



**UNIVERSITY OF GOTHENBURG**  
**SCHOOL OF BUSINESS, ECONOMICS AND LAW**

Master Degree Project in Accounting

## **Motivational Factors to Determine Accounting Choice**

Unfolding company size as assumption

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## Abstract

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**Purpose:** The purpose of this study is to investigate and unfold the criterion of company size as the underlining assumption of categorization in existing standard setting and financial research and is conducted in a Swedish context focusing on small- to medium sized real estate companies.

**Method:** I use semi-structured interviews with ten business leaders and two accountants specialized in SME accounting and real estate accounting when gathering the material and from there analyze the material with the use of my prior knowledge combined with the theoretic frame presented in the study.

**Conclusion:** I identify factors to help diversify the division of companies when determining whether they would benefit from a rules based or principles based accounting framework. In the Swedish setting I conclude that company size is a defining categorizing factor but that the current definition of size is limited to balance sheet aspects and would benefit from a wider definition where internal growth ambitions is one factor to include.

**Further research:** This study noted a possible shift of power, a potential power struggle, between the accounting profession and the auditing profession. This potential power shift may result in inefficiencies in small companies and future research may be beneficial. I also touch upon a perceived problem where some managers feel compelled by their accountant or auditor to change accounting framework to a more complex one, not because it is better suited for their need but rather to enhance their dependency of the accountant or auditor. This phenomenon might be of interest to study further as this might represent a highly undesirable effect of recent changes in the Swedish accounting framework.

**Key words:** Real estate accounting, K2, K3, rules based accounting, principles based accounting.

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## Abbreviations

BFN	Swedish accounting standards board, Bokföringsnämnden
FASB	Financial Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
IT	Institutional theory
K1-K4	Classification 1-4, regulatory accounting frameworks
LGC	Listed growth companies
LTD	Limited company
MCNG	Micro companies with no growth intentions
PPE	Property, plant and equipment
PHC	Private housing cooperatives
RFR	Council for financial reporting
SEK	Swedish krona
MSEK	Million SEK
SME	Small- and medium sized entities
SMG	Small- to medium sized growth companies

# **1 Introduction**

## **1.1 Purpose and objective**

The purpose of this study is to investigate and unfold the criterion of company size as the underlining assumption of categorization in existing standard setting and financial research. This study is conducted in small- to medium sized real estate companies in the Swedish setting to determine if other factors might crystallize as fundamental for the companies accounting choices.

In this study I have analyzed the Swedish accounting frameworks and discuss the Swedish K-system. I have studied the standard for division of companies in the K-system and evaluate if the existing standards are perceived as adequate by the companies to which they apply. In my analysis of the K-system I try to determine the effect the introduction of this system has had and investigate potential problems and tensions within the system. Further I study the accounting choices made by small- to medium sized real estate companies and unfold the motivational drivers behind these choices.

## **1.2 Disposition**

The paper will from here on include background and problem discussion followed by a theoretical framework that will help in analyzing the gathered material. After this there is a chapter describing the method by which this study is performed followed by the empirical chapter that present the findings. This chapter is in turn followed by an analytical chapter and discussion. Lastly I will divulge my conclusions and give suggestion of future research.

## **1.3 Background**

### **1.3.1 Rules based and principles based accounting**

Both in the larger regulatory constructs, like the IASB (International Accounting Standards Board) and FASB (Financial Accounting Standards Board), and on the academic scene there has for a long time been an ongoing lively debate about which of the basic accounting principles is the best and should be predominating; rules based or principles based accounting. What impact do these different ways of regulating accounting pose on businesses, governments and economic flows or internal processes in specific businesses or conglomerates?

The FASB member Katherine Schipper (2003) states “moving to a principles-based system is desirable, because such a system allows the appropriate exercise of professional judgment”. Principles-based accounting regulations force the profession and the regulators to evolve and to engage in advanced judgment. There is some evidence that accrual quality and earnings quality is enhanced under a relatively principles-based GAAP (Generally Accepted Accounting Principles) compared to under a more rules-based GAAP (Webster & Thornton, 2005). Agolia et al. (2011) states that “financial statement preparers are less likely to report aggressively when applying a less precise financial reporting standard than when applying a more precise standard” suggesting that a principles-based accounting regime will allow for a sounder handling of accruals when preparers need to reflect and act.

The general consensus now seems to be that a principles-based GAAP presents many advantages over a rules-based GAAP at least as long as you aggregate your viewpoint to an international setting. On a company level or even a national level there might well be other factors that come into play and the national regulators need to account for cost-benefit tradeoffs, resource allocation regarding control functions, taxation and much more and there are undoubtedly administrative costs associated to principles based accounting that may be unnecessary for some types of companies.

The conceptual framework of the IFRS (Deloitte, 2016) describes two key factors for preparation of financial documents and those are relevance and faithful representation. One of the main functions in accrual accounting is the harboring effect of smoothing, to show the economic situation as it should be if we could exclude cash flows. Accruals used right give us the means to show the economic reality and health of a company and not just the actual transactions. The general consensus is that a principles-based GAAP increases the possibilities to use accruals this way. Furthermore, a change to principles-based accounting may also lead to societal benefits, deterring fraud, changing the accounting profession and the auditing process worldwide (Carmona & Trombetta, 2008). As a counterweight Fekete et al. (2010), who also refers to Berinde (2004) and Berinde & Rachisan (2005), state that governmental information needs and the entities desire to optimize taxation will significantly influence accounting policy choices; especially in SME's located in countries where there is a strong connection between accounting and taxation in the local GAAP.

Governmental forces are driven by economic fundamentals where taxation is the way to balance the budgets and the tools to generate tax income are to restrict the tax base to the country limits and to then regulate taxation in a fashion that will smooth and grow the level of income in order to be able to plan and thrive as well as to use the collected taxes in a sound way and distribute the wealth to the needing areas (Talvi & Végh, 2005; Bucovetsky, 1991).

There are some natural restrictions of a country's tax base, for example mobility and customer location. Property is usually a natural income source due to its general aspects of immobility; you cannot move a house and upset the people or businesses residing there, why these types of objects are easy tax subjects in a single jurisdictional tax venture (Wilson, 1986). SME's share many of the same dependences that properties have as they as well, often are rooted to the local setting in a far greater extent than larger companies. A multinational company may close down production in a country due to a new tax law or an unfavorable change in the local accounting regulatory framework but the same cannot be said for the local pizzeria or your local car mechanic. The small company that rely wholly or mostly on the national consumer category is more dependant of the decisions made by the government in the country where the company acts. Studies suggest that taxation need a strategic stance and a long-term pursuit of maximizing common benefits and if the internal economic or political pressure grows too strong there will be a revolution of some sort why equilibrium of taxation is to strive for (Mirrlees, 1971; VOGEL, 1974).

Given the academic discussion one can conclude that on an aggregated level a principles based accounting framework is preferred. But there may be a point where cost-benefit or some other aspect prevails and thus makes a more rules based accounting frameworks favorable. The purpose of this study is to further explore the relations between rules based and principles based frameworks and under what circumstances one or the other might be preferable. In doing this I have concentrated on studying the current Swedish accounting situation.

The Swedish government recently engaged in a project to harmonize Swedish accounting, the K-project. In this project the government set up four different regulatory frameworks ranging from strictly rules based to mainly principles based. By studying the current Swedish accounting situation we can thus study a variety of accounting frameworks ranging from strictly rules based to more principles based. This made the Swedish setting ideal for this study.

### **1.3.2 The Swedish setting**

In 2005 all Swedish companies with stocks traded in a regulated securities market were subjected to IFRS (IFRS Foundation, 2013) and in order to simplify and harmonize accounting the Swedish accounting standards board, Bokföringsnämnden (BFN), decided to produce new accounting frameworks to set in place. Before this review of the Swedish accounting framework there were one standard for each item in the balance sheet and the income statement and this was deemed unnecessarily complicated for SME's. The government assigned the task of simplify accounting and lessen the administrative burden for SMEs to the BFN and thus the K-project was initiated (Eriksson, 2009). The vision was to design one accounting framework for each size of company and with companies divided into four categories, based on size and type of association, four new frameworks were developed. The purpose of these frameworks were to simplify accounting and lower accounting cost for small and medium sized entities (Bokföringsnämnden, 2004) and as of January of 2014 these new standards is in use for all Swedish companies to follow (Bokföringsnämnden, 2016).

Apart from IFRS, Sweden now have four regulatory frameworks, K1, K2, K3 and K4 (with subcategories based on association and business), that apply to different companies. Two factors are of importance in determining which of the four accounting framework a company is to adhere to: company type (i.e. sole proprietors, LTD (limited company) etc.) and company size. As stated earlier the main focus of the government in devising the K-system has been the division of companies based on size. If one were to simplify one might say that the smallest companies are subjected to an accounting framework almost solely based on rules and the larger the company gets the more principles based accounting choices are available.



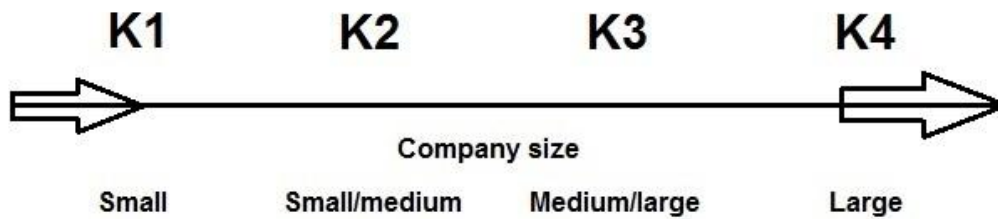


Figure 1

Sweden has over 1 million registered companies where almost 74 % are sole proprietors and in total just a couple of percent of the registered companies are by regulation titled large companies. There are definitions in several laws to define companies and BFN have compiled a document (Bokföringsnämnden, 2013) to help in the sorting of companies but the most important definition except company type is size where a company either can be large or not. A large company is defined as a company that, either have their securities noted on a regulated market, are a credit institution, investment firm or insurance company if the law (1995:1559) or (1995:1560) says otherwise or lastly if the company fulfill at least two of the three requisites as follows:

- The average amount of employees for the last two years has been more than 50.
- Total assets exceed 40 million Swedish krona (MSEK, SEK) the last two years.
- Net revenue has exceeded 80 MSEK the last two years.

Small companies are those companies that by definition are not large companies.

### *The Auditor*

As an adhered part of the simplification of accounting and cost management the Swedish government has removed the requirement of auditing of micro companies which was obligatory for all limited entities up until first of November 2010. Now, if at least two of the three requirements are met, the company is not required to hire an auditor. The requirements for not needing to hire an auditor is that the company employs no more than three persons, total assets is worth no more than 1.5 MSEK and last but not least the company's revenue is below 3 MSEK a year. About a quarter of a million Swedish companies fall into this category and this fairly new regulation may entail a shift in power between auditors and accountants (Barkman Lövdal, et al., 2012).

### **1.3.3 Division of companies into the different K-frameworks**

The regulatory framework K1 is for sole proprietors and other legal structures that by law may file simplified financial statements and thus applies to the smallest of the small companies. K4 is for large companies and groups that do not have their securities traded on a regulated market. These companies are required to follow a “translated” version of IFRS and follow the recommendations and interpretations regarding IFRS that the Council for financial reporting (RFR) supplies which are based on the very specific environment of Sweden.

In Sweden, companies that fall under the category of small companies have the choice to follow either K2 (BFNAR 2009:3 or BFNAR 2009:1) or K3 (BFNAR 2014:1). K3 is based on IFRS for SME but have a large amount of amendments and exceptions due to the Swedish tax law and the local jurisdictional connection between accounting and tax. All large companies that do not follow K4 or IFRS should follow K3. K3 is also available for small companies that choose to apply K3. K2 is a simplified accounting framework for smaller entities which is voluntary.

We thus have a large group of companies which can freely choose to follow either K2 or K3. This means that we have companies that are allowed to choose between a framework that is more rules based, K2, and another that is more principles based, K3. This is an interesting fact that is of great importance to this study. If we can study this group of companies to try and learn what motivates their choices we can gain some insight into what company factors will mean that a rules based framework is preferable and what company factors will mean that a principles based framework is preferable.

### **1.3.4 Differences between the K2, K3 and IFRS frameworks**

#### ***First main difference***

One of the main differences between K2, K3 and IFRS is the way to value assets, and more specifically fixed assets like for example property, plant and equipment (PPE), where the most interesting part is property and real estate.

One of the truest representations of property value is archived using IFRS where property for most part is supposed to be valued to fair value and regular revaluations can be done where the difference in value affects the income statement and the result of the company.

In K3 the company still has the ability to reevaluate property as they see fit but the difference in value will affect the equity part of the balance sheet. This is a lingering result of a Swedish accounting practice called “försiktighetsprincipen” (prudence principle) where income should be recognized when it is a fact but costs should be recognized as soon as possible. This is a tradition that has close ties to the Swedish tax system. To handle revaluations like this will impede comparability and may create bizarre effects on the result from one year to the next.

Using K2 property value is regarded as purchase price less depreciations and impairments and the only reevaluation that is allowed is impairments or later, if the reason for the impairment has disappeared, the company can choose to bring back the impairment less depreciation (SRF Konsulterna, 2016; BFN, 2014).

The connection to tax and demand for prudence makes the reevaluation-possibility in K3 hard to use due to the fact that the reevaluation does not affect the result and the income statement which in turn hinder comparability. The option to reevaluate may therefore be of little use for real estate companies or even harbor negative aspects. From a governmental point of view, with taxation at hand, the rules based frame of K2 secures a predictable tax base with a regulated cost structure that will govern that reported results in the financial statements and the taxable income are basically the same and the complication of the reevaluation process in K3 basically gives the same result. A reevaluation process where changes are recognized in the income statement like the handling under IFRS will alter the tax base and change the taxable income from one year to another and will decouple the reported and registered financial statements with the taxed figures. This in turn increases administrative costs. Rules based accounting thus simplifies taxation from a governmental standpoint and lowers the administrative burden for both government and company (Hellman, et al., 2011).

### *Second main difference*

Another main difference between K2 and K3 is how to depreciate property. K2 allows for straight line depreciation and if the company makes investments available for activation the cost of the investment is merged to the remaining value of the property and is then depreciated exactly as the rest of the property, with few exceptions. K3 like IFRS demands that separable units are valued and depreciated based on expected economic life and this is more complicated and more time-consuming than a straight line depreciation and the result will give the company greater costs that will skew the result and faster depreciation is not accepted by the tax law in Sweden why the demands on the accountants are higher under K3 and the result in the financial statement will differ from the taxable result as described above. From a fair representation viewpoint, and with regards to heighten accounting quality, K3 and a component depreciation approach is preferred, but with regards to taxation rules and a straight line depreciation K2 is preferred (Webster & Thornton, 2005) (Hellman, et al., 2011).

In addition to these differences there are many others, for example differences regarding other accruals, but the above described are the two that have been the main focus of the most discussion both in practice and in academia; though it is worth remembering that this area in reality is meagerly explored (Eklund & Vuorela, 2014; Callert, 2013; Edlund, et al., 2014; Josefsson & Lejdström, 2011; Nordlund, 2012).

Both of the above described main differences affect real estate companies more than they do many other types of companies. This makes real estate companies a suitable subject for this study.

## **2 Problem discussion**

### **2.1 Key factors utilized for dividing companies**

This extensive administrative apparatus that the government initiated was prompted by the apparent need to diminish some of the burdens of the smaller companies. The means used to achieve this was by developing the new regulatory K-frameworks where K1 and K2 is mostly targeted to the smaller entities and these frameworks are almost entirely based on rules. K1 and K2 leaves very little room for judgment by the preparer of the financial statements and this should in theory reduce administrative costs (Eriksson, 2009).

This then would be an active choice to exchange accounting quality in favor of diminishing costs and this notion is where there is a gap in knowledge. When do the perceived and actual benefits from rules based accounting become greater than principles based accounting? What factors are of importance in determining which companies are most likely to benefit from rules based framework rather than principles based framework? This we do not yet know. In the Swedish setting the main factor used to determine which type of regulatory framework a company should adhere to is company size based on balance sheet objectives. Was this choice and assumptions made by the Swedish government when devising the new frameworks correct? Will the new regulatory frameworks lead to an optimal and cost-efficient accounting? Can we perhaps identify other factors that might be of importance?

To answer these questions in full one would need access to extensive national financial data, and this is outside the scope of this study. There are however some indications that certain factors play a more decisive role in the decision making process of companies when making accounting choices in general. By studying these factors we may possibly gain insight into what motivates the choices made by different companies and their attitude to new regulatory frameworks. This in turn can help us understand if there may be some other way of constructing the division of companies that would benefit a larger population or gain knowledge to understand the need of different companies in the national setting. In academic literature we find reference to several such factors.

*Company size* - Watts and Zimmerman (1978) argues that firm size is a fundamental factor when studying the likelihood of earnings management and accounting choice. They state that larger firms are more likely to lobby for or against governmental interventions, like the issuance of new accounting standards, due to the fact that the larger companies have more to lose than smaller companies do. They conclude that that larger companies are more likely to receive government intervention if they experience fluctuating earnings or reports extraordinary profits. Larger companies are also, to a far greater extent than small companies, influenced by external factors such as stockholders and the media. Accounting practices that make for strange occurrences in the financial documents will attract attention from the stockholders and the media. This might in turn lead to undesirable governmental attention and governmental interventions. This influence from external factors can lead to a need for the company management to adapt sound accounting policies.

One interpretation of the situation might be that when it comes to the new accounting frameworks the need for governing and rules (i.e. a more rules based framework) was deemed to be greater for smaller entities seeing as how larger entities have many external stakeholders and influences that will contribute to regulating their activities (Drefeldt, 2015).

It is also apparent that changes in the cost of accounting will affect small entities more due to the fact that this cost is a greater part of the income statement than it is for larger companies mostly based on economies of scale why smaller companies are more dependant of lower costs and uncomplicated accounting processes (Eriksson, 2009).

***Growth ambitions*** - SMEs usually have a more limited ownership structure than larger companies and this is very much true for the companies in this study. The desires and needs of the owners in smaller entities will dictate more of the company's day to day activities, and what cash flow can be generated for the owner is in focus. Company ownership may therefore influence the company's financial conditions and accounting choices as a means to grow cash flow in an almost artificial way (Fekete, 2010; Tarca, 2004; Meek, et al., 1995; Shapiro & Varian, 1999).

In a study of larger companies Warfield et al (1995) conclude that companies where the management in no, or low degree, own the company, in higher degree will be associated with higher discretionary accruals and poorer earnings quality. If there is one or several strong owners demanding transparency the management would soon find that it is hard to manipulate accounting numbers for their own benefit and even if the owner community is detached from the day to day dealings in the company, the risk of accounting missteps can be mitigated by the use of one of the bigger accounting firms. Gul et al. (2002) conclude that the tendencies that Warfield observed of improved earnings informativeness with a high level of management ownership, is amplified by a low audit quality.

Chaney & Lewis (1998) confirm that there is evidence supporting that income smoothing is sometimes performed by managers not to increase their own welfare but instead to communicate the firms' earnings in a way that will be perceived more beneficial by the market. The actors on the capital markets are better able to assess companies' earnings when the fluctuations are small why there is evidence of managers that as a long term strategy use discretionary accruals to offset transitory transactions in the income statement (Chaney & Lewis, 1998; Chaney, et al., 1998).

This might suggest that ownership structure and, even more so, economic aspiration dictate choices and processes of a company. In my experience companies where the owners lack growth aspirations will have other needs and influences than entities that have owners with growth aspirations for their company. The will to grow and evolve will increase the need for finance, knowledge and expertise, relations and many other recourses. With no need for progress the status quo is strived for and the company is seen more as a jurisdictional shell than a vehicle for prosperity and this may indicate that the defined motivation behind the company is more important than size and company ownership when defining the needs of the company and my thoughts are backed in part by practitioners but this phenomenon seems to be less explored by the academic world (Berg, 2013; Pramhäll, et al., 2014; Deloitte.com, u.d.).

**External dependencies** – Organizations as well as individuals are dependent on outside factors. In the case of individuals it may be their landlord, employer or bank and the differences are not necessarily that large between person and organization. In parallel, a company is dependent on its landlord, customers and creditors. The desires and needs of the company dictate the level of impact this dependency has on the company and also what kind of dependencies are present (DiMaggio & Powell, 1983; Koot, 1983; Kotter, 1979).

An internet based designer, writer or marketer working from home may not need access to cheap financing, great infrastructure in close connection to the business and the change in taxation may have a marginal effect but when the same sole proprietor expand the business and employs, rent or buy office space and start to deliver to large multinational companies the dependencies shift. In the wake of change, growth and evolution follow dependencies and different organizations handle these situations differently but in common they have that if there are aspirations for change and growth, their dependencies will change and grow. These shifting needs will force the different companies to act in different ways and what is good and sound for one company is not necessarily good for the next one (Ibid.).

### **3 Theoretical framework**

#### **3.1 Institutional theory**

The steppingstone described above is the choice between rules vs. principles based accounting and the pivotal point is what decides the best practice.

The company might have aspirations of growth; the management struggles for safe income or the owner strive for low tax on high cash flow. None of these aspirations necessarily oppose the will of other, external, stakeholders. Banks and other investors might be equally interested in company growth, the government is likely to favor secure jobs and the tax agency would probably prefer high taxable income but there will always be a struggle between wills and needs.

The academic explanatory toolbox that this study used for analyzing the portrayed world is institutional theory where the evolved neo-institutional theory with its descriptive use of isomorphism would take center stage.

Philip Selznick published a book in 1957 with the title *“Leadership in administration: a sociological interpretation”* where he explained a phenomenon that he named *“institutionalization”*.

Organizations adapt and transform their processes, practices and organizational structures to fit in the system and maybe to mimic others in pursuit of perceived synergies or arbitrage. The focus for the organization is to attain values inherent in a best practice that competitors or other inspiring organizations might carry (Selznick, 1984; Scott.W.R, 1987). DiMaggio & Powell (1983) suggest that institutional theory is the answer to the epiphenomenal constructions studying collective behavior and how individual actions are aggregated. This theory let us break open a stagnated cage and view the inside where we can try to use new tools to describe what we see in order to perfect the order in which we work.

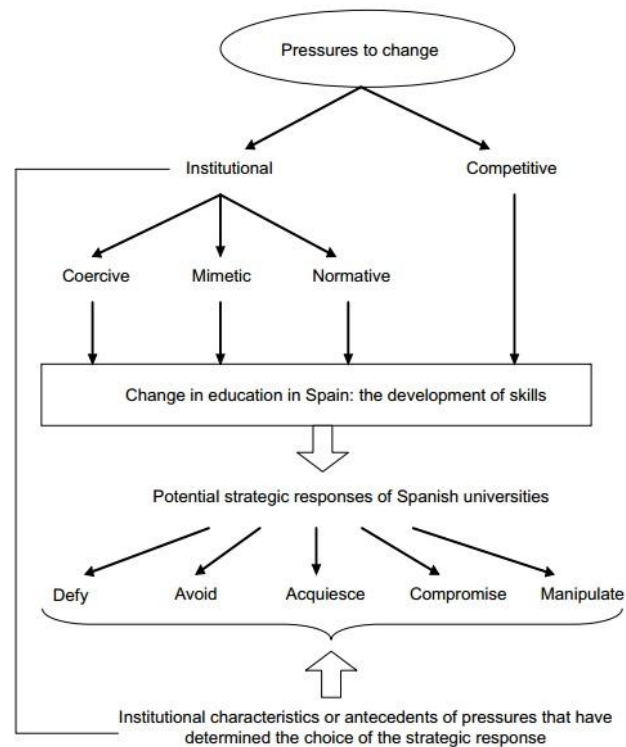
When talking about institutions in this setting it is imperative to define what we mean. An institution in the institutional theory is *“a set of rules that governs human behavior and shapes social relations”* (Lichtenstein, 1996, p. 244) where social constructs rather than laws are the rules that mold social understanding. An institution is something people or organizations do or perceive as right due to relationships that influence a network rather than governmental structures and decrees. Institutional theory (IT) focuses on the deeper understanding of the processes that changes the rules and norms in society and which also shapes new authoritative guidelines (Scott, 2008).

Alongside the classical institutional theory there have emerged a new orientation or more focused theoretical perspective called neo-institutionalism or neo-institutional theory that focuses on linkages between organizations and the institutional setting in which they operate (Dillard, et al., 2004) as well as the influence of the environment on organizations and their practices (DiMaggio & Powell, 1983). This part will help to understand the motivational drivers that inhabit every organization and to see the evolution of these drivers resulting from organizational change or other influences.

A major point of critique mentioned in research is that institutions and individuals are not static but rather intertwined in an ongoing process of interaction that shapes change and even replacement of institutions (Peters, 1999). The underlying assumptions of an existent structure is for there to be an institution (March & Olsen, 1989) or, as some claim, that structures are composed of incentives and constraints (Jensen & Meckling, 1976), with the assumptions of rationality underpinning this in contrast to rational myths. Discerning institutional change from shared external factors and new individuals is problematic (March & Olsen, 1989). Meyer & Rowan (2006) conclude that the world transitions to more complexity where fluid organizational structures and increasing institutional diversity defy easy categorization but given the evolution of the neoinstitutional theory it is a functional tool to decipher the empirical material of this study and act as an analytical magnifying glass that help focus the material. The neoinstitutional theory including isomorphism is described below as to template for further analyse.

## 3.2 Isomorphism

The basis for institutional theory is a pressure to change. Usually when the competition sprints ahead, there is some new technological or intellectual advance or when there is other stakeholder pressure for increased profits or reduced costs. In this study we see new accounting frameworks and the resulting environmental differences in the ecology of small- to medium sized companies.



(González, et al., 2009)

The institutional theory defines three ways to change and motivational drivers and these factors are derived from the concept in sociology that is referred to as isomorphism. Isomorphism is, as described above, when organizations try to mold their processes or structures into a shape similar to another and even though this practice might leverage progress but could also paradoxically limit development when it is needed (Frumkin & Galaskiewicz, 2004; Dacin, 1997; Deephouse, 1996). In “The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields” DiMaggio & Powell (1983) develop institutional isomorphism and divide it into coercive, mimetic and normative isomorphism. This is generally viewed as the foundation for institutional isomorphism and from where most research on the subject originate.

### 3.2.1 Coercive isomorphism

Coercive isomorphism is when a regulatory body that the target organization is dependent on, or who has power as a result of cultural expectations, forces rules and practices onto the organizational environment (DiMaggio & Powell, 1983). For example, the IASB or FASB’s influence the accounting profession, accounting education and accounting firms, as exemplified by the research by (Albu, et al., 2014) in Romania and (González, et al., 2009) in Spain. This study was brought about by the coercive force put on a very large part of the Swedish organizational community by BFN.



### **3.2.2 Mimetic isomorphism**

A perceived “right way” or best practice is usually the quintessential core of mimetic isomorphism. Mimetic isomorphism is the direct opposite of coercive isomorphism and is often initiated in a situation where the organization's goals or means to reach their goals are unclear. The organization thus observes some aspect that can help them, either to achieve a competitive advantage or remove a competitive advantage, and tries to incorporate this into their structure or processes e.g. when competitors adapt the organizational structure similar to the market leaders to reduce the organizational differences in terms of competitive advantage (DiMaggio & Powell, 1983). This behavior enables certain exchange processes of the organization to be undertaken efficiently (Etherington & Richardson, 1994). Mimetic isomorphism has also been called competitive pressure by some researchers (González, et al., 2009; Etherington & Richardson, 1994).

### **3.2.3 Normative isomorphism**

The last type of isomorphism is when organizations and other social constructs make changes due to professional pressure. Normative isomorphism is brought by inter-organizational networks of professionally accredited individuals where the education or work history will merit the isomorphism. Personnel will change employer and bring their experiences with them. DiMaggio & Powell (1983) argue that people from similar walks of life will tend to tackle tasks in the same way. Implicating that students with an educational background in Sweden; where the universities are limited, might lead to a narrower focus when evolving their future organizational reality. Or CEO's that try to climb the ladder will bring their experiences with them and change their new setting based on their history. This phenomenon can also be seen when studying economic and technological clustering and other types of social centralization (Breschi, 2001).

## **4 Method**

### **4.1 Study design**

#### **4.1.1 Data collection, interview theory and sampling**

This study studies human interaction, behavior and individual insights and thoughts and the data is evanescent in nature and only possible to understand in a context where I interpret the setting and give tools for understanding. The collected data of this study was gathered through semi-structured interviews that, according to Easterby-Smith, et al, (2002) is the best way to understand the respondents “world”, opinions, beliefs, subjective understandings, logical steps or is preferable when the interviewee may be reluctant to share other than under confidentiality. They include unstructured interviews, in the above description, but my choice fell on a semi-structured approach due to both time constraints and a definite need for some direct answers. An unstructured interview will allow the researcher to gather the most information about a person's individual reflections where the interview subject is free to wander or completely and the questions often are open and probing and this type of approach often takes a great deal of time and effort.

On the other hand, a structured interview with a totally predetermined agenda may mean that the researcher is deprived of information and this was the reason for why I chose a semi-structured approach; to gain as much knowledge as possible in the most efficient manner possible. This was also the reason for the use of mainly open questions. The use of open questions gives the interviewee a chance to elaborate where closed questions give straight answers. This study needed the contribution of company specific insight that the respondent could give freely why open ended questions were key for the result.

The interviews were held in confidential one-on-one sessions or in telephone conference with as few disturbing moments as possible. The questions asked were closed regarding company and interviewee details but for the purpose of gathering empirical material the questions were open with probing follow ups. I conducted a total of eleven interviews with a total of twelve individuals over the course of four weeks. The shortest of interviews was forty minutes long and the longest took one hour and thirty-seven minutes with an average just short of one hour. The longest interviews were held with the experts in order to gain extended knowledge of the field and with the noted group where I interviewed both the CEO and the chairman of the board at the same time. The interviews were recorded and transcribed for easy access to the material during the analysis phase but a total of three interviews were not recorded due to the requirements or wishes of the interviewee.

#### **4.1.2 The role of the researcher**

The study has benefitted greatly from the fact that I hold an active presence in the accounting community where I work and that I am very involved in real estate related issues. My work as an accountant also gives me a unique access to a wide variety of companies, which has helped this study immensely. The sample of respondents was chosen based on their size and structure as the study needed them to be subjected to the choice of K2/K3 and also was to benefit from a variety of intrinsic factors. Due to my access to my clients the study was conducted, in a large part, using willing respondents from my client list. To widen the respondent base I also posted ads on large forums where the hits I got were used in full. My prior understanding of the subject has allowed me to identify and understand a problem that is relevant for both practitioners and academics alike and I have been granted these interviews much thanks to my network in this field and the openness of the respondents might well be a result of them feeling that we were on equal terms.

This connectedness lets me study, in detail, a phenomenon that otherwise would be hard to study. Sweden has a long tradition of helping and supporting research why we often are blessed with more access to businesses than our counterparts in other parts of the world and by tapping into my extended network I got an intimate connection that benefitted this study with a large and deep material to work with.

Due to the fact that a large part of the respondents are connected in some way to me or my employer there might be some biases regarding accounting and choices even though the respondents found by other means validated the general themes by their responses. There is also the fact that my involvement in the field may have exposed me to preconceptions and cultural blindness that potentially hindered me to ask questions during interviews that could capture something I was not prepared for and whatever I would find could be interpreted based on my prejudice regarding the subject. In the start of this study these flaws were omnipresent and due to me noticing this I worked actively to counter these problems and question my own understanding during the entire study.

This process of me having to free myself from preconceptions and make use of factual knowledge led me to open up to the unknown elements of my surrounding and led me to notice things that I then, based on my knowledge of the subject, could act on which I now believe have been beneficial for the study as I most certainly have a greater material to analyze than I would, had I not made this journey.

One should take into account that respondents may be influenced by me as researcher or by the relationship or social differences and potential tensions that might be present between them and me. Lee (1993) suggests that some respondents may feel the need to give certain responses based on preconceptions of “correct” or “acceptable”, or as a consequence of their position in the social hierarchy. Another study done by Rosenthal (1966) found that biases can occur based on gender, class or race and these biases may inflict positive or negative on the responses and the truthfulness and reliability of the material gathered. I believe that the gathering of material benefitted greatly from my prior knowledge since the respondents then could feel secure in me knowing what they were trying to mediate and thus felt comfortable in venturing deeper into the actual problems of their company. This was then reinforced with the confidentiality of the responses and, with some of the respondents, their trust in the company I work with giving me further credibility.

Worth noticing is the possible dependency issue in a supplier-customer relationship but in this case I will state that my respondents are clients of my co-workers and that I seldom have any preexisting relationship with the respondents and where I do, the relationship is at the most brief and shallow. There may still be dependencies due to the fact that I got in touch with the respondents based on my employment and that the business of accounting is built on trust but as stated above I believe the benefits far outweigh the disadvantages.

#### **4.1.3 The analytic process**

The analytic process is based both on my preexisting knowledge of the subject and the application of the theoretical framework described above. Before the empirical presentation the transcriptions were searched and the answers were coded to suit different categories like general, factors, theoretical implication and so on. During the empirical presentation I have chosen quotes to emphasize the respondents' view of their reality in order to highlight the identified problems and the analytical elements bring forth aspects of the problem discussion and include the factors identified in this study. After this follows a more in-depth analysis where the connection between the empirical evidence, the identified decisive factors and the theoretical framework are investigated and analyzed.

## **4.2 Presentation of respondents**

This study is based on material gathered first hand from financially involved persons that represent twenty-nine real estate companies (marked “M” in the empiric sector). Interviews were also held with two accounting experts (marked “P” in the empiric section) in the area of real estate evaluation and accounting with special competence regarding small and medium sized Swedish real estate companies or regarding the regulatory accounting frameworks of K2 and/or K3.

The interviews held with the accountants give a broader understanding of both the given situation and perceived practical accounting problem in the study and also the view of the accounting profession in general and real estate accounting and SME accounting in particular. The insight into the daily dilemmas of the accounting professionals working with the new frameworks give a greater understanding and more profound sense of reason as one notice that the lack of guidance may create unintended economic effects on a larger scale.

The interviews with owners and economic insiders are the base for the empirical analyses and this material is accentuated by the accountants’ insight.

The respondents and their companies are representative for their respective company conditions and business segments but all companies have inherent characteristics that make them unique even though, for the sake of visibility and structure, the following presentation will group the companies based on the characteristic factors focused in this study. As defined above the key factors identified and utilized in this study are company size, growth ambitions and external dependencies. The Swedish government has based their division solely on size but I identify the other factors as valid in the future discussion.

The following categorization is brought by my work with the material and is mostly a result of this study. The need to sort the respondents and the noticed differences between the different segments of the respondents made for this division.

### **4.2.1 Accountants**

The easiest group to distinguish might be the two experts that were engaged to include a deeper understanding of the field and what the practitioners perceive as problems and benefits with the new frameworks and also to contribute with historic views of the progress and transition from the earlier system to the new.

Included in the study are the interviews of two reputable experts in the accounting field both with lengthy background in accounting and one with the express expertise in real estate SME’s where the other contribute with a extensive experience of SME accounting both from practice but also from the political perspective.

#### **4.2.2 Micro companies with no growth intentions (MCNG)**

MCNG's are the largest group of respondents and are made up by the Swedish equivalent of LTDs whose total assets are made up of one or two buildings with a value >50 million SEK and by a fairly Swedish construct of private housing cooperatives (PHC).

What is unique about these companies is the economic agenda that is very exclusive for this group. The ownership structure is often fairly uncomplicated where there is one strong owner or more often one lone owner to the company. In the case of the PHC the owners are the residents represented by a board similar to a larger company but the ownership interest is limited to the single apartment. In both these configurations the need and desire for growth is almost nonexistent with the owners, and this is the vital property of this group of companies. The limited company needs and growth ambitions combined with the relatively small company size makes for a minimal influential pressure from external dependencies.

This group consists of three representatives from the board of three PHC's, two owners of companies with one building (>20 MSEK) and one owner of a company with two buildings but still with an asset value of under 20 MSEK.

#### **4.2.3 Small to medium sized growth companies (SMG)**

The study includes two interviews with the single, largest owner of companies with a balance sheet exceeding 20 MSEK. The size may be of limited value and the absolute most significant noted factor for these companies was their growth ambitions and their prospects of growth which were clearly stated by the respondents. Also apparent where their dependence of external influences like banks and consultants especially compared to MCNG's.

As stated, most significant for the representatives of these companies where their strong, almost predominant focus on growth. To appreciate the value of the company; by almost all means in a balanced and economically viable way, is the singular most important objective and this puts the company on the radar for a wider economic surrounding. Relationship building with external dependencies is central and changes to their economic environment are fundamentally important.

#### **4.2.4 Listed growth companies (LGC)**

I was also granted access to a listed company and was able to interview several influential individuals with a publically listed real estate company. The company is by definition small enough to be able to choose between K2/K3 and listed on a marketplace that does not demand reporting under IFRS. The company has a strong owner that controls a large stake even though not a majority stake. This owner is active as CEO and together with the president of the board of directors they control the day to day business in full even though they answer to the annual meeting of shareholders as usual.

Growth was in focus but even more so the need to cater for their economic environment and to excel in competition with other companies. External dependencies are even more apparent in this company constellation compared to SMG's.

### 4.3 Delimit the selection

The sample selection excluded companies that falls under category one (K1) for several reasons. The main reason is due to the low economic impact these companies have on an aggregated level and also the fact that this researcher have extensive knowledge from working with the accounting in hundreds of companies like this. The inner workings of such companies are seldom complex and they largely exhibit similar prospects and financial limitations and are very similar to the companies that are presented in this study as MCNGs. Last but not least; the small size of these companies often exclude them due to the fact that it is hard to be a real estate company and still be small enough to be able to use K1 as accounting framework. K1-companies are thus excluded from this study in regards to the gathering of empiric material and will only be reflected on based upon the experts (including my) preexisting knowledge.

On the opposite side of the scale we have K4-companies that are so complex and that closely follow IFRS which makes these types of companies well studied. Within the framework of this study these companies are too complex and it would be almost impossible to portray the needs and opinions of these companies but it is also important to notice that K4/IFRS companies usually are large enough to have the recourses for this kind of accounting and therefore the needs for simplification and cost control lessens in regards to these companies.

These K1 and K4 companies, even though they constitutes the majority of companies in Sweden by number and contribute with the largest part of the economic prosperity for the country the, for this study, most interesting problem is the workings and possible tensions in between these companies (SCB, 2013; Bokföringsnämnden, 2004).

## 5 The empirical description of the companies situation

### 5.1 Business models and accounting interests

The governmental intentions for change in the accounting framework were mostly to minimize administrative costs and streamline national accounting. The pressure to change was brought by the adaptation of IFRS and the growing connection to the global economy but also by the perceived notion that the former regulations was too complicated for SMEs and thus needed the change.

*“The main governmental intention was to simplify accounting and lower the administrative cost for the small companies...” (P2)*

The BFN chose to divide companies by mere size when deciding if the company should abide under rules or principles but there are additional factors that decide what is best for the individual company.

As described earlier factors like size, ownership structure/economic agenda and external dependencies can decide what road the company will go when encountering an unfamiliar crossroad and what the respondents share confirms this theory.

### 5.1.1 Companies with low growth ambitions

The respondents of the really small companies in this study focus solely on cash flow and individual prosperity. The financial will of the owner dictate the need of the company but in this type of company the asset, the property, is only seen as a source of income and the company is merely a legal necessity. This is also true for the accounting and the preparation of financial documents.

*“I decide what the house needs and the financial statements are up to the accountants [...] what counts is that as much money as possible finds its way to my wallet at the end of the year. How that is resolved is of no consequence for me” (M2)*

There are seemingly no growth ambition showing in these companies and this is not necessarily related to the company size but rather to the ambitions and needs of the owners.

*“The PHC is what it is, members come and go but the house remains and we need to take care of it” (M7)*

Another interesting evidence of this stagnation comes when studying what the respondents intend for the companies to use a positive cash flow for. As stated earlier these companies are set up to provide financial stability for the owner based on the focal asset and not on the business opportunities this harbors.

*“We try to have reasonable pricing as not to scare away attractive buyers and still build capital [...] and that means we will not need to borrow or increase fees when the need for investment comes.” (M3)*

And with this apparent lack of desire for growth comes the minimalistic pressure from external dependencies.

*“Since I received the loan I have not had much contact with the bank. They send their bills and I pay them.”(M2)*

These companies seem to exist in a bubble were the protection, but also the dependence, come from a certified accountant that handles all, or most financial issues and the owner/manager usually trusts this person fully.

*“We can always call [the accounting firm] and get answers directly, they give us financial reports and we can also trust that they follow the law” (M1)*

This is also apparent in their lack of interest in what connected services they receive in their communication with their accountant.

*“[The accounting firm] have procured the auditing service and they handle our accounting, taxes and most of our financial governmental contacts. It is very handy” (M1)*

This indicates that the financial environment is left to experts and that the owner does not perceive governmental influences as troublesome. It also signals that they do not perceive their ignorance and total financial dependency as troublesome. This means that the entire economic and legal responsibility is left to a hired third party even though the owner, on paper, keeps the responsibility.

We can also notice what seems to be a power struggle or a power shift between the auditor and the accountant both on a national level but perhaps even more clearly in connection to small companies. The government has eased the requirement for company audits regarding the smallest companies and this, together with the simplification of the accounting frameworks where K1 and K2 is mostly rules based provides a basis for the accountant to take power and influence from the auditor due to the lessened need for advanced rulings.

*"[...] there are three persons that influence the accounting and that is the owner, the accountant and the auditor. Before (ed: K2/K3) the auditor had great power regarding accounting principles and the like [...] but now the power has shifted to me. The one who decides accounting principles for my customers now is me!" (P1)*

This notion gets verified by all the respondents involved in the smallest companies.

*"Nah, that is just an unnecessary cost [to hire an auditor], the ones that handles it [the accountant] now does the same things and keep a track of changes in laws and regulations" (M9)*

The smaller firms do not perceive the need for the highly qualified auditor when the entire accounting procedure is seen as a requirement from the government and not a tool for the company.

*"Accounting cost far outweighs the benefits of more information. Who is to read and benefit from more information in a single owner company?" (P2)*

When deciding between K2 and K3 all the MCNG's and both of the experts unified stated that their need for more financial information is nonexistent and that cost control is of essence.

*"I always suggest K2 if there isn't some great need for revaluation to adjust equity-balance. If there is I suggest K3, reevaluate and then move to K2. It is so much easier and cheaper." (P1)*

K2 is a standardized product that let accounting firms scale down their efforts and thus reduce the cost in line with the governmental intentions.

*"The house is a good source of income but I always need to manage costs [...] I know I should be more interested in the accounting but I can't be bothered when the accountant is so cheap" (M9)*

And the accountants in the study summed up when discussing the different values of the accounting frameworks and what decide the choice.

*"Accounting cost far outweighs the benefits of more information. Who is to read and benefit from more information in a single owner company?" (P1)*

The choice between K2 and K3 was uncomplicated in most companies and the main decision parameter was cost and the decision was usually made solely on recommendation of the accountant.

*"I had a meeting with my auditor [i.e. accountant] and he said it would not matter much to me but that K2 is easier and lowers the workload and thus gets cheaper..." (M10)*



And where there was lingering question marks cost was still the focal point. Two PHC stated that their accountant had suggested a change to K3 due to some unexplained heightened need for fair representation but they were very skeptical regarding this and said they were sure this was some concoction from some auditor trying to make more money.

*“It [K3] does give a more accurate picture of the finances but the question remains; who will benefit from that? ... I reckon they only suggest this change to be able to bill more” (M3)*

So to sum up the MCNGs we see that most are very small but there are a couple of PHC that sports balance sheets far larger than both SMG’s in the study why other factors may be crucial when deciding which accounting regime is best suited for these companies. Collectively across the board they lacked desire to grow the company in terms of more assets under management. They still wanted a sound economy with, if possible, growing returns but the asset base were seen as more or less fixed. Last but not least the respondents exhibited an almost fundamental lack of interest for the company’s economic environment and they did not perceive any threats or dependencies save their accountant, but this dependency they did not fear.

### **5.1.2 Companies with ambition to grow**

In this study I interviewed three companies where the owners showed clear intentions to grow their business and not only their bottom line and cash flow. Two of the companies were unlisted groups and one was a listed group but in common there was the fundamental interest in business as a starting point for engaging in real estate rather than the odd opportunity to buy a house. These companies were built by entrepreneurs with well defines agendas.

*“We are a real estate company that acquires, manages and develops properties in peri-urban areas” (M4)*

Their focal interests when talking about their choice in accounting framework were cost and industry acceptance. Both the experts and the company respondents noticed the strong institutionalization regarding how things are done in the real estate industry.

*“Nowadays most properties are packaged in separate companies and looking at the difference between K2 and K3 I can’t see many reasons to choose K3 in these companies.” (P1)*

*“K2 is a very standardized product ... why it is easy and relatively cheap to purchase this service externally” (M5)*

But there is one significant difference in the decision making process between the listed company and the unlisted ones and that seem to be the ownership structure and thus the legal requirements and needs. The listed company was structured with a parent company and all the properties were placed in separate companies as daughters in the company structure. This resulted in the need for group accounting and to be able to meet the different stakeholder needs they used K3 as the framework in the parent company and in the daughters they used K2.

The unlisted groups did not use that structure but instead the different owners owned an equal stake in all the different companies thus simplifying the requirements. This need for K3 in the parent company presented in the listed company comes from the listing more than the size and structure of the group and the external dependencies is a key factor, given that we include owners that lack management insight in these external dependencies. These external pressures have a larger impact in the accounting choices of the listed company compared with the others.

*“If they compare us to a company that reports under IFRS then the other company looks better and that skewness is complicated to handle.” (M5)*

And the different stakeholder demands sometimes clashes with the limited possibilities that K3 harbors.

*“When they [the banks] work the numbers through their standardized credit template we receive a lower scoring than if we would report under IFRS” (M4)*

The sizes of the companies are only brought up in relation to growth prospects like access to capital or comparative figures.

*“We are glad it is still allowed for us to package our properties in single units because it makes transactions easier and cheaper but to not be a group in that sense sometimes makes it harder to get financing for new projects” (M8)*

It is clear that these companies are dependent of their environment and that their management teams sometimes feel that their accounting framework does not support their aspirations.

### **5.1.3 Different motivations for accounting**

We can also see clear differences in reasoning regarding accounting and what values the accounting and the annual report brings. In the unlisted companies accounting is an external pressure where governmental interests are predominant.

*“I have no use for the annual reports other than when I need financing but even then they are fairly pointless because the banks do their own calculations on the business opportunity.” (M6)*

The auditor is seen as an enemy or governmental control function and the need for accounting is unclear.

*“One of the positives with real estate packaging is that I don’t need to hire an auditor.” (M6)*

And on the opposite side of the scale is the listed company that has a great need to appear in a good light compared to competitors and the financing community.

*“eventually we will need to change accounting framework to be able to compete on equal terms as our larger competitors ... neither the smaller owners, the banks or the media seems to be able to interpret our numbers and extrapolate the meaning of different accounting frameworks” (M4)*

There are also differences in what stakeholder is seen as the most important one. In the MCNGs the accountant was the primary external financial stakeholder with power to influence the financial conditions of the company.

In the unlisted companies there is a wider network of external stakeholders and they feel dependent on a larger group of external forces.

*“I spend most of the time networking, building relationships and doing business” (M6)*

But even if there are more external dependencies it is still a fairly concentrated group that essentially consists of a consortium of banks, the tax authorities and the accountant apart from the more general contractors and real estate related consultants where in the economic environment of the listed company there are a large number of stakeholders and forces surrounding the company as stated above.

The need to manage media, governmental changes, shareholder expectations, competitors, creditors, tenants and a wide variety of other financial risks is part of the day to day life of this company. This also transforms the relationship with accounting where they see the finalized product of the accountants as a tool to help in the struggle to grow their share of the market.

#### 5.1.4 Is K3 useful?

Last but not least there seems to be some kind of tension in the K3 framework. The framework include tools to get a fair representation of the finances but according to both the preparers and the users the way the framework regulates, for example revaluation the framework as of today is almost useless in this aspect.

*“No we do not [do revaluations]... Revaluation inflates the balance sheet and does not influence the income statement but the subsequent higher depreciation does” (M5)*

The framework as part of an extended effort to simplify and be of greater use to the users may have missed its mark due to a heightened workload in some aspects, such as the depreciation of components, and a lack in usefulness in the case of revaluation.

*“The main purpose [with K2/K3] was to lower the administrative costs for small businesses and K2 does just that but K3 does not. “ (P1)*

The listed company even goes as far as to state that their forced future is to one day change accounting framework to IFRS to be able to compete on equal terms. K3 is complicated and not very cost efficient and the comparability is lacking why the extended effort make the step to full IFRS integration seem shorter.

*“It has become more complicated to account ... the depreciations is the key problem I would say ... and the only way to end up with total faithful representation is to use IFRS” (M4)*

## 6 Reflective analysis connecting decisive factors and theory

### 6.1 Growth ambition as explanation for progression

The academic discussion has found that principles based accounting is the best practice that will offer the most accurate financial statements possible (Agoglia, et al., 2011; Carmona & Trombetta, 2008) but the Swedish government has found that there are situations where rules are preferred over principles (Eriksson, 2009). The BFN on behalf of the government concluded that the crucial factor to decide when rules based accounting should be preferred is company size. This study suggests that the Swedish government was right to assume that there are times when rules trump principles. However, this study also suggests that there are other factors besides from size that should be taken into account when judging the adequacy of accounting standards.

As shown above small companies need structure and persuasion to adequately handle their economic accounting. It have also been shown that the Swedish standard setters assume that with increasing company size follows an increased desire to connect to the financial market, and with this will follow the need for principles based accounting (Bokföringsnämnden, 2004; Eriksson, 2009; Fekete, 2010). My findings offer a slightly different perspective.

As shown above, companies controlled by entrepreneurs that value personal income maximization rather than maximizing growth and future prosperity in the business still see accounting as a governmental instrument of control to gather taxes and the financial statements are seldom of use to the company, regardless of company size. Conversely we see that companies with growth ambition and the ambition to expand their business, regardless of company size, will be highly interested in the financial statements and see accounting as an important tool in achieving their goals. This tells us that there are other factors than size to take into consideration when defining company needs or that categorization by company size could benefit from a redefinition of the factor size. Size measured as balance sheet expansion or contraction may be too limited and that other measures combined with other factors might well be more useful in predicting what accounting policy is best for the company.

To companies with some amount of external dependencies the choice of accounting framework can be of great importance. Accounting can influence the contact with stakeholders, such as investors, why the accounting framework, and more precisely what cost structure the framework causes, will influence the company. Companies in this situation generally feel they would benefit from a principles based accounting framework and they have an intrinsic motivation to use accounting as a tool in their business; even so many of these companies choose K2 over K3 because of the limitations of the K3. They choose K2 for simplistic reasons and a clear cost benefit when, in fact, they would much benefit from a more principles based framework. The companies of this description that does adhere to the K3 framework express definite feelings of being constraint by the inadequacy of the framework.

Furthermore we see that the listed company is influenced by a large amount of stakeholders, not only the above mentioned investor. In this company we can see, even more clearly than for those companies with a lesser amount of external dependencies, a strong intrinsic motivation to use accounting in order to portray the company more positively; this company used K3 expressly for this reason. They compare themselves and get compared with competitors and changes in accounting practices comes as a result from both outside pressure from external dependencies and from internal motivation where the management see the apparent benefits of change.

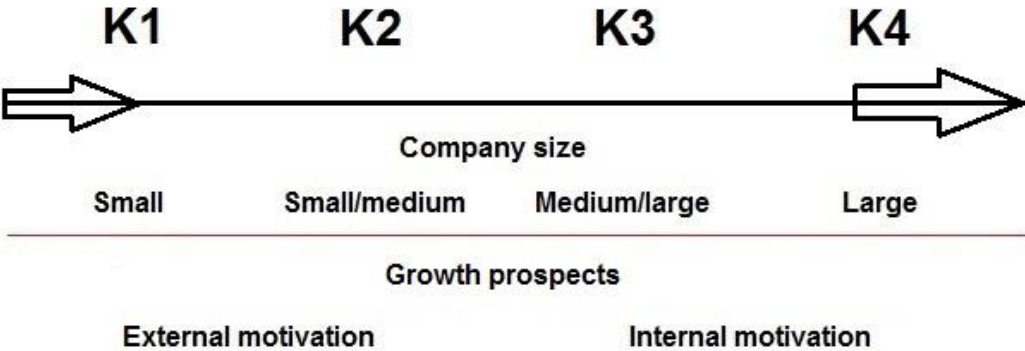


Figure 2

We can now complement figure 1 with the new motivational dimension that is given by the intrinsic growth ambitions described above and we can see that size in combination with economic ambition will make the company travel on the scale, as shown in figure 2. As shown above the ambition to grow strongly separates the different organizational interests in accounting information. Below, this additional contextualizing factor will be discussed in detail.

## 6.2 Isomorphism as explanation for progression

Figure 2 is based on the empirical material and suggests that on the left hand side of the scale companies' exhibit low degree of interest in the accounting procedure and the annual reports. On the left hand side the companies are generally smaller but, just as importantly, they also exhibit a lack of growth ambitions and we identify external rather than internal motivations for accounting.

The further to the left a company is positioned on the scale the greater will the need for external pressure become, seen from a governmental perspective, and the government will exercise force, i.e. coercive isomorphism, to ensure this kind of companies do what is expected of them in order to gather taxes and uphold the financial structure needed. When regarding the smallest companies this is true but we also see that larger companies will linger under a rules based framework like K2 not because there necessarily is a need for external pressure but rather that there is something lacking in between K2 and IFRS.

On the opposite side the companies show quite different characteristics and exhibits totally different needs and motivations. With the extended growth ambitions comes the internal motivation to enhance the accounting to be able to compete on a larger financial playing field. As the listed company representative argued; they would sooner or later feel obligated to change accounting framework in order to not stand out negatively. The larger competitors who use IFRS get better, easier and cheaper credits and the flow of capital and other recourses are larger and less sluggish than what the interviewed respondent of the companies that account under K3 is experiencing today. This motivation to shift towards a more principles based accounting framework comes from the economic agenda of the company and the ambitions of the managers and owners rather than being decided solely by the size of the company balance sheet or the size of the operations. This suggest intertwined mimetic and normative isomorphism where the financial community value principles based accounting and the cost for the company to not conform is measurable alongside the managements will to grow their company and compete on a larger arena which act as a mimetic pressure perceived as a necessity.

This study suggests that during the journey a growing company makes, it will procure different needs and these new conditions will expose the company to new internal as well as external pressures and dependencies. These external dependencies come in many different forms, for example the extended financing needs and the dependency of the banking community or extended media coverage, but in common they all seem to have that dependencies awaken an internal motivation with the management team to enhance the quality of the accounting. This suggests that a company that has a management or ownership constellation that have defined intentions of growth will most likely journey from accounting as an external pressure, where the governmental interests act as a coercive power, to realize internal motivational factors for accounting excellence that take the form of mimetic isomorphism.

As mentioned above companies where strong growth ambitions are present will develop internal motives for wanting to change their accounting procedures and in an aggregated perspective we can see that principles based accounting is the prevailing best practice why it is natural to assume that the management team will conform to a more principles based accounting framework if possible. This would suggest that mimetic isomorphism is at work when the managers realize their need to homogenize their business to better harmonize with the economic environment of their choice (DiMaggio & Powell, 1983; González, et al., 2009).

If we include the perceived isomorphistic pressure that emerged from the empirical evidence and combine this with the motivational drivers that could be derived with help of the decisive factors of size, growth ambitions and external dependencies we see that there are many different motives for accounting. We can now further complement figure 2 and add the additional dimension of isomorphistic pressure, as shown in figure 3. These different motives may be the key to create a functional accounting framework that supports the aspirations of every category of company.

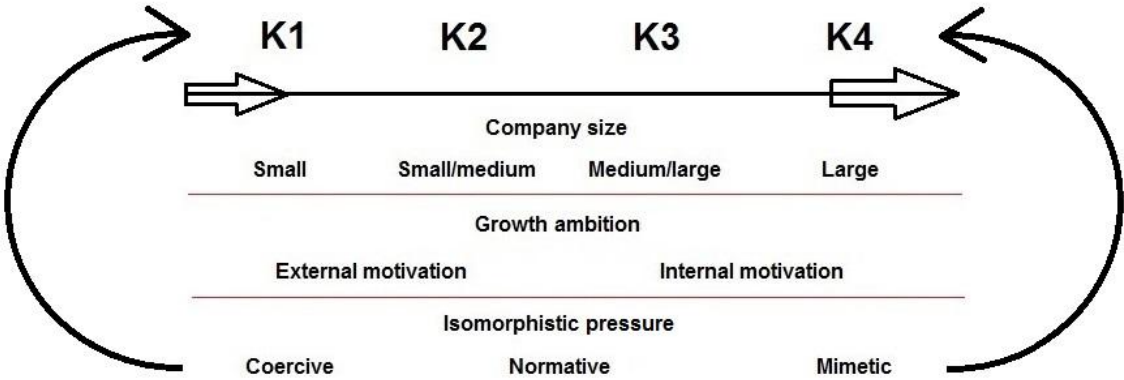


Figure 3

### 6.3 Tensions within the K-system

It would seem uncontroversial, based on the empirical evidence, to assume that K1 and K2 have met the set targets by being an easy to grasp, cost efficient accounting framework that provides the user with the necessary information. The more rules based accounting is needed in a situation where the preparer of financial statements are reluctant to see the need and where the accounting is tightly connected to the taxation. This reluctance was apparent in the empiric material and also the coercive isomorphism that the government is placing on these companies forcing them to subject to a practice they do not perceive as beneficial.

However, I have identified a tension within the K-system where companies that would benefit from a more principles based accounting framework lacks the alternative. The further to the right a company ventures on the scale above the greater will the need for principles based accounting become, and therein lies the difficulties. Somewhere in the middle of the journey the company will encounter situations where internal and external professional’s opinions start to affect the direction of the company. It can be when the company grows to the size where auditing gets more complex and the need for advanced rulings become a reality of day to day life or when new functions gets hired. This is when the normative isomorphism is seen and companies will start to conform into something that can fit the societal mold of economic competition.

The connection between accounting and taxation in Sweden, combined with the long tradition of prudence and faithful representation, has dictated the conditions for the more principles based accounting framework of K3 and this has resulted in inherent tensions in this framework. K3 increases the workload and accounting cost and the toothless possibility of revaluation will lessen the benefits of this framework. This will result in difficulties for companies that travel beyond a certain point on the scale, even for companies where the management team is set on the journey.

The tipping point for when a company would benefit from an accounting framework with principles that more coincide with IFRS is not fixed and it is probably different for every real estate company that will ever journey from left to right. However at some point the need for faithful representation will become predominant as a way to compete and collect benefits and that is when K3, with the limitations of revaluations and impairments, will become a stumbling block that may hinder the company's expansion. Because there is some distance between needing or wanting IFRS and having the recourses to prepare the financial statements accordingly. This distance may act as a lock-in effect for companies that see themselves as unable to take advantage of otherwise favorable conditions, and these companies would most certainly benefit from a few changes in the K3 framework and the support structure surrounding this framework.

This internal motivation for accounting change comes as a result of perceived competitive advantages present in the company's economic environment, which is the epitome of mimetic isomorphism that we clearly can witness in companies that have ventured further right on the scale. The above described difficulties inherent in K3 is evidence of a clash between the governmental need and their use of coercive isomorphism and the professionalism with the management team operating under pressure to perform but feel hindered when trying to move towards, what they perceive as best practice and their strains of mimetic interests.

As of now there is no aiding manual or established practice to facilitate uniformity and simplicity in the process of establishing component depreciation thus making each conversion costly and troublesome (Deloitte.com, u.d.). There is also skewness toward K2 as the only functional framework due to taxation aspects connected to the frameworks making the depreciation cost too demanding when sizing up the advantages.

## 6.4 Summary

If we combine everything we have established above we conclude that size is a simplification when dividing companies. Several aspects need to be taken into consideration in order to create the best framework possible to fit in between K2 and IFRS where K3 today is lacking.

This study shows that the smallest of companies need coercion and rules and the largest companies is better served using principles based accounting frameworks but the companies in between need nuances. These nuances are seen when applying other variables when defining which companies should be able to use which framework and when the standard setter revises the existing framework.

As shown in figure 3 the companies at the center of the scale, in the K2/K3 area, are not defined by their size but rather the internal growth ambitions present and external dependencies. Companies where the ownership structure and the management allows for the company to get subjected to financial markets will develop internal motivations to enhance accounting in order to satisfy other stakeholder categories compared to companies that lack these growth ambitions. Companies where



the ownership is centered and protectionist or where the growth is organic and supported by banks rather than external investors will not need the accounting superiority that is gained with principles based accounting and will stay under K2 for as long as possible.

The empirical material clearly supports that very small companies and companies where the internal motivations for growth are lacking see the accounting as a legal necessity that is costly and without benefits or with very little benefit for the company and the entire process is forced upon them by governmental agencies as a form of coercive isomorphism where the government unify the accounting in the subjected companies. The study also supports motivational transformation in certain companies where growth ambitions are present and, furthermore, the respondents suggests that their companies are hindered by the complexity of K3 in the same time as the benefits of revaluations are lacking why in reality they feel that there is no realistically good alternative for a company that is in the borderland between K2 and IFRS. The will to converge to principles based accounting is a part of the mimetic isomorphistic process that conform companies into similarities of sort when the management note a shortcoming in their situation and perceive some revered attribute in a competitor. There were also respondents suggesting that some accounting professionals, like large accounting firms and auditors take this opportunity to propose the complexity of K3 which may be a response to a power struggle or some wishes for extended income for these firms. The respondents collectively shy away from K3 as the best route why I suggest that these suggestions also can be a form of normative isomorphism where external consultants try to harmonize the processes of their clients in order to streamline their own business. This study offers a rather limited material to support this theory why further research will be necessary in order to support or reject this notion.

## **7 Discussion**

The academic discussion is relatively unified in the assumption that principles based rather than rules based accounting frameworks support the highest accounting quality and is preferable in most settings (Agoglia, et al., 2011; Schipper, 2003; Webster & Thornton, 2005). However, this academic discussion is usually restricted to an aggregated level were the object of discussion is the accounting practices of multinational companies or other behemoths of organizations. The Swedish government observed a need for simplified accounting in certain company categories. The Swedish standard setters noted a need to update the previous national accounting framework and, with an ambition to simplify accounting and lower the administrative costs, the K-project was initialized. During this project the standard setters perceived a need to divide companies into categories in order to accommodate different companies' specific needs regarding accounting flexibility (Bokföringsnämnden, 2004; Eriksson, 2009).

The need for simplification in combination with the preconceived notion in academia and practice that size is the fundamental factor that separates companies constituted that the Swedish standard setters chose to divide companies by size in the national setting (Bokföringsnämnden, 2004; Bokföringsnämnden, 2013; Watts & Zimmerman, 1978). Many researchers support the theory that size is a fundamental factor when dictating accounting terms for companies and they argue that larger companies have the support and the resources to handle principles based accounting and that smaller companies need controlling institutions and a more rules based accounting framework in order to function (Watts & Zimmerman, 1978; Drefeldt, 2015; Eriksson, 2009). The study at hand

confirms that simple accounting is important for the smallest companies where we see a lack of growth ambitions and that some larger companies benefit from principles based accounting. We also see that the coercive isomorphistic pressure the government uses to conform accounting in the smallest companies is necessary based on the empiric evidence and the respondents apparent lack of accounting interest; but this approach of coercion can also be beneficial for the economic environment on a national level and not just as a tool to handle a group of companies but to gain other synergetic benefits which Albu et al. (2009) conclude in their study of Romania and the shift in the accounting profession and the subsequent elevated level of knowledge in the profession that was the result of coercive isomorphism when Romania entered the European union.

Regarding the notion of size, I contribute by refining the definition of size since my empiric material suggest that financial volumes are subordinated ambitions and future prospects as defining aspect in a company's accounting decision process. Some researchers see beyond size and find that other factors may be significant when studying what motivates companies when making accounting choices and how different accounting settings could help different companies to thrive. They find that a company with a limited ownership structure with low growth ambitions may focus the company toward a narrow goal of financial targets (Fekete, 2010; Tarca, 2004; Meek, et al., 1995; Shapiro & Varian, 1999). Others find that external dependencies are important factors in the company environment and that the ambitions of the management will define the level of dependency. A connection to financial markets with investors, competitors and financial media in focus will change the motivational drivers of the management team (DiMaggio & Powell, 1983; Koot, 1983; Kotter, 1979).

This study complements this discussion when finding that in the observed companies growth ambitions where the predominate factor to dictate the accounting needs for the managers rather than the size of the company. I found that companies that make an isomorphistic journey from being coerced to account according to regulation towards a higher form of accounting needs will encounter situations where new influences will help transform the company and shift the focus of the management. This first step could be seen as normative isomorphism where both changes in staff and connectedness to consultants will act as a catalyst that affects the path of the company into a more unified entity that compares well with its environment. During this transformation some companies, like the noted group in this study, will grow to where the contact with their economic environment gets intrusive and the management's competitive ambitions will demand another shift in the company towards mimicking the ways of the competitors, mimetic isomorphism. In companies where the growth ambition is high, as in the noted group, the management will discover benefits in bettering the accounting in order to compete on the financial market. Predefined internal motivations for growth will expose the company to new economic circumstances that transforms the earlier externally motivated accounting needs into internal motivations for accounting quality. I therefore conclude that external dependencies may enhance internal motivation for accounting and support DiMaggio & Powell (1983) in the theory that companies that is exposed to isomorphism will grow similarities to match other actors in their economic surrounding but I also conclude that since academia have stated that principles based accounting is the basis for fair and true financial statements, this kind of harmonization clustering and isomorphistic pressure could be beneficial.

The Swedish standard setters had to include the national connection between accounting and taxation when devising the new frameworks and there is always a risk that this demand will stand in conflict to the needs of the companies subjected to the regulations (Fekete, 2010). When creating the K-frameworks size was decided to be the major defining factor to devise companies and this study shows that there are no tensions regarding the accounting frameworks K1 or K4 as these frameworks, and the level of individual choice involved, are well suited to the companies to which they apply. The tensions appear at the center of the scale where the government tried to form a middle ground between the rules based frameworks of K1 and K2 and the IFRS/K4.

The base for IFRS is fair representation (IFRS Foundation, 2013; Deloitte, 2016) and the base for the Swedish frameworks is prudence (Pramhäll, et al., 2014). In K3 the government has tried to merge the principles of fair representation with prudence policies and by doing this incorporated several limitations. The barriers this has created made the framework unsuitable for the companies in this study. IFRS demands revaluations and component depreciations and K3, even though it demands component depreciation which alters the cost structure of the company, does allow for revaluation of assets but in a way that does not benefit the companies. Most companies subjected to the choice of K2 and K3 will chose K2 due to cost and administration benefits. This handling will lower the governmental costs as well as company costs but still may not be a preferred outcome (Hellman, et al., 2011). My study suggests that companies might benefit from a framework like K3 if the revaluation principles are changed but still voluntary or if there were elements of lenience in the component depreciation part.

The Swedish standard setters' perception, that there was a need to nuance the debate regarding rules versus principles based accounting and the suggestion that rules based accounting frameworks are needed in certain situations, is supported in full by my findings. These findings doesn't necessarily contradict the existing literature but rather supply a new dimension in saying that if one unfold the ever present notion of size as the only categorization tool available and include other factors we find that even though many small companies will benefit from the control and simplicity that rules based accounting provides companies where growth ambitions are present might well be hindered in their growth if forced to conform to a rules based accounting. These companies will strive to make use of principles based accounting frameworks if available, independent of their size.

It may also be prudent to reflect upon the notion that rules based accounting may hamper professional judgment, as the inverse of Shippers statement (Schipper, 2003). With the introduction of the rules based frameworks of K1 and K2 rules based accounting got a firmer foothold on the Swedish accounting scene. Furthermore the Swedish government has removed the earlier requirement of auditing of micro companies. However, even though the group to which these changes apply in quantity is large the economical impact, on a national scale, is humble. The fact that the larger organizations are still subjected to principles based accounting (IFRS Foundation, 2013) and the fact that both these organizations and Sweden as a whole are influenced by international developments will insure that there is still a need for a cultivation of the accounting and auditing profession.

## **8 Conclusion**

### **8.1 Identifying the findings**

The purpose of this study was to investigate and unfold the criterion of size as the underlining assumption of categorization in existing standard setting and financial research. I have identified factors to help diversify the division of companies when determining whether they would benefit from a rules based or principles based accounting framework.

#### **8.1.1 Key factors that define a company**

I concur that principles based accounting will secure greater quality in the production of financial statements, deterring fraud and encourage professional judgment (Agoglia, et al., 2011; Webster & Thornton, 2005; Schipper, 2003), but I find that there is a large number of companies that will struggle to comply with these kinds of regulations. The societal benefits of faithfully represented financial documents on all levels of the economic system have to be weighed against the cost of administration and the risk of crippling the roots of the national economic machinery (i.e. the smallest of our companies). This is where the Swedish government chose the K-project, dividing companies by size and appointing different categories of companies' different amount of individual choice. When studying the respondents' answers I draw the conclusion that the government, in part, has succeeded in its goal to simplify for the smallest companies and lower the administrative costs but that regarding the transition between rules and principles it falters. It is my opinion after completing this study that there are three factors that should be included when regarding companies need and capability to handle principles based accounting to further perfect the accounting frameworks and fine-tune the balance between rules versus principles.

I identify that size is indeed a factor as the smallest of companies have limited resources available which may reflect negatively on the possibilities to account by principles. However I also find that what growth ambitions that are defined for the company and what external dependencies and pressures the company experience will be much more telling when judging the prospect of the company complying with a principles based accounting framework. In summary one could say that I find that company size is a defining categorizing factor but is limited and questionably useful if the definition of size is limited to balance sheet aspects. The factor size would benefit from a wider definition. Companies where the management exhibit growth ambitions benefit from the use of principles based accounting why this factor would complement balance sheet size, as demonstrated by the findings of this study which show that the old definition of size is subordinate to growth ambitions in the long run.

#### **8.1.2 Isomorphistic pressure and motivational factors**

Part of the objective of this study was to investigate what motivates small- to medium sized companies when making accounting decisions in order to help explain why different companies handle the constrains of accounting differently.

This study supports the basic need for a governmental intrusion in the freedom of some companies and the exertion of power, i.e. coercive isomorphism, regarding the accounting in these entities. This need is evident in companies lacking internal motivation for accounting. For the sake of communal recourses and distribution economics the governmental need is superior the need of the company and in these cases I also conclude that rules based accounting can be beneficial.

It has also been possible, in this study, to distinguish that companies with growth ambitions usually journey from external motivation to internal motivation for wanting to improve accounting quality in the company. This internal motivation comes from increasing external dependencies and a perceived need to compete on equal terms why companies that exhibit these characteristics of growth ambitions and external dependencies would be better suited to handle principles based accounting than companies that does not harbor these qualities. These motivations will affect accounting choice but the motivations themselves are transformed due to isomorphistic pressure. Management conformity or consultant impact may act as normative isomorphism to motivate towards accounting choices that include more freedom of choice. Later the connection to financial markets, competitors and media will further the process of uniformity in the marketplace. The highest witnessed form of internal motivation for principles based accounting where found in the noted group and it was apparent that the management was influenced by the company surroundings and I draw the conclusion based on the above discussion that perceived competitive benefits of a different accounting framework signals the presence of mimetic isomorphism.

### **8.1.3 Improvement potential in the K-frameworks**

As stated earlier this study suggests that K2, and implicitly also K1, have made accounting easier and more accessible for companies with limited recourses and the administrative burden and the cost have lessened. These frameworks have also lowered the cost and administrative burden of controlling the companies on an aggregated level.

As a flaw the study reveal that K3 may not have simplified accounting in the desired extent. The studied companies either does not use the framework, even though they could benefit from the use of more principles based accounting, or they use the framework but feel constrained and contemplate an upgrade to a higher accounting framework as soon as their resources allow it.

This perceived deficiency regarding this accounting framework comes from the extended workload and cost included in setting up a component depreciation scheme and the fact that revaluations of properties will affect the balance sheet and not the income statement. This in turn is due to a national connectedness between accounting and taxation. To allow companies to utilize the economical benefits of lower tax due to higher rate of depreciation could offset the drawbacks of an extended workload when comprising component depreciation.

The same is suggested to be true regarding revaluations where the IFRS allow for revaluations to affect the income statement which give the fairest representation of the financial situation of the company (Deloitte.com, u.d.). To make this kind of revaluation a possibility, like under IFRS, but not a requirement would probably improve the framework making it more accessible to the potential users.

### **8.1.4 Future research**

This study noted a possible shift of power, a potential power struggle, between the accounting profession and the auditing profession. The skewness I touched upon in this study might have been brought about by the legislative change regarding auditing needs for small companies or possibly by some other factor like the reduced need for advanced rulings under K2. Whatever the reason this potential shift towards a national dependence on relatively low-skilled accountants compared to the highly educated auditors may result in compromised accounting quality or other potential

inefficiencies in companies that are under no obligation of auditing, making them more vulnerable and potentially disrupting a part of the Swedish economy why future research may be very valuable.

I further noted a possible tension in the auditing and accounting environment as some of the respondents perceived that their auditors and/or accountants were trying to persuade them into an unnecessary (from the respondents point of view) change of accounting framework from the simplistic and relatively cost efficient framework K2 to K3 were the auditing and/or accounting workload would be much increased which, of course, would result in increased costs. These suggestions may be rational or may be an attempt to use the deficiencies of the current accounting frameworks to protect against dwindling consultation income, enabled by the introduction of the rules based frameworks and the lessened requirement of auditing. This might be an interesting subject for future research.

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## Appendix

Chart 1 - Respondents

Respondent	Function in the company	Company representation	Company type	Other
M1	President of the board		1 BRF <sup>1)</sup>	Medium size, no employees
M2	Owner and CEO		1 AB <sup>2)</sup>	Small, single building
M3	President of the board		1 BRF <sup>1)</sup>	Medium size, no employees
M4	Large Owner and CEO		8 AB <sup>2)</sup>	Listed, medium size, 3 employees
M5	President of the board	same as above	AB <sup>2)</sup>	Listed, medium size, 3 employees
M6	Owner and CEO		6 AB <sup>2)</sup>	Medium size, no employees
M7	Member of the board		1 BRF <sup>1)</sup>	Medium size, no employees
M8	Large Owner and CEO		11 AB <sup>2)</sup>	Medium size, 6 employees
M9	Owner and CEO		1 AB <sup>2)</sup>	Small, single building
M10	Owner and CEO		1 AB <sup>2)</sup>	Small, two buildings
P1	Expert in Real estate SME			9 years as real estate accountant
P2	Expert in SME and accounting			26 years as SME accountant

- 1) Private housing cooperative, a special legal form of cooperative tenant ownership  
 2) To be compared with Limited Company

Picture 1:

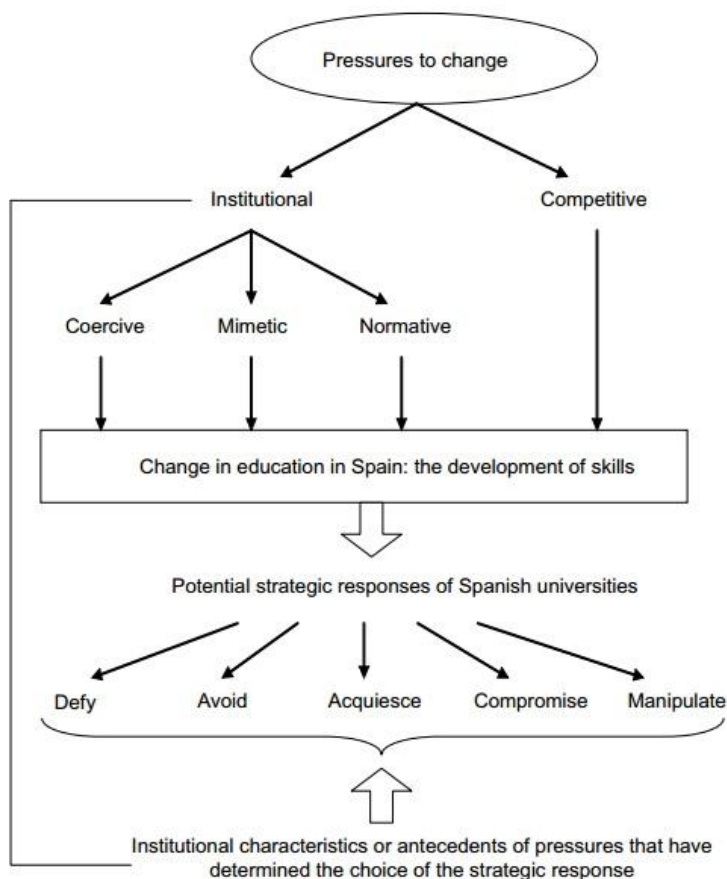


Figure 1

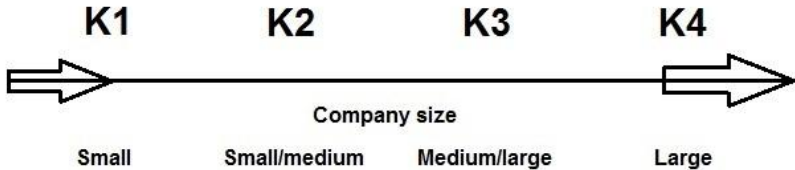


Figure 2

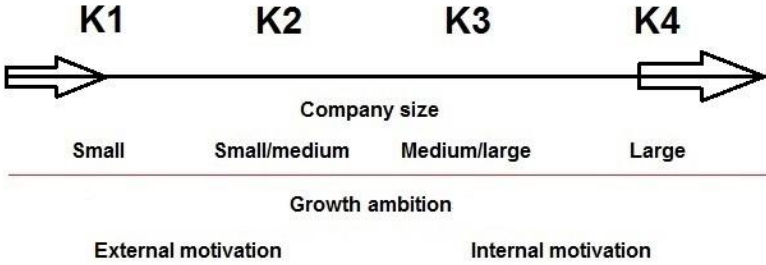


Figure 3

