Principles-based versus Rules-based

5.2.1.1 Is it possible to mix the principles-based K3 framework with the rules-based K2 framework within a real estate corporate group?

One underlying reason why the choice between the K2 framework and the K3 framework can be considered to be an issue is based on the fact that each framework is associated with different accounting research traditions, mainly the continental civil law tradition and the Anglo-Saxon civil law tradition. In other words, when choosing which framework to adopt, a choice regarding what research tradition to follow is also made. Consequently, it is important to point out that the real estate companies needs to take into consideration which research tradition to follow regarding if the management in the company wishes to follow a principles-based framework that is associated with K3 or a rules-based framework which is in line with K2. Before, it has been possible to use a mix of complementary rules, however, that will not be possible any more when the implementation of the K3 framework is a fact. Hence, a strict choice between the K2- and the K3 framework is mandatory. Even if the underlying smaller legal entities within Eklandia, Ivar Kjellberg and Stena have the opportunity to follow either the K2 framework or the K3 framework, a decision to follow the K2 framework would imply that mixed accounting traditions would be used since the parent companies within the corporate group as well as all the larger legal entities within the corporate group are obligated to follow the K3 framework. Thus, to mix a principles-based framework with a rules-based framework would be too complicated since the financial figures from the underlying legal entities would have to be recalculated on the consolidated level when preparing the financial statements. This is also applicable regarding the depreciation approach since the K3 framework requires component depreciation which differs from the depreciation method used in the K2 framework. As a result, Eklandia, Ivar Kjellberg and Stena consider to adopt the K3 framework consistently throughout the corporate group since the mix of a principles-based and a rules-based framework would imply more work. In turn, the use of two different regulatory frameworks would also imply more administrative costs. On the other hand, an important aspect to take into consideration is the amount of underlying legal entities since it might be significant regarding the accounting choice. For instance, if a real estate company only has a few underlying legal entities which all are smaller but together constitutes a large corporate group, in that sense, it might be possible to use two different regulatory frameworks within the corporate group. However, the empirical findings indicates that it would not be favourable to mix a principles-based and a rules-based framework within a real estate corporate group.

The adoption of the K3 framework will mainly imply disclosure of the market value as well as the usage of component depreciation. Since Eklandia, Ivar Kjellberg and Stena calculate the market value of their real estates, a possible transition to the K3 framework would not imply an extensive change in this context. At the same time, the use of component depreciation is a complex aspect to take into consideration since it requires personal judgement. For instance, if the useful life of a facade should be determined, the company needs to consider the material that the facade contains as well as if the facade faces south or north since it wears different. Another important aspect to take into consideration is if the

various parts of the facade have different useful life. For instance, this regards if the facade is painted or not since the paint does not have the same useful life as the facade. However, it is important to point out that Eklandia, Ivar Kjellberg and Stena uses the net operating profit in relation to the market value or in relation to investments regarding the operational management. This financial measure is calculated before the depreciations, thus, the depreciation method used in the company becomes irrelevant in that context. Even though component depreciation is not useful in the operational management it is still required by the K3 framework which the parent companies are obligated to follow. On the other hand, a possible adoption of the K3 framework within the underlying smaller legal entities will result in more work and in turn more administrative costs. Nevertheless, it is more complex to mix a principles-based and a rules-based framework within the corporate group since it would be inconsistent regarding the accounting practices.

5.2.1.2 What are the incentives for a small real estate company without underlying legal entities to follow either the principles-based K3 framework or the rules-based K2 framework?

Tranemobostäder is a small company and thus has the opportunity to choose either the K2 framework or the K3 framework. Since the company does not have any underlying legal entities, the situation with a potential mix of a principles-based and a rules-based framework as well as the mix of two different depreciation approaches are not an issue. Therefore, practically it would be easier for Tranemobostäder to adopt the K2 framework. At the same time, the K2 framework is a simplified regulatory framework established in order to facilitate the accounting for smaller companies. However, even if the use of the K2 framework would be practically easier for Tranemobostäder to apply, the company still considers to adopt the K3 framework. The reason for this is that the K2 framework does not reflect the business in an accurate way as well as the company recognizes more advantages with the K3 framework. For instance, the company has a large maintenance need and the use of component depreciation might enable a planned treatment which will have a positive effect on the result. This reasoning can be seen as a part of the long-term strategy since it enables the company to maintain residences with a high quality and in turn satisfied tenants. Furthermore, as mentioned earlier, an adoption of the K3 framework will imply disclosure of the market value of the real estates. Currently, Tranemobostäder does not have any established routines for calculating the market value, thus, a transition to the K3 framework will require more competence and resources. However, it is worth to mention that Tranemobostäder needs to implement these changes anyway regardless an adoption of the K3 framework or not. On the other hand, it is important to point out that Tranemobostäder situation might not correspond to other smaller real estate companies without underlying legal entities. Nevertheless, the empirical findings indicate that a small real estate company without underlying legal entities has the incentives to adopt the K3 framework.

5.2.2 Positive accounting theory and Legitimacy theory

5.2.2.1 *Complementary perspectives*

The underlying incentives for the real estate companies to adopt either the K2 framework or the K3 framework might be explained by the internal perspective associated with the positive accounting theory as well as the external perspective associated with legitimacy theory. The main assumption recognized from the legitimacy theory is that a company does not have the right to exist or to have resources. In order to gain these resources the management in the company needs to convince the society that it is worthy the resources to exist. However, when existing and having the resources how should the management optimize the wealth of the company? This question is not answered by the legitimacy theory. On the other hand, in the positive accounting theory the right to exist is already assumed and the theory focuses more on optimizing the managerial wealth and thereby the wealth of the company. However, a weakness with the positive accounting theory is that it ignores the broader perspective and the emphasis is put internally on the managerial interest. Thus, to only focus on how to get as much managerial wealth as possible without concerning the external environment, might have the effect that the company according to the legitimacy theory loses its right to resources and thereby in turn also its right to exist. Consequently, a trade-off between the driving forces within these two theories has to be made in order to create a balance between cost and benefit associated with the internal and external perspective. Arguably, these two theories might complement each other and contributes to a holistic perspective of the chosen research area.

The positive accounting theory and the legitimacy theory can also be seen as complementary theories in the sense that they both addresses the underlying reasons behind different accounting choices since they provide an explanation to why the management in the company engages in different accounting practices. Even though the theories are considered to complement each other, the incentives supported by the theories might clash. Depending on the reason behind the managerial incentives, a conflict might arise. For instance, as assumed in the positive accounting theory about the fact that the managerial wealth and self-interest drives the decision-making could result in the choice of adopting the K2 framework. This because the framework is considered to be less complicated to use as well as it does not require the same amount of competence and resources as the K3 framework. However, if the legitimacy theory is brought into the picture, the company might jeopardize their legitimacy as a result of ignoring various stakeholders that perhaps requires the usage of the K3 framework. This might be evident regarding the level of disclosure, thus, a trade-off has to be made. On the other hand, both theories need to be taken into consideration in order to achieve a more nuanced picture of the accounting choice.

5.2.2.2 *How can an internal perspective explain the incentives behind the accounting choice?*

In the positive accounting theory, the assumption about the managerial self-interest is central and can be used in order to examine the underlying reasons behind the adoption of different accounting practices from an internal perspective. As mentioned before, the parent companies

as well as the underlying larger legal entities within Eklandia, Ivar Kjellberg and Stena are obligated to adopt the K3 framework. Therefore, the incentives to follow the K3 framework can only be analyzed regarding their underlying smaller legal entities. However, it is important to point out that the companies are driven by the interest of the whole corporate group and not by the legal entities separately. Hence, it would imply too much work and costs to follow two different regulatory frameworks within the corporate group. Consequently, the K3 framework will be adopted consistently throughout the corporate group. In this sense, the positive accounting theory and the concept of the managerial self-interest might be used to explain the incentives behind a possible adoption of the K3 framework in the underlying smaller legal entities. The reasoning for this is that the managerial wealth would be larger if following the K3 framework consistently throughout the corporate group than mixing it with the K2 framework. On the other hand, Tranemobostäder is a small real estate company without any underlying legal entities and the choice to adopt the K3 framework could thereby be explained by other driving forces. For instance, Tranemobostäder might be driven by the fact that the company has a large investment need, which includes both maintenance as well as an increase of the real estate portfolio. In this situation, a possible adoption of the K3 framework would imply the use of component depreciation which might have a positive effect on the result and in turn allows more investments. Therefore, the managerial wealth is associated with the advantages that derive from the K3 framework. As a result, from an internal perspective, the incentives behind the accounting choice made by Eklandia, Ivar Kjellberg, Stena and Tranemobostäder could be explained by the managerial self-interest, which is assumed to be in line with the real estate companies expected future wealth. In other words, the accounting choice is considered to be beneficial for the companies in the long-term perspective.

5.2.2.3 How can an external perspective explain the incentives behind the accounting choice?

There could be other incentives for the real estate companies to adopt the K3 framework, which might be explained by the legitimacy theory. Initially, it is important to point out in the eyes of whom the company wants to be viewed as legitimate, in other words, which stakeholders are considered as important for the company. All the real estate companies have in common that they aim to have a long-term relationship with their tenants, thus it is important for the companies to have a high quality regarding the real estates as well as the living environment. In order to fulfil this purpose, the real estate companies need to conduct investments to enhance the quality of their real estate portfolio. The real estate industry is characterised by capital intensity, thus, to be able to conduct investments, the real estate companies are dependent on financial resources, both by equity as well as external financing. Therefore, it is important for the real estate companies to have a good and close relation to credit institutions. Eklandia, Ivar Kjellberg and Stena arrange gatherings with representants from credit institutions to provide them with required information. For instance, information that the banks might require could be associated with the market value of the real estates. In the annual report, Eklandia, Ivar Kjellberg and Stena already disclose information related to the market value, however, at the gatherings the information provided is more comprehensive.

Thus, in this perspective, the adoption of the K3 framework will not imply any significant changes regarding the real estate companies' relationship with the creditors. On the other hand, the situation for Tranemobostäder is different since the company has the opportunity to use a municipal guarantee as well as it has the opportunity to borrow from Kommuninvest Sverige AB. However, if this would not be possible in the future, the company needs to be able to be viewed as a stable company in order to still receive good terms and conditions regarding bank loans. Therefore, the choice to adopt the K3 framework could be seen as an attempt to strengthen their legitimacy.

In general, the external reporting of Eklandia, Ivar Kjellberg and Stena is mainly based on the consolidated level of the business. The underlying legal entities does also establish financial statements, however, these are not communicated externally. As mentioned earlier, since the parent companies as well as the underlying larger legal entities are obligated to follow the K3 framework, the adoption of the K3 framework for these companies cannot be considered to constitute an accounting choice. Instead, the choice between the K2 framework and the K3 framework applies for the underlying smaller legal entities. Thus, since Eklandia, Ivar Kjellberg and Stena do not communicate the financial reporting for these underlying legal entities externally, the accounting choice on this level is not influenced by the desire to be viewed as legitimate in the eyes of potential stakeholders. In other words, the external perspective cannot explain the incentives behind the fact that Eklandia, Ivar Kjellberg and Stena will adopt the K3 framework consistently throughout the corporate group. Instead, the choice to adopt the K3 framework could be explained by the reasoning that it will be complicated for the companies to use both of the regulatory accounting frameworks within the corporate group. On the other hand, the incentives behind the accounting choice could be explained from an external perspective in the case of Tranemobostäder. As mentioned above, the adoption of the K3 framework could contribute to strengthen legitimacy regarding possible relations to other credit institutions in the future. Another example of how Tranemobostäder could strengthen their legitimacy by the adoption of the K3 framework regards the fact that it is more flexible in contrast to the K2 framework. As a result, the K3 framework manages to reflect the business in a better way. For instance, the K2 framework only allows the use of an income statement divided by nature whereas the real estate industry is characterised by using an income statement divided by function. Therefore, if Tranemobostäder would adopt the K2 framework, the comparative financial figures based on the income statement would be different in contrast to using the K3 framework. In turn, this might affect the legitimacy since it would not be possible for potential stakeholders to compare Tranemobostäder with other real estate companies within the industry. Consequently, the driving forces behind the adoption of the K3 framework could be explained by the legitimacy theory. However, it is important to point out that legitimacy is also essential for the Eklandia, Ivar Kjellberg and Stena. Nevertheless, legitimacy is not a driving force considering the adoption of the K3 framework.

5.2.3 Cost and Benefit in Accounting

5.2.3.1 How can cost and benefit explain the incentives behind the accounting choice?

In general, a transition to the K3 framework will be extensive in the sense that it requires more competence as well as resources. In turn, this will imply more administrative costs. The incentives to follow the K3 framework could be explained by the costs and benefits associated with the accounting choice. Eklandia, Ivar Kjellberg and Stena considers to apply the K3 framework consistently throughout the corporate group since it otherwise will result in too much work. In other words, if the underlying smaller legal entities would have applied the K2 framework, the advantages associated with the K2 framework would not have exceeded the extra work it would imply to use two different frameworks considering the necessary recalculation when establishing the consolidated financial statements. However, it is important to point out that the real estate companies actually wants to have it as simple as possible regarding the underlying smaller legal entities. With this reasoning, a choice to adopt the more complicated K3 framework could be seen as contradictory. Nevertheless, the fact is that it will be even more complicated for the companies to mix the K2 framework and the K3 framework within the corporate group. Consequently, the administrative cost of mixing two different regulatory accounting frameworks will exceed the cost of choosing a more complicated framework for their underlying legal entities. Furthermore, the incentives behind the adoption of the K3 framework in Tranemobostäder could be explained by the costs and benefits associated with the accounting choice. The advantages recognised with the K3 framework are greater in contrast to the K2 framework. Moreover, the benefits associated with the K3 framework will exceed the costs associated with the K3 framework.

5.3 Does the K-project contribute to a simplified regulation?

The aim with the K-project is to simplify the regulation concerning companies with different sizes. It might be favourable for companies that are not part of a corporate group since the situation with a possible mix of a principles-based and a rules-based framework as well as the mix of two different depreciation approaches will not emerge. However, it is questionable if the aim to facilitate the accounting is achieved regarding companies with underlying legal entities. The reasoning for this is the fact that the parent company in a large corporate group as well as the underlying larger legal entities are obligated to follow the K3 framework, thus, as the empirical findings indicates, it is less complicated to use the K3 framework consistently throughout the corporate group than to mix two different regulatory accounting frameworks. On the other hand, the underlying smaller legal entities might not be in the need of the K3 framework and the use of the K2 framework would be more suitable in their situation since it is a simplified regulatory accounting framework. Nevertheless, the cost of adopting the K3 framework for the underlying smaller legal entities is still less than mixing a principles-based with a rules-based framework within the corporate group. However, it is important to take into consideration that the study concerns the real estate industry and that the underlying

smaller legal entities mainly constitutes pure real estates. Therefore, the situation with underlying legal entities might not be as complicated in other industries.

5.4 The accounting choice?

According to the Swedish Accounting Standards Board, the K3 framework is considered as the main framework to adopt in a non-listed company. As the empirical findings indicate, this objective might be achieved since all of the real estate companies in the study considers to follow the K3 framework. As mentioned above, the parent companies in a large corporate group as well as the underlying larger legal entities are obligated to adopt the K3 framework whereas the underlying smaller legal entities have the possibility to choose either the K2 framework or the K3 framework. However, it is questionable if it can be considered as an accounting choice for the underlying smaller legal entities. The reason for this is that the real estate companies are characterised by a decision-making process that incorporates the interest of the corporate group all together instead of a single legal entity. As a result, if the parent companies within a corporate group as well as the underlying larger legal entities are obligated to follow the K3 framework, it will be adopted consistently throughout the corporate group even if the underlying smaller legal entities have the possibility to choose to adopt the K2 framework. Arguably, in the reality it might not be considered as a choice for the underlying smaller legal entities which framework to adopt since it would not be feasible to mix a principles-based and a rules-based framework within a real estate corporate group. Moreover, the adoption of the K3 framework will imply the use of component depreciation and even if the underlying smaller legal entities applies the K2 framework, the depreciation method needs to be revised on the consolidated level. Therefore, it is puzzling that it is described as a choice between the K2 framework and the K3 framework for the underlying legal entities. On the other hand, Tranemobostäder has the opportunity to choose either the K2 framework or the K3 framework since it is a small real estate company without any underlying legal entities. In this case, it can be described as an accounting choice. However, it can be argued that the choice between the K2 framework and the K3 framework does not constitute an entirely independent choice in the reality anyway. The reasoning for this is that the K2 framework is too limited to be used in a real estate company since it does not depict the business in an accurate way. Furthermore, to compare Tranemobostäder with other companies within the real estate industry might not be possible since the K2 framework only allows an income statement divided by cost and the real estate industry is characterised by using an income statement divided by function. Arguably, considering this specific situation, it might not be an entirely independent choice to adopt the K3 framework.

Chapter 6 - Conclusions

In the first part of the conclusions a discussion of the underlying incentives for a real estate company to follow either the K2 framework or the K3 framework is provided. Thereafter, limitations of the study are presented and finally suggestions for future research are given.

6.1 Discussion

What are the underlying incentives for a real estate company to follow either the K2 framework or the K3 framework?

Eklandia Fastighets AB, Ivar Kjellberg Fastighets AB and Stena Fastigheter AB have underlying legal entities and thus constitutes a corporate group. The parent companies as well as the underlying larger legal entities within the corporate group are obligated to follow the K3 framework. However, the underlying smaller legal entities within the corporate group have the possibility to adopt either the K2 framework or the K3 framework. Although, Eklandia, Ivar Kjellberg and Stena consider to adopt the K3 framework consistently throughout the corporate group. The reasoning for this is that a mix of a principles-based framework and a rules-based framework within the same corporate group would be too complicated since the financial figures from the underlying legal entities would have to be recalculated on the consolidated level when preparing the financial statements. Therefore, the administrative cost of mixing two different regulatory accounting frameworks will exceed the cost of choosing a more complicated framework for their underlying legal entities. Due to the extra competence and resources the mixture of a principles-based and a rules-based framework would imply, the adoption of the K3 framework could also be explained by the managerial wealth associated with the accounting choice. On the other hand, the external perspective does not manage to explain the adoption of the K3 framework. The reason for this is that the underlying legal entities within the corporate group do not communicate their financial statements externally since the external reporting is mainly based on the consolidated level of the business. Thus, the accounting choice for the underlying legal entities is not influenced by the desire to be viewed as legitimate in the eyes of potential stakeholders. However, it is important to point out that legitimacy is essential for Eklandia, Ivar Kjellberg and Stena. Nevertheless, the external perspective is not a driving force considering the accounting choice.

Tranemobostäder AB is a small real estate company which is not part of a corporate group and does not have any underlying legal entities. Thus, the company has the opportunity to follow either the K2 framework or the K3 framework. Nevertheless, Tranemobostäder considers adopting the K3 framework. Practically it would be easier for Tranemobostäder to adopt the K2 framework. At the same time, the K2 framework is a simplified regulatory framework and does not reflect the business in an accurate way. For instance, the K2

framework only allows the use of an income statement divided by nature whereas the real estate industry is characterised by using an income statement divided by function. Therefore, the comparative financial figures would be different in contrast to using the K3 framework. In turn, this might affect the legitimacy since it would not be possible for potential stakeholders to compare Tranemobostäder with other real estate companies within the industry. Thus, the incentives behind the adoption of the K3 framework could be explained by an external perspective. On the other hand, Tranemobostäder might be driven by the fact that the company has a large maintenance need and the use of component depreciation might enable a planned treatment which will have a positive effect on the result. Therefore, the managerial wealth is associated with the advantages that derive from the K3 framework. This reasoning could also be explained by the costs and benefits associated with the accounting choice since the advantages recognised with the K3 framework are greater in contrast to the K2 framework. Moreover, the benefits associated with the K3 framework will exceed the costs associated with the K3 framework. As a result, it would be more beneficial for Tranemobostäder to adopt the K3 framework.

All of the four real estate companies consider choosing the K3 framework. However, it is questionable if the adoption of the K3 framework can be regarded as an accounting choice. Eklandia, Ivar Kjellberg and Stena are characterised by a decision-making process that incorporates the interest of the corporate group all together instead of a single legal entity. Arguably, in the reality it might not be considered as a choice for the underlying smaller legal entities which framework to adopt since it would not be feasible to mix a principles-based and a rules-based framework within a real estate corporate group. On the other hand, Tranemobostäder has the opportunity to choose either the K2 framework or the K3 framework. However, it can be argued that this does not constitute an entirely independent choice in the reality anyway. The reasoning for this is that the K2 framework would not depict the business in an accurate way and thus the comparability could be influenced which in turn might affect the legitimacy.

6.2 Limitations

When conducting the study one characteristic that was important regarding the explanation of the incentives behind choosing an appropriate framework was whether a real estate company is part of a corporate group or not. This was not known in beforehand and thus the study took an unexpected turn. The reason for this is that the underlying smaller legal entities within a corporate group did not have the possibility to choose between the K2 framework and the K3 framework independently since the company was characterised by a view that incorporates the whole corporate group and not a legal entity separately. Since this finding was not known in beforehand, the selection of the sample was also based on other company characteristics. Thus, in three of the companies in the study the choice between the K2 framework and the K3 framework concerned underlying smaller legal entities within a real estate corporate group, whereas in one of the companies in the study the choice between the K2 framework and the

K3 framework concerned a small real estate company without underlying legal entities and which is not part of a corporate group.

Although, there is still a clear distinction in the reasoning behind the adoption of the K3 framework concerning a company that is part of a corporate group and a company that is not part of a corporate group. However, the sample in the study does only concern one small real estate company which is not part of a corporate group and is thus not influenced of the reasoning concerning the consolidated reporting. As a result, the incentives for only one such company were mapped. Hence, it is important to be aware of that there might be other incentives for a small real estate company to follow either the K2 framework or the K3 framework than the ones exemplified by Tranemobostäder. Moreover, since only one small real estate company that is not part of a corporate group is investigated in the study, the relative size of this real estate company is not reflected upon regarding if it would be a determinant factor concerning the accounting choice. Furthermore, neither the relative size of the underlying smaller legal entities within the other companies was reflected upon in the study.

In general, there could be other regulatory accounting frameworks that the real estate companies can choose among. For instance, in a corporate group where the parent company follows IFRS, the underlying legal entities within that corporate group have the opportunity to follow a framework called RFR2. This accounting framework is a simplification of IFRS and is also a principles-based framework. Moreover, in comparison to the K3 framework, the component depreciation is not required in RFR2. Furthermore, in RFR2 there is a requirement for a higher disclosure level in contrast to the K3 framework. Nevertheless, the study concerns the underlying incentives for choosing either the K2 framework or the K3 framework, as a result, other regulatory accounting frameworks are ignored.

6.3 Further research

The study aims to investigate the underlying incentives for real estate companies to choose either the K2 framework or the K3 framework. Since this study only includes one real estate company that is not an underlying legal entity within a corporate group, further research could incorporate several real estate companies with similar characteristics in order to create a more extensive mapping of the underlying incentives behind the accounting choice. Thus, it would also be possible to investigate whether the relative size has an impact on the accounting choice. Moreover, the relative size of an underlying small legal entity within a corporate group could also be a basis for further investigation. Furthermore, the empirical results indicate that if a company have underlying legal entities, the accounting choice will be influenced by this. Therefore, a future research could include an investigation regarding whether underlying legal entities within a real estate corporate group will still have similar influence on the incentives concerning the accounting choice. Moreover, another study could incorporate an investigation of whether the amount of underlying legal entities has an impact on the accounting choice.

In the current situation, important financial ratios associated with the operational management in real estate companies are the net operating profit in relation to the market value or investments. Since the net operating profit is calculated on the revenues and the operating expenses, the financial ratio does not take into account the depreciations. Therefore, a future study could constitute an investigation whether the net operating profit will still be an important financial ratio after the implementation of the K3 framework and the use of component depreciation. In other words, it could be interesting to examine if other important financial ratios will emerge. Moreover, in general, a potential research opportunity could be to conduct a before and after analysis in an attempt to investigate the “real” outcome of the implementation of the K3 framework. On the other hand, a future study could address an investigation regarding companies within other industries. The reasoning for this is that the empirical findings indicate that one specific characteristic was important regarding the accounting choice. This characteristic was whether the choice concerned an underlying legal entity within a real estate corporate group or not. However, this characteristic might be seen as an important factor that is associated with the real estate industry since the underlying legal entities constitutes in some cases pure real estates. Therefore, it could be interesting to examine if underlying legal entities are as significant in other industries.

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Interviews

Eklandia Fastighets AB, Ingrid Jonason, Gothenburg (2013-04-26)

Ivar Kjellbergs Fastighets AB, Dag Bergäng & Annika Pålsson, Gothenburg (2013-04-11)

Stena Fastigheter AB, Pierre Wennström, Gothenburg (2013-04-11)

Tranemobostäder AB, Susanne Nordliden & Annica Blom, Tranemo (2013-04-25)

Appendix - Interview guide

1. What is the company's attitude towards the choice between the K2 framework and the K3 framework? Which framework will be adopted?
2. What are the incentives to follow either the K2 framework or the K3 framework?
3. How does the company account for the value on the property portfolio?
4. Which factors are important regarding investments to maintain or expand the real estate portfolio?
5. Does the company engage in sale of properties and what is the reasoning for such action?
6. Which stakeholders are considered as important for the company and how does the relation with these stakeholders look like?