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The implementation of the K3 framework

A study of construction companies' application of K3

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Abstract

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Background and problem discussion: An increased globalization has led to a need for harmonization of the accounting regulations. The decision to implement IFRS for public companies in countries of the European Union inspired the Swedish Accounting Standards Board to develop new framework for non-public companies. One of these is K3, a principle-based framework released in 2012. K3 implies companies to do their own interpretations, and for companies in the construction industry with extensive projects and lease contracts, accounting decisions can have significant effects.

Purpose of the study: The purpose of this study is to analyze how the K3 framework has been implemented in Swedish construction companies and how it differs between companies. The aim is also to compare how the annual reports have changed within each individual company, as a result of the new framework.

Theoretical framework: The K-project is a result of a desire to harmonize the Swedish accounting standards, where K3 is considered as the main framework. This section focuses on concepts and principles of K3.

Methodology: Since the research question is a "how" question, the appropriate design of the thesis is a case study. All collected data is based on annual reports of three companies in the construction industry.

Analysis and conclusion: The annual reports, prepared according to K3, are analyzed and both similarities and differences are observed when comparing the companies with each other. Even more similarities are noticed when comparing annual reports of individual companies from the financial year when K3 was implemented and the year before. These similarities can be compared with the research of Pernilla Lundqvist (2014), who concludes that a company can precede the accounting regulations. For the capital market, the transition to K3 should not influence the assessments, whether to buy or sell, to a greater extent.

Keywords: K3 framework, K-project, principle-based, annual reports, construction industry, lease, depreciation, concern contribution, ongoing projects.

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1. Introduction

1.1 Background

Ever since the double-entry bookkeeping system was introduced in Italy in the 13th century (Lee, 1977), national regulations for accounting have been developed all around the world. This development has led to significant regulation differences across national borders. With the sharply increased level of globalization during the last century and the emergence of multinational corporations, a greater need for harmonization has arisen. Thus, the importance for investors and other stakeholders to be able to compare businesses and results has increased (Marton, Lumsden, Pettersson, Lundqvist, 2012).

A first step to reach harmonizing was taken when the International Accounting Standards Committee was founded in 1973. This organization provided accounting standards that a few countries implemented. Later, in 2001, the organization was renamed the International Accounting Standards Board (IASB). The standards which the IASB released are called the International Financial Reporting Standards (IFRS) and it was decided that countries that were members of the European Union had to implement the IFRS from the year 2005. This decision was only for public companies and their preparation of consolidated financial statements (Marton et al, 2012).

From a Swedish perspective, it was considered that the existing national regulations for non-public companies were not satisfying. The issue was that these companies could choose between different accounting principles and therefore manipulate their results. This led to financial information that was difficult to understand for the stakeholders. Furthermore, it was regarded that the regulations for non-public companies had to be adjusted to the international accounting environment that IFRS implies. To solve this situation, the Swedish Accounting Standards Board decided in 2004 to develop four specific frameworks: K1, K2, K3 and K4. This project is called the K-project and the four frameworks are suited for different categories of companies (Bokföringsnämnden₁ 2014).

The K3 framework is principle-based and considered as the main framework for non-public companies, suitable for all corporate forms. It was released in June 2012 (Marton et al, 2012) and for companies that fulfill the requirements for bigger companies, whose financial year was initiated the 1st of January 2014 or later, the K3 framework is compulsory (Sveriges Redovisningskonsulters Förbund, 2014). Despite the fact that the implementation of the K3

framework has been optional for all annual reports that have been published so far, some companies have already released annual reports based on K3.

Since K3 is principle-based, it gives companies the opportunity to implement the framework based on their own interpretations. This thesis intends to explore companies which have already made the transition to the K3 framework and then to analyze effects and differences between how companies have interpreted and implemented the principles.

Differences between K3 and previous regulations are, among other things, the way leasing is declared and how ongoing projects are valued in the annual report (Bokföringsnämnden, 2012). Since companies in the construction industry usually have a need for machines and other equipment and thus possibly use lease contracts, as well as doing projects that reach over longer periods of time, accounting decisions can have significant effects. Therefore it is appropriate to analyze how this sector of companies has implemented the new framework.

1.2 Problem discussion

Despite the fact that the K3 framework has not been compulsory for financial years which have started before 2014, the regulations have been available for use since June 2012 (Marton et al, 2012). This means that some companies have already chosen to make the transition to the new framework. What is characteristic with K3 is that it is principle-based, and this means that the companies have to do their own interpretations when implementing the framework.

Although the desire to simplify the accounting regulations is strong, the interpretations can lead to differences between companies (Drefeldt, Törning 2012). This matter is particularly interesting for potential and existing investors when comparing companies and their opportunity for return on investment. Beaver (1968) concludes in his article that the investors' changes in stock portfolio increases strongly when new financial information is released. New accounting regulations are therefore important from an investor's perspective because they affect the financial information. Examples of changes which K3 causes are the usage of the *percentage-of-completion method* (Bokföringsnämnden, 2012). Since this method involves companies which have projects that extend over several financial years - typical for construction companies, it is relevant to analyze this industry. Also the industry's use of lease contracts makes this sector extra interesting. Thus, companies in the construction industry have to make a lot of decisions based on interpretations (Bokföringsnämnden, 2012).

1.3 Research question

The main research question of this thesis is the following:

- How have companies in the construction industry implemented the new K3 framework into their annual reports and how do these implementations vary?

1.4 Purpose

The purpose of this study is to analyze how the K3 framework has been implemented in Swedish construction companies. Effects of the transition to K3 can differ between companies because of its principle-based perspective and this study aims to highlight both similarities and differences. The purpose is also to compare how the annual reports have changed within each individual company, as a result of the new framework.

1.5 Abbreviations and definitions

- SRF (Sveriges Redovisningskonsulters Förbund): Association of Swedish Accounting Consultants.
- BFL (Bokföringslagen): The Swedish Accounting Law.
- BFN (Bokföringsnämnden): The Swedish Accounting Standards Board.
- BFNAR (Bokföringsnämndens allmänna råd): General advice of the Swedish Accounting Standards Board.
- IASB: International Accounting Standards Board.
- IFRS: International Financial Reporting Standards.
- IFRS for SMEs: International Financial Reporting Standards for Small and Medium-sized Entities.
- PAT: Positive Accounting Theory.
- RR (Redovisningsrådets Rekommendation): Recommendations of Accounting Council
- Swedish Companies Registration Office (Bolagsverket).
- Swedish Tax Agency (Skatteverket).
- US GAAP: Generally Accepted Accounting Principles in the United States.
- ÅRL (Årsredovisningslagen): The Swedish Annual Accounts Act.

2. Theoretical Framework

2.1 Literature search

The literature search for the theoretical framework was initiated in Business Source Premier and several articles were found in the database, all of them peer reviewed. Key words which have mainly been used in the article search are:

- Rule-based
- Principle-based
- Positive accounting
- Qualitative methodology
- Research method

For information about the K3 framework, and the K-project in general, published books and electronic sources were used. Big parts of the theoretical framework are based on BFN's guidance of K3, and to get a deeper understanding for K3, course literature was also used. Furthermore, inspiration for relevant literature has been gathered from previously written theses which have concerned similar subject areas.

2.2 The importance of accounting and annual reports

In the beginning of the 20th century, the sharing of financial information from the companies was based on optionality. It was not until the stock market crash in 1929 that attention was given to the fact that something had to be done about the corporate information. After the stock market crash, investors and financiers were discouraged of involving themselves in companies and they were afraid of the fact that they were given misleading information or no information at all (Falkman, 2000). The consequence of the absence of satisfying information was an establishment of accounting regulations and norms that would provide relevant information to stakeholders. The financial information gave the stakeholders, both external and internal, a good base for decision-making (Törnqvist, 1997).

Today, the accounting is mainly based on the capital market perspective which means that the accounting works as a basis for investors when deciding whether to keep, buy or sell shares in companies. In Sweden the accounting is also the primary source for taxation (Skatteverket₁).

Depending on corporate form and size, the companies have to provide different types of financial statements (Skatteverket₂ 2014). These financial statements create the basis of making it possible for stakeholders to predict the future of a company (Törnqvist, 1997). One kind of financial statement in the Swedish regulations is the annual report. This report consists of an income statement, a balance sheet, a management report and notes (ÅRL 2:1). For companies that have an auditor, an audit report has to be attached to the annual report (Bolagsverket₁ 2014). Bigger companies are also obliged to include a financial analysis in the annual report (ÅRL 7:31).

2.3 Principle- versus rule-based accounting standards

Accounting standards can be either principle- or rule-based. A principle-based accounting standard does not give so much guidance of how the standards should be used in practice. Instead of containing a great deal of details, it involves statements of intent (Shortridge, Myring, 2004). This means that the companies are required to make professional assessments and interpretations before implementing the standards (Marton et al, 2012). The outcome is that the principle-based standards can be practiced in various situations. An advantage of this perspective is that it allows more compact standards and an easier overview. A weakness of the principle-based accounting standards could be that the comparison between companies diminishes when more precise standards are excluded (Shortridge et al, 2004).

Rule-based accounting standards are normally more specific and describe how to implement them in a more detailed way. The possibilities to interpret the rule-based standards are more limited and this enables a more fair comparison between the financial statuses of companies (Shortridge et al, 2004). Thus, a positive quality of the rule-based accounting standards is that it reduces the opportunities for companies to make judgments about accounting issues, which increases the objectivity. A side-effect with rule-based standards is an overproduction of standards when trying to cover every possible issue. Another problem that could appear is when the economic environment changes, something that could lead to useless and dysfunctional rule-based standards. The reason why this may happen is because of the preciseness and the lack of adaption that characterize the rule-based accounting standards (Benston. Bromwich, Wagenhofer, 2006).

2.4 The K-project

As mentioned in the background of this thesis, the development of accounting has turned towards a more internationally harmonized approach. This harmonizing has mostly affected the public companies with the International Financial Reporting Standards (IFRS) in the European Union and other parts of the world, but also with the Generally Accepted Accounting Principles (US GAAP) in the United States (Shortridge et al, 2004).

To adapt the development of the international harmonization into Swedish non-public companies, the Swedish Accounting Standards Board decided, in 2004, to develop new accounting regulations (Bokföringsnämnden₁ 2014). Further reasons for developing new regulations were that the existing regulations were considered to be unnecessarily complicated. They were also ambiguous and implied the companies to combine different regulation systems. As a result of the complicated regulations, the financial information was hard to understand for stakeholders (Marton et al, 2012).

The decision that the Swedish Accounting Standards Board made in 2004 resulted in the development of four specific frameworks: K1, K2, K3 and K4, where K stands for category. This project was called the K-project and the four framework levels are suited for different categories of companies (Bokföringsnämnden₁ 2014). The purpose was to design a complete regulations system that would facilitate for the companies (Drefeldt et al, 2012).

Depending on size and corporate form, the companies have to pick one of the frameworks. The framework that is used has to be applied entirely. Companies can choose to apply a framework with a higher level than they normally would choose, but if so, they have to apply all regulations of the selected category (Bokföringsnämnden₁ 2014). For non-public companies whose financial year was initiated the 1st of January 2014 or later, it is compulsory to apply one of the frameworks from the K-project (Sveriges Redovisningskonsulters Förbund).

2.4.1 Definition of smaller and bigger companies

Companies can be divided into either bigger or smaller companies. According to ÅRL a bigger company fulfills more than one of the following conditions:

- Average number of employees has been more than 50 during the last two financial years.
- The company's declared balance sheet total has exceeded 40 million SEK for each of the last two financial years.
- The company's declared turnover has exceeded 80 million SEK for each of the last two financial years (ÅRL 1:3 pt. 4).

Companies which do not fulfill the conditions to be a bigger company are defined as smaller companies (ÅRL 1:3 pt. 5)

2.4.2 The four categories

The first of the four frameworks is the K1 which has a rule-based perspective (Drefeldt et al, 2012). Companies, which according to BFL can prepare simplified annual accounts and have a turnover that does not exceed 3 million SEK, can use the K1 framework. The framework can only be used by companies owned by physical persons, for example general partnerships and sole traders (Marton et al, 2012).

K2 is the framework for smaller companies which are not classified as parent companies or concerns (Bokföringsnämnden₂ 2014). As well as K1, this framework is ruled-based. The K2 framework is divided into two categories depending on whether the companies prepare annual accounts in accordance with BFL or annual reports in accordance with ÅRL (Drefeldt et al, 2012).

The K3 aims for all corporate forms, except for public companies, but it is mandatory for bigger companies to implement these regulations. The framework is based on IFRS for SMEs and therefore it has the principle-based perspective (Marton et al, 2012).

Non-public companies which have chosen to prepare their consolidated financial statements in accordance with IFRS have to use the K4 framework (Marton et al, 2012).

2.5 K3 (BFNAR 2012:1)

K3 is the main framework for companies which have to prepare annual reports according to ÅRL (Drefeldt et al, 2012).

2.5.1 Application of K3

As mentioned earlier, the K3 framework is obligatory for non-public bigger companies, and for smaller companies, it is voluntary to implement these regulations. The framework is used when the financial report is prepared. When using K3 it has to be applied entirely; it is not allowed to mix regulations and frameworks. For example, it is not possible for a smaller company to value immaterial assets with the regulations from K3 if the company has chosen to implement the K2 framework (Bokföringsnämnden, 2012). Information about which framework that has been used has to be presented in the financial report (Drefeldt et al,

2012). To achieve a fair view from the accounting, which is a legal requirement according to ÅRL, K3 demands the companies to prepare certain additional data (Drefeldt et al, 2012).

Since the K3 is principle-based, it only provides guidance for how to prepare the financial reports. This implies that K3 does not always meet the uncertainties which can emerge during the process with preparing the financial reports. When using K3, it is important that the economical content of a transaction is reported. In a situation when K3 cannot give a company complete answers, additional guidance has to be looked for in a special order. Primarily, the company has to find regulations in K3 which are intended to be used in similar situations. If these regulations cannot be found either, the next step is to follow the main principles of K3 and the K3 definitions for assets, debts, incomes and costs. If answers cannot be found in previous steps, a last resort is to find guidance in the international accounting standards issued by IASB and approved by the European Union (Drefeldt et al, 2012).

2.5.2 Concepts and principles

There are some basic principles in K3. One of them is the assumption that the business is going to continue to operate. When preparing the financial report, the company has to evaluate whether or not their business can fulfill this assumption (Bokföringsnämnden, 2012).

Another important principle is consistent application and comparability. To compare financial progress within a company, it is necessary that the company implements concepts, principles and valuation models in the same way every financial year. It is mandatory to specify the implementations which have been made and this also simplifies the comparison between different companies (Drefeldt et al, 2012).

In K3, the precautionary principle is also important. This means that valuation of items has to be made with caution, particularly when uncertainty prevails. The value of assets and incomes shall not be overestimated and the value of debts and costs shall not be underestimated (Bokföringsnämnden, 2012).

K3's general advice for valuation of assets and debts is to use fair value. Often fair value is equated with purchase value which is the most utilized valuation model. There are situations when other valuation models can be used, or have to be used (Drefeldt et al, 2012).

2.5.3 Income statement

According to the K3 framework, the income statement can be prepared in two different ways. The first way of dividing the income statement is according to type of cost and this is also the most commonly used one among Swedish companies. The second way of preparing an income statement is by dividing it according to function. ÅRL specifies the posts which should be included and also how they should be arranged. The posts can be aggregated or divided into sub-posts as long as it is considered as improving the lucidity. It is necessary to specify in notes if posts are aggregated. Using different ways of preparing the income statement complicates the comparability (Drefeldt et al, 2012).

2.5.4 Balance sheet

Preparing a balance sheet means that the posts in the ledger are declared lumped together into a summary of the company's total assets, provisions, debts and equity on the last day of the financial year. When preparing a balance sheet according to K3 it has to be done in a format that is specified in ÅRL. In addition to this format, K3 also demands some posts declaring the company's tax assets. If it is considered as it would improve the lucidity or if posts are trivial, they can be merged. Posts can also be added if it is necessary for achieving an even more fair view of the company (Drefeldt et al, 2012).

2.5.5 Depreciation

K3 refers to ÅRL: fixed assets with a limited period of use have to be depreciated systematically over this period of time. The depreciation is declared as a cost in the income statement and the residual value of the asset can be found in the balance sheet (Bokföringsnämnden, 2012).

2.5.6 Concern contribution

According to K3, a concern contribution has to be declared as an appropriation in the income statement. Concern contributions which have not been declared as appropriations before the transition to the K3 framework do not have to be reclassified to appropriations (Bokföringsnämnden, 2012).

2.5.7 Leasing

When a lease agreement is established it has to be classified as either operating lease or financial lease. Operating lease implies that the lessor has full responsibility for the asset and that the user declares the lease as a cost in the income statement, instead of an asset in the

balance sheet. Financial lease is the opposite; the user declares the asset in the balance sheet and therefore has to manage it as other assets with depreciations et cetera. For legal entities financial lease contracts can be classified as operating lease contracts and a notification has to be provided. The notification has to include information about future minimum lease expenses for:

- Within one year
- Later than one year but within five years
- Later than five years (Bokföringsnämnden, 2012)

2.5.8 Reporting of projects

When a project is performed, there are two methods for reporting revenues and costs for the project. The main rule is the *percentage-of-completion method* and the alternative method is the *completed-contract method* (Bokföringsnämnden, 2012).

The percentage-of-completion method can be used in both fixed-price contracts and current account contracts. When having a fixed price agreement, revenues and costs are reported gradually based on completion. If it is a current account agreement, both revenues and costs are reported as the project is carried out (Bokföringsnämnden, 2012).

The completed-contract method can only be used for fixed-price contracts. Revenues and costs are reported when the project is essentially completed. Until the completion, expenditures are declared as assets and billings are declared as debts in the balance sheet. Using this method can be complicated in the construction industry since inspections of what was considered completed can show that more work has to be done (Bokföringsnämnden, 2012).

2.6 Positive Accounting Theory

Positive Accounting Theory (PAT) explains and predicts which accounting method companies will use. The theory assumes that individuals are rational and act for their own self-interest (Deegan, Unerman, 2011). Shareholders have an interest in that the managers, who take care of their companies, work for maximizing the profit. To achieve trust from shareholders, the managers are willing to reveal information about the company. From the perspective that individuals act for their own self-interest, the managers will only maximize the profit if it benefits themselves (Broberg, Tagesson, Collin, 2009). PAT can also explain proved relations between accounting choice and firm variables like leverage and size (Watts, Zimmerman,

Jerold, 1990). PAT can be relevant in this thesis since managers' self-interest could possibly affect the interpretation of K3 when implementing the framework.

2.7 Previous study of application of new accounting standards

In a study, Pernilla Lundqvist (2014) examines the application of accounting standards of Volvo. The study focuses on Volvo's reporting of revenues and provisions over time, and the review of annual reports shows that Volvo's accounting rarely is affected by new regulations. However, the review concludes that changes in Volvo's accounting occur gradually and that the changes have been made several years before the new regulations have taken effect. When new regulations take effect, Volvo's accounting is already in accordance with the changes of regulations. Reasons why Volvo has made these changes, at such an early stage, is sometimes explained by an adaption to international praxis, but also by the desire to give a fair view. Furthermore, Lundqvist concludes that interpretations of standards can imply that two companies declare similar transactions in different ways. Despite differences, a homogeneous application is achieved as long as the interpretations are within the framework. To be able to compare financial information, homogeneous application is a prerequisite.

2.8 Usage of theoretical framework in the analyzing process

The purpose with the theoretical framework is to give a satisfying overview of the K3 framework. The theoretical framework is much about how parts of K3 are supposed to be applied and this information has been compared with findings in the empirical data. This comparison has been analyzed to see how the chosen companies have implemented the framework. Based on findings in the empirical data, the theoretical framework has also been expanded afterwards, so the empirical data could be analyzed properly. Some parts of the theoretical framework, for example the positive accounting theory and the research by Lundqvist (2014), are intended to help explain in the analysis why the companies have made some of their interpretations.

To fulfill the desire of giving a satisfying overview, information about the history behind and the development of K3, but also information about the whole K-project was added. Even if this information is not necessary for the analysis, it was considered important for understanding the entirety.

3. Methodology

3.1 Research design

To fulfill the purpose of the thesis and answer the research question, the report has been made from a qualitative perspective. Analysis and interpretations are significant parts of the qualitative research and the report is going to examine how, and not for how many companies the K3 framework has been implemented. The choice of making a deeper analysis of three companies in the construction industry gives the thesis tendencies which can be identified as attributes in a case study (Baxter et al, 2008).

The study is based on observations which are analyzed together with a theoretical framework and the main research question is a “how” question. This type of research question is preferably answered by doing a case study. Case studies are also applicable for studies which concern present events and when the researcher has little or no control. These three attributes correspond with the characteristics of this thesis (Yin, 2014).

When designing a report in the form of a case study, the first step is to develop a study question. In this case the study question is about how companies in the construction industry have implemented the new K3 framework. Next step is to come up with study propositions, if there are any, and in this thesis there are no propositions. When a study does not have propositions, it is important having a purpose, and in this case the purpose is mainly to analyze how the framework has been implemented. The third step is to define the units of analysis and identify parts of the units which are relevant for the study. The three chosen companies; Arcona, John Svensson Byggnadsfirma and MVB Öst, represent the units of this thesis. The parts which have been identified as relevant for the study are the income statements, balance sheets and related notes of their annual reports. The fourth step is to link data with propositions mentioned in step two, but since this thesis does not have any propositions, the fourth step processes the connection between data and the purpose. The last step is to interpret the findings and in this thesis it is done in the analysis section (Yin, 2014).

Since the purpose of the thesis is to analyze and understand how the selected companies have applied the K3 framework and also to see what differences the principle-based perspective has contributed, a comparison between the companies has been made. The comparison is primarily based on historical and documentary research. It is also necessary to study and analyze annual reports from the year when K3 was first implemented and the year

before to get a deeper understanding of what effects K3 has had in each company (Quinlan, 2011).

By reading other essays, inspiration and guidance regarding structure and contents have been collected and this has facilitated the development of this thesis.

Due to the limited timeframe, the review is based on annual reports of only three companies. They all have a turnover of between 400 million and 1 000 million SEK. It was necessary that the companies had published annual reports prepared according to K3.

In the thesis, focus is directed towards the legal entities' income statement and balance sheet, as well as related information such as notes in the annual reports. Thus, the consolidated financial statements are disregarded. The reason for focusing on only the legal entities is because not all of the companies had consolidated financial statements in their annual report. Why only income statement, balance sheet and related information was selected is because it was considered most interesting for the general public since these are the most basic parts of annual reports (Bolagsverket₂ 2014). The management reports were excluded since they contain more than just financial information, which would complicate the comparability.

3.2 Selection of industry

Since K3 is a relatively new framework, and also because it has not been compulsory for any so far published annual reports, it has been difficult to find annual reports prepared according to K3. Through research it was found that some companies within the construction industry had already made the transition to K3. Accessibility was thus an important motive when choosing companies to evaluate in this thesis.

When choosing industry it was considered interesting to analyze companies which could have multi-year projects, because these types of projects are more complicated when assessing how to declare revenues and costs for each year. Construction companies also have a need for equipment to be able to operate. This can lead to a requirement for lease contracts, which affects the financial information differently depending on if the lease is financial or operating. These characteristics in combination with good accessibility resulted in a selection of only construction industry companies.

3.3 Selection of companies

To see if the research question was even possible to review, the work with this thesis was initiated by searching for annual reports prepared according to the K3 framework. Assisted by the database Retriever Business, an advanced search was made. Based on the following criteria a search-result was obtained:

- Number of employees: at least 51
- Corporate form: limited companies
- Non-public companies
- Business sector: construction industry
- Financial year: 201312

The 157 hits were sorted by turnover - from highest to lowest, and the first three companies which had applied the K3 framework were selected for this thesis. The chosen companies are Arcona AB, John Svensson Byggnadsfirma AB and MVB Öst AB. All of them fulfill the criteria to be classified as bigger companies. Annual reports for the three companies were downloaded from the database Retriever Business.

The main reason why the search was performed according to the criteria above was to fulfill the requirements for being obligated to implement the K3 framework (for more information, see 3.3.2). The motive for choosing companies from just one business sector was to obtain a greater possibility to achieve comparability between the companies.

3.4 Data collection

The data for *Empirical Findings* is all taken from annual reports of the three chosen companies and their homepages. For Arcona and MVB Öst AB the annual reports for financial year 2013 were mainly used since this was the first financial year when the K3 framework was implemented. The third company, John Svensson Byggnadsfirma, implemented K3 for the first time in the annual report for financial year 2012 and therefore this annual report was principally used.

To get a deeper understanding of the effects of the new framework it was also necessary to compare the annual reports with the year before. Thus, annual reports for financial year 2012 were used for Arcona and MVB Öst and the annual report for 2011 was used in the case of John Svensson Byggnadsfirma. The reason for not using annual reports for more years is because it would not add any more clarity of the transition to the K3 framework.

3.5 Empirical structure and method of analysis

The section for empirical findings begins with a brief presentation of the selected companies to get an understanding of what businesses they operate in and their extent. All the empirical data is gathered from the annual reports and the homepages of the companies.

The presentation of data is thereafter divided into two main parts: *Income statement* and *Balance sheet*. Then two sections follow, containing noticeable differences between the companies' annual reports and differences between annual reports prepared according to K3 and annual reports prepared according to earlier regulations. Why the data in general is not divided according to company is because it is desired to facilitate comparability. Since the research question is about comparing the implementation of the new regulations, it was considered more suitable to present the data together. In the section for income statement, the data is occasionally divided according to company. The reason is that one company has a different way of arranging their income statement and dividing the data makes the comparison more clear for the reader.

The annual reports were examined and the information that was perceived as most relevant was selected and compiled under each headline in the empirical findings. This method has resulted in a disregarding of some posts and notes in the annual reports. To clarify the collected data, tables have been inserted to summarize some of the information.

The main purpose of the analysis is to discuss and try to respond the research question. On the basis of the theoretical framework, the empirical data is reviewed to observe the effects of the implementation of K3. The chapter begins with a section containing a comprehensive analysis, which afterwards proceeds into an analysis focusing on specific parts of the annual reports.

The analysis focuses on both differences and similarities between the companies that have been discovered. The differences between the companies and their interpretation of the principle-based regulations are considered more interesting to evaluate deeper. It is more interesting because of the fact that exactly the same transaction can be reported differently due to the room for interpretation that the new framework brings.

3.6 Source criticism

All data in *Empirical findings* is based on annual reports. Since annual reports follow elaborated regulation systems and are controlled by auditors, these sources can be assessed

as legitimate. Of course there is always a risk that annual reports are manipulated in some way, but the control system can reduce this risk (ÅRL, chapter 9).

The theoretical framework is exclusively based on sources that have been considered as reliable. All articles are peer reviewed and the books are evaluated from a critical perspective. Electronic sources from the Swedish Accounting Standards Board, the Swedish Tax Agency and Swedish Companies Registration Office can be classified as legitimate since these are impartial authorities. The Association of Swedish Accounting Consultants can possibly be questioned considering the fact that it could angle information in a way that would favor the interests of the association.

3.7 Credibility and evaluation of the study's methodology

Yin (2014) presents four tests which can judge the quality of the research design. The first test is construct validity, where attention is directed towards earlier studies to judge the study's subjectivity. Since the framework has not been implemented before, no earlier studies are available and therefore the construct validity has to be considered as low. The next test is about internal validity and it is possible to apply on exploratory studies. The test for external validity is maybe the most relevant for this thesis, since it is a test about generalizing a study's findings. Based on only one study it is not appropriate to generalize. Since this study is based on only three companies, and since the construction industry is considerably more extensive, it is not appropriate to draw any general conclusions about the implementation of K3. The last test is about reliability which is a test that shows if an identical research of another investigator would resolve the same findings and conclusions. A big part of this study is about highlighting what is considered interesting from the authors' point of view and this assessment can obviously differ depending on author. The reliability is also affected by the fact that the framework is relatively new and thus, the subject lacks a supply of earlier studies. Furthermore, praxis of how interpretations should be done have not emerged and therefore a similar study could bring other outcomes in a year or two. As for the reliability it can probably be regarded as quiet low.

Earlier studies about the K3 framework, for example *Component Depreciation In Swedish Real Estate Companies* by Simon Lind and David Scherling, have been based on interviews and not annual reports. The possibility to analyze annual reports prepared according to K3 has not existed before and therefore this thesis contributes with a new perspective of analyzing the framework.

4. Empirical findings

4.1 Presentation of analyzed companies

Arcona AB is a subsidiary company to Veidekke Entreprenad AB since 31 of December 2013. The company performs building projects and is specialized in areas such as schools, hotels and hospitals. The turnover for the financial year 2013 was 977 million SEK (Arcona AB Annual Report 2013).

MVB Öst AB is owned by the parent company MVB Holding AB. The occupation is based on house construction in the region of Stockholm. The company's turnover for 2013 was 438 million SEK (MVB Öst AB, 2014).

John Svensson Byggnadsfirma AB is a subsidiary company to JSB Gruppen AB. Their main business area is house construction. Turnover for the financial year 2012 was 606 million SEK (John Svensson Byggnadsfirma AB Annual Report 2012).

4.2 Income statement

The income statements of Arcona and MVB Öst, from the annual report when K3 was first used (2013), are both divided by type of cost which differs from John Svensson Byggnadsfirma. From the 22 posts of ÅRL's arrangement for income statement divided by type of cost, Arcona uses 12 and MVB Öst uses 13 of them. In the two companies some of these posts have been renamed to fit the business of the company. Type of income statement for the three companies is summarized in the table below.

	Arcona	John Svensson	MVB Öst
Type of income statement	Cost	Function	Cost

The post *Other external costs* is explained in notes and includes cost of audit and leasing costs in Arcona and MVB Öst. In the case of MVB Öst the lease costs of the year are only summarized in the note with no further details. The note of Arcona on the other hand specifies future lease costs for the company and they are divided into two: lease payments within one year and lease payments later than one year but within five years. In the section for accounting and valuation principles Arcona declares that all lease contracts are classified as operating lease.

In contrast to Arcona, MVB Öst has a post called *Other operating income* in their income statement. This means that MVB Öst has two posts for operating income, *Net sales* and *Other operating income*, in the income statement.

The depreciation post for Arcona is small and has no detailed description in the income statement. However, information about depreciation costs is presented under the headline *Accounting and valuation principles* in the annual report. Arcona uses a straight-line method based on a period of five years for all fixed assets.

MVB Öst has a post for both depreciation and write-down which is more significant and it is also specified in a note. The note explains the principles for how the depreciation is made but it does not specify the sum of the post. The depreciation is made according to plan and for tangible fixed assets they use a depreciation rate of 20%.

The income statement from the annual report when K3 was used for the first time (2012) for John Svensson Byggnadsfirma is divided according to function. This form of arrangement in ÅRL consists of 19 posts and John Svensson Byggnadsfirma uses 10 of them. Two of the posts given in ÅRL, *Cost of sales* and *Administrative expenses*, are lumped together in the income statement of John Svensson Byggnadsfirma. The post *Earnings before interest and taxes* refers to four notes which clarify personnel costs, audit costs, depreciations and leasing costs.

In the note for depreciations, John Svensson Byggnadsfirma specifies the exact amounts for different categories of depreciation costs. Depreciation principles can however be found in the section for accounting principles in the annual report. Fixed assets are depreciated according to plan and the depreciation rate for buildings is 2-5% and for vehicles, machines and inventories the depreciation rate is 20%. The different depreciation methods are compiled below.

	Arcona	John Svensson	MVB Öst
Depreciations	- All fixed assets: 5 years	- Buildings: 2-5% - Vehicles, machines and inventories: 20%	- Tangible fixed assets: 20%

In the note for lease costs, in the annual report of John Svensson Byggnadsfirma, lease costs are divided into the financial year's costs and future costs. In the section for accounting

principles, it is declared that all lease contracts are classified as operating lease according to the recommendation of BNFAR 2000:4. Type of lease for the companies is compiled in the table below.

	Arcona	John Svensson	MVB Öst
Type of lease	Operating	Operating	Not specified

The three companies have all a post named *Appropriations* which is specified in notes. This post includes changes in tax allocation reserve for all of them. MVB Öst and John Svensson also include the difference between booked depreciation and depreciation according to plan. This information cannot be found in the income statement of Arcona. Both Arcona and MVB Öst declare concern contribution in the appropriation post unlike John Svensson Byggnadsfirma, which has a separate post for this information in the income statement. The post also includes changes in tax allocation reserve for the three companies. A summary of how the companies have declared their concern contribution can be found below.

	Arcona	John Svensson	MVB Öst
Declaration of concern contribution	In <i>Appropriations</i>	Separate post	In <i>Appropriations</i>

4.3 Balance sheet

4.3.1 Assets

Mutually for the three companies' first annual reports prepared according to K3 is that none of the companies declare any intangible assets in the balance sheet. They all have posts for tangible and financial assets which can be found in the section for fixed assets. Tangible assets in Arcona are collected under one post; *Inventories, tools and installations*, and the value is negligible. In the section *Accounting and valuation principles* it is described that all lease agreements in the parent company are declared as operating lease and therefore no leased assets are included in the post *Inventories, tools and installations*. John Svensson Byggnadsfirma has the same post as Arcona but also another one called *Machines and other technical facilities*. For lease agreements the company uses the regulations of BFNAR 2000:4, which means that the parent company declares them as operating lease. In the case of MVB Öst the tangible assets are declared in one post; *Inventories, tools and installations*, and the

calculation of the value is specified in a note. In the table below it is specified how the companies have declared their tangible assets.

	Arcona	John Svensson	MVB Öst
Declaration of tangible assets	- <i>Inventories, tools and installations</i>	- <i>Inventories, tools and installations</i> - <i>Machines and other technical facilities</i>	- <i>Inventories, tools and installations</i>

For financial fixed assets Arcona and John Svensson Byggnadsfirma have a similar distribution which consists of *Shares in concern companies* and *Receivables in concern companies*. MVB Öst has only the first of these two posts in their balance sheet.

The section for current assets does not differ much between the three companies. The only difference is that Arcona and John Svensson Byggnadsfirma have a post containing receivables for ongoing contracts. Otherwise, the posts used by the three companies are the following:

- *Accounts receivable*
- *Receivables in concern companies*
- *Tax receivables*
- *Other receivables*
- *Pre-paid expenses and accrued income*

In the annual report of Arcona it is described that the *percentage-of-completion method* is used for both fixed-price and current account contracts. These receivables can be found in the note connected to the post *Receivables for ongoing contracts*. MVB Öst also uses the *percentage-of-completion method* but only on current account contracts. For fixed-price contracts the company does their revenue recognition when the project is finished and uses therefore the *completed contract method*. In contrast to Arcona, MVB Öst declares these receivables in the section for short-term liabilities. John Svensson Byggnadsfirma uses the *percentage-of-completion method* for all ongoing projects that can be valued in a satisfying way. The company refers to the regulations of RR 10 for the implementation of this method.

	Arcona	John Svensson	MVB Öst
Fixed-price contracts	<i>Percentage-of-completion method</i>	<i>Percentage-of-completion method</i>	<i>Completed contract method</i>
Current account contracts	<i>Percentage-of-completion method</i>	<i>Percentage-of-completion method</i>	<i>Percentage-of-completion method</i>

In the table above, methods are presented of how ongoing projects are declared in the companies.

4.3.2 Liabilities and equity

This part of the balance sheet starts with equity for the three companies, which all are arranged in the same way. The equity is divided into sub-posts depending on if it is restricted or non-restricted equity. They all have a note connected to the headline *Equity* where changes in equity during the year are specified.

The next post for the companies is *Untaxed reserves*. Also this one is explained in a note. In the case of Arcona this post only contains tax allocation reserves, but for the other two companies it also includes depreciations in excess of plan. What Arcona has, but the other ones do not, is a post for provisions where warranty obligations are stated.

For liabilities John Svensson Byggnadsfirma has a post for long-term debts and it is specified in two notes. Arcona and MVB Öst do not have any long-term liabilities at all. For current liabilities there are several similarities between the companies. Arcona and MVB Öst have a post for ongoing projects which is connected to the *percentage-of-completion method*.

4.3.3 Other differences

In the section for accounting and valuation principles in the annual reports of Arcona and MVB Öst it is clearly stated that the annual report is prepared according to the K3 framework. This information is also presented in the annual report of John Svensson Byggnadsfirma, but when describing and specifying their principles they sometimes also refer to other regulations and recommendations such as RR 10 and BFNAR 2001:1.

4.4 Essential differences between annual reports prepared according to K3 and earlier annual reports

Like earlier years, all lease contracts of Arcona are still classified as operating lease. However, the way of presenting these contracts differs from earlier annual reports. The lease costs are included in the post *Other external costs* and specified in note for both 2012 and 2013. The difference is that for financial year 2012, total lease costs (premises rents are excluded) for the year are summarized. The annual report for 2013 on the other hand reports future lease costs for the company and they are divided into two: lease payments within one year and lease payments later than one year but within five years.

The annual report of Arcona is overall more detailed after the transition to the K3 framework. For example the section for accounting and valuation principles is more extensively described. Also some of the other notes are more extensive and information rewarding.

For the annual report of John Svensson Byggnadsfirma prepared according to K3, a post for concern contribution has been added in their income statement. This post did not exist in the annual report for the year before.

For MVB Öst the transition to K3 did not imply any noticeable differences in the formation of income statement, balance sheet and related notes.

	Arcona	John Svensson	MVB Öst
Essential differences after the transition	- New division of lease costs - More details	- New post: concern contribution	- No noticeable differences

Essential differences between annual reports prepared according to K3, and earlier annual reports are summarized in the table above.

5. Analysis

Since the three companies do fulfill the criteria to be classified as bigger companies, their only option when choosing between the four frameworks of BFN was K3 (ÅRL 1:3 pt. 4). The principle-based perspective of K3 is reflected occasionally in form of different interpretations of the content of the annual reports.

When comparing the annual reports prepared according to K3 with the year before, the way of preparing is almost similar. This may depend on the fact that K3 is principle based, thus the companies have the possibility to interpret the framework in a way that is almost similar to earlier regulations (Shortridge et al, 2004). Arcona stands out a little from the crowd by increasing the level of details generally in their financial information. This could possibly be explained by a desire of clarifying how the company has chosen to interpret the new framework. In turn, this can favour the company's objective to fulfill concepts and principles of K3, such as comparability and fair view (Drefeldt et al, 2012).

The relatively small changes when implementing K3 can be compared with the findings of Lundqvist's research (2014). The development of the K-project, and thus K3, started in 2004 and therefore it has been known for a long time that a new framework would take effect. Lundqvist (2014) presents in her study that Volvo often precedes the accounting regulations and this could possibly be the case for Arcona, John Svensson Byggnadsfirma and MVB Öst in the implementation of K3.

Even when comparing the implementation of K3 between the companies, the likenesses are many. However, some differences do exist. The arrangement of how the financial information is presented differs, for example in the income statements for the three companies where they are arranged either by type of cost or according to function. Both ways are in accordance with K3. Some of the posts are divided into sub-posts and this is probably a way for the companies to clarify the information (Drefeldt et al, 2012). When analyzing details of the financial information, more differences are observed and they are analyzed further below. Since the differences within each individual company are few after the transition to K3, similar differences between the companies already must have existed with earlier regulations.

Reasons for different interpretations can be explained by the positive accounting theory. For example, if there was a bonus connected to the key performance indicator return on assets, managers would probably choose to declare all lease as operating to keep the value of

assets low. Even if it is in accordance with the K3 framework it might not be the best for the company, but it would favour the self-interest of the managers (Broberg et al, 2009).

5.1 Lease

All of the companies have lease costs but they are presented in different ways. The only company that seems to have followed the K3 framework and the requirements that implies the companies to declare what type of lease it is and specify future minimum lease expenses (Bokföringsnämnden, 2012) is Arcona. Since Arcona has not declared their lease contracts in this way before, this new way of presenting lease contracts must be an adaption to K3. John Svensson Byggnadsfirma also specifies what type of lease it is, but for future expenses they only summarize the amount and not according to the requirements of K3 (Bokföringsnämnden, 2012). What is missed for John Svensson Byggnadsfirma is a division of what periods of years the expenses are attributed to. In the case of MVB Öst, they only summarize their total lease costs without any further information about lease type and future expenses.

A noteworthy observation is that John Svensson Byggnadsfirma, even if they follow K3 concerning the specification of type of lease, refer to other regulations for their declaration of lease contracts. Since the K3 framework has to be applied entirely (Bokföringsnämnden, 2012), it may seem strange that John Svensson Byggnadsfirma refer to BNFAR 2000:4. Possibly they could have done their own interpretation and been thinking that since the regulations are similar in this case it is okay to refer to other regulations than K3. To avoid this confusion that could arise by referring to other regulations, they should have excluded the reference to BNFAR 2000:4.

According to K3, lease contracts have to be classified either as financial or operating, but for legal entities it is accepted to classify all lease as operating (Bokföringsnämnden, 2012), and this is what both Arcona and John Svensson Byggnadsfirma have done. An explanation of why they choose to declare lease this way could be that it is preferable not declaring them as financial. A higher proportion of operating lease keeps the value of the assets low since this type of lease is immediately declared as a cost. Therefore, this could benefit certain key performance indicators, such as return on assets. According to the positive accounting theory, managers act for their own self-interest by keeping the key performance indicators on a good level (Deegan et al, 2011).

5.2 Depreciation

The three companies have all declared how the depreciation is done and they all follow the K3 framework and depreciate systematically over a period of time (Bokföringsnämnden, 2012). What differs between the companies is the way they declare the information. The way John Svensson Byggnadsfirma presents depreciations for different asset categories, in a note, is much more comprehensive than for the other two companies. The K3 framework does not have any requirements for presenting details for depreciation in a note, but it would probably help the capital market to get a better understanding for the financial status of the companies.

5.3 Concern contribution

The three companies have declared concern contributions in their income statements. Arcona and MVB Öst include these in their post *Appropriations* and this is entirely in accordance with K3 (Bokföringsnämnden, 2012). John Svensson Byggnadsfirma has chosen to separate concern contributions from their appropriations post and according to K3, this is only permitted if it has been declared as a separate post the previous year (Bokföringsnämnden, 2012). Since this separation does not exist in the annual report the year before, it seems that John Svensson Byggnadsfirma has disregarded the requirements of the framework.

5.4 Ongoing projects

When analyzing assets in the annual reports, the three companies resemble each other in the way they declare their assets. A relevant difference in how the companies declare assets is in the declaration of ongoing projects. Arcona uses the percentage-of-completion method for all ongoing projects and they can be found in the section for current assets. MVB Öst on the other hand only uses this method for current account contracts. For fixed-price contracts they use the completed-contract method. They also differ by declaring ongoing projects in the section for short-term liabilities. Despite the differences, both companies seem to follow the requirements of the K3 framework (Bokföringsnämnden, 2012). John Svensson Byggnadsfirma, just like Arcona, uses the percentage-of-completion method for all ongoing projects, but they refer to RR 10. Although John Svensson Byggnadsfirma follows the requirements of K3, it could be interpreted that it is not allowed to refer to other regulations since K3 has to be applied entirely (Bokföringsnämnden, 2012). However, John Svensson

Byggnadsfirma may have reasoned that using RR 10 is within the K3 framework and thus they actually apply K3 entirely.

As regards the choice between the percentage-of-completion method and completed-contract method, it could affect the usage of the precautionary principle. The completed-contract method can be risky since inspections of a completed project could lead to unexpected costs and therefore the expenses for the project could have been underestimated (Bokföringsnämnden, 2012).

6. Conclusion

The study's main research questions were: *How have companies in the construction industry implemented the new K3 framework into their annual reports and how do these implementations vary?*

Unlike earlier studies about K3, which have been principally based on interviews, this thesis is based on a research of the actual outcome. This distinguishes the thesis from earlier studies and is therefore its strength. Based on the selected companies, examples can be found of how implementations can be done.

After investigating the three companies, the research question can be answered by saying that the transition to K3 has not resulted in any bigger differences when comparing annual reports prepared according to K3 with earlier annual reports. That is to say that the implementation of K3 does not differ a lot from how earlier regulations have been implemented. The similarities can be explained by Lundqvist's findings (2014), which is that the reviewed companies in this thesis have preceded the accounting regulations. For the capital market, which uses the financial information for predicting the future and as a support for decision-making, the transition to K3 should not influence the assessments to a greater extent.

When comparing the companies' annual reports, prepared according to K3, with each other, many similarities but also some differences are identified. The differences are mainly in the areas of lease, depreciation, concern contribution and ongoing projects. Some of the differences can be referred to the transition to K3, but many of them already existed before.

Despite the fact that K3 is principle-based and not always specific, the companies could in some occasions choose to be more generous with their information. For example when declaring depreciations, Arcona and MVB Öst could have followed the example of John Svensson Byggnadsfirma and given more details about their depreciations. Furthermore, confusion and ambiguity emerge when a company refers to other regulations, for example in the case of John Svensson Byggnadsfirma when they refer to RR 10 and BFNAR 2000:4. The intention with K3 is to achieve a comprehensive framework and therefore it can be questioned why the company also refers to other regulations.

Since K3 is a relatively new framework, and that only a small part has made the transition to K3 so far, it would be interesting for future research to study this area deeper. As a result of the obligatory implementation of K3 from the 1st of January 2014, it opens the possibility to study more companies and other industries. It could also be interesting, for example in five years, to try to identify if the interpretations of K3 changes gradually year by year.

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