Mandatory Adoption of IFRS: Its Effect on Accounting Quality, Information Environment and Cost of Equity Capital – The Case of Swedish Banks

Business Administration
Master’s Thesis
30 ECTS

Term: Spring 2011
Supervisor: Hans Lindkvist
Acknowledgement:

I would like to express my gratitude to several people who helped me out a lot in order to accomplish this research study. I would like to thank my supervisor Hans Lindkvist for his productive advice, support, supervision, and valuable & professional guidance. I am thankful to Berit Hjort, the librarian, for her valuable guidance in reference work.

My thanks also go to the interviewees Henrik Bonde, a Specialist IFRS Group Finance in Swedbank; Gunvor Hedström, Department of Finance SEB; and anonymous who helped me by giving answers of the research questions on time. Without their support it was almost impossible to do this research work.

My thanks also go to my all friends who motivated and encouraged me to accomplish this research on time and helped me out to read this paper thoroughly for the improvement of the research.

Furthermore, I would like to thank my parents from the bottom of my heart who gave me birth in this beautiful world thereby let me get this wonderful opportunity to do the research in the subject of my interest.

Last but not the least; I also would like to give thanks to my whole family members and my beloved one back in my home country for their prayers and motivational supports.

Thank you all.

Rekha Gautam
24 May 2011
Abstract

IFRS standards are getting acceptance day by day rapidly in all over the world. It is because IFRSs are the global and common language, which are more transparent and comparable for the investors and users residing in different nations. IFRSs are mandatory for all companies listed in capital market within EU from the beginning of 2005. As a member state of EU, Swedish banks also adopted mandatory IFRS from 1 January 2005. However, the banks were already implementing IFRS to some extent as most of the standards in SGAAP (Swedish Generally Accepted Accounting Principles) were already directly translated from IAS. After mandatory period, the banks adopted all new, updated and revised standards in accordance with EU recommendations. Nevertheless, there are little or no material effects of adoption of IFRS standards except some particular standards. Such particular standards are: IFRS3, IAS39, IAS27, EU Occupational Pension Directive, IAS32, and Deferred Acquisition Cost. And the main differences between IFRS and SGAAP are IAS1, IFRS3, financial assets, financial instruments, intangible assets, hedge accounting and tax driven. But, the Swedish GAAP no longer exists now for the companies listed in capital market as mandatory IFRS is into force.

Furthermore, I examined transparency & accounting quality, information environment, and cost of equity capital of four sample banks after mandatory IFRS adoption. But, I find the level of transparency and financial reporting quality has not been increased over the years. Regarding accounting quality, I also examined earning management, loss recognition, and value relevance. I find little evidence of less earning management, and find unclear evidence regarding loss recognition and value relevance. In other word, I find little evidence of increased accounting quality, although Sweden is a country with strong regulatory enforcements. Moreover, I also find little evidence of improved information environment but find information cost increased; although I find lower information risks after mandatory IFRS adoption. I, however, find lower cost of equity capital after mandatory IFRS adoption because for banks it will be easy to reach wider investors communities residing in different nations.

Nevertheless, the evident advantage of IFRS is that the capital market can use information based on common rules.

Key words: IFRS, EU, SGAAP, accounting quality, information asymmetry, cost of capital/cost of equity capital
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**Abbreviation**

EU – European Union

EC – European Commission

EEA – European Economic Area

IASB – International Accounting Standard Board

IASC – International Accounting Standard Committee

IFRS – International Financial Reporting Standard

IAS – International Accounting Standards

SFRB – Swedish Financial Reporting Board

GAAP – Generally Accepted Accounting Principle

SGAAP – Swedish Generally Accepted Accounting Principle

SEB – Skandinaviska Enskilda Banken

QCs – Qualitative Characteristics

UK – United Kingdom

RR – Redovisningsrådet

FAR – Föreningen Auktoriserade Revisorer

SFASC – Swedish Financial Accounting Standard Council

FSA – Financial Supervisory Authority

BFN – Bokförmärkningsnämnden

AAA – Annual Accounts Act

US – United States

SEK – Swedish Kronor

bn – billion

m - million

IFRS1 – First Time Adoption of IFRS
1. Introduction

In this chapter the background of the study within the subject will be described. Then the research questions, purpose, relevance and the limitations of the study will be presented. Finally, the structure of the thesis will be presented.

1.1. Background

Due to rapid globalisation and internationalisation of companies, some accounting professionals and participants realized the need of one set of accounting standard all over the world (Roberts et al. 2002) as financial reporting practices vary from one nation to another (Bebbington and Song 2003). Therefore the IASB, accounting standards setting body of accounting professionals and other participants, brought a new concept of single set of accounting standard called IFRS which also include old and revised IAS. The European Commission (EC) also realized the need of introduction of this new accounting standard that meet the need of investors and to be compatible with global developments (ibid). A major breakthrough came in 2002 when EU legislated for the mandatory adoption of IFRS from the beginning of 2005 for all EU Companies whose securities are traded in the regulated market within the European Union (Commissions of the European Committees 2002). However, this mandatory rule was temporarily exempted for those companies that were listed in both EU and non-EU market and the companies who have only publically traded debt securities until 2007 (European Parliament 2002). But, this exemption period is already over and thereby it is essential to implement IFRS by all listed companies whether they are equity or debt based.

As a member state of EU, Swedish companies listed in the regulated market were also not far from the mandatory adoption of IFRS since the beginning of 2005 (KPMG 2005). From this point onward, in order to bring accounting harmonisation, all listed companies started to prepare their consolidated financial statements according to the requirements of IFRS (ibid). However, IFRS is mandatory only to the companies’ consolidated financial statement (EC 2008). The annual accounts should be prepared in accordance with the recommendations of Swedish Financial Reporting Board (SFRB) (Estandardsforum 2010).

In recent years the IFRS standards are gaining acceptance worldwide rapidly as it is believed that IFRS ensures higher accounting quality through greater level of transparency and comparability, which ultimately reduces the information asymmetry and thereby cost of capital. However, the past literatures also suggest
that if a country once adopts greater disclosures (IFRS), it would not certainly produce higher financial reporting quality, would not improve information environment and would not reduce cost of capital. This is because these factors (reporting quality, information environment and cost of equity) are highly associated with a country’s institutional factors and management incentives (e.g. Ball et al. 2006, Jeanjean and Stolowy 2008). Therefore, this paper analysed the effects of mandatory IFRS adoption on accounting quality, information environment, and cost of equity capital; but only within the banking sector in Sweden.

1.2. Research Questions

The major research questions of this research paper are:

1. Does IFRS ensure a high level of transparency and accounting quality?
2. How does financial reporting quality affect information asymmetry?
3. Does IFRS adoption reduce cost of capital?

This research report mainly will focus to provide answers in these research areas.

1.3. Purpose of the Study

The main purpose of this research paper is finding out the answers of above mentioned research questions in relation to local GAAP. Beside this, this paper tries to analyse prior research papers on adoption of IFRS and its impact on accounting quality, information environment and cost of equity capital in order to examine current empirical findings. Moreover, this paper also tries to fill the gap of previous research papers.

1.4. Relevance of the Study

Since IFRS are new accounting standards and are getting acceptance all over the world, as an accounting student it is important to have in-depth knowledge about the implication of IFRS. I urge that this study will not only broaden my knowledge but also will be helpful for all accounting students and for the people who are interested to have knowledge regarding new accounting standards (IFRS). Furthermore, I believe that this study will also be helpful for the investors, stakeholders and future researchers.

1.5. Limitations of the study

This research paper is limited only in four banks within Swedish banking sector, listed in NASDAQ OMX Stockholm Stock Exchange due to time and cost
limitations. Apart from this, mathematical tools have not been used to prove the result as this paper has not applied quantitative research method. Thus, this research is only based on the past literature, financial statements of sample banks, and the answers provided by respondents according to the interview guide presented in Appendix.

Moreover, language is the major barrier to understand Swedish Accounting Environment as most of the books and literatures are only available in Swedish language.

1.6. Structure of the Study:

This paper consists of 6 parts, the below figure describe each part briefly.

![Figure 1: Structure of the thesis.](image-url)
2. Research Methodology

This chapter comprises the methods that have been used while collecting data in order to accomplish this research paper. The chapter also provides the reason behind the selection of methods. In this chapter I will discuss research philosophy, approach, design, strategy, data collection method, sampling, reliability and validity, and ethical consideration of the research.

2.1. Research Philosophy

The term research philosophy relates to the development of knowledge and the nature of that knowledge (Saunders et al. 2009). In other word, it concerns with the development of knowledge in a particular field. However, the development of knowledge may not be as dramatic as a new theory of human motivation; but it is the modest ambition of answering the question of a specific problem (ibid). There are two types of research philosophy: ontology and epistemology (Bryman and Bell 2007; Saunders et al. 2009).

Ontology concerns with nature or reality (Bryman and Bell 2007, Saunders et al. 2009). It describes our opinion in a real way. Ontology philosophy can be divided into two aspects: objectivism and subjectivism (Saunders et al. 2009). Objectivism is a normative emphasis which insists that the social phenomena and their meanings exist in reality external, i.e. independent, to social actors (Bryman and Bell 2007; Saunders et al. 2009). On the other hand subjectivism, often referred as constructionism, asserts that the social phenomena and their meanings are created from the perceptions and consequent actions of social actors (Saunders et al. 2009).

Epistemology concerns with acceptable knowledge in the field of study (Saunders et al. 2009). It refers to the ways of acquiring knowledge (Bryman and Bell 2007). Epistemology philosophy further can be divided into two aspects: positivism, and interpretivism (Saunders et al. 2009). According to Saunders et al. (2009) positivism relates with philosophical stance of the natural scientist. And interpretivism is an epistemology that reinforces researcher to understand the difference between humans in our role as social actors (Saunders et al. 2009).

This research paper implies constructionism of ontology and interpretivism of epistemology philosophy. This is because I am going to investigate whether the adoption of IFRS improves accounting quality, information environment, and cost of equity capital of the organizations and how the adopters perceived IFRS. In other
words, this study is based on the interpretation of the action of IFRS adopters from their point of views, which according to Bryman and Bell (2007) is the interpretivism research philosophy. The constructionism of ontology position will guide to accomplish conclusive result in accordance with analysis, where the respondents’ (social actors) views, perceptions and their actions in reality are the main considering factors.

2.2. Research Approach

There are two main research approaches: deduction and induction (Saunders et al. 2009). According to Bryman and Bell (2007) “deductive theory represents the commonest view of the nature of the relationship between theory and research”. In other word, deduction approach concerns with testing of theories through developing hypotheses (Saunders et al. 2009). The researchers at first develop theory and then test it with empirical observation by using hypotheses in order to derive outcome (Bryman and Bell 2007). However, it also controls to allow the testing of hypotheses. Moreover deduction explains about casual relationship of the variables (Saunders et al. 2009). As described by Saunders et al. (2009) deductive approach is related to positivism of epistemology philosophy.

On the other hand, inductive approach consists of collection of data in order to develop theory through the analysis of those data (Saunders et al. 2009). In other word, theory is developed through the observation of empirical reality (Bryman and Bell 2007). Contrary to deductive approach, inductive approach is related to interpretivism of epistemology philosophy (Saunders et al. 2009).

More clearly, deduction entails a process of (Bryman and Bell 2007):

\[
\text{theory} \rightarrow \text{observations/findings}
\]

The reverse is the process of induction

\[
\text{observations/findings} \rightarrow \text{theory}
\]

The above process clearly reflects that in deduction theory guides research. Opposite to deduction, in inductive approach the outcome of the research (Bryman and Bell 2007). According to Ghauri et al. (1995) induction is based on empirical findings and deduction is based on logic. Both deduction and induction approaches entail an element of each other. But, the induction approach represents an alternative strategy for linking theory and data, though it contains an element of deduction approach (Bryman and Bell 2007).
However, this research paper is the combination of both approaches. This is because in this paper at first theoretical framework has been constructed with the help of books and past literature on adoption of IFRS, its impact on accounting quality, information asymmetry, and cost of equity capital, Swedish accounting environment and other relevant theories. Then, on the basis of theoretical framework interview guide has been prepared and other relevant sources have also been used in order to construct empirical findings. Thereafter, empirical findings have been tested against theoretical framework rather than testing theories with empirical findings. This examination leads to the conclusion whether the findings are in line with theories or not. If the findings are not in line with theory, the paper will develop new theory. In one word, in this paper theory guides research and research will be analysed against theory in order to develop new theory. More clearly:

Theory → observation/findings → theory

2.3. Research Design

Research design is the general plan of how we do to answer the research questions (Saunders et al. 2009). According to Bryman and Bell (2007:40) “A research design provides a framework for the collection and analysis of data. A choice of research design reflects decisions about the priority being given to a range of dimensions of the research process”. In general, there are five types of research designs: experimental, cross-sectional, longitudinal, case study, and comparative design (Bryman and Bell 2007).

This research study applies case study research design. This is because case study is a “strategy for doing research which involves an empirical investigation of a particular contemporary phenomenon within its real life context using multiple source of evidence” (Robson 2002: 178 in Saunders et al. 2007). This research paper investigates four organizations within the banking sector. The reason behind this choice is that case study needs to use multiple sources of data (Saunders et al. 2007). For this regard, I have used relevant information from the companies’ websites, annual reports, and have performed semi-structure interview in order to collect required date (ibid).

However, this research paper is based on multiple case studies. According to Saunders et al. (2007) if the author examines the evidence from more than one company, it will be known as multiple case studies. Moreover, multiple case studies are more preferable than a single case study (Yin 2003 in Saunders et al. 2007).
2.4. Research Strategy

According to Bryman and Bell (2007) there are mainly two types of research methods, which researchers generally imply in their studies: Qualitative and Quantitative. According to Kent (2007) “Quantitative research is focused primarily on the construction of quantitative data, and quantitative data is a systematic record that consists of numbers constructed by researcher utilizing the process of measurement and imposing structure”. Bryman and Bell (2007) emphasize quantitative research as the collection of numerical data which is measurable and also shows a view of relationship between theory and research as deductive.

On the other hand qualitative research concerns with words rather than number, which is non-measurable (Bryman and Bell 2007). According to Bryman and Bell (2007) qualitative research method is an inductive view of the relationship between theory and research. It concerns with generation of theories instead of testing (Saunders et al. 2009). The analysis of the data will be conducted through the conceptualisation instead of conducting through the use of diagram and statistics.

This research paper is based on qualitative research methods. According to Bryman and Bell (2007) there are several ways of conducting qualitative research methods; for example: observation, interview, focus groups, language-based approach, and the collection and analysis of text and documents (ibid). Each method differs from another. Researcher can use any of the mentioned method or can combine those (ibid). Therefore, this research paper employed mixed approaches of interview and the collection & analysis of text and documents in order to get findings about the effects of IFRS on banks’ consolidated financial statements, its effect on accounting quality, information environment and cost of equity capital.

2.5. Data Collection

Data collection is the way of collecting relevant information from different sources to answer the outlined research questions (Ghauri and Grønhaug 2005). According to Ghauri and Gronhaug (2005) there are two different ways of data collection: secondary and primary data collection. Both data are very useful while writing thesis (Wiedersheim-Paul and Eriksson 2001).

Secondary data are the information which are already collected by researchers to fulfil their own purpose of study. However, the secondary data are very useful to us in order to solve, understand and explain our research problem in best possible way. The major sources of secondary data are: books, journals, article, and web-based information (ibid). Although it is easy to find a large amount of secondary data,
researcher needs to be careful of the fact that the data originally were used for another purpose and could be less important for current study (Wiedersheim-Paul and Eriksson 2001). Apart from this, the researcher also has to think about the reliability and validity of the sources that he/she is going to use (ibid).

Contrary to secondary data, primary data are the original data collected by us to solve the research problem. Primary data can be collected through observation, experiment, social survey, and interview (ibid). The method of investigation or collection of data needs to be designed according to the environment on which the researcher is going to use it (Wiedersheim-Paul and Eriksson 2001). If the research is going to use questionnaire, he/she has to be carefully prepared in terms of questions and layout. Moreover, reliability and validity should be the major concerns while collecting primary data (ibid).

In this research paper, I began with the collection of secondary data in order to construct theoretical framework. University database (Emerald, Business Source Premier, Science Direct), library catalogue, e-brary, Google search engine, SSRN, and relevant but reliable web-pages (e.g. IASB, IAS Plus, Deloitte, and related website) are the major sources of collection of journals, articles, books, and other information in related subject matters. Among the secondary data sources, Karlstad University library database is the most utilized source of this study. Thereafter, I have collected and analysed other texts and documents such as banks’ website, annual reports and other publications in order to pick some important information about adoption of IFRS and its impact.

In order to collect primary data, I have used interview approach of qualitative research method. Interview in qualitative research method includes: semi-structured interview and unstructured or in-depth interview (ibid). According to Saunders et al. (2009) both interviews are non-standardized. However, this paper employed semi-structured interview. This is because semi-structure interview provides an opportunity to develop a list of questionnaire on a specific topic known as interview guide (Bryman and Bell 2007). Moreover, researcher also can provide interview guide upon request, which can assist to fortify the dependability of the research (ibid).

In order to make interview flexible I have used open questions so that interviewees can express their views without any hesitations. However, in semi-structured interviews, the order in which the questions have been asked may vary but the preference has been to keep track of the questions in the same order as in the interview guide (Bryman and Bell 2007).
Semi-structure interview can be performed in several ways; for instance face-to-face interview, telephone interview, and email (Bryman and Bell 2007, Saunders et al. 2009). But I found email interview as the most appropriate method of collection of data. Although in face-to-face interview it is easy to understand body language and unease of face of the respondents, email interview is cost effective and is less time consuming (Bryman and Bell 2007).

The interview guide is attached in Appendix, which was sent to the respondents via email. The interview guide consists of two parts: first part is about the background and profiles of the respondents, whilst second part concerns with the set of questions related to research questions.

The below figure represents how both secondary and primary data are significant to this research paper:
2.5.1. Sampling

This research paper is based on the four largest banks of Sweden: Nordea Bank AB (publ.), Swedbank AB (publ.), Svenska Handelsbanken AB (publ.) and Skandinaviska Enskilda Banken AB (publ) (SEB). I choose to accomplish this paper only in these four banks because they are playing dominant role in the country’s financial sector. I also believe that it is important to know the impact of adoption of IFRS on accounting quality, information environment and cost of equity capital. I, therefore, focused on the Swedish market because I haven’t found any research that has been done in this topic, especially not in the specific topic like banking sector.

Although I choose four dominant banks within Sweden as sample banks, I was able to get responses only from three banks: Svenska Handelsbanken, Swedbank, and SEB. I sent reminder emails to Nordea, but I didn’t get any response on time. Therefore, I am unable to analyse this paper with the help of primary data in terms of Nordea Bank AB (publ.). However, in terms of Handelsbanken and Swedbank they are quite cooperative and I got very prompt response, but I got response from SEB only five days prior to the deadline.

2.6. Reliability and Validity of Research

The term reliability is primarily concerned with the issues of consistency and stability of measures. Although in qualitative research the term measurement is not appropriate, reliability is the fundamental criteria that evaluate the quality of the research (Bryman and Bell 2007). According to Miles and Huberman (1994:278) “a reliable study is consistent, reasonably stable over time and across researcher and methods”. The reliability of the research can be seen from external and internal perspective (LeCompte and Goetz 1982). According to Lecompe and Goetz (1982) external reliability is the degree to which a study can be replicated. However, it is difficult to meet this criterion in qualitative research. In internal reliability what the members of the research team see and hear can be considered as reliable (Bryman and Bell 2007). This research paper examines the impact of IFRS in accounting quality, information asymmetry and cost of equity, which are on the basis of the financial statements of sample banks and the experience faced by the finance department of related banks. However, this research study cannot be consistent and reliable over and across the time because of personal opinions provided by the respondents.

Validity urge about the accuracy of the study. It observes whether a researcher measure the things that he/she was supposed to measure or not (Colosi 1997). Like
reliability, validity also can be seen from both internal and external perspective (LeCompte and Goetz 1982). Internal validity concerns with the relation between empirical findings and theoretical framework developed by researchers (Bryman and Bell 2007). According to LeCompte and Goetz (1982) internal validity tends to be a strong point of qualitative research as it insists researchers to make sure about a high degree of congruence between concepts and observations. External validity, on the other hand, describes the degree of generalisation of the findings (Bryman and Bell 2007). External validity represents a problem for qualitative researchers because of its nature of small sample size or case study (LeCompte and Goetz 1982). Although the sample banks chosen for this study are the dominant banks in Sweden, the result that will come from this study could not be the same for another bank. In other word, findings cannot be generalized in terms of another bank residing in Sweden because of respondents’ personal opinions. Therefore, this study does not ensure a higher level of validity in terms of generalization.

2.7. Ethical Consideration

Generally ethics are defined as codes and conducts which every researcher should follow while conducting research (Bryman & Ball 2007). Ethics are associated with norms, values and corporate social responsibilities (ibid) thus are critical aspects for the success of any research work (Saunders et al. 2009). Since I am going to use qualitative research through the collection of primary and secondary data, it is crucial not to break ethical rules and regulations. According to Bryman and Bell (2007) ethical issues cannot be ignored since they relate directly to the integrity of the research. Therefore, the literatures that I have used in this research paper, for instance books; journals; articles; and other sources, are cited and referenced properly in order to avoid plagiarism. According to Diener and Granall there are four main unethical factors, harm to participants; lack of informed consent; invasion of privacy; and deception, that should be avoided while conducting the research work (in Bryman and Bell 2007). Thus, in this research paper I have put my best efforts to avoid these factors. For this regard, emails with questionnaire to the interviewees have been sent very politely and have given sufficient time to answer the questions. Furthermore, as described by Bryman and Bell (2007) in business research it is important that researchers are conscious of the ethical issues and concerns so that they can make knowledgeable decision. Thereby, this paper concerned about the confidentially of interviewees and as per the interviewee’s permissions their identity might be kept anonymous or might be disclosed.
3. Theoretical Framework

This chapter consists of the theories used to give the answer of the research questions presented in introduction chapter. Theory does not only lead the empirical findings but also is the primary tool for analysing the findings in a proper way. However, other relevant theories are also presented in order to provide insight knowledge. Moreover, recent literatures have been analyzed to find out the gaps so that this study can fulfil those gaps.

3.1. The IASB Conceptual Framework

The IASB Framework deals with general purpose financial statements as well as consolidated financial statements. These financial statements should be prepared and presented at least annually and with the information directed toward a wide range of users (AASB 2004). The Framework is also concerned with the objective of financial statements, and the qualitative characteristics, which determine the usefulness of information in financial statements (ibid). According to the Framework, the objective of the financial statements is to provide information about the financial position, performance, and changes in financial position of an entity that is useful to a wide range of users in order to make economic decisions (ibid). Financial statements that are prepared to provide information meet the common needs of most users. Nevertheless, the financial statements do not provide all information that the users may need in order to make economic decisions. This is because financial statements do not provide non-financial information (ibid).

Qualitative characteristics are the aspects that make the financial information useful to the users. According to the IASB (2009) the qualitative characteristics includes three main types of attributes (QCs) that determine the usefulness of financial information. These characteristics can be described in below figure:

![Figure 3: Qualitative Characteristics (QC)](image-url)
As described by IASB (2009) the fundamental QCs make information regarding financial reporting useful. Likewise, enhancing QCs improve the usefulness of financial information in a broader way. However, enhancing characteristics either alone or in connection with each other cannot make financial information useful if the provided information is irrelevant or not faithfully represented (IASB 2009).

3.2. IFRS

IFRS are the accounting standards issued by the IASB, an independent organization working for the public interest based in London, UK. The major objective of this organization is to develop one set of accounting standards that are highly qualitative, understandable, enforceable, and globally acceptable (IFRS 2011). Prior to restructure of IASB in 2000, International Accounting Standards were issued by IASC (International Accounting Standards Committee) (Ball 2006). The IASC was established in 1973 by the professional accountancy bodies in Australia, Canada, France, Germany, Japan, Mexico, Netherlands, United Kingdom and Ireland, and the United States (ibid). Since 2001 the IASC standard-setting functions have been taken over by IASB (IAS Plus 2011a). The IASB sets the rules under the new foundation which is known as IFRS foundation, but it continues to accept the IAS rules issued by the IASC (Ball 2006). According to Ball (2006), the IASB is better-funded, well-staffed and more independent than the IASC.

3.2.1. First Time Adoption of IFRS (IFRS 1)

In order to bring uniformity in the companies’ financial reporting the IASB at first issued IFRS1, for the first time adoption of IFRS, in June 2003 with the effective date of beginning on or after 1 January 2004 for all public entities (IAS Plus 2011b). The main goal of IFRS1 is to ensure that the company’s financial statements under IFRS as well as interim financial reports of that specific period of time should provide an appropriate starting point, be transparent for the users and be comparable over all periods presented (Greuning 2009).

IFRS1 applies when a publicly accountable entity wants to transit from local GAAP or other accounting standards to IFRS and adopt it for the first time. The IFRS1 contains some standards and each individual standard should be fulfilled by an entity at the time of reporting of its first IFRS financial statements (ibid). These standards includes: comparable information, identification of the basis of reporting, retrospective application of IFRS information, and formal identification of the reporting and the transition date (ibid). The financial statements under the first time adoption should be for the comparative periods and must convey the information
of both previous accounting standards and IFRS (ibid). According to Greuning (2009) while preparing financial statements under IFRS, IFRS should be applied retrospectively except in some certain exemptions.

Today IFRS is rapidly gaining acceptance globally (Deloittee 2008) as IASB made it mandatory adoption for all publicly accountable entities and thereby the importance of IFRS1 is also increasing significantly. It is because the company’s first IFRS financial statements itself tells enough whether that company is eligible to adopt IFRS in its consolidated financial statements or not (Holt 2011).

**Accounting Policy:**

An entity shall prepare and present an “opening IFRS balance sheet” at the date of transition of IFRSs (IFRS 2008). From this point onward accounting in accordance with IFRSs will start. Moreover, an entity shall choose the same accounting policies in its opening IFRS financial statement throughout all periods presented in its first IFRS financial statements (ibid). Those accounting policies shall comply with each IFRS with the effective date of at the end of its first IFRS reporting date (ibid) except under some conditions where an entity claims targeted exemptions from retrospective application of IFRS or if IFRS prohibits to apply IFRSs retrospectively (ibid).

Furthermore, an entity that is preparing opening IFRS financial statement should recognise all assets and liabilities as required and permitted by IFRSs (ibid). An entity also should reclassify items that it recognised in accordance with previous GAAP as one type of asset, liability or component of equity; but for different types of asset, liability or component of equity in accordance with IFRS. In addition to these, an entity should apply IFRS in measuring all recognised assets and liabilities (ibid).

However, the accounting policies that an entity uses in its opening IFRS financial statement may vary from those that it used for the same date using its previous GAAP (ibid). The adjustments arise from events and transactions before the date of transition of IFRSs are required to do. Thus, an entity should recognise those adjustments directly in retained earnings at the transition period to IFRS (ibid).

**Explanation of transition to IFRSs**

An entity should describe how the transition from previous GAAP to IFRSs affected its reported financial position, financial performance and cash flows (IFRS2008).
Reconciliations

To fulfil the above mentioned explanation, an entity's first IFRS financial statements shall include:

(a) “reconciliations of its equity reported in accordance with previous GAAP to its equity in accordance with IFRSs for both of the following dates:

(i) the date of transition to IFRSs; and

(ii) the end of the latest period presented in the entity's most recent annual financial statements in accordance with previous GAAP.

(b) a reconciliation to its total comprehensive income in accordance with IFRSs for the latest period in the entity's most recent annual financial statements. The starting point for that reconciliation shall be total comprehensive income in accordance with previous GAAP for the same period or, if an entity did not report such a total, profit or loss under previous GAAP.

(c) if the entity recognised or reversed any impairment losses for the first-time in preparing its opening IFRS statement of financial position, the disclosures that IAS 36 Impairment of Assets would have required if the entity had recognised those impairment losses or reversals in the period beginning with the date of transition to IFRSs” (IFRS 2008).

“The reconciliations required by above paragraph (a) and (b) shall give sufficient detail to enable users to understand the material adjustments to the statement of financial position and statement of comprehensive income. If an entity presented a statement of cash flows under its previous GAAP, it shall also explain the material adjustments to the statement of cash flows” (ibid).

“If an entity becomes aware of errors made under previous GAAP, the reconciliations required by above mentioned paragraph (a) and (b) shall distinguish the correction of those errors from changes in accounting policies” (ibid).

“IAS 8 does not deal with changes in accounting policies that occur when an entity first adopts IFRSs. Therefore, IAS 8's requirements for disclosures about changes in accounting policies do not apply in an entity's first IFRS financial statements” (ibid).

“If an entity did not present financial statements for previous periods, its first IFRS financial statements shall disclose that fact” (ibid).

Derecognition of financial assets and liabilities

Except in some circumstances, a first-time adopter should apply the derecognition requirements in IAS39 Financial instruments: Recognition and Measurement
prospectively for transaction occurring on or after 1 January 2004 (ibid). In other word, “if a first-time adopter derecognised non-derivative financial assets or liabilities in accordance with its previous GAAP as a result of a transaction that occurred before 1 January 2004, it shall not recognize those assets and liabilities in accordance with IFRSs (unless qualify for recognition as a result of a later transaction or event)” (ibid).

Nevertheless, “an entity may apply the derecognition requirements in IAS 39 retrospectively from date of the entity’s choosing, provided that the information needed to apply IAS39 to financial assets and financial liabilities derecognised as a result of past transaction was obtained at the time of initially account for those transactions” (ibid).

3.3. Accounting Harmonisation in EU

“Harmonisation’ is a process of increasing the compatibility of accounting practices by setting bounds to their degree of variation” (Alexander et al. 2009, p.40).

The issue of accounting harmonization arose at the same time when six European countries, France; Germany; Italy; Belgium; The Netherlands; and Luxemburg, signed in the Treaty of Rome in 1957 in order to form European Union1 (Nobes and Parker 2006). At that time, France and Germany were the most influencing countries in the accounting regulations. In 1973 when United Kingdom and Ireland became the part of European Union, they introduced Anglo-Saxon way of accounting and financial reporting (ibid).

In 1970 the Common Industrial Policy was approved for the member states of EU in order to create common capital market through unified business environment within the member state (ibid). The concept of common capital market also demanded harmonization in company law and tax law. This is because companies were started to operate in several states of the member countries. Thereby it was important to produce financial statements that ensure higher degree of reliability and comparability to the investors. The harmonization in company law and taxation was also necessitates in order to facilitate the movement of capital market and to enable a fair competition among the companies within the member countries (ibid).

At the same time when EU was giving efforts for the accounting harmonisation; in 1973 IASC (International Accounting Standards Committee) was formed in order to bring accounting harmonization in the global market (Alves and Antunes 2011).

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1 At that time the European Union (EU) was known as European Economic Community (EEC)
However, in 1970s and 1980s the standards issued by the IASC was not getting acceptance as its standards had no formal authority and the low quality standards also might be the reason (Alexander et al. 2009).

In July 1978 and in June 1983 EU issued the Fourth and Seventh Company Law Directives respectively in order to introduce national legislation by all EU member countries. In other word, EU made mandatory requirement for the implementation of EU directives by all member states (ibid). However, this rule was exempted unless the member state enacted EU Directives in its legislation (ibid).

The Fourth Directive is the combination of Anglo-Saxon and Continental accounting tradition (ibid). This directive is focused to provide coordination for the provision of member state regarding the presentation and content of annual accounts and reports, the valuation methods used and their publication in respect of all companies with limited liability (Europa 2011a). The most important requirement of the Fourth Directive content was it should show a ‘true and fair view’ in the published accounts (Alaxendar et al. 2009). The Fourth Directive also comprised many options for the recognition and measurement of balance sheet items and profit and loss items.

The Seventh Directive coordinates national laws on consolidated financial statements (Europa 2011b). It extended the principles of the Fourth Directive in order to prepare annual accounts of public limited companies (Alexander et al. 2009). Thereby it belongs to the family of “accounting directives” which form the arsenal of community legal acts that governs company financial statements (Europa 2011b).

However, by the early 1990s the European Commission realized that the useful harmonisation through EU Directives were burdening and time consuming. It was also realized that the Fourth Directive was unable to cover several topics which even were complicated for the further amendment. Therefore, in 1995 The European Commission developed its new ‘Accounting Strategy’ through analyzing the conformity between IASs and the content of European Accounting Directives. It is because the IASC already started to issue more proactive accounting standards with clear preferences than 1970s and 1980s, which still can be regarded as acceptable (Alexander et al. 2009). Under the new accounting framework, European Commission announced that the individual states have right to choose whether they want to implement IAS rather than national GAAP (ibid).
Furthermore, in order to create single large capital market within the EU, in 1999 European Commission agreed on the Financial Services Action Plan (ibid). The objective of this Plan was to contribute better functioning internal market through the single set of high quality international accounting standards in companies’ consolidated financial statements (EC 2002). Therefore, in March 2000 the European Commission proposed that by 2005 all listed company should implement Commission’s Financial Services Action Plan (EC 2002).

In 2001 the International Accounting Standards Committee (IASC), whose objective was to develop single set of high-quality accounting standards, was replaced by the International Accounting Standards Board (IASB) (ibid). The accounting standards, IASs, issued by IASC were also renamed by International Financial Reporting Standards (IFRS). These new standards, IFRS, should ensure a high degree of transparency and comparability for financial reporting, and are mandatory for all companies whose stocks are traded in regulated market (ibid).

In order to meet the need of global harmonization, in 2002 Regulation (EC) No. 1606/2002 was approved by the European Parliament on the application of IAS/IFRS (ibid). According to the EC regulation 2002, all listed companies within member state must prepare their consolidated financial statements under IFRS from the beginning of 2005 (Commissions of the European Committees 2002). However, this mandatory rule was temporarily exempted for those companies who were listed in both EU and non-EU market and the companies who have only publically traded debt securities until 2007 (European Parliament 2002). This exemption period is now over and thereby all listed companies either they are equity or debt traded must have complied IFRS in their consolidated financial statements (Alexander et al. 2009).

3.4. Swedish Accounting and Legal Environment

The accounting regulation in Sweden began when the Municipal Income Tax Act (by creating the link between tax and accounting) and Accounting Act were passed in 1928 and 1929 respectively (Blake et al. 1997, 1999). After the formation of Accounting Act, the legal accounting frameworks were put into place (ibid). At that time to 1960s, the Swedish accounting regulation was greatly influenced by German accounting environment (Jönsson 1984; Blake et al. 1997, 1999). In other word, there was a close relationship between company law and tax law which still can be seen in Swedish accounting structure (Jönsson 1984).
However, from sixties onward the US accounting theorist has become stronger that impacted in Swedish accounting system as well (Jönsson 1984; Blake et al. 1997, 1999). From that point onward, there was a kind of mixture of basic German Structure and American decision-oriented structure in Swedish accounting system (Jönsson 1984). This is because the tax-accounting link was reinforced in both Companies Act of 1975 and Accounting Act of 1976 (Blake et al. 1997, 1999). Besides this, in seventies a number of tax incentives were introduced which had significant impact between tax and accounting link (ibid). The most remarkable introduction was the legal provision of credit extended (600 MSEK) by the Swedish government to the company named Uddeholm AB. Due to this credit policy, the government decided to make such kind of loan taxable so that the extended loan could be shown as income in profit & loss account and as an asset in the balance sheet (Zeff and Johansson 1984).

Due to the connection between accounting and taxation (Nilsson 2006), in the beginning of 1980s, standard setters introduced a prudence principle as a basis of measurement (Artsberg 1993). However, untaxed reserves were widely used by the state and were mainly hidden in the Balance Sheet (Nilsson 2006). Therefore, from the middle of eighties a separate disclosure of untaxed reserves and market oriented measurement had started in order to achieve relative importance according to the Accounting Act 1976 (Artsberg 1993).

Furthermore, in the year 1991, Sweden changed its tax policy and introduced a scheduler or dual tax system. Under the new tax policy, Sweden introduced a flat rate of 30% tax in capital income (Andersson and Fall 2000) which was 22% lower than the previous tax rate (Blake et al. 1997, 1999). The new policy removes many of the special forms of tax reliefs and also reduced the effect of the tax-accounting link (ibid).

Moreover, in order to bring uniformity in the accounting system within member states of EU, EU issued fourth and seventh directives in 1978 and 1983 respectively. The major objective of these directives was transparency and comparability so that the investors in member countries could easily understand and interpret the financial statements (Joos and Lang 1994). As a member state of EU, it was important to implement these two directives in Sweden. Thus in 1995 Sweden introduced a new Accounting Act, Annual Accounts Act, in order to implement the requirements of these directives (Blake et al. 1999). This act was mandatory and legally into force from the financial years beginning after December 1996 (Nilsson 2006). The Act contained a requirement that the accounts should present “true and fair view” and if the law was not sufficient to achieve this objective, supplementary
information should be presented in the accounts. This new Act was also continued with tax-accounting link (Blake et al. 1999).

Nevertheless, there was debate on the implementation of EU-directives in Sweden. The major argument on this issue was whether the execution of EU-directives would be a step towards Anglo-American accounting standards (Nilsson 2006). According to Nilsson (2006) if the implementation of EU-directives has had any material (de facto) impact on the financial disclosures, it would be possible to examine in the Swedish Annual Reports from 1997. However, the Redovisningsrådet (RR), jointly promoted Financial Reporting Council body in 1989 by Föreningen Auktoriserade Revisorer (FAR) and Bokföringsnämnden (BFN) together with the Federation of Swedish industries (Blake et al. 1999), already began to produce accounting standards primarily based on IAS for listed companies since the beginning of 1990s (Nilsson 2006). For this reason, RR’s (Swedish Financial Accounting Standard Council SFASC) standards mostly were directly translated from IAS. In other word, publicly accountable companies in Sweden, whose securities are traded in the Swedish Exchange and other regulated market, were adopting IAS/IFRS in some way. This is because IAS was already partly implemented through Swedish GAAP since 1991 although IAS/IFRS adoption was not mandatory until 2005 (ibid).

Further, in 2001 RR (SFASC) made some special changes in its eight standards in accordance with IAS/IFRS that were effective from the financial year beginning or after 1 January 2001 (IAS Plus 2002). These SFASC standards include: SFASC 9- Income Taxes (based on IAS 12), SFASC 10- Construction Contracts (based on IAS 11), SFASC 11- Revenues (based on IAS 18), SFASC 12- Property, Plant and Equipment (based on IAS 16), SFASC 13- Associated Company (based on IAS 28), SFASC 14- Joint Ventures (based on IAS 31), SFASC 18- Earnings per Share (based on IAS 33) and SFASC 20- Interim Financial Reporting (based on IAS 34) (ibid). Beside these important changes, due to the tax reasons some minor national changes were also made (Estandardsforum 2010).

In sum, Sweden is adopting IAS/IFRS gradually since the starting of 1990s (Nilsson 2006) prior to the adoption of EC regulation in 2002. But, from 2005 Sweden permits mandatory IFRS in consolidated financial statements of all types of listed companies (EC 2008). However, it does not give permission to implement IFRS in the annual accounts (legal entities financial statement) of listed and other companies (ibid). Moreover, there is no requirement of tax-accounting link in the companies’ consolidated account as a single firm in a group of companies is responsible for taxation (Smith 2006).
The annual accounts of the companies, whose stocks are traded in the stock market, are to be prepared according to the recommendations issued by the Swedish Financial Reporting Board (SFRB) (Estandardsforum 2010). Although the SFRB recommendations are based on IFRSs, some changes have been made in the international requirements in order to adjust IFRSs with Swedish legal and tax environment and in the cases deemed necessary by the SFRB (ibid). Moreover, according to the PricewaterhouseCoopers (2009) the Swedish national standard-setters have not announced any convergence plan yet.

Furthermore, the accounting environment or the accounting is also shaped by some enforcement like legal or regulatory environment of the country (Ball 2006). According to Levine (1998) Sweden is a country with strong regulatory enforcement that provides strong reporting incentives.

3.5. Swedish GAAP

According to KPMG (2005) the Swedish Generally Accepted Accounting Principle (SGAAP) is based on Swedish Annual Accounts Act (AAA), standards (Redovisningsrådet RRs), interpretations (URAs) and guidelines. As described by KPMG (2005):

- "RRs are issued by a private sector body, the Redovisningsrådet.
- The AAA requires entities to prepare financial statements that give a fair presentation in accordance with SGAAP, and also specifies, for instance, formats, basic principles, disclosure requirements and audit requirements."

The AAA is based on European Commission’s fourth, seventh and eleventh directives. All credit institutions, brokers and dealers in securities and insurance companies are covered by two special accountings acts: Annual Accounts Act 1995 and Bookkeeping Act 1999 (IAS Plus 2011c). Moreover, Both the Swedish standards (RRs) and interpretations (URAs) are designed for the use of companies listed in regulated stock market. Thus an entity that wants to implement RRs must comply with all standards and interpretations as well as disclosures requirements (KPMG 2005). Furthermore, both the bold and plain type paragraphs of RRs have equal authority and must be complied. Similar to IFRS, RRs permit for departure if compliance would be misleading but departure from specific AAA requirements is prohibited (ibid). SGAAP also contains a hierarchy of alternative sources like IFRS for the situation when RRs do not cover a particular issue (ibid).

However, Swedish GAAP no longer exists now for the companies listed in capital market as mandatory IFRS is into force since the beginning of 2005.
3.5.1. Differences between IFRS and Swedish GAAP

As described above in Sweden prior to 2005 the direct translation of IFRS had been implementing partly since the early 1990s through SGAAP with some major translations in 2001. Therefore, the differences between SGAAP and IFRS have been reduced over time. However, there are some major dissimilarities between these two accounting standards which can be summarized below (Paananen 2008):

Table 1: Differences between IFRS and SGAAP.

<table>
<thead>
<tr>
<th>Description</th>
<th>Swedish GAAP</th>
<th>IFRS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Combinations</td>
<td>Goodwill amortisation over economic life(max 20 years)</td>
<td>Goodwill amortisation is no more longer allowed and instead regular impairment test has to be made. Identification of more intangible assets and liabilities.</td>
</tr>
<tr>
<td>Financial Assets</td>
<td>Lowest of cost and market. Fair value accounting only in some special cases.</td>
<td>Financial assets are primarily valued at fair value.</td>
</tr>
<tr>
<td>Financial Instruments</td>
<td>No complete coverage.</td>
<td>Financial instruments are valued at fair value. Stricter requirements for hedge accounting.</td>
</tr>
<tr>
<td>Stock-based Compensation</td>
<td>Not covered</td>
<td>Stock based compensation is accounted for in the income statement.</td>
</tr>
<tr>
<td>Investment Properties</td>
<td>Only historical costs are allowed</td>
<td>Fair value accounting is allowed.</td>
</tr>
<tr>
<td>Agriculture</td>
<td>Lowest of cost and market</td>
<td>Fair value accounting.</td>
</tr>
</tbody>
</table>

Source: Paananen (2008)

3.6. Determinants of IFRS

To identify the determinants of IFRS, I have analyzed the past literature on determinants of both voluntary and mandatory IFRS adoption by listed companies.

In order to determine firms disclosure of IFRS or US GAAP financial information, Ashbaugh (2001) examined more than two hundred non-US firms listed in London Exchange and found the systematic differences in firms characteristics, number of
international listing in equity market, and standardized financial information relative to national GAAP as driven factors. Her study also revealed that firms are more likely to implement IFRS when they participate in seasoned equity offerings and when they are cost effective to implement. Likewise, Cuijpers and Buijink (2004) analyzed 133 non-financial firms listed in EU disclosing IFRS or US GAAP in 1999 and discovered foreign listing (listed in the U.S stock exchange and or EASDAQ exchange in Brussels), and the geographical dispersion of firms’ operation are the major factors.

Furthermore, the expected determinants of adoption of non-local GAAP according to past literature are the stock-exchange listing, international operation, country-specific determinants, corporate governance, and the size of the firm (Cuijpers and Buijink 2004). These determinants are the common characteristics for the companies that adopt IFRS or US GAAP (ibid). Similarly, after examining the determinants of voluntary implementation of IFRS by listed companies in Germany, Gassen and Sellhorn (2006) identified the size, international exposure, dispersion of ownership, and recent IPOs as the crucial forces. Likewise, after considering the factors that are already analysed by past studies, (Fito et al. 2009) found size and the growth of an entity as the major determinants to adopt IFRS.

Bova (2008); and Bova & Pereira (2010) in their study identified foreign ownership as a major determinants of IFRS compliance. According to them, higher the foreign ownership higher will be the IFRS compliance and higher the IFRS compliance, higher will be the share turnover. Bova (2008) also suggests higher foreign ownership can reduce a firm’s cost of capital.

Following the rule of IASB, EC made legal requirements of mandatory adoption of IFRS for all listed companies within the member states, including Sweden, from 1 January 2005. Legal requirement, therefore, is an important determinant of adoption of IFRS (EC 2002).

3.7. Transparency and Accounting Quality

Due to fast growing globalisation and internationalisation of businesses it was important to improve investor confidence in this global capital markets through international language of disclosure and transparency as investors can come from any country around the globe (Cox 2008). Thereby, IASB started to set accounting standards through the new foundation named IFRS (European Union 2002) so that investors can easily evaluate investment opportunities (Cox 2008). These standards (IFRS) are based on a single set of high-quality standards that promote greater
confidence in transparency and comparability of financial reporting to the investors (European Union 2002, Cox 2008). In one word, IFRS improve overall quality of financial reporting and efficiency of capital markets (European Union 2002). Cox (2008) also cited that the reason behind increasing acceptance of IFRS by the countries around the world is its single financial reporting language.

When comparing IFRS to local GAAP in terms of transparency and accounting quality; Ball (2006) described that IFRS promises more accurate, comprehensive and timely financial information than national GAAP. According to him, IFRS financial reporting information ensures greater level of transparency and comparability. According to Barth et al. (2006, 2008) a firm that implement IFRS has less earning management, more timely loss recognition, higher value relevance of accounting amounts, and a lower cost of capital than local GAAP. In other word, the firms that adopt IFRS have higher accounting quality than the firms that adopt national GAAP. Barth et al. (2006, 2008) also suggests that applying IFRS is associated with improvement in accounting quality.

Since past literatures emphasize IFRS as a higher quality accounting standards than the local GAAP (e.g. Ball 2006, Barth et al. 2006, 2008); the most recent research paper of Chen et al. (2010) also identified that a majority of accounting quality indicators improved after adoption of IFRS throughout EU. In other word, there is less of managing earnings towards a target, a lower magnitude of absolute discretionary accruals, and higher accruals quality (Chen et al. 2010).

However, it is not certain that once a county adopts IFRS, it would produce high quality financial reporting (Ball 2006). This is because accounting quality is directly or indirectly affected by some factors (Chen et al. 2010). Such factors are: the quality of the standards; a country’s legal and political system; and financial reporting incentives (Soderstrom and Sun 2007). According to Soderstrom and Sun (2007) accounting quality has direct impact by all these factors and indirect impact by a country’s legal and political system. He believes that the improvements in accounting quality largely depend on changes in a country’s legal and political system, and financial reporting incentives. In other word, financial reporting quality is not only shaped by accounting standards but also by political, legal and economic forces (Ball 2006; Bova & Pereira 2010).

While analyzing accounting quality in Sweden, Paananen (2008) test whether the quality of financial reporting has increased in Sweden after mandatory adoption of IFRS in 2005 and found no increase in financial reporting quality over the two accounting periods of adoption. But, she identified some indications of a decrease in
financial reporting quality measured as smoothing of earnings, timely loss recognition, and value relevance. In other words, her analysis suggests that the quality of financial reporting has decreased in Sweden after the mandatory adoption of IFRS. That means IFRS does not ensure high degree of transparency and accounting quality relative to SGAAP.

However, the transition to IFRS would have incremental effects on the quality of financial reporting (Chen et al. 2010) through greater level of transparency and comparability. This is because IFRS is a generally accepted single and common financial reporting language (Jeanjean and Stolowy 2008).

3.8. Information Asymmetry

Literatures on IFRS suggest that IFRS would generate high quality financial reporting (e.g. Barth et al. 2006, 2008; Chen et al. 2010). Hence, investors expected that adoption of IFRS reduce information asymmetry between the firm and investors, which ultimately eliminate information risk and thus reduce the cost of capital (Armstrong et al. 2010). Since, IFRS emphasises better reporting standards and permits for greater comparability (Bova & Pereira 2010), Barth (2008) believed that IFRS disclosure will improve firm’s information environment and thereby reduce the cost of capital.

Furthermore, IFRS adoption offers increased comparability and thus reduces information costs and information risk to investors, which helps to enhance competition and efficiency in the market (Ball 2006). According to Choi and Meek (2005) adoption of IFRS not only reduces information asymmetry to the investors and corporations but also facilitates for them to make more efficient investment decisions and hence minimizes the cost of capital.

While analyzing literatures on information asymmetry, Leuz and Verrecchia (2000) identified that adoption of IFRS reduces information asymmetry and thereby cost of equity capital. Likewise, Ashbaugh and Pincus (2001) in their study found analyst forecast errors decreased after disclosure of IFRS. Cuijpers and Buijnk (2004) examine three proxies for information asymmetry: analyst following, cost of equity capital, and uncertainty among analyst and investors in order to find out whether the IFRS adopters have lower level of information. Their result suggests that there is a positive effect of IFRS adoption on analyst following. However, they are unable to provide evidence of a lower cost of capital for IFRS adopters. They also found higher level of uncertainty among analysts and investors adopting IFRS relative to firms using domestic GAAP.
Nevertheless, Wang et al. (2007) and Horton et al. (2010) examine the effect of mandatory adoption of IFRS and found the same result as identified by Ashbaugh and Pincus (2001) i.e. earning forecast errors decreased after adoption of IFRS. Horton and Serafeim (2010) identified that IFRS reconciliations offer new information to the investors. Beuselinck et al. (2010) found significant and positive effect on the information processing of financial analyst but heterogeneously. In other word, they found significant increase in information accuracy after adoption of mandatory IFRS but the accuracy level depends upon analyst.

Since mandatory transition from local-GAAP to IFRS is a commitment to increase levels of disclosure, internationally recognized accounting standards (IFRS) reduces information asymmetry between the company and investors (Platikanova 2009) thereby lower the transaction costs (Cuijper and Buijnik 2004) and market liquidity costs (Platikanova 2009).

### 3.9. Cost of Capital

Past literatures advocate that IFRS requires greater financial disclosures than the national GAAP (e.g. Ashbaugh and Pincus 2001). In other word, the accounting standards under IFRS determine accounting quality, which provides two key benefits to mandatory IFRS adopters in order to reduce cost of equity capital (Lee et al. 2008). First, adoption of single set of uniform accounting standards improve financial statement comparability through cross-border capital flows and as a result reduce the cost of capital (ibid). According to Li (2010) the enhanced financial statement comparability is beneficial mainly to those firms which are located in different nations. This is because the value of one firm is correlated with another firm. Therefore, if the firms in both countries apply IFRS then the information disclosed by firms will be more comparable and more useful to valuate, which ultimately reduce to estimation risk and cost of equity capital (Dye 1990).

Secondly, adoption of increased financial disclosure (IFRS) reduces the information asymmetry and thus reduces firms’ cost of capital (Lambert et al. 2007; Lee et al. 2008; Armstrong et al. 2010). These theoretical assumptions are also supported by many empirical studies (Li 2010). For instance, Botosan (1997) indicates that greater disclosure is associated with a lower cost of equity capital for the firms that attract the low analyst following. Richardsson and Welker (2001) also found a negative relation between quality of financial disclosure and cost of equity capital for firms with low analyst following. Consistently, Fransis et al. (2005) suggests that firms with expanded disclosure policy leads to lower cost of equity capital.
Prior research on voluntary adoption of IFRS suggests that IFRS adoption reduces firm’s cost of capital (e.g. Leuz and Verrechia 2000). However, it is not certain that the mandatory adoption of IFRS produces the same result as voluntary adoption (Sunder 2007). This is because accounting is shaped by institutional factors such as economic, political & legal factors (Ball 2006). These institutional factors may differ from one nation to another although IFRS adoption is mandatory within the European Economic Area (Lee et al. 2008).

In order to find out whether the mandatory adoption of IFRS reduces the cost of capital, Prather-Kinsey et al. (2008) examine European companies and found cost of capital decreased in both countries domiciled in code law and common law. Lee et al. (2008) examine IFRS with institutional factors and found little evidence in the reduction of cost of capital in those countries that have low financial incentives and enforcement. On the other hand, they found significant reduction with the countries that have strong financial incentives and enforcement. Likewise Li (2010) examines cost of equity capital on an indicator variable and legal enforcement. Her findings also suggest that the mandatory adoption of IFRS significantly reduces the cost of capital but it depends upon the strength of the countries’ legal enforcement. Furthermore, her findings also provide evidences that increased disclosure and enhanced information comparability are the main mechanisms behind the reduction of cost of equity.

In sum, research concludes that if both financial incentive and legal enforcement are strong, IFRS certainly will reduce cost of equity capital.

3.10. Recent Literatures on Mandatory IFRS Adoption:

Prather-Kinsey et al. (2008) examines the effect of mandatory IFRS on European countries and found financial reports under IFRS more value relevant and informative and thereby reduce cost of capital. Moreover, they also examine the heterogeneity in capital market consequences of IFRS adoption according to the legal origin of the country i.e. code law and common law in which firms resided. Their result suggests that firms from code law countries experienced more significant market consequences than the common law countries. However, the banking sectors are not included in their sample firms. Therefore, this paper examines the effect of IFRS in the banking sector. Moreover, Soderstrom and Sun (2007) argued that accounting quality does not only depend upon the quality of standards but also on the firm’s overall institutional setting as well as legal and political system of the country in which the firms are domiciled. Daske et al. (2008) examined the economic consequences of mandatory IFRS in 26 countries around
the globe. They found that the capital-market benefits occur after adoption of IFRS but only in countries with strong legal enforcement and where institutional factors provide strong reporting incentives. Jeanjean and Stolowy (2008) analyzed the effect of mandatory IFRS adoption on earning management of code law (France) and common law (Australia and UK) countries and found no decrease in earning management but increase in code law country. They also found that only the adoption of common language will not lead to lower earning management but the management incentives and country’s institutional factors play vital role in framing financial reporting quality. Therefore, apart from the higher quality disclosures, management incentives, and country’s legal and political factors are equally important in order to determine financial reporting quality.

Although the implementation of IFRS is mandatory in firm’s consolidated financial statements, some European companies, e.g. Sweden, still require to prepare individual financial statement using local standards for tax and other purposes (Jermakowicz & Gornik-Tomaszewski 2006; Macías and Muñó 2011). Therefore, Macías and Muñó (2011) investigated the financial reporting quality by comparing accounting quality of the countries that permit or prohibit IFRS on individual financial statement. They found that accounting quality of the countries that have to prepare legal entities financial statements under local standards (prohibit IFRS) is significantly lower than the countries that permit IFRS fully. Nevertheless, Jermakowicz & Gornik-Tomaszewski (2006) investigated IFRS adoption process throughout the European firms and found that a majority of EU firms adopted IFRS only for consolidation purposes as legislated by EU Regulation. They also found that firms do not have expectation of lower cost of capital but found IFRS adoption process costly, vague and burdensome. They further identified increased volatility in financial result and complexity and found that the majority of firms would not adopt IFRS if not mandatory legislated by EU Regulation.

Paananen (2008) examined the effect of IFRS on financial reporting quality and identified no incremental effect over the first two years of adoption. In opposite, she found some indication decreased in financial reporting quality. In other words, she found smoothing of earning, less timely loss recognition and less value relevance. Her overall result suggests that the financial reporting quality is decreased after mandatory IFRS adoption. However, the financial sector is excluded from her sample as they are under the regulation of the Swedish Financial Supervisory Authority. And it’s been more than five year of mandatory IFRS adoption thereby this paper examines the effect of IFRS over the year but only in banking sectors.
Armstrong et al. (2010) investigated European equity market reaction of 16 events related to adoption of IFRS. They found positive reaction with greater information quality and lower information asymmetry, more pronounced for banks, consistent to the investors’ expectation in the post-IFRS adoption period than the pre-adoption. However, they also found an incrementally negative reaction for firms that reside in code law countries. Nevertheless, their overall results suggest that investors expected net benefits to IFRS adoption in Europe connected with greater information quality, lower information asymmetry, more accurate enforcement of the standards, and convergence.
4. Empirical Findings

In this section, all the information collected from the texts and documents regarding effects of adoption of IFRS and the data gathered through interview will be presented.

4.1. Adoption of IFRS

4.1.1. Basis of Presentation

Prior to the beginning of 2005 sample banks’ financial statements were based on Swedish GAAP. However, Swedish accounting standards have been gradually aligned to IFRS since 2000. Until the end of 2004, 29 IFRS standards had already been adopted by Swedish accounting standards. From 2005 onward, banks consolidated financial statements have been prepared on the basis of IFRS and interpretations of the standards by IFRIC, as endorsed by EU. In addition to this, certain complementary rules in the Swedish Annual Accounts Acts for Credit Institutions and Securities Companies (1995:1559), Supplementary Accounting Rules for Groups RFR1 and the supplementary UFR statements issued by the Swedish Financial Reporting Board have been implemented. Besides this, the accounting regulations of the Swedish Financial Supervisory Authority have also been applied. These accounting rules and recommendations have been applied as amended by the corresponded authorities over the years. The consolidated financial accounts give true and fair view of the Groups’ financial position and result of operations. Sample banks financial statements except Nordea have been prepared in SEK. The Nordea’s statements are prepared in Euro. All figures are rounded in million. The annual accounts of sample banks have been prepared on the basis of Annual Accounts Acts of Credit Institutions and Securities Companies in order to give true and fair view of the company’s financial position and result of operations in accordance with SGAAP.2

4.1.2. Effects of Transition to IFRS

As legislated by EU all listed companies must prepare their consolidated financial statements in accordance with IFRS from 1 January 2005. That means comparative

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2 This paragraph is on the basis of sample banks’ annual reports from 2004-2010. See links:
http://www.nordea.com/Investor+Relations/Financial+reports/Annual+reports/804982.html;
http://www.handelsbanken.se/ireng;
periods in 2004 must be restated according to the accounting principles and validated as of year-end 2005 (Swedbank 2004). In November 2004 Stockholm Stock Exchange also recommended all listed companies to present the main effects of IFRS adoption in the year-end report (Nordea 2004). The effects of IFRS in sample banks can be described as follows:

**Swedbank:**

The introduction of mandatory IFRS did not have significant effect on reported profit or on the bank’s financial position as of year-end 2004. Increased reported profit was the result of IFRS3, business combinations (goodwill amortisation was replaced with impairment testing) (Swedbank 2004). The introduction of IFRS required to present reported profit and equity that contains the minority interest in subsidiaries’ profit and equity. Therefore, the reported profit and financial position according to IFRS principles of 2004 were 9.9 bn and 47.4 bn SEK respectively. However, at that time IAS39 was exempted from the requirement to restate comparative periods and was also not fully endorsed by EU (ibid). In 2005, IAS 39 was introduced by the bank as endorsed by EU (Swedbank 2005). Thus, the opening balance as of 1 January 2005 was different from closing balance as of 31 December 2004 (47.4 SEK bn) and became 46.6 bn SEK (Swedbank 2004). According to the new standards goodwill in the Group companies is tested for impairment instead of amortisation (Swedbank 2005). Minority interest, which previously was reported as a liability, has been included in equity and profit from the year 2005. Moreover, under the new policy entire financial instrument (IAS39) is measured at fair value and recognized in its entirety while previously the bond portion of the instrument was only measured at amortized cost and recognized separately (ibid).

The new accounting policies have resulted in changes regarding classification in income statement and balance sheet. Furthermore, insurance operations are no longer consolidated on a separate line but rather in the same way as other subsidiaries. Apart from this, discontinued operations that are significant for the Group are reported on a separate line in the income statement (ibid).

In 2006, the comparative figure from the translation of currency component in currency hedge of investments in foreign subsidiaries and associates of cost has been restated (Swedbank 2006). However, the profit for the year 2005 decreased by SEK 38m but closing equity increased with SEK 235m. Moreover, Swedbank has been adopting IFRS instruments as per the required standards in order to show true and fair view (ibid). As of 2007 interest income and interest expenses related to
financial instruments held for trading are recognized in the consolidated income statement as net interest income (Swedbank 2007). Prior to this period they were recognized in the income statement as net gain and losses on financial items were at fair value. Besides this, both the group and parent company has irrevocably elected fair value to measure certain portfolio of loans and deposit as well as derivatives. This is because it was necessary to eliminate portfolio’s aggregate interest rate risks. Since the comparative figure has been restated according to the requirement of IFRS, it affects reported profit negatively by SEK 293m in 2006 and also lowers the closing balance of equity capital by SEK 138m (ibid).

In 2008 Swedbank adopted amended IAS39. Amended IAS39 permits the reclassification of certain financial assets from the valuation category of Financial Instruments at fair value. However, Swedbank has not adopted any other new or amended standards in 2008. Swedbank also hadn’t expected to have an effect on the Group’s future financial reporting (Swedbank 2008). From the first quarter of 2009, Swedbank started to implement amended IAS1 that requires financial reports to be updated which include other comprehensive incomes (ibid). According to the annual report 2009, the new standard IFRS9 issued by the IASB will affect Swedbank’s financial reports although the scope of the effect could not be determined at the same time. It is because the valuation of Swedbank’s financial assets is largely depending on how hedge accounting rules are designed and how financial liabilities are treated. Likewise, Swedbank couldn’t make an assessment until the period when annual report 2009 was issued. However, both the interpretations and the amended standards that have been issued are not expected to have a significant effect on Swedbank’s financial statements (Swedbank 2009). The revised IFRS3 was implemented by the bank but it didn’t affect the Group’s financial statement because Swedbank did not make any acquisition in 2010. The revised IFRS3 applied for the purchase method to business combination with several significant changes (Swedbank 2010). Although the amendments version of IAS27 was issued, the Group did not apply it in 2010 in connection with Swedbank AB’s acquisition of interest without control in subsidiary First securities AS. However, the acquisition of amounting to SEK 621m has been recognised in accordance with the new rules in IAS27 as an equity transaction with owners. This recognition has had negative effect on the banks’s retained earnings in equity attributable to the parent Company’s shareholders which is reduced by SEK 497m. In contrary, according to the previous accounting policies, a corresponding item would have rather been recognised as an increase in goodwill. In other word, IAS27 has had negative effects in Swedbanks’s financial reports. Nonetheless, other new,
revised or amended standards issued by IASB or interpretations from IFRIC do not have significant effect on the consolidated financial statements (ibid).

Moreover, from the beginning of 2010 Swedbank started to present financial statements for Groups and Parent’s Company in separate sections in order to increase clarity and the opportunity to use relevant headings. Therefore, Swedbank added a number of new lines in the consolidated balance sheet for liabilities at the amounts reclassified from previously presented balance sheet items. The presentation of notes also has been changed in 2010 annual report (ibid).

**Respondent View:**

According to Henrik Bonde, a Specialist IFRS Group Finance in Swedbank, mandatory requirement is only the reason behind adoption of IFRS in consolidated finance statement. He, however, also argues that a global accounting language benefits banks. For instance: by reducing funding cost. He further cited that it is easier for investor community to understand the entities when they feel familiar with the accounting language. But he also replied that there are no vast difference between SGAAP and IFRS. In other word, they are very close and only the few differences exist and the main difference is tax driven as SGAAP was the base for tax calculation and tax payments.

According to Bonde, total IFRS ensures greater level of transparency due to many jurisdictions and extensive disclosure requirements compared to old requirements. Moreover, he cited that IFRS permits better reporting standards and greater comparability as a total, i.e. IFRS is much easier to compare entities operating in different countries/jurisdictions. He, however, argues that the comparison between, for example Swedish banks, has been reduced. This is because IFRS contains more options, laws and single best practice to recognize a certain transaction than old Swedish GAAP.

Regarding accounting quality, Bonde replied that on global level the accounting quality increase, but for Swedish banks that is not always the case. The treatment of derivatives was, for example, based on what item they hedged. According to IFRS derivatives always have to be measured at fair value. Hence, the hedged item is adjusted instead. According to him, under some circumstances it is hard to achieve hedge accounting according to IFRS, but it was easier according to old GAAP. But, IASB is working with a replacement of IAS 39, among other things to improve the alignment with management’s policies and activities.
On the question regarding the effect on earning management, Bonde replied that the accounting is more based on management´s subjective estimations, depending on larger use of fair values, impairment tests instead of amortisation together with impairment tests. However, significant judgments and estimates have to be disclosed. But current IFRS contains more options compared to old GAAP, which might increase earning management. Nevertheless, he also states that the loss recognition under IFRS is more accurate than the local GAAP. He cited that according to old GAAP, for example, hedge accounting could be done on amortized cost basis. Losses might be amortized during remaining periods. Furthermore he also replied that if value relevance implied fair value, accounting amounts are more relevant in relation to local GAAP. He further explains that in terms of global level IFRS adoption definitely will produce greater quality financial reporting.

In terms of the question regarding information environment, Bonde replied that mandatory IFRS adoption may improve information environment in relation to Swedish GAAP but not in all cases. For example regarding defined benefit pension plans, which before was not reported at all even if the employer had the ultimate responsibility to cover losses for example in an insurance scheme. He also replied that the IFRS reconciliations offer new information to the investor and corporations. Furthermore, he replied that IFRS has increased information costs, but hopefully reduces the information risks. According to him, a well known global language is better than many different. Bonde also believes that IFRS helps to make more efficient decision to the investors. He also replied that Swedbank is able to improve the firm´s information environment after mandatory IFRS adoption as he believes that there are always improvement possibilities.

He further believes that IFRS ensures lower cost of equity capital through increased disclosure (IFRS) and improved information environment because the entities reach a wider investor community. However, he also believes that besides increased disclosure and improved information environment, for banks clear and strong regulation environment are important because banks are very dependent on trust. He further urges that a strong regulatory environment ensures lower cost of equity capital. He believes that all financial reporting is prepared according to IFRS and IFRS is a global language that is a benefit.

The major effects of IFRS on consolidated financial statements according to Bonde, is defined benefit pension plan since all derivates are measured at fair value instead
of amortised cost. As an effect of that many of the cash instruments that economically are hedged by derivatives also have to be measured at fair value.

Regarding the question about two financial statements, consolidated and legal entities, Bonde replied that it is necessary to prepare two sets of financial statements since IFRS is not a good basis for tax calculation and tax payments.

**Handelsbanken:**

From 1 January 2005, like other banks Handelsbanken also have started to use new accounting standards issued by IASB and adopted by EU. However, the application of new accounting polices reduced the opening shareholders’ equity by SEK 438m (Handelsbanken 2005). Due to the application of new accounting standards the major changes were in the acquisition balance sheet, which were in more detail than in the past. According to the new rules goodwill is no longer amortised and intangible assets should be recognised as assets. Moreover, Handelsbanken implemented IAS39 in its consolidated financial statement from 1 January 2005. Thereby the effect of the revaluation of financial assets and liabilities was recognized directly against shareholders’ equity. However, there was no material effect on the presentation of Handelsbanken financial reports due to the application of IAS39. Apart from this, various types of off-balance sheet commitments must be recognised according to the new standards (ibid). Because of the new accounting policies, Swedish legislation started to implement EU occupational pension directive. The changes in accounting policies have had negative effect on Handelsbanken group’s opening Shareholders equity, which was decreased by 3,265m SEK (Handelsbanken 2006). From 2006 the defined contribution has been changed into defined-benefit plan. Therefore the opening shareholder’s equity has been adjusted by SEK 280m. Because of the reclassification, all interest income and expenses related to financial assets in the trading book are now reported under Net gain/losses on financial items at fair value. However, the adjustment of the comparative figures has an impact only on the distribution within net interest income (ibid).

Although the IFRIC10, Interim financial reporting and impairment, was adopted by EU; Handelsbanken had not applied IFRIC10 in the year 2007. Handelsbanken had not adopted any new standard in 2007 thereby there was no effect on the financial statements (Handelsbanken 2007). Amended IAS39 has been applied by Handelsbanken in 2008, which permits reclassification of certain financial instruments from the available-for-sale category to the loans and receivable category as well as to the hold to maturity category. According to the annual report 2008, the
new classification better reflects the Group’s intentions with the holding. Handelsbanken also implemented IFRIC11 IFRS2 (Group and Treasury Share Transactions), and IFRIC14 IAS19 (The Limit on a Defined Benefit Asset, Minimum Funding Requirements) and their interaction have been implemented in financial reports. However, these applications have not affected the Group’s financial reports of Handelsbanken (Handelsbaken 2008).

Due to the new provisions of presentation of financial statements in IAS1, a separate statement of the components was included in other comprehensive income. Other comprehensive income includes the changes in equity not derived from transactions with owners. Handelsbanken started to implement IFRS8 from the financial year 2009. Under IFRS8 accounting standard, the presentation of segment information is based on the same policies as those used for internal reporting to central and managing functions. The effect of this policy for Handelsbanken Group is that income for the segments is presented before internal profit allocation at product level. In some circumstances, the application of IFRS8 has only resulted in a few minor changes to the presentation of segment profit and loss. Other standards and interpretations, IFRIC13; IFRIC9; IAS39; IAS27; IAS32; IAS1; IFRS2; and IAS23, applied by Handelsbanken have had little or no impact on consolidated financial statement (Handelsbanken 2009).

In the fourth quarter of 2010 the presentation format of the balance sheet was modified. According to the modified format, claims on central banks have been shifted to the new item called other loans to central banks which were previously reported under loans to credit institutions. By doing so, the new presentation of the balance sheet better replicates the Group’s risk exposure. In 2010 the new IFRS3 Business Combination and changed IAS 27, Consolidated and Separate Financial Statements, have been implemented in consolidated accounts. However, these standards (IFRS3 and IAS27) did not affect Handelsbanken’s financial statements. Moreover, Handelbanken decided to apply the minor changes as issued by IASB on IFRS7 (Financial Instrument: Disclosure), and IAS1 (presentation of financial statements) although these changes were not mandatory until the period. Nevertheless, these early application has led to some adjustments in disclosure concerning financial instruments. In other aspects there were no changes in financial statement of 2010 than 2009 (Handelsbanken 2010).

**Respondent View:**

Anonymous in Handelsbanken provides answer to the questions raised in the process of research. He provides answers according to his personal opinions and
According to him the main purpose of adoption of IFRS is to have a global language for financial reporting with the purpose of increased transparency and as a consequence make it more cost efficient to participate in different markets and for the users more cost efficient to compare the financial statements on a global basis.

Regarding the question similarities and differences between SGAAP and IFRS, he replied that for listed companies in Sweden there is no Swedish GAAP. The EU Regulation requires an application of IFRS in the consolidated statements. There is basically only one major difference; the possibility to use the carve-out from IAS39. Other differences are just temporary due to the adoption process in EU for new IFRSs.

Regarding the question whether the IFRS ensures greater level of transparency or not; he replied that whether the transparency has increased or not, for single entities globally, depends on the previous GAAP. Sweden actually had, in all important aspects, implemented IASC standard already as the basis for Swedish GAAP therefore he consider the difference in transparency, more related to enhanced IFRSs rather than an actual difference between the Swedish GAAP and IFRS.

Furthermore, he believes that the main merit with IFRS is to create a certain minimum requirement globally which should enhance transparency. However, he does not consider that all the present IFRSs result in better reporting and he considers that some IFRSs actually reduces the possibility to compare different entities with each other and also reduces the possibility to compare different years even for a single entity.

In all important aspects the banks already used IFRS since local GAAP was based on IFRS, he believes that the question regarding the impact of IFRS on bank’s accounting quality is irrelevant. To explain: Regulated entities in Sweden, both used general accounting standards as well as the FSA regulations. Both these standard setting bodies based their standard setting on IFRS or IASC standards to be more precise, wherefore the move to IFRS, was more of a change into new IFRSs than actually totally changing the local GAAP.

Regarding the question earning management he believes that the bank is not involved in earning management. Furthermore, since they actually have already applied the old IFRSs (IASC standards) there is no direct change in the accounting standards between IFRS and SGAAP. Instead, the changes that have occurred have been due to changes in the internationally accepted accounting standards rather than
due to the implementation of IFRS. Regarding the questions timely loss recognition and value relevance he replied that these questions are irrelevant since SGAAP already was based on IASC standards.

Regarding the quality of financial reporting he replied that if IFRS enhance quality or not depends on the quality of the work performed by the IASB Board. Presently many questions depend on the work of IASB. The quality may instead be that a global accounting language is used, not the actual standards in themselves.

Regarding information environment he replies that mandatory IFRS adoption does not improve information environment in relation to Swedish GAAP. He further replied that the IFRS reconciliations neither offer new information to the investors and corporations nor depends on previous GAAP. But in terms of Handelsbanken IFRSs do not offer new information. Moreover, the main objective of IFRS is to have a global language for financial reporting with the purpose of increased transparency and as a consequence make it more cost efficient to participate in different markets and for the users more cost efficient to compare the financial statements on a global basis. However, if that actually has been achieved or not is questionable. Some of the standards produce irrelevant and subjective result which may create uncertainty and also make it costly to adjust the figures to be able to create comparable numbers. On a high level, some parts of this may have been achieved, especially when analyzing accounts from less developed countries. Furthermore, he replies that the quality of the information given depends on the interest of the preparer to actually display the true picture of the performance of the entity or not.

He believes that IFRS does not ensure lower cost of equity capital. He also replies that he does not see direct link between the cost of capital and the enforcement powers in order to reduce cost of capital. Nevertheless, he believes that IFRS create a common language for reporting, that is the advantage of IFRS. Since they do not consider that they had any material differences between local GAAP and IFRS, he consider the question regarding the major effects of IFRS on bank’s consolidated financial statement to be non-applicable. Regarding the cost while preparing two sets of financial statements, in his view there are no major differences for them between following IFRS via the Swedish accounting act and full IFRS implementation. For that reason there is no major costs incurred while preparing financial statements. Regarding the question whether they adopt IFRS or not if it was not mandatory, he replied that there is no alternative today since there is no
local GAAP. Furthermore, since the previous GAAP was based on IFRS, the differences were not material in practice.

**SEB:**

Because of the implementation of new accounting standards (IFRS), the consolidated figures of 2004 must be restated for comparison and reformat purpose (SEB 2004). According to the IFRS first time transition rules, the standards which are applicable from 31 December 2005 shall be applied retrospectively. There are several exceptions in the transition rule. Such exceptions are the possibilities of not presenting the comparative information for one year concerning IAS32, IAS39 and IFRS4. Therefore, SEB decided to apply these exceptions in terms of IAS32 and IAS39 (SEB 2005). In other word, SEB decided to implement IAS32 and IAS39 prospectively from 1 January 2005. However, many of the standards already had been implemented through the Swedish GAAP, the changes and effects mainly come from the standards IFRS1-4, IAS32 and IAS39 that have been implemented after the mandatory adoption period (ibid). According to the new format, the goodwill amortisation was eliminated as per IFRS3 (Business Combination), which brought positive effect of SEK 822m in Profit and Loss 2004 (ibid). Nevertheless, financial instrument IAS39 created some volatility in Profit and Loss, Equity and Balance Sheet but the effects were minor. Moreover, the accounting for the Employee stock option program was governed under IFRS2 (Share based payments) and the cost associated with the program was SEK 55M, which was neutralised in equity (ibid). Apart from this, there was a negative effect on the opening balance of Equity 2005 of 1,424m SEK because of the deduction of notional amounts of swaps hedging employee stock options programmes which was classified as equity instruments according to IAS32 (Disclosure and Presentation) (ibid). Adoption of IFRS insurance contracts primarily changed the classification of contracts and has a small effect on Profit and Loss. Furthermore, there was a negative effect of SEK 229m on the opening balance of equity due to the valuation of Deferred Acquisition Costs in 2004 (ibid).

From 2004 two special purpose entities (Osprey and Three Crowns) and some smaller entities have been consolidated as required by IFRS3, Business Combinations. This change has increased total assets by SEB 15bn without any effect on net profit. In addition, because of the new accounting polices the presentation format of Profit of Loss and Balance Sheet differ from earlier lay-out (SEB 2005).
The adoption of the changes to IAS 19, IAS39 and IFRS 4 did not have significant changes in the Group’s accounting policies and have not affected reported profit or equity (SEB 2006). The amended IAS 21, IAS39 and IFRIC4 were mandatory for accounting periods beginning on or after 1 January 2006, but these accounting policies and interpretation have not had effects on the Groups accounts (ibid). IFRS7, amended IAS1, IFRIC8, IFRIC9, and IFRIC10 have been implemented in 2007 financial statement. However, these implementations did neither have significant impact on Group’s financial statements (SEB 2007).

Amended IAS 39 “Financial instruments: Recognition and measurement” has been adopted mandatorily by SEB from the beginning on or after 1 January 2008. According to the amended policy reclassification of financial assets permit reclassification of certain financial assets out of the held for trading and available for sale categories under certain circumstances (SEB 2008). The amendment to IFRS7 introduces related disclosures requirements for such reclassified assets. This amendment was into force from 1 July 2008 in consolidated financial statements. Apart from this, some interpretation IFRIC11 and IFRIC14 have been implemented but these interpretations did not affect consolidated financial statements (ibid).

IFRS2, Share-based Payment, effects the definition of vesting conditions thereby amended IFRS2 introduces a new concept of “non-vesting” conditions. However, the amendment had no substantial impact on the consolidated financial statement. Further, IFRS8 Operating Segments replaces IAS14 Segment Reporting and aligns operating segmental reporting with segments reported to senior management as well as requiring amendments and additions to the existing segmental reporting disclosures. However, there were no notable effects in consolidated financial accounts. On the other hand, the revised IAS1 changes the presentation format of financial statements from the previous accounting policies. Nevertheless, amended IAS23, IAS32 and new interpretations IFRIC13 and IFRIC16 have been implemented in 2009 financial statement but there were no material effect in the consolidated financial statements (SEB 2009).

The guidance in IFRIC8 and IFRIC11 has been incorporated in amended IFRS2 and the previous guidance of IFRIC11 is supplemented also with regard to the classification of intra-group transactions. The amended IFRS3, Business Combinations, will change how future business combinations are accounted for in respect of transaction costs, possible contingent considerations and business combinations. However, the standard does not have an impact on previous business combinations. Amended IFRS5, Non-Current Assets Held for Sale and
Discontinued Operations, explains that this standard specifies the disclosure requirements that exist for the assets or disposal groups classified as assets held for sale or discontinued operations. It also illuminate that the general requirement in IAS1 is still valid in some extent. Furthermore, amended IAS1 states that the potential settlement of debt through the issuance of shares is not relevant to its classification as short-or-long-term. The revision to IAS27, Consolidated and Separate Financial Statements, primarily influence the accounting for transactions or events that result in a change in the Group’s interests in its subsidiaries. Amended IAS38, Intangible Assets, present clarification of the fair value of an intangible asset acquired in a business combination. In other word, intangible assets are grouped and treated as an asset if the assets have similar useful lives. Amended IAS39 adopted by bank is an illumination of eligible hedged items. However, these amendments have not had a material effect on the banks’ consolidated financial statements (SEB 2010).

Respondent View:

Gunvor Hedström, Finance Department SEB, replied except mandatory requirement the main reason behind adoption of IFRS is, it is of interest of align with commonly accepted rules i.e. the international and public quotation aspects. Nevertheless, according to her, in Sweden there is no big difference between IFRS and SGAAP. It is because the regulators (Finansinspekionen) and accounting boards have aligned over the years.

Regarding the question transparency, she believes that IFRS ensures greater level of transparency because IFRS are more common presentation and disclosures. Moreover, she believes that IFRS requires reporting and disclosures together with accounting principles why it increases comparability and transparency overall. Though, voices have been raised that in particular the financial instruments area is hard to compare as there are many choices in the standard.

Regarding bank’s accounting quality, she does not believe that the implementation of IFRS has increased quality compared to local GAAP but it has aligned reporting and disclosures. Regarding earning management, she replied that in IFRS there are principles for the overall treatment but there are also expert judgments involved. These expert judgments are not by definition earning management but, when comparing different entities, these judgments can of course make it hard for analysis. In addition to this, she does not find the loss recognition more accurately than the local GAAP. This is because recognising losses are always hard and a theoretical loss model does not make it easier. Current rules requiring a defined
event, though recognizes losses in a later stage and this face is one of the drivers for changing IFRS to an expected loss model. Regarding value relevance, she replied that following local regulatory requirements already before the implementation of IFRS the change were not very big for them in Sweden. One of the larger changes though was hedge accounting where Sweden used to have a deferred hedge accounting model. Nevertheless, she agrees that in overall IFRS generates higher quality financial reporting with transparency following from common disclosures. She also believes that to some extent the majority of accounting indicators increased in bank after mandatory IFRS adoption.

Regarding the question information environment, she replied that IFRS adoption does not improve banks information environment to a large extent. SEB already before IFRS had to comply with local Financial Supervisory Authority requirements with specified presentation and disclosure requirements. In addition, being quoted on the stock exchange SEB also had to comply with rules set by the Board for Financial Reporting. Nevertheless, she believes that IFRS reduces information costs and information risk to investors thereby enhances competition and efficiency in the market. This is because under IFRS, information is more common and readily available for investor to compare thus it helps to make more efficient decision to the investors.

Regarding cost of capital, she believes that compliance to commonly accepted accounting principles offers comfort to investors, analysts and rating agencies that's why most probably cost of capital is lower. In other word, IFRS may lower the cost of capital because IFRSs are common and increased disclosures. However, besides increased disclosures, she believes that the strong legal enforcement contributes to lower cost of capital. According to her Sweden has a strong legal enforcement that helps to reduce cost of capital consistent with IFRS and aligned regulatory requirements put on banks also adds to the enforcement.

Regarding the question role of IFRS information environment and advantages of IFRS in the bank, she replied that IFRS is the base for their internal Group Accounting Policy where they document their interpretation and application of the standards. The major effects of IFRS on the bank’s consolidated financial statements, according to her, are the financial instruments with portfolios/impairment/hedge accounting, leases, insurance, employee benefits and goodwill.

Since Sweden prohibits IFRS in legal entities financial statements, she does not think that preparing two sets of financial statements are costly. That is because as
long as they also have to follow rules set by the FSA and Board for Financial Reporting, the differences are not that big in the statutory reporting of the bank. Moreover, if IFRS was not mandatory legislated by EU, the bank prefers to adopt it. It is because SEB is an international organization and quoted on the stock exchange.

Nordea:

The main changes after adoption of IFRS in accounting principles of Nordea include: changes in measurement of assets and liabilities, timing of recognition and derecognition of assets and liabilities, and changes in presentation and classification of the balance sheet items (ibid). Broadly, these changes are associated with implementation of IAS1 Presentation of Financial Statements, IFRS3/IAS27 Business Combination including Goodwill, IFRS4 Insurance Contracts, IAS36 Impairment of Assets, and IAS39 Financial Instruments (ibid).

As per the recommendation of Stockholm Stock Exchange, Nordea presented the main effects of IFRSs on opening balance for 2005 in its 2004 annual report. These effects were on the basis of preliminary calculations thus some changes were made during 2005 (Nordea 2004, 2005). Apart from this, after implementation of international reporting standards the presentation format of Nordea’s account has changed along with reclassifications of the balance sheet as well as certain income and expenses (Nordea 2004). Implementation of IFRS brought a positive net effect on equity of approx. EUR 160m in opening balance (ibid). However, in 2004 Nordea’s business operations are not based on the principles of IFRS4 and IAS39. In 2005 financial instrument (IAS39) is fully implemented thereby the accounting policies of Nordea have also been changed (Nordea 2005). And the adoption of IAS39 affected approx. EUR -6m on the operating profit for the year 2005 thus the IFRS opening balance has also been changed (ibid). Furthermore, Nordea started to do impairment test in accordance with IFRS3 since goodwill is no more amortised (ibid).

Nevertheless, Nordea’s financial statements under IFRS represent increased transparency in terms of net fee and commission income (Nordea 2006). In 2006 Nordea changed the way of presentation of revenue and expense from the life insurance business. According to the new principle all premiums received are initially recognized against the balance sheet as deposit and has no net impact on the income statement (ibid). Classifications of interest income on funding swaps have been reclassified under new standards in order to illustrate the nature of the transactions in better way. However, this change has affected both interest income and expenses (ibid). Non-cash collaterals have been classified in the balance sheet.
and further classified to the item “Financial instruments pledged as collateral” in the case where counter-party has the right to sell or pledged the securities transferred (ibid). In 2007 the presentation on the income line “Profit from companies accounted for under the equity method” has been changed from pre to post taxes. The effect of this change was in income, which was decreased by EUR 14m and EUR 12m on “profit from companies accounted for under the equity method”, and “income tax expense” respectively but the net profit for the year was unchanged. Furthermore, fair value option has been applied on certain assets and liabilities in Nordea Markets (Nordea 2007).

In order to make financial statements transparent and comparable in accordance with IFRS, Nordea has made some changes in accounting polices according to the requirement. Therefore in 2008, Nordea changes the way of presentation of received dividends, treasury bills and other eligible bills (Nordea 2008). Nordea has not made reclassifications according to the new amendment in IAS39 and IFRS7, although these amendments were effective from of 1 July 2008 (ibid). These amendments in IAS 39 and IFRS7 as well as amendments in other standards e.g. IAS1, IAS23, IAS27, IAS32 including new standards IFRS8 have been into force from 1 January 2009 (Nordea 2008, 2009). However, IFRS3, parts of IAS39 and IAS27 were implemented from July 2009 and applicable only from 2010 (Nordea 2008). However, revised IAS23, amended IAS32, IAS39 including IFRIC9, and IFRS2 as well as “Improvements to IFRSs and new interpretations (IFRIC13, 14, 15, 16) have had no or only little impact on Nordea (Nordea 2009). Furthermore, the accounting policy under “net fee and commission income” has been changed in 2010 annual report (Nordea 2010). Nordea has implemented all revised, amended, and improved standards by IASB except the new standards i.e. IFRS9 which is the replacement of IAS39. This new standard (IFRS9) will be into force in Nordea with the effective date from 1 January 2013 (ibid).

In sum, the sample banks have been implementing the revised, amended and improved standards issued by IASB and as endorsed by EU.

4.1.3. Main Differences between IFRS and SGAAP according to Nordea

According to IFRS1 during the first time adoption, companies must show comparative figures for at least one year thereby Nordea presented comparative information for disclosures required by the standards in 2005 (Nordea 2005). Nordea has implemented IFRS1 for the first time on 2005 thus the annual report of
2004 was entirely based on SGAAP. Since the comparative figure was necessitated for the first time, the main differences that affected the financial statements can be described below (ibid):

Table 2: Differences between IFRS and SGAAP.

<table>
<thead>
<tr>
<th>Description</th>
<th>SGAAP</th>
<th>IFRS</th>
</tr>
</thead>
<tbody>
<tr>
<td>IAS 1 Presentation of Financial Statements</td>
<td>Minority interests were deducted from equity and separately disclosed.</td>
<td>Minority interests are included as a separate component in equity.</td>
</tr>
<tr>
<td>IFRS 3, Business Combinations and IAS 27 Consolidated and Separate Financial Statements</td>
<td>Certain exceptions from full consolidation have previously been permitted, the major exception being the life insurance business. Life was earlier disclosed in one line in the income statement and in separate lines for assets and liabilities respectively in the balance sheet. Group undertakings that are not credit institutions, securities companies or insurance companies were earlier consolidated in accordance with the equity method</td>
<td>These are now consolidated line-by-line</td>
</tr>
<tr>
<td>IAS 36, Impairment of Assets</td>
<td>based on a previous version of IAS 36</td>
<td>the revision of IAS 36 has introduced new principles during 2003</td>
</tr>
</tbody>
</table>

5. Analysis:

This chapter consists of an analysis of empirical findings presented in chapter 4 with the help of theories presented in chapter 3. In other word, this chapter analyses the effects of IFRS adoption, differences between SGAAP and IFRS, and the research questions presented in chapter 1.

5.1. Effects of IFRS

As per IFRS (2008) entities that want to implement IFRS in their consolidated financial statement should prepare and present an “opening IFRS balance sheet”. Thereby all sample banks prepared and presented opening IFRS balance sheet in 2005. From that point onward, accounting in accordance with IFRSs of the sample banks’ as described by IFRS (2008) started and thus the accounting policies of the sample banks changed. As explained in IFRS (2008) an entity should describe how the transition from previous GAAP to IFRSs affected its reported financial position, financial performance and cash flow. With this description, the sample banks presented the effects of transition to IFRS. Due to the implementation of IFRS, there was positive effect of IFRS in Nordea and SEB’s opening balance sheet. On the other hand, there was no significant effect of IFRS in Swedbank’s financial position and negative effect on Handelsbanken’s and SEB bank’s opening balance.

Because of the application of new accounting standards under IFRS, the major changes in the sample banks’ financial statement are in the acquisition balance sheet, which are in more detail than in the local GAAP. Moreover, as described in (IFRS 2008) there is exception to present comparative information in terms of IAS39 for one year. Therefore, all the sample banks implemented IAS39 on their consolidated financial statements from the beginning of 2005, which brought negative effect on Swedbank’s and Nordea’s opening balance. However, it brought minor volatility on SEB’s profit and loss, equity and balance sheet; and there was no significant effect on Handelsbanken reported profit.

With the reference of IFRS (2008) an entity that is preparing opening IFRS financial statement should recognise all assets and liabilities as required and permitted by IFRSs. Therefore, all the sample banks recognised their assets and liabilities according to the recommendation of IFRS. However, the recognitions of assets and liabilities have not brought material effect in the sample banks’ consolidated financial statements. But, after recognition of financial assets and liabilities; financial statements started to reflect the Groups’ financial positions in better way. This is
because under IFRS financial assets and liabilities are primarily valued at fair value (Paananen 2008).

Moreover, under the new accounting policy as described by Paananen (2008) goodwill amortisation is no longer allowed and instead the impairment should be tested. Thus, the sample banks eliminated goodwill amortisation and started to make impairment test as per the recommendation of IFRS3. This elimination of goodwill and impairment test brought positive effect on SEB’s profit & loss and Swedbank’s reported profit. However, the effect due to elimination of goodwill amortisation has not been mentioned in the other sample banks’ financial statements. Furthermore, like Paananen (2008) described, sample banks started to recognise intangible assets as assets after the mandatory IFRS adoption.

From the above empirical findings it can be analysed that the sample banks have been adopting new, amended and revised IFRS standards as per the recommendation of IASB and EU; although the banks had been implementing IAS standards prior to the mandatory period to some extent (Nilsson 2006). Thereby, all assets, liabilities, income and expenses have been restated and reclassified in accordance with IFRS standards to present fair value accounting like IFRS (2008) and Paananen (2008) described. However, there are no major effects on the sample banks’ financial statements because of the adoption of new, revised and amended IFRS standards except some particular standards related to banks. Such particular standards that effected financial statements are: Swedbank – IFRS3, IAS39 and IAS27; Handelsbanken – EU Occupational Pension Directive; SEB – IFRS3, IAS32 and Deferred Acquisition Cost; Nordea – IAS39. Moreover, in many cases it is hard to analyse how the adopted (new, amended, and revised) standards effect sample banks’ financial statement.

5.1. Differences between IFRS and SGAAP

SGAAP was already the translation of IASC standards. Therefore as described by Paananen (2008) the differences between SGGAP and IFRS reduced over time. However, from the above empirical findings and theoretical framework, the main differences between IFRS and SGAAP can be analysed as follows:
Table 3: Differences between IFRS and SGAAP.

<table>
<thead>
<tr>
<th>Description</th>
<th>SGAAP</th>
<th>IFRS</th>
</tr>
</thead>
<tbody>
<tr>
<td>IFRS3, Business Combination</td>
<td>Like Paananen (2008) explain, under SGAAP the sample banks used goodwill amortisation</td>
<td>After mandatory adoption sample banks started to test impairment rather than amortisation.</td>
</tr>
<tr>
<td>Intangible Assets</td>
<td>There was separate treatment of intangible assets by the sample banks.</td>
<td>Banks started to consider intangible assets as assets.</td>
</tr>
<tr>
<td>Financial Assets</td>
<td>Like Paananen (2008) the sample banks used fair value accounting in some special cases only.</td>
<td>With the reference of Paananen (2008) financial assets of the sample banks are primarily valued at fair value.</td>
</tr>
<tr>
<td>Financial Instruments</td>
<td>There was no complete coverage of financial instrument in the sample banks financial statements</td>
<td>Like Paananen (2008) describe financial instruments by banks are valued at fair value.</td>
</tr>
<tr>
<td>IAS 1 Presentation of Financial Statements</td>
<td>Minority interests were deducted from equity and separately disclosed.</td>
<td>Minority interests are included as a separate component in equity.</td>
</tr>
<tr>
<td>Hedge Accounting</td>
<td>It was easier to achieve hedge accounting under SGAAP.</td>
<td>In some circumstances it is hard to achieve hedge accounting under IFRS.</td>
</tr>
<tr>
<td>Tax Driven</td>
<td>SGAAP was on the basis of tax calculations and tax payments.</td>
<td>There is no link between tax and accounting.</td>
</tr>
</tbody>
</table>

5.2. Transparency and Accounting quality

As mentioned by Cox (2008) due to the rapid globalisation and internationalisation of businesses, it is important to improve investor confidence in this global capital market through the common language of financial disclosures and transparency. With this reference, the sample banks also changes their accounting policy with the introduction of IFRS from the mandatory period i.e. 1 January 2005. This is because IFRSs standards are global accounting language that promotes greater confidence in transparency and comparability of financial reporting to the investors (European
Union 2002, Cox 2008), which according to the respondents benefits banks. Like European Union (2002) IFRS improve overall quality of financial reporting and efficiency of capital market, respondents of sample banks believe that through the global language of financial reporting it will be easier for the investor community to understand the entities when they are familiar with the accounting language. It is because the main purpose of IFRSs is increased transparency and as a result of this, it makes it more cost efficient to participate in different market and for the users.

Ball (2006) believed that IFRS assures more accurate, comprehensive and timely financial statement than the local GAAP and IFRS is now required to be implemented in consolidated financial statement. However, there are no vast differences between Swedish GAAP and IFRS as most of the standards in SGAAP were directly translated from IAS. Like Ball (2006) described IFRS ensures greater level of transparency, and the respondents believe the same but in terms of global perspective. This is because IFRSs are more common presentation and disclosures compared to local GAAP. And IFRS creates a certain minimum requirement globally which should enhance transparency. Moreover, in a global perspective IFRS permits better reporting quality and greater comparability as described by Ball (2006). Nevertheless, in terms of Swedish banks, the level of transparency and reporting quality has not been increased over the years compared with local GAAP. It is because IFRS contains more options and laws to recognise certain transactions in relation to SGAAP. In addition, all IFRSs standards do not result in better reporting but some IFRSs actually reduces the possibility. For instance, in some circumstance it is difficult to achieve hedge accounting according to IFRS; which was easier in old GAAP.

While analysing earning management, timely loss recognition, and value relevance like Barth et al. (2006, 2008), Paananen (2008), and Chen et al. (2010); there are contrast views among the respondents. According to Handelsbanken since the Swedish GAAP already was the translation of old IAS there is no earning management after mandatory IFRS adoption. However, I got contradict view in his opinion. This is because in one hand he said there is no earning management. On the other hand, he believed that the quality of information depends upon interest of preparer while preparing information in the statements. In contrary to Handelsbanken, the rest of the two respondents’ opinions almost support the view of Paananen (2008) that after the mandatory adoption there are possibility of earning management. This is because IFRS contains more options compared to old GAAP, although in IFRS there are principles for the overall treatment. In other
word, Like Paananen (2008) I find little evidence of less earning management after mandatory IFRS adoption.

Moreover, in terms of loss recognition and value relevance I find unclear evidence from the respondents. This is because the respondents’ opinions vary between each other. One respondent replied that the questions of loss recognition and value relevance are irrelevant since SGAAP already was based on IASC standards. Another respondent’s opinion supports the view of Barth et al. (2006, 2008) and Chen et al. (2010). In other word, loss recognitions are more accurate; for instance in old GAAP hedge accounting could be done on amortized basis. And accounting amounts are more value relevant under IFRS than local GAAP as IFRS is based on fair value accounting. On the other hand, the third respondent’s opinion almost supports the view of Paananen (2008) because the respondent did not find the loss recognition more accurately than SGAAP. Furthermore, there is no big change in value relevance after mandatory IFRS adoption.

Nevertheless, empirical findings suggest that besides increased disclosure, some enforcements like clear and strong regulations environment as described by Soderstrom and Sun (2007); Daske et al. (2008); Jeanjean and Stolowy (2008) are important in order to lower earning management and to determine financial reporting quality. This is because accounting quality is directly or indirectly affected by these enforcements (Ball 2006). As described by Levine (1998) Sweden is a country with strong regulatory enforcements that provide strong reporting incentives. But, this study finds little evidence of less earning management over the years after mandatory IFRS adoption. Furthermore, as described in above paragraph I find unclear evidence in terms of loss recognition and value relevance. This might be because the respondents’ answers differ from each other as their answers mostly rely on personal opinions rather than the opinions from the bank. As a result, I find little evidence of increased accounting quality over the years in terms of Swedish banks although Sweden is a country with strong regulatory enforcements.

5.3. Information Environment:

Like other literatures on IFRS for instance Barth et al. (2006, 2008); Chen et al. (2010), most of the findings suggest that in a global perspective IFRS would generate high quality financial reporting. Therefore, to some extent findings of Swedbank agree with the view of Barth (2008) that IFRS disclosure may improve the firm’s information environment in relation to Swedish GAAP but not in all cases. For instance defined benefit pension plan, which before was not reported at all. However, from the empirical findings, it can be analysed that Swedbank is able
to improve the firm’s information environment after mandatory adoption period like Barth (2008) described. This is because under IFRS there are always improvement possibilities. Furthermore, Swedbank supports the view of Horton and Serafeim (2010) that IFRS reconciliation offer new information to the investors and corporations. However, unlike Ball (2006) IFRS reduces information cost; Swedbank believes that information cost has increased over the years after mandatory IFRS adoption. But to some extent Swedbank also supports the view of Ball (2006) that IFRS hopefully reduces the information risks. It is because IFRS is a well known global language which is better than many different. Consistent to Choi and Meek (2005), Swedbank believes that IFRS helps to make more efficient decision for the investors since IFRSs are well known global language.

On the other hand, unlike Barth (2008) empirical findings of the other two banks suggest that mandatory IFRS adoption does not improve information environment to a large extent in relation to Swedish GAAP. This is because banks already had to comply with local Financial Supervisory Authority requirements with specified presentation and disclosure requirements. Moreover, Handelsbanken contradict the view of Horton and Serafeim (2010) as it believes that IFRS reconciliation does not offer new information to the investors and corporations. This is because the main purpose of adoption of IFRS is only to have a global language for financial reporting with the aim of transparency and through cost efficiency. But, that does not mean IFRS offers new information to the investors since it is not known whether the objective of transparency and cost efficiency has been achieved or not. That is also because some of the IFRS standards produce irrelevant and subjective result which may creates uncertainty and also make it costly to adjust the figures, which to some extent supports the view of Cuijpers and Buijnik (2004) that investors adopting IFRS have higher level of uncertainty relative to local GAAP.

Although SEB believes that IFRS does not improve information environment to a large extent, it supports the view of Ball (2006) that IFRS reduces the information risk and information cost. This is because IFRS information is more common and readily available for investors to compare, which helps to make more efficient decision to investors. In other word, IFRS helps to reduce information risk and information cost through commonly accepted language, but it has not improved bank’s information environment compared SGAAP.

In sum, I find little evidence of improved information environment, but find the evidence of increased information cost after mandatory IFRS adoption. However, most of the findings suggest that there is a lower information risk after mandatory IFRS adoption.

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5.4. Cost of Equity Capital

Like Botosan (1997), Fransis (2005), Lee et al. (2008); empirical findings of SEB and Swedbank suggest that IFRS ensures lower cost of capital as IFRSs are more common and increased disclosures. It is because through IFRS financial statements, for banks it will be easy to reach wider investors communities and it also offers comfort to analysts and rating agencies. Moreover, like Lambart et al. (2007); Lee et al. (2008); and Armstrong et al. (2010), Swedbank believes that IFRS ensures lower cost of capital through improved information environment. However, besides increased disclosures and improved information environment; accounting is also shaped by some institutional factors (Ball 2006). Therefore, strong regulatory environment is important in order to reduce cost of equity capital because banks are very dependent on trust. Financial statements under IFRS are easy to translate and compare for the investors domiciled in different nations because IFRS is a global language which is a benefit to banks. In other word, mandatory adoption of IFRS significantly reduces the cost of capital as explained by Li (2010) in the country with strong regulatory environment. Sweden is a country with strong regulatory enforcement that provides strong reporting incentives (Levine 1998), which helps to reduce cost of capital consistent with IFRS. This is because strong regulatory environment ensures lower cost of equity capital.

Contrary to Botosan (1997), Fransis (2005), Lambert et al. (2007), Lee et al. (2008), Armstrong et al. (2010), and above two banks; empirical findings of Handelsbanken suggests that IFRS does not ensure lower cost of capital and there is no direct relationship between the enforcement powers and cost of equity capital. Nevertheless, the only advantage of IFRS is that it creates common language for financial reporting.

Although I find little evidence of higher accounting quality and improved information environment in terms of Swedish banks, the majority of the findings suggest that IFRS ensures lower cost of equity capital. In other word, like Prather-Kinsey et al. (2008) and Li (2010), I find lower cost of equity capital after mandatory adoption of IFRS. This is because Sweden is a country with strong regulatory enforcements (Levine 1998). And through IFRS financial statements, for banks it will be easy to reach wider investors communities residing in different nation.
6. Discussion and Conclusion

This chapter consists of discussion and conclusion that the author drew. It discusses and summarizes the most important findings presented in previous sections. Moreover, this chapter provides overall answers of research questions presented in chapter one. In addition, suggestion for further research is also presented.

In 2002 through EC Regulation No. 1606/2002, EU legislated that all listed companies domiciled in member states should prepare their consolidated financial statements from the beginning of 2005. This is because IFRS standards are one set of common financial reporting standards, which are more comparable and transparent for the investors and users residing in different nations. Therefore, as a member state of EU, Swedish banks also adopted IFRS in their consolidated financial statement from the mandatory period. Nevertheless, for Swedish banks the main objective of adoption IFRS is not only because adoption of IFRS is mandatory. But, it is also because IFRSs are globally and commonly accepted language for financial reporting.

Prior to the mandatory adoption period, the banks prepared consolidated financial statement in accordance with SGAAP. However, SGAAP already was on the basis of international accounting standards (IAS) as most of the standards in SGAAP were directly translated from IAS. In other word, Sweden was implementing IFRS/IAS standards gradually prior to the adoption of EC Regulation. As a result, the differences between SGAAP and IFRS also have been reduced over time. However, the main differences exist between these two standards are: IAS1, IFRS3, financial asset, financial instruments (IAS39) intangible assets, hedge accounting, and tax driven. But, SGAAP no longer exists now for the companies listed in capital market as mandatory IFRS is into force.

After mandatory period, the banks adopted all new, amended and revised standards in accordance with EU recommendations. Nevertheless, there are little or no material effects of adoption of IFRS standards in the sample banks’ consolidated financial statements except some particular standards related to banks. Such particular standards are: IFRS3, IAS39, IAS27, EU Occupational Pension Directive, IAS32, and Deferred Acquisition Cost.

Nevertheless, due to the link between tax and accounting the Swedish banks also should prepare legal entities financial statements according to the recommendations
-Discussion and Conclusion-

of SFRB. The SFRB recommendations are also on the basis of IFRSs, but some changes have been made in the recommendations to adjust IFRSs with Swedish legal and tax environment and in the cases deemed necessary by the SFRB. In other word, Swedish banks should prepare two sets of financial statements i.e. consolidated financial statement as required by EC and legal entities financial statement (annual accounts) in accordance with SFRB. But, most of the findings suggest that there are no major costs incurred while preparing two sets of financial statements.

Moreover, it is believed that IFRSs are the global language financial standards which ensure transparency and accounting quality, lower the information asymmetry and thus reduce the cost of capital. Not only this, IFRS financial statements are more comparable for the users and investors in relation to local GAAP. With these reasons, the IFRS accounting standards are getting acceptance rapidly day by day all over the world. However, it does not mean that once a country adopts IFRS, it will produce greater financial reporting quality; improve information environment and thereby reduce cost of capital. This is because accounting quality, information environment and cost of capital directly or indirectly are connected with country’s institutional factors. For instance: legal or political enforcements. Generally, it is said that IFRS ensures greater accounting quality, lower information asymmetry, and reduces cost of capital in the country with strong institutional factors.

Sweden is a country with strong legal and political enforcements. I, therefore, analysed the transparency & accounting quality, information environment, and cost of equity capital after mandatory adoption of IFRS of the sample banks. But, I find the level of transparency and financial reporting quality has not been increased over the years. In terms of accounting quality, I also examined earning management, loss recognition, and value relevance. I, however, find little evidence of less earning management and find unclear evidence in terms of loss recognition and value relevance. In other word, I do not find strong evidence of higher accounting quality. Moreover, I find little evidence of improved information environment but find information cost increased; although I find lower information risks after mandatory IFRS adoption. Nevertheless, a majority of the findings suggest that IFRS ensures lower cost of equity capital. This is because through IFRS, for banks it will be easy to reach wider investors communities residing in different nations.
6.1. Suggestion for Further Research

This research study has been carried out for four Swedish banks. Due to the cost and time barrier I was unable to do research by taking more banks as sample. Since I got answers only from three banks out of four, the evidences of the research questions are only based on these three banks. Therefore, it is strongly recommended to do the research in same topic by taking more samples. Furthermore, this research is based on Sweden therefore future studies can be done throughout the European banks. Apart from this, further research can be done for all listed companies in Sweden in order to know accounting quality, information environment, and cost of equity capital after the mandatory IFRS adoption. Moreover, the research on the same topic also can be carried out for the unlisted companies that are implementing IFRS in their financial statements.

In addition, mathematical tools have not been applied in this research study as this research has not employed quantitative research method. Thus, further study can be deployed using mathematical tools through quantitative research method in order to prove the results.
References:


Appendix

Interview Guide

Interviewee Profile

Full Name: 
Age: 
Gender: 
Designation: 
Working Years 
Company Name: 

Questionnaire:

1. In your opinion what is the main reason behind adoption of IFRS? Is it only the mandatory requirement or other factors such as internationalization, ownership structure, size etc are also the reasons?
2. What do you think are the similarities and differences between SGAAP and IFRS?
3. Do you think adoption of IFRS ensures greater level of transparency? Why?
4. Do you think IFRS permits better reporting standards and greater comparability?
5. What is the impact of IFRS on bank’s accounting quality? After mandatory adoption, does the accounting quality increased/decreased? How? Please explain in comparison to the standards you were using prior to 2005 (non-mandatory periods).
6. In your bank, how the mandatory IFRS adoption effect on earning management? Does it increased/decreased after mandatory adoption?
7. What’s the scenario of timely loss recognition? Do you found the loss recognition more accurately than the local GAAP?
8. What is your opinion regarding value relevance of accounting amounts in relation to local GAAP? Does it more relevant after mandatory adoption?
9. Does IFRS adoption definitely will produce greater quality financial reporting? If not, what are the major factors that influence accounting quality (for instance:
the quality of the standards; a country’s legal and political system; and financial reporting incentives)
10. Do you think the majority of accounting indicators in your bank increased after mandatory IFRS adoption? Explain.
11. Does mandatory IFRS adoption improved information environment in relation to Swedish GAAP? How?
12. Do IFRS reconciliations offer new information to the investors and corporations?
13. Do you believe IFRS reduces information costs and information risk to investors thereby enhances competitive and efficiency in the market? How?
14. Does IFRS help to make more efficient decision to the investors?
15. Does the accuracy level of information provided by IFRS depends upon information analyst? How?
16. Do you think your bank is able to improve firm’s information environment? Why and how?
17. Do you think IFRS ensures lower cost of equity capital through increased disclosure and improved information environment?
18. Besides increased disclosure and improved information environment, does strong legal enforcement also required in order to reduce cost of capital?
19. Do you think Sweden has a strong legal enforcement that helps to reduce cost of capital consistent with IFRS?
20. In your organization what is the role of IFRS in information environment? What are the advantages of IFRS?
21. What are the major effects of IFRS on your consolidated financial statements?
22. Since Sweden prohibit IFRS in legal entities financial statements, what’s your opinion regarding cost? Don’t you think it is costly?
23. If IFRS was not mandatory legislated, would you prefer to adopt it? Please explain briefly.