Items affecting comparability in the financial statements

A quantitative study of the development in Sweden 2005-2010, its causes and the implications for financial statement users

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Abstract

The thesis investigates the phenomenon of items affecting comparability and its development in 30 Swedish companies during the period 2005-2010. It further tries to answer the question of how these items affect different groups of financial statements users. Previous research indicates that managers have incentives to take a “big bath” during crises. To answer the questions both a quantitative research by examining 180 annual reports and a qualitative containing three interviews has been conducted. The result reveals an increase of reported items affecting comparability costs during 2008 and 2009. Managers engage in “big bath” accounting as well as accounting for cutting down on the extra capacity that emerges during recessions. The impact this has on the users of financial statements varies, where some find it to be an important issue, others see it as a minor problem. The small sample used made the study fragile for extreme values. In order to make more conclusive conclusions a larger sample would be necessary.

Key words: Items affecting comparability, big bath accounting, recession, and users of financial statements.
# Table of content

1. Introduction 5
   1.1 Background 5
   1.2 Problematization 6
   1.3 Aim 7
   1.4 Research questions 7

2. Theory 8
   2.1 History of Items affecting comparability 8
   2.2 Previous research regarding Items affecting comparability 9
   2.3 Earnings management and big bath accounting 10

3. Methodology 13
   3.1 Definition of items affecting comparability 13
   3.2 Choice of sample 14
   3.3 Choice of research method
      3.3.1 Quantitative data from Annual reports 16
      3.3.2 Ratios 16
      3.3.3 Interviews 17
   3.4 Criticism against the methodology 18
   3.5 Framework 20

4. Empirical results and analysis 22
   4.1 Aggregated level
      4.1.2 Total Amount in SEK 23
      4.1.3 Interviews and analysis of the aggregated results 24
   4.2 Industry level
      4.2.1 Retail 26
      4.2.2 Information technology – IT 27
      4.2.3 Engineering 27
      4.2.4 Basic materials 28
      4.2.5 Constructing 29
      4.2.6 Interviews and analysis of the industry level 30
   4.3 Size comparison
      4.3.1 Large companies 31
      4.3.2 Small companies 32
      4.3.3 Interviews and analysis 33
   4.4 Implications for financial statement users
      4.4.1 “Do not mistake IAC for extraordinary items” 34
      4.4.2 Different users, different answers 36

5. Conclusion and suggestion for future research 38
   5.1 Summary and Conclusion 38
   5.2 Criticism of the study and suggestions for future research 39
References

Articles 40
Litterature 40
Magazines 40
Laws, Rules and Recommendations 41
Electronic Sources 41
Annual Reports 41
Interviews 43

Appendix

Interview questions 44
Diagrams 45
Aggregated - IAC:s median and mean 45
Basic Materials - IAC:s median and mean 46
Engineering - IAC:s median and mean 47
Constructing – IAC:s median and mean 48
Retail – IAC:s median and mean 49
IT – IAC:s median and mean 50
Large companies – IAC:s median and mean 51
Small companies – IAC:s median and mean 52
1. Introduction

This chapter covers a background of the study as well as a problem discussion. It leads down to the part where we clarify our aim and finally our research questions.

1.1 Background

The financial statement is probably the most important source for investors when looking for information to base their investment decisions on. Hence it is of great importance that investors can understand the information and that it is presented in a trustworthy and comparable manner. It has been argued that the relevance of financial statements has been declining for some time (Francis & Schipper, 1999). When speaking in terms of a decline in relevance, it refers to the explanatory power of financial statements in predicting future earnings.

It is critical for investors to have comparable information in order to be able to make the optimal investment decision. Therefore, items in financial statements that are affecting the comparability should be of interest to the investor since they diminish the ability to take the best decision. The reason for accounting for these IAC:s separately represents a need from the users of financial statements to distinguish which actions that are representative of the company’s operations and which are not (Massoud et al., 2007). There is a big difference between a company that report poor earnings due to a fire in one of their facilities, than one where it is due to a drop in sales. Both companies may report poor earnings, but the fundamentals behind it are radically different. Many items affecting the comparability means a harder time for analysts and investors to predict future outcomes (Bernstein, 1972).

There are several issues and implications with the concept of IAC:s. First of all, there exist no congruent definition of what an IAC is. Companies vary in their definitions, what one company report as an IAC, another account for as ordinary. If that was not enough, even the regulators are having a hard time determining the same thing. IAC:s are closely related to extraordinary items, i.e. non-recurring or “special” items. These items where accounted for in a separate line in the income statement until 2003 (Massoud et al., 2007). In order for firms to be allowed to account for these items as extraordinary, they had to state why this was the

1 IAC = Items affecting comparability
case. It means that the cause for the anomaly and the impact it had on the company’s performance had to be stated in the financial report. To clarify the implications it had on the reporting, the events of 9/11 2001 are a good example. FASB gave the recommendation that none of the costs that emerged due to the events on that day, were to be accounted for as extraordinary (Massoud et al., 2007). It may seem a bit odd, since the attacks certainly fall under the category of extraordinary events. The reason for the decision however, was that FASB determined that it was too difficult to determine which extra costs that was due to the terrorist attack and which ones that were ordinary (Massoud et al., 2007).

As have been described, the reason behind presenting IAC:s separately is that users of financial statements easily can see where the revenues or costs come from, in order to determine weather it is important or not. That is also one of the issues with the concept. Both Massoud et al., (2007) and McVay (2006), point out that there are incentives for managers to engage in classification shifting in order to influence the users. The reason is that users of financial statements tend to neglect the impact of these items when they conduct their analysis. The phenomena may be used by managers because it gives them the possibility of presenting the company’s performance in a more flattering way, by shifting ordinary costs to IAC:s (McVay, 2006). The absence of clear regulations do also leave room for managers to conduct “big bath” accounting, in order to “clean up” their income statements. Reason for conducting a “big bath” can be the change of a CEO, who wants a clean “sheet”, or a recession that legitimize poor performance (Walsh et al., 1991). It is better to report poor earnings when times are bad and IAC:s are an easy way for managers to “create” higher costs and thus poorer earnings. It creates a platform for better earnings in the future (Walsh et al, 1991). As most people are aware, the global economy is still recovering from one of the severest recessions in the last 70 years. The shockwaves that the bankruptcy of Lehmann Brothers created hit the market very hard. According to theory, there was no better time to report IAC:s than now.

1.2 Problematization

It lies in the interest of financial statement users to receive accurate information about companies’ development. Otherwise it diminishes their chances to perform accurate forecasts, which is the foundation for rational investment decisions. IAC:s, influence the estimation process, since analysts and investors must determine what the “real” sometimes referred to as “the underlying” result is. If companies engage in classification shifting, or inform of items as
non-recurring, this can be a problem as well as help when the result is to be estimated. Another area of concern is “big bath” accounting where the costs are overstated in one period, which generate unsustainable high earnings in the coming periods. However, there are natural causes for IAC:s as well but they always creates uncertainty and are important to analyze in the estimation process. Hence, in times where the reported IAC:s are high, uncertainty regarding forecasts should also be high. Therefore, it is interesting to investigate how these items develop over time, or more specifically during the latest recession.

1.3 Aim

The aim of the thesis is to investigate how the reported IAC:s change over the period between 2005 – 2010 in 30 Swedish companies. More specifically we want to analyze how they move during the period of the latest recession and what the reasons behind the movements are. Furthermore we want to discuss how this affects users of financial statements.

1.4 Research questions

1. How does the IAC:s of Swedish companies develop during the five-year period of 2005-2010 and more specifically react to a period of financial crisis?
2. What are the causes for the results?
3. How does the results affect users of financial statements?
2. Theory

The chapter includes literature review divided into three parts. The first part discusses the history of items affecting comparability while the second part focuses on previous research regarding these items. The final part covers previous research regarding earnings management and big bath accounting during periods of recessions.

2.1 History of Items affecting comparability

The concept of items affecting comparability was first formed in 1917, called uniform accounting, in a document created by the Federal Reserve Bank. This document was reissued one year later when it was recommended that extraordinary gains and losses should be recognized on the income statement. These items were not frequently recurring and often of an unusual character. The regulations changed back and forth regarding if they were to be shown in the bottom line after net income, or if they were to be accounted directly in the net income. Over the years it has been a problematic area where the regulations regarding how these items should be accounted for have shifted and been a constant cause for uncertainty (Massoud et al., 2007).

The purpose with extraordinary items has always been for the reader of the financial statements to separate extraordinary events from ordinary and thus exclude the extraordinary items in their forecast of future gains and losses (Bernstein, 1972). Still, the classification of the items has always been problematic, since the lack of regulations opens the door for a vast variation of definitions of IAC:s. Hence, companies have a lot of room to classify items according to their own opinion, which in turn creates uncertainty (Artsberg, 2005). In 2003 the IASB decided to eliminate all kinds of extraordinary items in the financial reporting. In IAS 1 - presentation of financial statements, it is stated that the income statement and the notes should be free from extraordinary gains and losses. The motive for the decision was the “difficulty of objectively separating the financial effects of one event from one another” (Massoud et al., 2007). All the members of the European union are obliged to follow these rules and thus Sweden are among them (Internationell redovisningsstandard I Sverige, IFRS/IAS 2009).

Since this decision was taken, most companies have gone from writing “extraordinary items” or “special items” to instead write “items affecting comparability” (Fagerström & Lundh...
2005). However there is a difference in how companies’ account for IAC:s compared to “extraordinary items”. The extraordinary items had their own line in the income statement after earnings from operations but before earnings after tax. IAC:s on the other hand, do not necessarily need to be presented in the income statement. It is up to the company to decide how specific they want to be in their reporting. However, it is stated in today’s rules that items occurring under unusual circumstances should lead to separate information in the annual reports. One example of such an item is restructuring costs (IAS 1).

2.2 Previous research regarding Items affecting comparability

Little research has been conducted regarding the existence and appearance of IAC:s which is one of the reasons why it has been chosen to be examined within this thesis. There are however some research that have been focusing on the use of these items as an earnings management tool and how it affect users of financial statements.

In 1972 Bernstein discussed in which ways there was a problem with extraordinary gains and losses. It was mentioned how managers continuously reported costs as extraordinary while they in fact were not and through this fooled investors and analysts to exclude these costs when trying to calculate future earnings. He argued that it was too much subjectivity involved in the judgments and that newspapers often trusted these judgments and thereby fooled investors (Bernstein 1972). This kind of behaviour is as mentioned in the introduction, called classification shifting and is commonly used as an earnings management tool according to research made by McVay (2006). It is a way for managers to hide core expenses as if they were special. This shift does not change the bottom line earnings but it overstates the core earnings. It is often used as a way for managers to meet analysts forecasts of earnings, since these forecast benchmarks often tend to exclude the IAC:s (McVay 2006). Opposed to these findings Riedl and Srinivasan (2010) finds that items placed in the income statement as a special item are less persistent than those only presented in notes. According to them, if firms were to engage in earnings management the opposite would be true (Riedl & Srinivasan 2010).

The most common kinds of IAC:s is restructuring costs and capital gains (Claesson et al., 2010). The phenomenon of restructuring costs and its implications on analysts and stock prices has been examined earlier (Poon et al., 2001). It was found that restructuring costs are largely connected with future negative excess returns when the Dow Jones Industrial Average
30 corporations were examined between 1988 and 1995. Further it was found that the larger amount of restructuring costs announced in the Wall Street Journal, the more negative the stock price reaction was (Poon et al., 2001). One of the reasons for firms to account restructuring costs as IAC:s is to inform investors that it is a one-time event and that it hopefully will lead to something positive in the future. These findings however, imply that it may not be the best thing for a company to do.

Claesson et al., (2010) studied many different factors regarding IAC:s. They conclude that decisions regarding restructurings and how that information is announced have a significant impact on investors. They continue with concluding that there exists freedom for companies in determining which items that are to be reported as IAC:s. That in turn leads to large differences between companies. Finally they do believe as a result of their research that no restructuring costs should be accounted as IAC:s. This is because it is a part of a company’s business to from time to time restructure.

2.3 Earnings management and big bath accounting

Many studies have been examining the use of earnings management (Healy & Wahlen 1999). Since our study covers a time of financial crisis, a walkthrough of some of the earnings management literature covering previous crises is relevant. It will help us understand and analyze our results.

Chia et al., (2007) examines companies listed at the Singapore stock exchange to see whether their choice of auditors during the Asian financial crisis had any effect on the use of earnings management. Their hypothesis was that the increased need of control from stakeholders puts pressure on management to deliver credible earnings, which would reduce the earnings management. They find that the overall level of earnings management decreases during the crisis, but that the income decreasing earnings management increases. Meaning that the companies manipulate their earnings downwards because of the higher level of tolerance from stakeholders during a crisis. Agarwal et al., (2007) finds a similar pattern in their study about Japanese banks. They found that Japanese banks earnings management decreases during the Asian financial crisis between 1997-1999.
Wall and Wiik (2010) studied how earnings management changed during the recent financial crisis in Sweden. Their study is made on 179 companies listed on the Stockholm Stock exchange\(^2\) divided into four categories based on industry. The time period examined is the three-year period from 2007 to 2009. Their study is built on the two hypotheses that earnings management during the crisis is mostly made of manipulating the earnings downwards and that overall earnings management should decrease during the period. Both of these hypotheses were rejected and the result is found to be insignificant. They discuss whether their findings can be due to what Leuz et al (2003) discusses in their study, which finds Sweden to have a very low presence of earnings management compared to other countries. Further on they found differences between the different industries with the most notable being that the industry called “seldom buy” showed the highest earnings management score of them all.

One common factor in these studies is that they do believe that the earnings management is decreasing during a crisis since the control and attention to the statements gets higher. Another one is the hypothesis that the earnings management during a crisis is focused on manipulating the earnings downwards, so called big bath accounting.

Big bath accounting is the use of earnings management to manipulate poor earnings downwards so they become even poorer. The idea behind it all is that in the subsequent years, the chance of showing higher returns increases (Kirschenheiter & Melumad 2002). It has been described as way of “cleaning the stables” when the year already is bad and the expectations from stakeholders are low (Walsh et al, 1991). A well describing quote is the one from Jim Henry, journalist at BNET concerning General Motors second quarterly report of 2008;

"If you “re going to take a bath, make it a big bath. Chuck in every piece of bad news you can think of. That way, you get as much bad news as possible out of the way at the same time. Each individual piece of bad news gets less attention, than if you announced them one at a time.” ([www.bnet.com](http://www.bnet.com))

Numbers of studies have been made around this phenomenon with different approaches. Healy (1985) examined bonus plans and their incentive effects on managers. He finds that the use of big bath accounting in bad years could be a way of maximizing bonuses in following years. He argues that when earnings are lower than the bonus limits, costs can be inferred

\(^2\) Nasdaq OMX Stockholm is referred to as the Stockholm Stock Exchange in the thesis
earlier and income deferred to next year. Walsh et al (1991) finds a relationship between the amount of extraordinary items in the statements and big bath accounting. “The potential for creative accounting has been induced by the discretionary nature of extraordinary item adjustments” (Walsh et al, 1991).

Hirvonen et al (2010) examines whether big bath accounting has occurred on the Stockholm stock exchange and which factors that influence it. The factors studied are the correlation between change of CEO, state of economy, company size, negative earnings and debt to equity ratio. They find a positive significant correlation between big bath accounting and negative earnings, debt to equity ratio and to some extent change of CEO. They do not find any significant correlation between company size and big bath accounting and neither between state of economy and big bath accounting.

A possible weakness with Hirvonen et al (2010) findings regarding the state of economy is that they did only study a two-year period. They looked at the two years 2006 and 2009 and compared the aggregated amount of depreciation, appropriation and write–offs. The excluding of 2008 means a possible loss of information from an important year in the financial crisis. Using statistical regressions and models with data collected from databases also makes their study less in-depth.

To summarize, not s much research has been made regarding IAC:s and how they develop in a recession. However some research have been made. Previous research states that IAC:s have been a complicated area with many changes and lack of clear regulations. The research regarding earnings management and recessions has pointed to the direction of “big bath” accounting but that earnings management as a whole decreases. No studies have examined these two aspects together in the same way that will be done in this thesis.
3. Methodology

The chapter covers the methodology chosen for this thesis. It starts with the definition of IAC:s followed by the choice of sample. The next part covers the research method, which is divided into two parts, quantitative and qualitative data. The chapter ends with a part of criticism against the chosen methodology and a framework of how the different parts contribute to the analysis and conclusion.

3.1 Definition of items affecting comparability

There is no congruent definition of how to account for IAC:s and what should be seen as an IAC, hence we have been forced to use our own definition. The chosen IAC:s with the highest frequency in the study are the following:

Revenue and gains

- **Capital gain** – Gain from any kind of sale that is not connected with the company’s core business.
- **Discontinued operations**
- **Divestment** – Gains related to any kind of divestment not shown as discontinued operations.
- **Revaluation** – Revaluation of assets (positive).
- **Currency hedging** – Hedging positions (positive) connected to hedge accounting.
- **Others** – items referred to as IAC:s not included in the other categories

Cost and losses

- **Restructuring costs** – Any kind of cost that is connected to restructuring within the company.
- **Capital loss** – Loss from any kind of sale that is not connected with the company’s core business and not shown as discontinued operations.
- **Impairment loss** – Goodwill and intangibles
- **Impairment loss** – All impairments that are not related to goodwill and intangibles
- **Penalties** – Costs related to disputes and penalties
- **Discontinued operations**
- **Divestments** – Costs related to divestments not shown as discontinued operations
- **Revaluation** – Revaluation of assets (negative) other than write-downs.
- **Currency hedging** – Hedging positions (negative) connected to hedge accounting

At the beginning we had no clear picture of which items that should be accounted as IAC:s. Theories such as McVays (2006) article regarding classification shifting gave an insight of some of the items. However, we formed the definition along with the progress of the research as it turned out that companies accounted for these items in varied ways. Meaning that some of the companies had many IAC:s that other companies did not have.

Even though a company did show restructuring costs during several years it has still been recognised as an IAC. This is partially because the company itself has recognised it as an IAC and also because IAS 1 mention that it should be noted within the statement. The reason for why we have included the items above and not only the items that the companies themselves categorize as IAC:s are to fully cover all items that affect the comparability. Companies do in some cases draw gains from not accounting for some IAC:s as IAC:s and instead include them in the ordinary items. It is important to be consistent in the definition in order for the results to be valuable. To solely rely on a company’s own definition would create differences in the sample and compromise the comparability, which in the end would weaken the conclusions.

### 3.2 Choice of sample

The study consists of 30 companies from the Stockholm stock exchange. In order for the sample to be representative for the entire market, the companies were chosen from five different industry categories. It is also a way to see if there exist differences among sectors in the frequency and the way to account for IAC:s. In order to be able to explain the results properly, the results should be divided into different components (sectors) to see how they affect the results. The industries and companies are the following:
The companies were selected from the investor’s magazine Aktiespararens (No. 3, 2011) compilation of companies from the Stockholm Stock Exchange. The magazine is issued by the Swedish Shareholders Association each month and is considered among investors as a trustworthy source. This compilation had divided the companies into several different sectors where you can see five of these above. These sectors were chosen due to that they represent big industries and somewhat represents the entire market. We deliberately neglected sectors such as the financial sector, due to the complex material their financial reports are made of. Of the five sectors that were chosen, the six companies with the highest market value were selected. However a few exceptions were made. The first exception was the Lundin Mining Corporation, which were one of the top 6 companies in the basic materials sector. Lundin Mining is however registered in Canada and thus their financial statements do not comply with Swedish regulations. Hence, the company on seventh place in market value in the basic materials sector, Höganäs, were selected. The other exception was the retail company Byggmax. Byggmax became listed on the Stockholm stock exchange in 2010 and was therefore not comparable with the other companies. Byggmax was replaced with the company that was in seventh place in the retail sector, RNB.

There are reasons for why to examine the time-period of 2005-2010 as well. In 2005 the new IFRS regulations were implemented. If we had investigated the years before 2005 it may have had an effect on the comparability. The time-period also captures the interesting period of the recent recession. The events that followed the bankruptcy of Lehmann Brothers are essential for this study, since it allow us to see if it had any effect on the reporting of IAC:s. It also creates a chance to see the development when the economy started to grow again in 2010.
3.3 Choice of research method

The research consists of data collected from two sources. Firstly, data from the 30 companies annual reports during the six – year period from 2005 to 2010. The second source of data is from interviews with three persons whom are experts within their fields and are affected in their work by IAC:s.

3.3.1 Quantitative data from Annual reports

Previous research in areas like this are often conducted through statistical methods where the data are collected from a database. However, our aim was to treat every annual report as unique and try to find which items that could be accounted as IAC:s for every company. That is why the data has been collected by reading through the 180 annual reports and determine the IAC:s by hand. Since not all of the IAC:s can be found by just studying the income statement there is no way to collect these numbers from a database. All of the reports were examined thoroughly to find which numbers that are to be seen as IAC:s. Often these numbers can be found by studying the endnotes or by reading the administration report, although some required a more thorough examination. As an example many restructuring costs could not be found in the income statement or in the endnotes as a specific item. This is due to that the cost is divided into many of the different cost items within the income statement. As mentioned, not all of the items we have classified as an IAC have been classified as such before. However, most of the items are backed up by previous research regarding special- and extraordinary items (McVay 2006; Massoud et al., 2007; Bernstein, 1972).

3.3.2 Ratios

The data gathered from the annual reports were used to calculate different kinds of ratios. The ratios were calculated for each company and then aggregated on industry level and on an overall level. The 30 companies were also divided into two groups of 15 companies, large and small, according to their market value.

\[
\frac{(Revenue - costs^3)}{Average\ Equity^4}
\]

\[
\frac{(Revenue + costs)}{Average\ Equity}
\]

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3 The revenue and costs we refer to are the total amount of revenue and costs that we account as items that affect the comparability

4 Average Equity is counted as the average equity in each company from 2005 to 2010
Revenue/Average Equity

Costs/Average Equity

What the study is trying to determine is whether there is a change in the reported amount of IAC:s during the examined period. To solely rely on the total value would have created a bias for the larger companies in the sample. Their results would have a significant larger impact on the aggregated level. However, by weighting the reported IAC revenues and costs against the companies own equity the ratio is representative for all companies within the sample, regardless of firm size. What these ratios reflects are the change of reported IAC:s. (Revenue-Costs) reflects if it is the reported revenues or the costs that are the predominant one. (Revenue+Costs) reflects the total amount of reported items, regardless of if it is positive or negative for the company’s earnings. Obviously you can calculate these yourself from just looking at the results from Revenue/Average equity and Costs/Average equity. However to present the results in this way gives the reader a better insight and makes it easier to follow the development in this area from 2005 to 2010.

The study started by calculating the ratios based on equity for every single year. However, there was a weakness with the ratio when big acquisitions had been made. It had a significant affect on equity. Hence, the average equity was calculated which got rid of the “acquisition effect” that would have had an impact on the results. Once the ratios were calculated for each company over the 6 years, the results were compiled and the mean and median results calculated on industry, firm size and aggregated level. Some of the companies reported extreme values, which impacted the mean results. Hence, using the median as a measure in order to diminish the effect of the extreme values turned out to be a good idea. However, the diagrams presenting the mean value are also presented in the appendix. Note that the median is calculated for each ratio by itself. This means that for example the median of revenue + costs for a sample not have to be the same as the median of costs + the median of revenues. It may be confusing to the reader when analysing the graphs but we found this way to be more reliable and fair than to add the medians together.

3.3.3 Interviews

The second part of the data collection consists of three interviews. It was decided to interview three persons from different backgrounds and with different occupations. The first interview was with the former economic journalist at Dagens Industri, Björn Wilke, The second one
was with the analyst and researcher Peter Malmqvist while the last one was with the founder and partner of the fund Didner&Gerge, Henrik Didner. The reason why these three were chosen to complement our quantitative data was to help us in answering our second and third research question. They could help us in analyzing the results as well as they are essential for the understanding of how this affects financial statement users.

Our interview objects give us a different view when discussing the results. More specifically the three interviews were chosen because of their ability to give us three different viewpoints on our results and explain how they are affected and use IAC:s in their work. They do all help analyzing the results found during 2005-2010 but they also represent three different kinds of users of financial statements. Wilke, the former journalist represents the societal point of view, whereas Malmqvist represent the analysts and Didner the asset managers. Their incentives for not telling us the truth are very small since it is in their own interest to examine this problem, compared to representatives from companies who may have other incentives.

The interviews with Malmqvist and Didner were made at their offices while the interview with Wilke was made by phone. We do not believe that this has had any impact on the results from the interviews. A weakness of phone interviews is that the body language not can be analyzed. The questions asked are in a semi–structured form in order to get the interview objects to speak freely of the issues (Saunders et al., 2009).

3.4 Criticism against the methodology

Criticism can be pointed at different weaknesses in the study. One weakness is that the sample only does consist of 30 companies. This makes it harder to fully draw conclusions about the entire population (Stockholm stock exchange). Thus the same can be said about the sample of six companies in each sector. A general assumption is that the bigger the sample is, the more conclusive the results get. However, other restrictions have to be taken into account when conducting a study as well, such as time frames etc. It should also be mentioned that the classification of companies into sectors is based on the classification that Aktiespararen (No. 3, 2011) had. This classification does not mean that the companies within each sector are having the same core business. There are for example really large differences between a company like ABB and a company like Scania. The same can be said about Ericsson compared to Orc Software. This weakens the conclusions about the results between different sectors. Still it gave us a varied sample with large and small companies from different sectors.
It may seem strange that companies such as Electrolux and TeliaSonera not was a part of the sample, but no matter how we would have chosen to categorize the companies, arguments of why it would be wrong could always be made. Hence to have a third party to categorize the companies minimize the subjectivity in the report.

Another weakness is the subjectivity when deciding which items to be classified as IAC:s. This is due to that it does not exist a clear definition of what an IAC is. However, we believe that we contribute with research that has not been done in a similar way before. We also argue that since companies and annual reports differ amongst each other and are in some ways complex it would be a weakness to not go in-depth and try to understand the numbers before categorising them. Another weakness that should be mentioned is that no interviews were conducted with employees on the examined companies. They would probably have a different perspective and the analysis and the discussion would likely have benefitted from it. However, they would probably not give us the same objective viewpoint as our chosen interview objects. It is also doubtful whether they would want to participate in a study that partly examines earnings management.

Another possible weakness is the ratios chosen. Neither the mean nor the median is “perfect” in its way of describing the results. However, the median is probably the best measure, since extreme values do not get the same effect. Concerns whether using average equity instead of just equity is another issue that has been discussed. By choosing to use average equity instead of equity the “acquisition effect” was reduced, but at the same time average equity can also be misleading. Growth by acquisition can many times be the cause of the emergence of IAC:s and hence it should be weighted against the new total equity. The company becomes bigger after an acquisition, therefore the IAC:s should also become bigger and there should be no need of any adjustments. However, after going through the empirical results, we made the judgment that the increase in equity that some companies experienced after an acquisition had a too big effect on the results the following years. Hence, presenting the results weighted against the average equity should be of higher explanatory power compared to equity.
The lack of previous studies that has been conducted in the same manner as this study, force us to bring forward a new analytical framework to explain our results. Previous research is focused on determining whether earnings management has occurred or not, little has been said if the results have logical explanations. Hence, to rely solely on theory and our own opinions to explain our result would not result in an analysis of high quality. That is why the interviews were added to the study. The framework above is a way to clarify how the three analytical tools are connected to our three research questions.

To answer question one, what the development of IAC:s over the period looks like, we only need the quantitative data. By looking at the quantitative data a picture of the development within the field emerges. The quantitative data explains what has happened black on white. To answer the second question, it becomes more complex because it is not as black and white as the first question. To answer this, all three analytical tools are needed. The quantitative data reveal the results, whereas the theory and interviews are needed to discuss what the causes might be. To solely rely on either the theory or the interviews would make the analysis a bit thin. Finally, in order to answer the third research question, we must use theory and interviews. The quantitative data will not help us with explaining how this affects users of
financial statements. The interviews however, they have a chance to explain how this affect
them in their work. There are also theories on what impact this has on users of financial
statements, which are good to use as a benchmark when comparing the answers from the
interviews. These are the reasons why all the analytical tools are necessary and add value to
the analysis.
4. Empirical results and analysis

The empirical and analysis part begin with describing the results found, on an aggregated level. It continues with describing the results divided into the different industries and divided into two groups by size. Every quantitative part is followed by a part containing empirical material from interviews and an analysis of it. It all leads down to the last part where the interviews explain how the IAC:s affects financial statement users.

4.1 Aggregated level

The graph indicates that during the two years, 2008 and 2009 there was an increase in the amount of IAC costs compared to the IAC revenues. Though it should be mentioned that costs more commonly exceed revenues in all years. However, with that in mind there is a significant increase in the amount of IAC costs reported especially in 2008 but also 2009. As shown in the graph, IAC (Revenue-costs) went down to approximately -3% of equity in 2008 and 2009 before it went back to what looks to be its normal level in 2010.

Looking only at the IAC costs vs. revenues, the development from 2007 and onwards is very different. From 2005 to 2007, the reported revenues and the reported costs are more or less following each other. However, in 2008 and 2009 the costs increased to a new level, whereas the revenues from IAC dropped to almost zero. The effect of it all was that the sum of Revenues-Costs decreased, which the blue line in the graph is a proof of. Looking at the total amount of IAC:s (red line) it reveals that the amount reported in 2007 is almost as high as in
2008. But looking at the costs and revenues contributing to that amount, there is a drastic different. In 2007 a big part consists of revenues, whereas in 2008 this part is almost nothing. Interesting is that the total amount of IAC:s is higher during 2007 than 2009. This is due to that 2007 was a year when many companies reported high IAC revenues.

**4.1.2 Total Amount in SEK**

This graph reveals the IAC:s for each of the years, in total amount of SEK. The purple staple represent the amount of costs these items add up to, whereas the green staple represent the revenues arising from these items. It shows that the total amount of IAC:s in absolute numbers are consistent with the result we saw above. There are some differences though. In the graphs where the amounts of items affecting comparability were weighted against equity, 2008 seemed to be the year where companies reported the highest amount of these items. That is if you add the revenues and the cost together. In this graph however, 2009 is without question the year where these items added up to the highest value. As discussed in the previous part, there is a difference in what the total IAC:s consist of. In 2008 and 2009 it almost entirely consists of costs, whereas in 2006 and 2007 there are many IAC revenues.
A deeper examination of the results reveals that two of the 30 companies, Ericsson and Stora Enso, contribute to approximately 50% of the entire IAC costs in 2009. That is why this graph can be misleading to determine whether there is a trend or not. Other observations that should be mentioned are that of the entire amount of IAC revenues in 2007, 70% can be attributed to the revaluations of biological assets (forest), done by Holmen, SCA and Stora Enso. Regarding the amount of IAC revenues in 2006, as much as 50% can be attributed to a divestment done by Atlas Copco. These are things worth having in mind when interpreting the results. The impact of a few can contribute significantly to the aggregated model. Having said that, the graph does support our other results and works as an explanatory tool for the understanding of how single companies can affect the results.

### 4.1.3 Interviews and analysis of the aggregated results

The result from the empirical study indicates that companies, in general, report higher IAC costs during a recession than during other years. Hence what is the reason for the increase in reported IAC costs in 2008 and 2009?

“A part is understandable, but it does not explain the entire anomaly” (Malmqvist, 2011). This quote seems to be the general view on the issue. What he meant was that it is not entirely irrational that these items increases when times get rough. It is in a time of recession that the management identify that there exists a need for cutting down on the extra capacity. The significant increase of reported restructuring costs is therefore nothing to be upset of. However, the reported amount of these items is something that should be more regulated. “The IASB tried to be very strict when it comes to reporting restructuring costs. Restructuring costs almost always consist of termination wages for the cut-down on personnel and IASB tried to implement that all the depositions for the wages could be derived from a specific person. However, it was too complex and did not work in the end, so the regulations are not that rigorous today” (Malmqvist, 2011).

It is almost impossible to discuss IAC:s without mentioning earnings management. Few investigate weather there are natural explanations for the reporting of these items. Having said so, it does not mean that earnings management do not occur in IAC reporting. “What I have always found interesting is that companies always seem to have bad luck, but they never seem to have luck. Something about that is a bit odd” (Wilke, 2011). According to Malmqvist (2011) many of the companies account for costs during the bad years that will be paid out as
late as three years later. Reservations that does not become payouts, becomes gains in the future when the reservation is resolved, hence affecting the income in a positive way. With few exceptions, almost all the graphs show an increase of IAC costs during the recession years. Even if the median proved to be a more relevant measure, one should have in mind that a majority of all the extreme values also occurred during 2008 and 2009. That is also an indicator of an increase of IAC:s costs. The quantitative data also reveal that the highest amount of reported revenues were reported in 2007. According to both Didner (2011) and Malmqvist (2011) the reason is probably that in times of high growth companies find themselves prepared to sell some of their assets since they receive a good price for it. It can be a possible explanation for those results. However, there is no prior research that confirms that explanation.

The results are in line with the findings of Chia et al., (2007), which finds evidence that during a recession, companies exaggerate their losses in order to clean their sheets. The results contradicts the conclusion from Hirvonen et al., (2010) study, where they find no correlation between the economic state and the reporting of IAC:s. The results are however coinciding with Healy (1985) and his research regarding bonus plans and the incentives to decrease earnings in periods when it is more accepted. According to his study managers infer costs earlier in bad years to receive higher earnings in later years. Which is in line with our results that show large net minus results of IAC:s during 2008 and 2009 while 2010 they are back at their “standard” level.

To summarize there is a significant increase in IAC costs during 2008 and 2009. Depending on if we look at the IAC divided by equity or just the total billion amounts, the IAC costs are the highest in 2008 and 2009 respectively. A part of this is probably due to what can be called “big bath” accounting. The companies are not afraid to report high costs during these years because it is more accepted. While it should be stated that a large part is due to natural reasons as well. The findings fro the quantitative research and the interviews are supported by previous “big bath” accounting theory. However it contradicts previous study made regarding the correlation between economic state and amount of reported IAC:s (Hirvonen et al., 2010).

4.2 Industry level

In the previous part, the results of the study were presented on an aggregated level. The point with presenting the information in industry format is that it reveals what the aggregated
results consist of. It increases the explanatory power, since the entire result is divided into several components. Hence, for the understanding of the results it is necessary to look at the components that the result consists of.

### 4.2.1 Retail

The industry proved to be the one with the least amount of reported IAC:s, both revenues and costs were lower than in the other sectors. Three out of six companies, H&M, Axfood and Clas Ohlsson, reported almost no IAC:s at all during the years 2005-2007. In 2008 and 2009, these three presented a small increase of IAC:s, but compared to other companies within the sample it was close to nothing. However, the other three, BILIA, RNB and Kappahl reported IAC:s more frequently. For instance, in 2009 RNB conducted an impairment of their goodwill position that was created during the company’s acquisition of JC. The impairment of the goodwill was 500 million SEK, which in relation to their equity, was as much as 47%, which is an extreme number. The standard value of IAC/Equity for other companies were somewhere between 0-8%. The (revenues-costs) fluctuate from -1.5% - 0.5% during the examined period. Compared to the aggregated model, it is quite moderate fluctuations, which means that the retail industry category did not affect the overall result to the same extent as other industries. The blue line representing (revenues-costs), is important to look at since it explains the relationship between the IAC revenues and costs. The line reveals which of revenues and costs who is the predominant one and how the relationship develops over time. It is interesting to see that 2006 had higher costs than 2008 and 2009. This is largely because of the fact that four of the companies show large restructuring costs this year. No further explanation of why these restructuring costs emerged during 2006 was given.
4.2.2 Information technology – IT

The companies within the IT sector showed variation in their results. Axis, IFS and Hi-Q reported very few IAC:s during the examined period. Of the companies examined within this sector, Ericsson is the one influencing the result the most. In 2009 Ericsson reported IAC:s of a value as much as 12% of their equity, whereas the other companies within the sector presented IAC:s of a significant lower value. Like in the case with the retail industry, the IT-sector is not the main contributor to the trend of higher IAC costs during the recession years on an aggregated level. However, the results indicate that IAC:s increased in 2008 but they went back to the level of previous years in 2009. A bit interesting is the fact that the reported IAC:s increases in 2010 again. The IT-sector is the only industry who report more IAC:s in 2010 than in 2009. Another interesting observation is the lack of IAC revenues. During the entire examined period, there are almost no IAC revenues at all, just a few in 2006 and 2007. It means that almost all reported IAC:s had a negative effect on the companies’ earnings.

![Fig 6. IAC IT (% of equity) Median](image)

4.2.3 Engineering

The results from the engineering sector are much less spread than the ones from the retail and IT industries. The variations between the companies are small throughout all of the observed years. The graph reveals that the IAC costs increased significantly in 2009. In contrast to the two previous industries, the engineering sector does not have any extreme values. Obviously some companies reported more IAC:s than others, but overall the spread among the companies were remarkably low. For all the years except 2009, the difference between the company who reported the IAC of highest value, compared to the one who reported the
lowest, was as little as 2%. In 2009 that number was 6%, but the four other observations the same year varied just 2%, which is interesting considering the turbulence during the period. In 2009 the median value of IAC/Equity were as much as 6%, whereas the same value for the entire sample was approximately 3.4%. In contrast to the two previous industries, the engineering sector is a big contributor to the high amount of reported IAC:s in 2009 for the aggregated results. Like in the case with the IT-industry, the engineering sector reports almost no IAC revenues at all.

### 4.2.4 Basic materials

The basic materials industry is very influenced by the activities of the three major forest companies, Holmen, SCA and Stora Enso. There are several observations that affect the result significantly. The graph reveals that both the IAC revenues and costs increased in 2007. A closer examination of the reported figures unfolds the reason for it. The three forest companies conducted a revaluation of their biological assets that year. The revaluation increased the value of their forest with as much as 2-5 billion SEK. The same year, all three companies had significant restructuring costs that even exceeded the amount of the revaluations they had conducted. Boliden also showed large IAC costs due to their hedging positions in metalprices. That is the reason the graph shows such a dramatic increase in the total amount of reported IAC:s in 2007. In 2010, Holmen and Stora Enso reported a new revaluation of their biological assets, which meant that the value increased with a bit more than 1.5 billion SEK in average. Once again both companies reported restructuring costs at
the same time, even though the revaluation exceeded the restructuring costs this time. Hence, (IAC Revenues-IAC costs) was positive this year. However, when erasing the extreme values from the observations, companies proved to report quite similar amounts of IAC:s within the sector.

4.2.5 Constructing

Compared to other industries there were not many extreme values that affected the results. However, some contributed more to the total value of IAC than others. Nibe reported very few IAC:s during the entire period which means that they did not contribute with any IAC items to the overall result. The increase in IAC:s in 2008 is mostly due to restructuring costs that four of the examined companies reported. The four companies were Assa Abloy, Skanska, NCC and Peab. All of them increased their restructuring costs significantly in 2008, which is the reason behind the result shown in the graph. In 2009, it was only Assa Abloy who reported IAC costs to nearly the same extent as they did in 2008. Hence, the reported numbers in 2009 decreased back to almost the same level it was before the crisis. An interesting observation is that this is the only sector that shows an increase of IAC revenues when the financial crisis emerged. The reason for it is that NCC reported a gain on a divestment in Poland, which had a positive impact on the result with 493 million. Also Skanska reported gains due to the selling of assets for 686 million. These gains ended up to be 6% and 4% respectively of the company’s equity. Compared to the other years within the
sector, these positive numbers had a large impact on the IAC revenues in 2008.

![IAC Constructing (% of equity) Median](image)

### 4.2.6 Interviews and analysis of the industry level

When going through the results on industry level, a few observations are interesting. To begin with, there are significant differences in the amount of reported IAC:s among the sectors. As proven in the empirical presentation, retail show less IAC:s than all the other industries, followed by the IT-industry. An indication of that there might be different “standard levels” within different sectors regarding the reporting of these items. It should still be mentioned that a majority of the sectors showed an increase in reported costs during 2008 and 2009, but that it is compared to their own “standard level” not against each other. Basic materials and retail showed higher IAC costs in 2007 and 2006 due to high restructuring costs these years. They do show higher reported IAC costs in 2008 and 2009 compared to their average level but show the highest level of costs in a year when the economy in fact was in a good mode.

“There is a big difference if you compare H&M with ABB due to the nature of their businesses. H&M is a quite simple company; they sell clothes, whereas ABB is a far more complex organization. IAC:s should occur there more often than in H&M.” (Wilke, 2011). Two things can be inferred from the quote: First, the business of the company matters. A more complex organization increases the likelihood of higher amount of reported IAC:s. Second, the size of the company does not necessarily imply that it is a complex one. Hence, it means that size does not have to be an essential factor when looking into what affects IAC:s. H&M is one of the biggest companies on the Stockholm stock exchange, and still they were
the company who reported the least IAC:s. Malmqvist (2011) also agrees that it is rather the complexity than the size of a company that determines its “standard level”. Still, companies have a tendency of becoming more complex when they increase in size (Malmqvist, 2011). Didner (2011) refers to companies such as H&M, which show a low amount of IAC:s as healthy companies. H&M start up several new shops and shut down several as well during a year. Still they show no restructuring costs or IAC:s related to these events. According to both Didner (2011) and Malmqvist (2011) this is because they can afford it.

The reason for that the retail industry show lower amounts of reported IAC:s compared to equity, is probably because the retail industry is the least complex of all the sectors. The companies within this sector mainly buy and sell goods. They neither have any R&D costs, nor major facilities that can incur large expenses. Compared to the three sectors which reported the most IAC:s, where almost everyone of them have major facilities and R&D departments.

In accordance with what we can conclude from the interviews, it seems like our results can be explained by the complexity of the industries. There is however no other research that supports these findings since almost no research has been focusing on the complexity of companies within this context before. As have been explained, most previous research such as McVay (2006) and Massoud et al. (2007) has either been focusing on earnings management or the regulations surrounding IAC:s. The quantitative studies have only investigated the entire market, without taking into consideration that the market is divided into several components. This makes it hard for us to use any previous theory when analyzing the results. However it is a interesting finding that complexity of the business may have an impact on the reporting of IAC:s.

### 4.3 Size comparison

In this part the companies have been divided into two groups with 15 in each group. One group with the 15 largest companies according to market value and one with the 15 smallest companies.

#### 4.3.1 Large companies

The 15 largest companies show a low variation in amount of reported of IAC:s during the 6 year period, except year 2009 and to some extent also 2008. There is a remarkable increase in
the total amount of IAC:s in 2009. The other years the amount is pending between 1 and 2 % while 2008 show 3% and 2009 show 4,5%. The previously recognised pattern regarding higher cost and a low net result of IAC:s during 2008 and 2009 can be seen here as well. What is interesting is the fact that 2009 is the year where the highest change occurs, compared to the aggregated median where it was in 2008.

The large differences in 2009 and in some ways also 2008 are due to the high restructuring costs and impairments made by many companies during these years. These are the most notable facts from the large companies. As can be seen in the graph everything is around the same level except the years of 2008 and 2009 while the IAC income remains stable over all the years. All of the engineering companies were big ones and are therefore included in this group and thus have a large impact. Since that sector was the only one with the highest IAC:s during 2009 and not 2008 it is a big reason for why the results look like they do.

### 4.3.2 Small companies

A large and notable difference is the fact that 2008 is year when the highest difference occurs. In 2008 IAC costs as well as total IAC:s show the highest value. While the net result of IAC:s show the lowest value this year. This means that the smaller companies take up the most of their restructuring costs this year instead of 2009. That is indeed a very interesting observation, since the result is so clear. There is a big difference in the results of the small compared to the large companies. A notable fact is that this group consists to 2/3 of companies from the retail industry and IT industry. These were the two industries that seemed
to be least affected by the financial crisis, especially if you exclude Ericsson. The IAC revenue is almost the same for the small companies as for the large companies.

![IAC Small Companies (% of Equity) Median](image)

4.3.3 Interviews and analysis

When comparing the 15 largest companies with the 15 smallest companies, one finding was particular interesting. Overall there were quite insignificant differences, but one observation stood out. For the smaller companies the year with the highest amount of IAC:s was 2008, whereas for the larger companies it was 2009. What is interesting with this is that the difference between the two categories is quite significant; there is a rather big difference between the peak and the year presenting the second highest amount of IAC. What it means is that for the aggregated results for the entire sample, the increase in 2008 is due mainly because of the smaller companies and vice versa for the levels of 2009.

According to Malmqvist (2011), the crisis stroke so suddenly that few companies had the time or resources to engage in big bath accounting. It was rather a state of panic and a “stop the bleeding” scenario. In 2009 when things were a bit calmer, companies started to engage in big bath accounting according to him. If this is the case, it indicates that the smaller firms did not engage in earnings management as much as the larger companies did. A finding that contradict the findings of Chia et al., (2007) that smaller companies are more likely to engage in earnings management since the larger ones are under much more supervision. Another possible reason for the larger companies to report less IAC:s in 2008, may be that it took more
time to oversee the entire organization and determine what to do, whereas the smaller companies were more flexible and could act faster.

Like in the case with complexity, little research has been made about differences in firm size. Most research just look at the entire market, hence it makes it difficult to compare the results with previous research. Our findings suggest that small companies and large companies have reported IAC:s during different time periods in the financial crisis. It is interesting because of the way it contradicts previous theory. It is basically only Chia et al, (2010) who discuss the issue in terms of firm size. Their findings are not in line with ours, rather the opposite. If the results are an indication of that larger firms’ rather than smaller firms’ engage in big bath accounting, then they also contradict the findings of Hirvonen et al, (2010). They concluded that there is no relationship between firm size and earnings management, which is a bit contradicting to the findings in this study. However, it is not possible to make vast conclusions based on the result, it can only be stated that there are indications that the previous research is not applicable in this case.

4.4 Implications for financial statement users

The next part contains the statements from the three individuals that were interviewed. The presented information reveal how they look at IAC:s and how that affect them in their work. This is also compared to what is said in previous research within this area.

4.4.1 “Do not mistake IAC for extraordinary items”

“My main concern regarding IAC:s, is the lack of regulation. To hand over the power to the board so they can determine for themselves what is an IAC and what is not” (Wilke, 2011). As explained in the theoretical part, extraordinary items and IAC:s are closely related. Many of the extraordinary items also fall under the category of being an IAC (Massoud et al., 2007). Claesson et al., (2010) concludes that companies should not report restructuring costs as an IAC, since restructuring is a part of a natural cycle of a business. However, even if restructuring may not qualify as an extraordinary item it can still be affecting the comparability. “I think restructuring costs are among the most ordinary there is, however, do not equal IAC with extraordinary items. A restructuring can have a big impact on the result and create a lot of noise, which makes it harder for me to conduct an analysis. That is usually how I determine an IAC” (Malmqvist, 2011). What can be said is that it confirms the picture
of IAC:s as a measure containing many items as both Massoud et al., (2007) and Bernstein (1972) concluded.

Since the definition of IAC is a bit vague to say the least, it creates uncertainty for financial statement users. “I used to say, in Electrolux nothing happens twice.” (Wilke, 2011). It is within this context we should determine weather the results are due to big bath accounting. Based on the quantitative research in this study it is very hard to say whether the increased costs are due to big bath accounting or if they are natural. The answer is probably a bit of both, just like all our interviewed objects suggested.

A surprise was that Didner (2011) did not find the issue with IAC:s as such a big problem like the others. In his work as a fund and asset manager, he said that IAC:s was just a small part of a much wider analysis. There were other factors that were more important to him than the reporting of IAC:s. “As an asset manager, I become something of a generalist in my knowledge of the stock market and its participants. This issue is more of an accounting problem and therefore lays a bit outside my area of expertise” (Didner, 2011). It was not the particular amount of reported items that concerned him, but rather how frequently they occurred. “If a company often report IAC:s, then you have to take it into consideration, otherwise you can erase it from the earnings.” (Didner, 2011). The answer to the question weather a financial statement consisting of a lot of IAC:s compared to one with none, is more difficult to evaluate the answer was “Yes, but there are a lot of factors that are more important than IAC:s. However, it does not make it easier.” (Didner, 2011).

The one who experienced IAC:s as a significant problem in his work, was Malmqvist (2011). In contrast to Didner, these were items that he examined carefully, since it was essential for him in his work. The difficult part is to determine weather the IAC:s are exaggerated or not. As an example he spoke of Assa Abloy: “Assa Abloy accounted for a restructuring and made deposits for it. If they keep their current pace when it comes to the payouts of this restructuring, they will be done in 2016. It is not reasonable that a company can account for a restructuring so far in advance. Their numbers are misleading”. That is the main issue that he struggles with, to determine the underlying results. He also found that 2008 and 2009 were two years that were particularly difficult to forecast. A part of it because of the increase of IAC: costs.

Wilke (2011) had another view on the issue. As an investigating journalist he wants the companies to report as truthful as possible. Not because it would make his job more difficult,
but rather because companies should not be able to intentionally mislead investors. The discussion was much about the lack of regulations and the problems with handing over the power to the subjective judgment of the board. Like Didner (2011), the frequency of the reported IAC:s was something that interested him. He has been writing about both Electrolux and Telia Sonera, and their questionable reporting of these items. It appeared as he found it to be more of a question regarding right and wrong. He had a more societal viewpoint where companies are supposed to report accordingly.

4.4.2 Different users, different answers

It is difficult to make any conclusions of how this affects different financial statement users. It seems like it is subjective and that it depends on how the user perceives the reported numbers. Asking our interview objects on how big of an issue IAC:s are, rendered three different answers. Even if all agreed that there were problems with the concept and that they all were convinced that companies do engage in big bath accounting, their opinions regarding the importance of it varied. It was the analyst (Malmqvist) who found it to affect him in his work the most. Little research is done within the field in categorising how different stakeholders perceive this phenomenon and it is an area that should be investigated further. However, the research that has been conducted has had a focus on the analyst view (Bernstein, 1972). Mainly because they are the ones who conduct forecasts and are one of the groups who constantly uses financial statements. Not surprisingly the research has its starting-point from an analyst perspective.

As have been discussed before, other research within the field often discuss the regulations regarding IAC:s (Massoud et al., 2007) and their affect on the standard setters (Healy et al., 1999). This is the area where Wilke (2011) had many thoughts. It is actually not surprising that it was he who raised most concerns regarding the regulations, although the others also agreed that the regulations were bad. The research conducted by both Massoud et al., (2007) and Healy et al., (1999) have a focus in describing potential problems for users of financial statements. Where Bernstein (1972) adapted the analyst view, the others had a more “objective” angle. Since Wilke is a former journalist, it is not surprising that he raises concerns over the regulations, rather than how it affect him in his work. The most surprising fact was how different Didner (2011) and Malmqvist (2011) reasoned regarding the issue. Where Didner’s job as a fund manager is to perform forecasts and invest accordingly. Intuitively it seems to be rather close to the job of the analyst. However, they were the ones who represented the biggest difference in the matter, which was very surprising. No prior
research seems to have investigated the issue of how different financial statement users are affected. However, in this study by just interviewing three people we have extended the research. The conclusion that can be made is simply this; Is the reporting of IAC:s a problem for users of financial statements? Yes. A big problem? It depends on whom you ask.
5. Conclusion and suggestion for future research

In this chapter we summarize the study before presenting the conclusions and the answers to the research questions. The chapter ends with suggestions for future research.

5.1 Summary and Conclusion

The thesis has been investigated how IAC:s change in 30 Swedish companies during the time period of 2005 – 2010. It started with three research questions;

1. How does the IAC:s of Swedish companies develop during the five-year period of 2005-2010 and more specifically react to a period of financial crisis?
2. What are the causes for our results?
3. How do these results affect users of financial statements?

The study measured the development on an aggregated level, divided the companies into five different groups based on industry, as well as two groups based on firm size. Further, interviews have been used to analyze the results from the quantitative study and also answer the third research question of what these items mean to different stakeholders.

How does the IAC:s of Swedish companies develop during the five-year period of 2005-2010 and more specifically react to a period of financial crisis?

The answer to the question is that there is an increase in reported IAC:s around the financial crisis years of 2008 and 2009. The total amount of IAC:s on average increases during these years, and particularly the IAC costs. The net result of IAC:s (that is IAC Revenues – IAC Costs) show large negative movement during 2008 and 2009 while it went up again in 2010. The other years do not reveal any significant trends. What can be noted is that 2007 do show a higher amount of IAC:s than 2005, 2006 and 2010 and that these IAC:s consist of much more revenues than the other years.

What are the causes for our results?

The answer to the second question and the explanation to the results can be divided into two main reasons. The total results can partially be explained by the nature of restructurings and that a crisis often leads to an increase of these. Further, the other part can probably be explained from the phenomenon of big bath accounting. Meaning that firms added extra costs during the recession in order to gain higher results in later years. We also find indications of
that the larger companies in our study are more likely to have engaged in big bath accounting than the smaller companies. At industry level we find that the complexity of the industry probably is a better explaining factor of the amount of reported IAC:s than firm size is. We find that the higher the complexity the higher is the chance of large amounts of IAC:s, although firm size and complexity often walk hand in hand.

**How do these results affect users of financial statements?**

The answer to the third question is that the existence and increase of IAC:s have a varying impact on financial statement users. While an analyst may see it as an important issue, a fund manager may not agree. However all our interview objects conclude that IAC:s add “noise” to the financial statements, the difference lays in how much they consider it to affect them in their work. Three interviews make it difficult to make any vast conclusions, but it does however give an insight in how financial statement users are affected.

**5.2 Criticism of the study and suggestions for future research**

Criticism can be pointed against the small sample, which makes it hard to fully draw conclusions about the entire market. Further it becomes fragile for extreme values. It can also be argued that our way of deciding which items that are to be accounted as IAC:s and which are not, depending on every company specific situation, involves too much subjectivity. Another possible reason for criticism is that the interviews with three persons, is not enough to base conclusions regarding financial statement users as a whole. But as mentioned in the conclusions, it does contribute to the understanding of the problem.

During the work with the thesis a few areas have emerged that would be of interest to examine further. First, it would be interesting to see whether the same results would be reached with a larger sample, and thus giving it more credibility. To dig deeper into how IAC:s affect financial statement users with a larger study containing more interviews with people representing different groups of users of financial statements, is an area that would benefit from more research. Above all, the findings regarding complexity and firm size as explanatory factors for the amount of reported IAC:s can be investigated further.
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Interviews

Didner, H., Founder of the fund and asset management company Didner&Gerge, Uppsala, May 12, 2011, Didner&Gerge, Uppsala. Personal interview

Malmqvist, P., Chairman of SFF (Svenska finansanalytikerföreningen) and independent financial analyst, Stockholm, May 10, 2011, Nacka, Stockholm. Personal interview

Wilke, B., Former journalist at Dagens industri, Uppsala, May 9, 2011. Telephone interview
Appendix

Interview questions

1. Our study of 30 companies on the Stockholm stock exchange show a increase of reported IAC:s during 2008 and 2009. This increase is especially due to increased IAC costs during these years. What is your explanation of these results?

2. Can a part of it be explained through “big bath” accounting?

3. Do you have any other commentaries to these results?

4. There are differences among different sectors when it comes to the amount of reported IAC:s. Do you have any opinion regarding that?

5. What is an IAC according to you?

6. How does an increase in IAC:s affect you in your work?
Diagrams

The calculated data used to create the graphs, the graphs showing IAC/ordinary equity as well as the graphs for each specific company can be mailed in an excel file if needed.

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Aggregated - IAC:s median and mean

![IAC Aggregated Mean]

![IAC Aggregated Median]
Basic Materials - IAC:s median and mean

IAC Basic materials Mean

IAC Basic materials Median
Engineering - IAC:s median and mean

IAC Engineering Mean

IAC Engineering Median
Constructing – IAC:s median and mean

IAC Constructing Mean

IAC Constructing Median
Retail – IAC:s median and mean

IAC Retail Mean

IAC Retail Median
IT – IAC:s median and mean

IAC IT companies Mean

IAC IT companies Median
Large companies – IAC:s median and mean

IAC Large companies Mean

IAC large companies median
Small companies – IAC:s median and mean

**IAC Small companies mean**

- (Revenue - Costs)/Average Equity
- (Revenue + Costs)/Average Equity
- Revenue/Average equity
- Costs/Average Equity

**IAC small companies median**

- (Revenue - Costs)/Average Equity
- (Revenue + Costs)/Average Equity
- Revenue/Average equity
- Costs/Average Equity