Conversations on Accounting Practices

A Study of an Enforcement Body in a Time of Regulatory Change

Anna-Stina Gillqvist

STOCKHOLM SCHOOL OF ECONOMICS

Conversations on Accounting Practices

When EU adopted the International Financial Reporting Standards (IFRS) as a common accounting standard, each member state was required to have external enforcement bodies with responsibility for financial reporting supervision. This thesis investigates Sweden as a case study of how the evolvements initiated at the European level were set to practice in a member state.

The thesis adopts a theoretical framework taking its inspiration from Wittgenstein's ideas on rules and rule-following. In particular, the thesis frames accounting regulation as a regulatory space, where the positions and roles of different actors are outlined in the course of regulatory conversations on accounting practices.

Accounting issues related to goodwill impairment testing, measurement of pension liabilities and recognition of deferred tax assets are investigated as empirical examples of enforcement statements. The thesis reminds about the importance of understanding a new regulatory actor in relation to those actors already present within the regulatory space, including non-accountants such as actuaries and valuation specialists. The thesis concludes that whether these actors understand accounting issues as accounting problems is decisive for the enforcement body's ability to shape accounting practices. In addition, the thesis argues that the existence of shared agreements on how to read the accounting standards are central for their enforceability.

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Foreword

This volume is the result of a research project carried out at the Department of Accounting at the Stockholm School of Economics (SSE).

This volume is submitted as a doctor's thesis at SSE. In keeping with the policies of SSE, the author has been entirely free to conduct and present her research in the manner of her choosing as an expression of her own ideas.

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Stockholm, September 12, 2016

Anna-Stina Gillqvist

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Acronyms

CESR	Committee of European Securities Regulators
EECS	European Enforcers Coordination Sessions
ESMA	European Securities and Markets Authority
FAR	The professional institute for authorized public accountants, approved public accountants and other highly qualified professionals in the accountancy sector in Sweden
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
SEAG	Swedish Enterprise Accounting Group (*Näringslivets Redovisingsgrupp*)
SFRB	Swedish Financial Reporting Board (*Rådet för Finansiell Rapportering*)
SBA	Swedish Bankers' Association (*Svenska Bankföreningen*)
SSA	Swedish Society of Actuaries (*Svenska Aktuarieföreningen*)
SSFA	Swedish Society of Financial Analysts (*Sveriges Finansanalytkers Förening*)

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Chapter 1

Enforcement bodies as a part of accounting regulation

Every interpretation, together with what is being interpreted, hangs in the air; the former cannot give the latter any support. Interpretations by themselves do not determine meaning.
Wittgenstein 1953:198

Different actors are commonly described as fulfilling different, and separate, functions in relation to accounting and financial reporting. These actors are assumed to fulfill their tasks in a specific chronological order. First, the regulators and the *standard setters* write the formal laws, rules and standards that are to determine financial reporting. Second, the *preparers* apply these regulations in order to produce the financial reports. Third, the *auditors* review the financial statements to ensure that these are prepared in accordance with current regulations. As a fourth step, in some jurisdictions an external supervisor (an *enforcement body*) will enforce the accounting standards by reviewing the financial reports after that these are published. However, enforcement bodies sometimes also provide accounting pre-clearances in advance of the issuance of financial reports. In these cases, the enforcer will participate in the chain of events before (or simultaneously with) the auditors. Different types of organizations, including securities

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regulators, review panels or stock exchanges can be enforcement bodies. Examples of such bodies are the U.S. Securities and Exchange Commission (U.S. SEC), the UK Financial Reporting Review Panel (FRRP), or the Norwegian *Finanstilsynet*. After these actors having contributed to financial reporting, different *users* of financial reports are finally to rely on the accounting information for decision-making purposes. Often, there is a focus on the shareholders as users (sometimes represented by financial analysts), but also creditors, employees and customers could be potential users of the financial reports.

1.1. An increased focus on enforcement in the EU

The importance of the enforcement bodies in accounting regulation has varied in time and space. A special event highlighted the role of enforcement bodies within the European Union. In 2005, the union adopted the International Financial Reporting Standards (IFRS, issued by the International Accounting Standards Board IASB) as a common accounting standard. With this adoption came a requirement for each member state to nationally appoint an independent and external enforcer with the task of supervising listed entities' financial reporting. In addition, a pan-European structure for co-ordination of the national enforcement bodies' activities started to emerge.

In 2001, the Committee of European Securities Regulators (CESR) was formed to promote consistency in supervision of European securities markets. In 2011, this body developed into the European Securities and Markets Authority (ESMA). Standards on how to pursue and co-ordinate enforcement of accounting standards were issued by CESR (2003, 2004b), later replaced by new guidelines issued by ESMA (ESMA 2014). The group supporting ESMA in issues related to for instance financial reporting and auditing is the Corporate Reporting Standing Committee (CRSC). As a permanent subgroup of CRSC, the European Enforcers Coordination Sessions (EECS) was formed. Within EECS, meetings were held amongst the national enforcers, who discussed enforcement issues that had already been

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made and those pending. These decisions were compiled into a common database of enforcement decisions. Only enforcers have access to this database, but since 2007 extracts with compilations of decisions are published continuously.

In a number of European countries, enforcement bodies had previously not been a part of accounting regulation. (Fédération des Experts-comptables Européens 2002) Thereby, the role and status of enforcement bodies as regulatory actors was not a given when the requirement to form these came into effect. Some years later, Berger (2010) stressed the (remaining) large differences in how different EEA countries enforced accounting standards.[1]

1.1.1. Enforcement of accounting standards in Sweden

In Sweden, self-regulation had long been relied on as an ideal for accounting regulation and no enforcement body existed. However, Rolf Rundfelt had scrutinized annual reports for several years, and documented his observations in *Tendencies of annual reports of listed firms*. These reports were published by the Stockholm stock exchange and had no legal standing. Nevertheless, preparing entities took notice of them.

After Rundfelt had written his last *Tendencies of annual reports of listed firms* in 2000, the Stockholm stock exchange started to send out letters with "observations" on the financial reporting of listed firms. These letters were not made public, but were addressed directly to the listed entities. This work of the Stockholm stock exchange was later taken over by the *Panel for Monitoring Financial Reporting* (PMFR). Similar to the stock exchange, the PMFR also wrote letters directly to the listed entities. In addition to this, the PMFR however also made their criticism public in the form of official enforcement decisions. Between 2003 and 2006, 28 enforcement decisions were published. (Panel for Monitoring of Financial Reporting 2014)

With the regulatory changes within the EU, the government allocated enforcement responsibilities to the Swedish stock exchanges. This was at

[1] Taking Sweden as an example of a country where no accounting errors were actively enforced, he (p. 32) questioned whether the absence of enforcement measures in Sweden could be explained by high "quality of financial reporting" or by "less strict" enforcement.

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the time the Stockholm Stock Exchange (OMX Nordic Exchange Stockholm, later Nasdaq OMX Stockholm and today Nasdaq Stockholm) and Nordic Growth Market NGM. The government appointed the Swedish securities regulator *Finansinspektionen* as the competent authority. This implied that *Finansinspektionen*'s duties were limited to supervising the enforcement activities pursued by the stock exchanges and to directly supervise the financial reporting of the limited number of entities with Sweden as their home member state that were listed on a regulated market within EEA but outside of Sweden. (*Lag (2007:528) om värdepappersmarknaden*, *Finansinspektionen* 2009)

When put into practice, both *Finansinspektionen* and the stock exchanges found this regulatory solution unsatisfactory. (*Finansinspektionen* 2009, van Haartman *et al.* 2010, Lennartsson 2013) In a joint suggestion, the auditors' association FAR, the Swedish standard setter, the Swedish Financial Reporting Board (SFRB), and the stock exchange Nasdaq OMX Stockholm argued in favor of a reallocation of enforcement duties. They suggested that an independent panel with members drawn from accounting's different constituencies should be set up to perform the enforcement activities (van Haartman *et al.* 2010).

Several reasons were put forward for change, including: the difficulties in the national coordination of enforcement when duties are allocated to different organizations (*Finansinspektionen* 2009, van Haartman *et al.* 2010), the possible conflicts of interests when enforcement of accounting standards is performed by market participants (*Finansinspektionen* 2009), the difficulties in gaining a "strong voice" in European co-operation, and the obstruction of the competitive position of the stock exchanges (as the cost of the enforcement duties increases the listing fee) (van Haartman *et al.* 2010).

In 2013, after several years of discontent with the Swedish enforcement system, a new governmental investigation (SOU) argued for a change in regulatory structures whereby the current competent authority *Finansinspektionen* was suggested to assume all the enforcement responsibilities as from 1 January 2016. From this date, the stock exchanges should thus be relieved from the enforcement duties (SOU 2015:19). To date, there is no governmental decision taken on whether to accept the suggestion of the

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SOU and the initially adopted organization remains. It is still unclear how the enforcement duties will be allocated in the future.

1.2. Accounting regulation as a regulatory space

Central in the introductory portrayal of the roles of different actors in relation to financial reporting is the assumption that accounting standards have a superior position in accounting regulation. However, this assumption has not been uncontested. In particular, Cooper and Robson (2006) question the assumption within earlier research on accounting regulation that written rules have a fundamental effect on accounting practices. Instead, they argue that there is plenty of discretion in how rules are applied. Three different strands of research are invoked to show the extent of this discretion. First, they argue that the earnings-management literature indicates that accounting can be "manipulated". Second, the literature on intra-method accounting choice is seen as further indicating that there is significant discretion in how rules are applied. Third, compliance studies have found that many rules are in practice looked on as discretionary (see for instance Shah 1996). Moreover, similar views on rules are found within regulatory bodies, where the rules regulating these bodies are subject to discretion and interpretation when implemented in practice. (See Bedárd, 2001, investigating disciplinary procedures for accounting associations and Fogarty *et al.*, 1997, investigating requirements for practice reviews.) (Cooper and Robson 2006)

Cooper and Robson (2006) take the collective findings of these research areas as an indication on that the interpretation and implementation of rules need further attention. They argue the importance of furthering our understanding of "how far specific rules actually limit discretion" and how regulations are used in practice. They stress in particular the importance of studying how practices are negotiated between different organizations.

> We would thus wish to encourage research on how, and to what extent, managers and auditors use rules to produce the results they want, or conversely, how far specific rules actually limit discretion. Broadening the research agenda involves examining not only the development of accounting rules, but also

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> how they are interpreted, implemented and audited and the impact of the location of the interpreter. It is time to go beyond simple explanations for accounting choices, which typically focus on the impact on manager's bonuses, and examine the role of corporate and industry history, the structures of markets, spatial and temporal location, the incentive structures of auditors, the social and cultural capital of the field, as well as economic interests, in affecting how accounting rules and standards are used. The concept of regulation within accounting research has typically equated regulation with standard setting, but there are many other issues at stake. For example, these might involve inter-organizational negotiation between large organizations (corporations and audit firms), perhaps involving lawyers, accountants, and managers. (Cooper and Robson 2006)

Hatherly *et al.* (2008) make a similar call for further research, arguing that financial accounting research has failed to take into account the ambiguity of accounting standards and the impact of discretion on accounting practices. Similar to Cooper and Robson (2006), Hatherly *et al.* (2008) highlight the earnings-management literature as an indication on that even a system as U.S. GAAP, which has accumulated a large body of extensive rules, seems to be open to discretion, as earning do appear to be "manageable" within the boundaries of acceptable accounting.[2]

In the accounting policy choice literature, the possibilities of preparers to affect the accounting outcome is a central assumption and finding. For instance, Ball *et al.* 2003 show that preparers' incentives affect accounting quality, implying that similar accounting standards may lead to dissimilar accounting practices.

If the accounting standards do not alone determine accounting practices, how could accounting regulation then be described? In this thesis, the analytical concept of the "regulatory space" provides alternative assumptions for understanding accounting regulation in practice. This concept was introduced to understand regulation in contemporary societies (Hancher and Moran 1989) and has been adopted to understand accounting regulation (Young 1994, 1995, MacDonald and Richardsson 2004, Malsch and Gendron 2011, Bozanic *et al.* 2012, Canning and O'Dwyer 2013). The con-

[2] This could be said to be the basic assumption of positive accounting theory (see e.g. Watts and Zimmerman 1978) and the idea of that "economic consequences" will affect firms' lobbying decisions as well as accounting choices (see e.g. Zeff 1978).

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cept of regulatory space acknowledges the shifting roles amongst the actors described above, where different actors can act as regulators at different points in time. In addition, it allows for the possibility of seeing other actors as accounting regulators than those formally appointed as such. Thereby, the roles of different actors are neither fixed nor determined by any formal structure, but rather the roles and powers of actors involved are understood as fluid and changeable. In addition, Black (1998, 2002) suggests that "regulatory conversations" will organize the regulatory space because the identities of the actors of this space will be created and defined in communicative interactions with others.

1.3. Aim of the thesis

This thesis will study an enforcement body in Sweden as a case of how an increased focus on enforcement of accounting standards on the international level has come to affect national accounting-regulatory practices. Studying the role of enforcement bodies within a specific national setting can support an understanding of enforcement bodies in other contexts.

Theoretically, the study will rely on literature arguing that accounting regulation must be studied as a social practice. Foremost, there is an acknowledgement that accounting standards are ambiguous. This has two important implications. First, accounting practices and notions of compliance must be understood as social constructs, being the outcome of joint constitutive efforts. Second, the role of enforcement bodies can only be understood when studied as a part of its broader regulatory context, here formulated as a regulatory space. Therefore, the aim of this thesis is to *understand the role of an enforcement body in shaping accounting practices*.

To help achieve this aim, three research questions are formulated. A first research question focuses on the process when the investigated role evolves. This process is important to understand because it sheds light on why the role at a specific point in time has become what it currently is. In addition, knowledge about this process may provide an input for generating ideas on how to shape this role. The question takes it focus upon the events relating to a regulatory change. The reason is that this is a period of

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time when a change in the role of the enforcement body may be expected. The first research question asks:

How does the role of the enforcement body evolve in a time of regulatory change?

Because the broader regulatory context is believed to matter for the role evolved, the thesis also investigates the activities performed and the statements made by actors the newly introduced enforcement body encounter. A second research questions therefore asks:

How do other actors participate in the regulatory space?

With the increased use of international accounting standards, accounting regulation must increasingly be understood against an international background. The enforcement bodies are still located at the national level. A third research question therefore investigates the implications of this for the enforcement body.

What are the implications for the enforcement body of the local and global aspects of the regulatory space?

To answer these research questions, and thus to fulfill the aim of this study, the thesis investigates a number of accounting issues and the enforcement practices that manifest around them.[3]

1.4. Outline of the thesis

After the introduction of the research area, and the explanation of the aim of this thesis as presented above, this thesis consists of the following parts. In chapter 2, the theoretical framework is presented along with relevant

[3] "Enforcement of accounting standards" can be (and has been) used to signify many different things. For instance, auditing, supervision of auditors (in Sweden Revisorsnämnden) or the courts of law may as well be seen as examples of enforcement. In this thesis the usage of the term "enforcement" follows how this term has been used within the recent European development as presented above (see further chapter 4).

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previous research. This chapter will help the reader place the topics of the thesis in a wider context, highlighting the more general issues at stake and explaining the current state of knowledge on the issues investigated. The method chapter (chapter 3) will provide a description of assumptions underpinning this thesis and will also describe all the practical matters of the empirical investigation, including the choice and collection of empirical material and the analysis of the empirical data. Chapter 4 presents the empirical background to the thesis and an overview of the relevant standards, regulations and events preceding the events investigated in the main empirical chapters 5–8. Each of these four empirical chapters focus on specific accounting issues that have (chapters 5-6, 8) or have not (chapter 7) been addressed in public enforcement statements. The subsequent discussion chapters (9-10) draw upon the theoretical framework of chapter 2 in order to explicate the empirical chapters. In chapter 11, the main conclusions from this thesis help to foreground some practical implications. This chapter also acknowledges some limitations of the study and suggests some future research.

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Chapter 2

Accounting regulation as a social practice

> Accounting is neither a static nor a homogeneous phenomenon. Over time, all forms of accounting have changed, repeatedly becoming what they were not.
> *Hopwood 1983, p. 289.*

This chapter provides a context for the empirical area and the research aim presented in the previous chapter. This context aims to create an understanding for how the specific empirical phenomena investigated in this thesis can be analyzed by highlighting the more general phenomena at stake. This will be done both by outlining the theoretical framework relied on in the main empirical chapters 5 – 8 and explicitly applied in the analysis in chapter 9 – 10 and in the conclusions presented in chapter 11. The framework consists of two interrelated analytical concepts: the *regulatory space* and *regulatory conversations*.

In relation to this theoretical framework, there is also a discussion of relevant previous research that provides an overview of the previous knowledge in the areas addressed by this thesis.

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2.1. The regulatory space

Discussing regulation in contemporary societies, Hancher and Moran (1989) emphasize that regulation in modern societies is seldom explainable through dividing actors into the regulating public actors, striving for the public good, and the regulated private actors, who must be controlled by the public. Instead, they argue that regulation in advanced economies are better understood as a complex net of interactions and interdependencies, where a number of actors contribute to a process of creating and shaping regulations. Regardless of the area of regulation, previous research has found that large multinational firms are key participants in this process. Therefore, it is relations between "large, sophisticated, and administratively complex organisations" that often dominate economic regulation. The large firm becomes a "locus of power, a reservoir of expertise, a bearer of economic change, and an agent of enforcement in the implementation process". The large firms have therefore attained attributes that afford them a "public status" and can no longer be understood as receivers of regulation (regulatees). Instead, they must be understood as "governing institutions". The interdependencies among different governing organizations will shape economic regulation. (Hancher and Moran 1989)

> While much economic regulation does indeed involve the making of rules and the enforcement of standards, this occurs within a framework of much more diffuse intervention, concerned with a wide range of often unstated and even contradictory objectives. Economic rule-based regulation is not a distinct activity; it is woven into a larger fabric of intervention. The overall pattern is marked by a high level of social and administrative complexity. (Hancher and Moran 1989, p. 275.)

Hancher and Moran (1989) argue that studies of regulation often suffer from the "instinctive belief" that any private influence on regulatory processes is "illegitimate". The distinction between private and public actors, they argue, relies on the assumption of that "public interest is pursued at the expense of the private" and that any sign of private actors influencing (or benefiting from) regulations is a "distortion" of these. Hancher and Moran conclude that these assumptions have led to the formulation of reg-

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ulatory capture theories, where private influence on public matters is investigated from the viewpoint that such influence is unwanted.

> [O]rganizational alliances are constantly forming and reforming without any reference to a conventional public-private divide. Parties bargain, co-operate, threaten, or act according to semi-articulated customary assumptions. The allocation of roles between rule makers, enforcers, and bearers of sectional interests constantly shifts, again obeying no obvious public-private dichotomy. In such a world firms are not bearers of some distinct private interest which is subject to public control; they are actors in a common sphere with other institutions conventionally given the 'public' label. (Hancher and Moran 1989, p. 276.)

Given these assumptions, the expression "regulatory capture" is meaningless to rely upon. Rather than investigating "captures", researchers are urged to focus on investigating who participates in (and who benefits from) regulation, and to try to understand the shifting and complex relationships of actual regulation. What should be paid attention to is "the nature of this shared space: the rules of admission, the relations between occupants, and the variations introduced by differences in markets and issue arenas" (p. 276). (Hancher and Moran 1989)

The understanding of regulation as a space has some important implications. A space is "available for occupation" and may be unevenly distributed between "major and minor participants". In addition, there could be different and separate spaces, where individual sectors could be understood as examples of different regulatory spaces. According to Hancher and Moran, key matters to explain when investigating a regulatory space are the "inclusion and exclusion, the relative power of the included, [and] the scope of regulatory issues". They argued that inclusion and exclusion tends to be "systematic" (rather than a matter of choice) because admission to the regulatory space normally will be the result of "routine application of established practices". (Hancher and Moran 1989, p. 278.)

For Hancher and Moran, the "range of issues" open for public decision-making defines the regulatory space (p. 277). Issues, as well as groups, can be "organized" inside and outside of the regulatory space. Thus, the space it not assumed to have any natural boundaries, but rather "experience

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of history, the filter of culture, and the availability of existing resources" influence what becomes "regulatable" (p. 278). The political and legal setting, history, organizations and markets will therefore all impact the regulatory space and its distribution of power.

2.1.1. Accounting regulation as a regulatory space

In the accounting literature of the 80s and the early 90s, an analytical concept similar to that of the regulatory space was created to explain moments of accounting change. By talking about an "accounting constellation", Burchell *et al.* (1985) show that accounting change may be related to events taking place in a societal level. They illustrate this by showing how value added accounting in the UK "arose out of a complex interplay of institutions, issues and processes" (p. 408). Similarly, Miller (1991) investigates how a specific management accounting innovation, namely discounted cash flow techniques, became a major influence on practices even though it arose as a logical construct at business schools rather than as a response to a practical accounting problem. Robson (1991) studies how the creation of an accounting standard-setting body was retrospectively translated into an instance of "self-regulation".

Developing the thoughts of Hancher and Moran (1989), Young (1994, 1995) adopts the concept of the regulatory space into the area of accounting. When doing so, Young (1994) describes regulatory space as a space of accounting change.

> […] regulatory space is an abstract conceptual space within which changes in the recognition and measurement practices of financial accounting occur. This space is constructed by people, organizations and events that act upon accounting and accounting practices. Regulatory space encompasses the set of accounting problems for which a rationale for standard-setting action can be developed. It is within this space that the process of change in financial accounting practices occurs. (Young 1994, pp. 84-85.)

Young (1994) claims that previous research on accounting change have focused too exclusively on major accounting innovations. She contends that however interesting these transformative changes are, much of accounting

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change is more "mundane" and "less innovative" than the changes that have attracted research attention. Here, she emphasizes that accounting change needs not to be "dramatic", because the accounting regulatory space is "a space for tinkering with existing practices and financial statements" (p. 85). In particular, changes in financial accounting practices are, according to Young, commonly related to issues of recognition (i.e. on when asset, liabilities, revenues and expenses are to be recognized in the balance sheet or in the income statement). She argues that the "processes underlying these types of accounting changes" have remained "largely unexamined." (Young 1994, p. 83.) Hatherly *et al.* (2008) make a similar point when arguing that the tendency of research to focus on major accounting scandals (such as Enron and WorldCom) has left the "normal, non-scandalous practice of financial reporting unexamined" (p. 132).

Young (1994) suggests that the application of regulatory space as a theoretical lens creates a focus on understanding who is occupying the space, as no specific organizations can be assumed to have a dominant position within the space solely based on their formal position. Agenda-setting power is thus an empirical, and not a structural, concern. When studying the U.S. standard setter, the *Financial Accounting Standards Board* (FASB), Young directs attention to actors beyond the standard setter, but whose activities are interlinked with the activities of the standard setter. These actors are for instance the U.S. SEC, the auditors, and the preparers of financial reports.

Whereas Hancher and Moran (1989) argue that many different actors could be expected within a regulatory space, some researchers emphasize that "actors" are not necessarily homogenous "interest groups". Young (1994) suggests that the interests initiating accounting change could be described as "ambiguous", "unfocussed" and "lacking in specificity" (p. 85). Interest should not therefore be considered stable or unequivocally attached, or even attachable, to actors of different categories (Laughlin and Puxty 1983, Hindess 1986, Young 1994). Rather, interests are created and changed while actions, problems, and solutions are linked together by the actors themselves. (Young 1994) Discussing standard-setting processes, Laughlin and Puxty (1983) emphasize that it cannot be assumed that different "groups" or "parties" share a common interest in these processes. Rather than assuming that specific groups or parties will adhere to certain

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"interests", Laughlin and Puxty (1983) argue for recognizing two basic "worldviews", which could each be drawn on by anyone. These are the worldviews of the "user" and the "industry".

Hopwood (1994) highlights the absence of actual users in accounting regulatory processes, and pointed to how the user had become a "silent voice" to invoke by "the audit industry or capital market regulators" (p. 249). In later research, Young (2006) investigates how the "user" has been introduced as a central interest group in standard-setting activities only during later times. She explains "users" not as a real-life category of individuals pursuing some active interest through standard-setting activities but rather as an invention and a construct. Previously, different accounting was not assessed in relation to its "usefulness" for economic decision-making, but rather in relation to its adherence to "desirable accounting conventions such as conservatism, consistency, historical cost and matching" (p. 582).

2.2. Regulatory conversations organizing the regulatory space

Outside the field of accounting, Black (2002) develops a theoretical frame for a further understanding of developments of regulatory spaces. She suggests discourse analysis as a useful tool for investigating aspects of regulation that have previously been under-explored or have been observed empirically but nevertheless remain under-theorized. Here, she advocates "regulatory conversations" as "a new site of analysis for the study of regulation" to provide an opportunity of exploring these aspects further. Methodologically, discourse analysis asks questions about what conversations occur, where they occur, who engages in them and whether and how these conversations "work".

Black (2002) sees regulatory conversations most likely to be a part of regulatory practices under certain circumstances, including where regulation is based on written norms and where there is discretion (granting that almost all regulatory systems could be characterized like this). Conversations may occur when there is "uncertainty" surrounding the regulatory process insofar that "the task of regulation is uncertain and ambiguous, and where

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agreement on the definitions of problems and solutions presupposes an extensive intersubjective sharing of ideas and negotiations of meaning" (p. 172). In addition, the context of regulation may matter; for instance regulatory contexts in which transparency is expected are more likely to give rise to conversations. Foremost, Black urges researchers to:

> [L]ook at whom conversations are between, where they occur within the regulatory process or regime, what they are about, and how they 'work' to co-ordinate action and constitute regulation. It would look at the way that interpretations and conceptualizations are formed, at what understandings are shared and by whom, at which are contested and between whom, and at the strategies used in developing or contesting those understandings, including rhetorical devices. (Black 2002, pp. 195-196.)

Black (2002) argues that there is a significant potential for contribution to our understanding of regulatory processes in seeing meaning as a product of social activity and in assuming that language and agency are interrelated. A number of different suggestions are made, whereof four will be of special importance for this thesis.

First, Black (2002) argues that discourse analysis provides a ground for challenging more formalist perspectives on interpretations, by its emphasizing of that there is no inherent meaning in written norms. (Black 2002) This line of reasoning has its origin in the philosophy of the later Wittgenstein and similar thinkers. Second, to manage regulatory language, she argues that actors create "inter-subjective communities" (e.g. so-called "interpretative" or "epistemic" communities) to enable interpretations to be made. Third, she argues that regulatory conversations are used to repair the written rules, and for creating certainty in that there is mutuality of the interpretations made. In addition, she argues that the intersubjective understandings (created within the conversations) are necessary for enabling coordination and action. Forth, Black (2002) suggested that regulatory conversations constitute the identities of the involved actors. Below, these four arguments will be further explained and explored.

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2.2.1. Language and meaning

In the later Wittgenstein, language is devoid of meaning. What exists is a finite number of usages of a specific word or a specific sentence. None of these usages correspond to any essential object. "The game" is taken as an illustrative example. (See Wittgenstein 1953:66-71) Although we talk about many different types of "games", there is no common definition that forces us (or enable us) to define any individual activity as a "game". However, different "games" may have overlapping features. The similarities among these features enable us to see a "family resemblance" amongst different things we are looking at. The "games" we are aware of are a continuum where instances share certain aspects but not others, and no aspects are shared by every "game". Thus, in the absence of an essential meaning of "the game", classification through formulations of definitions is not only difficult but also virtually impossible. There is simply no essential object, or essential meaning, to define. No individual feature runs through the entirety of the continuum. Rather, many different features interlock and even though concepts used in this way has no common essence, they are nevertheless perceived as existing and used in a multitude of fashions. The meaning of any word exists only through its usage within a specific "language game". (Wittgenstein 1953)

This Wittgensteinian understanding of meaning as use provides insights on the limitations of the possibility of formulating rules to dictate behavior or to provide a specific answer (as in the case of mathematic formulas). The following of a rule is not a mechanical reaction to how the rule is formulated, but rather an individual judgment to make sense out of what to consider the "correct" reaction (or answer) regarding a rule. The rule may not capture a situation but rather the specific situation must instead always be attached to the rule by an act of interpretation. Each individual application of a rule to a specific case takes place "without guidance". (Wittgenstein 1953:292)

Following his line of reasoning, Wittgenstein notes that by extension any action can be interpreted as conforming to a specific rule. Here, Wittgenstein appears to conclude that meaning can never be locked in, neither by an initial formulation of a rule, nor by its later interpretations. He de-

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scribes interpretations as hanging "in the air" together with the rule they are aimed to clarify. Interpretations are no different from any formulated rule insofar as neither of these are able to determine meanings that are applicable to subsequent cases. (Wittgenstein 1953:198)

But if rules do not specify meaning: how is it that they cause us to react in specific ways to specific signs? Wittgenstein offers the traffic sign as an example of rule-following, where we repeatedly exhibit the same reaction (rule-following) to the same sign (rule). He suggests that we react as we do because we have gotten used to reacting in this way. Rule-following is (if nothing else) a "custom". (Wittgenstein 1953:198) We react to a rule in the specific way we learned to react previously (Wittgenstein 1953:189). This explains why not every encounter with a rule leads to a conscious act of trying to interpret the rule. Without further considerations, the meaning of a rule occurs to us "in a flash" (Wittgenstein 1953:197). Thus, "'obeying a rule' is a practice" (Wittgenstein 1953:202).

2.2.2. Epistemic communities

As the "appropriate action" to follow from rules will be unclear without "tacit understandings on which written norms or practices are based" (p. 176), Black (2002) argues that it will become necessary to create interpretative communities in the application of laws. This is not a problem unique to written laws, but legal language could enhance the interpretative difficulties, given that it requires "training" to become knowledgeable in its use. (Black 2002, cf. Wittgenstein 1953:189.) This implies that "control over the interpretation" becomes a concern, whenever the right to the interpretation is thought to be kept within a legal sphere (a "legal interpretive community"), constituting of courts and lawyers. (See further Goodrich 1989, pp. 105-121.) However, the regulatory practices, performed within the wider "regulatory interpretative community" could still differ greatly from how the "legal interpretive community" would reason.

Black (2002) argues that although the term "interpretative community", and other similar concepts (such as "semiotic group", see further Jackson 1988, or "enforcement community", see further Parker 1999) have been used in research, there is still a need for further analyses of how these

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communities work. She calls for studies of how individuals shape and are shaped by their surrounding "structures". In addition, Black appeals for attention to the heterogeneity of these communities. The communities are based on "mutuality of interpretations", i.e. when it is certain that one's own interpretation is consistent with interpretations made by others. However, this mutuality will never be comprehensive, and different views will always exist within an interpretive community. Differences are expected to lead to "battles". (Black 2002)

These communities develop either at a "surface" or at a "deep" level. At the surface level, there is shared understanding of practices. At a "deeper" level, a shared understanding of the regulatory goals and the values of the regulatory system is built up, and there is a shared commitment to these. There is also a shared understanding of how to deal with inadequacies and inconsistencies of written regulations.

The formation of interpretive communities, at least at a surface level, is "critical" in regulatory processes. Black argues: "Without that socio-linguistic competence, there will be little effective regulation, even where there is a will and capacity to comply" (p. 179). In these processes, regulatory conversations will be "vehicles" for meaning creation, where interpretive communities coalesce to change already existing interpretations and of behaviors. In relation to professionals, the term "epistemic community" is commonly used. (Black 2002)

> Epistemic communities are networks of knowledge-based communities with an authoritative claim to policy-relevant knowledge within their domain of expertise. They are characterized by shared values or principled beliefs as to the normative rationales for social action, shared understandings of the nature of a problem and of causal linkages between possible policy actions and desired outcomes, intersubjective and internally defined criteria for validating knowledge; and a common policy enterprise. […] Epistemic communities could be seen as a particular form of interpretive community: in addition to sharing linguistic practices and normative commitments, members of epistemic communities are professionals, and share a technical knowledge as to causes and effects and a common policy enterprise. (Black 2002, p. 189, including note 128.)

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In accounting research, the notion of (epistemic) communities has been drawn upon to explain different phenomena, including the construction of auditing expertise (Gendron *et al.* 2007).

2.2.3. Repair by rule formation or rule application

While the presence of "uncertainty" may create a perceived need for regulatory conversations, the production of "certainty", Black argues, central to regulatory processes. Certainty is reached when a sufficient level of "mutuality of interpretations" have been created. In particular, certainty will be valuable in relation to the interpretations made by authoritative bodies with "the power to determine interpretations and impose sanctions for breach" (Black 2002, p. 179). Attempts to increase the precision of written rules can be seen as a strategy for ensuring that there will be mutuality of interpretations.

Relying on previous research, (and with a striking resemblance to the arguments of the rules versus and principles debate in accounting, see e.g. U.S. SEC 2003) Black (2002) argues that these attempts would usually be unfruitful. Rather than provide a solution they typically create new problems, including "rule overload", "rule system complexity" and "creative compliance" (where the "spirit" of the law is neglected). It follows that precision is not a property of certain laws and that the increasing of precision is not an available road for producing certainty. Certainty exists only through the processes of interpreting laws. Here, the "socio-linguistic competence" provides a basis for perceive certainty in how to understand the meaning of the law. Simultaneously, those outside of the "socio-linguistic community" will still perceive the implications of the written rules uncertain. (Black 2002)

> Thus the 'precision' of law is more a rhetorical device than a functional asset, as linguists have long argued. […] Precision does not on its own produce certainty. Rather as socio-linguistics suggests, the certainty or uncertainty of norms has little to do with the way that they are expressed; it has everything to do with how they are understood and interpreted. Certainty, that is, mutuality of understanding and interpretation, is a product of socio-linguistic compe-

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> tence. Given that competence, apparently uncertain terms will be certain to that particular socio-linguistic community. (Black 2002, p. 180.)

The above described problems with rules and rule-following will create a need for regulatory conversations to "repair" the rules (see further van Dijk 1997). In the usage of rules, we could therefore expect to observe actions including attempts to change written rules, exceptions and the practices of "negotiated settlements" in the enforcement of rules (Black 2002, 1998).

Black (2002) argues that "intersubjective understandings" have a central position in much discourse analyses. Only when these are created, is action assumed to be possible. Regulatory conversations are the site where tacit knowledge and shared meanings are created. In the course of conversations, "regulatory communities" will form, enabling "shared common-sense knowledge and shared methods of practical reasoning" to be developed. This is crucial, given that regulations are only assumed to become "effective" when an understanding of them is internalized. Thus, "practices, attitudes, experiences, [and] personal codes of morality" will all create informal structures of control.

Notably, Black (1998) distinguishes between three "different types or occasions of conversations", i.e. conversations occurring in "the process of rule application", conversations occurring in "supervised rule formation", and conversations occurring in "monitoring and enforcement". First, conversations on *rule application* will occur when regulations have already been formulated by a distant regulator (in "some form of primary legislation", p. 79), as for instance the EU competition law). Central to this type of conversation in formal or informal providing of "guidance and waivers" on how to interpret the law. Second, conversations on *supervised rule formation* will occur when the regulatees are formulating "their own rules under the supervision of, and in negotiation with, a regulatory body" (p. 85). Here conversations will not only arise in relation to how the pre-specified law shall be applied in the specific case, but also in relation to how new rules (with "a greater degree of specificity", p. 85) could be formulated without intruding upon the original rule. Third, conversations will occur in relation to *monitoring and enforcement*. These conversations often occur at a decentralized level and include elements of "elaboration, adjustment or waiver of the

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rule, or […] guidance as to its meaning" (p. 86), similar to those elements in conversations on rule applications. The difference is primarily that these conversations are most often initiated by the regulator (rather than by the regulatee) and that the conversations address perceived breaches of rules and how such breaches shall become handled.[4]

2.2.4. Conversations and identities

Additionally, Black (2002) emphasizes the ability of regulatory conversations to "position actors and constitute their identities" (see further Czarniawska-Joerges 1996). Identities are thus created in social interactions through processes similar to the way a "reputation" is created. This identity is also (at least partly) "reflexive", implying that the identity as perceived by others affects how an individual (or organization) perceives its own identity. In addition, institutional factors, such as participation (or non-participation) in organizations can also contribute in the construction of an identity. Notably, the identity created can be "enabling" or "constraining" for the possibilities of action, and it will thereby create the actual role of an actor in regulatory space with consequences for the actor's ability to influence agenda setting and the "battle for interpretive control". Identities are however not formed once and for all, but are rather "open and shifting". They are continuously developing along with continued conversational interactions. They are also heterogeneous at a given point in time, as different and even contradictory perceptions can be held simultaneously about one single individual or organization.

2.3. Rules, principles and the need for accounting judgments

As mentioned above, the problems of specifying rule-following (i.e. "compliance") by formulating rules (i.e. accounting standards and accounting

[4] As the word "rule" in accounting has been used to distinguish between "rules" and "principles" based standards, I will modify Black's terms slightly. In the following, I will use the expressions "standard and guidance formation" and "standard application" to refer to the above described occasions.

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regulations) has been recognized in practice. The issue is discussed in a debate on whether accounting standards ought to be "rules based" or "principles based".

A common argument in this debate is that rules cannot possibly prescribe accounting treatments for every imaginable event regardless of the length and detail of the "rules". Therefore, it is argued, it is better to rely on less specific accounting standards ("principles"), which by design require judgment in their application. This contrasts with the "rules based" approach, which seeks to minimize the need for judgment. (U.S. Securities and Exchange Commission 2003)

The U.S. GAAP commonly has been characterized as a "rules based" regulatory system and the IFRSs as a "principles based" one, yet there are questions regarding the suitability of characterizing standards in this way.

Schipper (2003) challenges the understanding of U.S. GAAP as "rules based" by pointing out that the U.S. standards are based on "principles", but also include features (such as "scope and treatment exceptions and detailed implementation guidance") that make them "appear to be rules-based".

Similarly, Bennett *et al.* (2006) conclude that IASB's and FASB's accounting standards combine "rules" and "principles" and that judgments are needed in the application of both. They argue therefore that the distinction between rules-based and principles-based standards is "not meaningful, except in relative terms" (p. 191). Brown *et al.* (1993) conclude that any accounting standards must be assumed to be "inherently incomplete" and showed that different types of professional judgments are necessary in the application of accounting standards.

In an interview posted in December 2011 at the IASB website, Wayne Upton (the IASB Director of International Activities and Chairman of IFRS Interpretations Committee and with previous engagement with FASB) argues that it is a mistake to consider FASB standards as "rules based" as principles underlie both IASB and FASB standards, with differences being primarily differences in "degree". (Bruce 2011)

In statements made by the U.S. SEC, Dennis (2008) finds that the expressions "principles based" and "rules based" accounting standards are used with shifting meanings, referring interchangeably to a standard derived

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from a conceptual framework and to a specific way of writing regulations (i.e. by writing "principles" rather than "rules").

2.3.1. Implications for enforcement of accounting standards

The way accounting standards are written has implications for enforcement of accounting standards. Especially, it has been suggested that it may be difficult to enforce principles based standards and that more (rules based) guidance is required in order to facilitate enforcement. (Schipper 2003, Alexander and Jermakowicz 2006, Ball 2009). Boone *et al.* (2013) found that the U.S. SEC is more likely to take enforcement action when the authoritative literature surrounding an issue is "more rules based".

Within accounting research, it has been widely recognized that accounting standards are commonly applied differently in different geographical areas and that enforcement may be one of the factors influencing accounting practices. For instance, Holthausen (2009) concludes that there is little research evidence on the factors shaping financial reporting outcomes, but suggests that both ownership concentration (Leuz 2006) and enforcement may be explanatory factors (Leuz *et al.* 2003, Burgstahler *et al.* 2006, Lang *et al.* 2006, Leuz 2006, Daske *et al.* 2008).

Hatherly *et al.* (2008) suggest that technologies and training are the two main constraints on actual accounting choices. Concerning technology, accounting software, for instance, restricts the possibilities of changing earlier entries without creating visible traces. Concerning training, individuals typically learn by observing multiple "examples of 'correct' classification and 'appropriate' concept application" (Hatherly *et al.* 2008, p. 149), which will impact how future classifications will be done.

Wittgensteinian reasoning suggests that it is meaningless to draw any (research) conclusions on whether rules are followed or not, as there is no possible "compliance" detached from the usages of the standards in different contexts. Instead, an understanding of rule-following as a changeable "use", rather than an objective fact that follows from the initial rule formulation, entails the existence of a gap between a standard and its application, a gap which must be closed by (active or learned) interpretation. This gap is crucially important to study in accounting research, as this is where ideas

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about "compliance" develop in practice. Accounting regulation cannot therefore be studied (solely) by focusing upon standard setting or upon enforcement, but must be studied within a wider regulatory space.

2.4. The role of (international) firms and organizations

Hancher and Moran (1989) suggest that multinational firms are important actors in current regulatory spaces and several researchers have emphasized the role of international organizational firms (and networks) in accounting regulation (Hopwood 1994, Cooper and Robson 2006, Loft *et al.* 2006, Suddaby *et al.* 2007, Humphrey *et al.* 2009, Malsch and Gendron 2011). In 1994, Hopwood suggested that the lack of knowledge about how accounting develops in the international arena might be due to the relatively small number of individuals involved and the multiplicity of their responsibilities.

Bozanic *et al.* (2012) argues that it has "long been recognized that those regulated are able to influence the regulations". They argue that this influence can be manifested in two different ways: through "active attempts by those regulated to influence the codification of a proposed regulation before it is issued" or "passively on the interpretation of a regulation after it has been issued" (p. 466).

Burchell *et al.* (1980) emphasize the interplay among different (public as well as private) actors that has historically driven accounting regulation forward. State-governed actors have been appointed with certain duties, but private actors have remained important in regulatory developments. When the U.S. SEC was created, it "made rather limited use of its regulatory powers in the accounting area, allowing the profession to invest in that chain of institutional mechanisms for the explication, standardization and codification of financial accounting practice" (p. 7). In this U.S. case, Burchell *el al.* argue that the private standard-setting organizations governed the progress. In the U.K. too, self-regulation became an important feature of accounting regulations whereas state interventions become more common in Germany and France. (Burchell *et al.* 1980)

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Cooper and Robson (2006) emphasize the importance of understanding large and multinational firms as actual regulators, and urged further research on the "multiple sites" of the numerous organizations involved in the construction of accounting practices, including different non-governmental organizations (NGOs). They argue that the Big Four accounting/auditing firms in particular are important "sites" of accounting regulation which are not yet sufficiently explored.

Mapping a regulatory space in a U.S. environment, Young (1994) concluded that the *American Institute of Certified Public Accountants* (AICPA), the U.S. SEC and the U.S. Congress are all involved in agenda-creating events, important for the activities of the FASB. She emphasizes that different actors are active within different accounting issues and that for any given issue, actors enter and leave the regulatory space. Nevertheless, some actors consistently engage in processes of accounting change and thereby consistently occupy the regulatory space. The engagement of these actors has become institutionalized through their roles as employees of larger accounting/auditing firms, or as members of certain committees (for instance the AICPA *Accounting Standards Executive Committee*).

In a social network analysis of the organizations affecting Canadian accounting and auditing standard setting, Richardson (2009) maps a network consisting of 61 organizations and 131 inter-sections clustered into four main groups: "Domestic Securities Regulator's", "IOSCO/World Bank", "IFAC/Basel", and "Domestic Accounting and Auditing Standard Setting" (within which the *Canadian Institute of Chartered Accountant*, CICA, is found to hold an important position). A number of organizations (including the e.g. the CICA *Accounting Standards Oversight Committee*, and the Basel Committee) are found to be "key players", providing "a crucial point of access to the network" (p. 585). He finds that standard setting for accounting and auditing is interconnected, both within Canada as well as internationally, and there is a strong focus on "the needs of international capital markets" at the expense of other stakeholders.

Power (1996) argues that "audit verification takes place against the background of a network of trusted experts" (p. 307). This network serves to extend the "unaccountable and unauditable" (p. 305) areas. The actuaries are here taken as one example of experts that auditors commonly rely up-

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on, although he argues that their expertise is bordering to have become internalized by the auditors.

Mulligan and Oats (1995) illustrate that tax professionals are a "powerful, elite group of knowledge experts" (p. 1) that may influence tax laws as well as tax practices. Mulligan and Oats argue that this enables the tax professionals to contribute in the shaping of their wider institutional environment.

2.4.1. The role of professional associations

Hopwood (1994) underscores the influential position of the auditing industry, the International Federation of Accountants (IFAC) and the Fédération des Experts-comptables Européens (FEE) within accounting regulation. Investigating the IFAC, Loft *et al.* (2006) show how this organization (with members such as the *World Bank* and the *International Organization of Securities Commission*, IOSCO) has turned into an important audit standard setter. They point out the influential relationships between the larger accounting firms, IFAC and other regulatory organizations and warn against understanding organizations such as IFAC as merely attempting to avoid interference with self-regulatory structures. This they do by identifying overt attempts to guard the "public interest" and tracing the "global financial infrastructure" emergence. Within this infrastructure, organizations such as IFAC are seen to "have experienced major change in [their] authority and jurisdictional significance in recent years" (Loft *et al.* 2006, p. 444).

Similarly, Humphrey *et al.* (2009) emphasize how the developing relationship between the audit profession and what they label an "international financial architecture" is currently creating a new regulatory landscape within this the possibilities and constraints of auditing are not yet sufficiently understood, but where it is clear that the international organizations are increasingly important. Like Cooper and Robson (2006), they encourage further research on the international sites of accounting regulation and on the activities of the larger accounting firms at them. They ask in particular to what extent will the ongoing change result in "self-regulation […] reemerging in a modified form of regulatory partnership between the firms, public oversight boards and the larger national accountancy bodies"

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(p. 821) and whether the auditor's "capacity to exercise professional judgement is enhanced and/or unduly constrained by global regulatory arrangements" (p. 821). Investigating what they term "the emergence of a transnational regulatory field in professional services" (p. 333), Suddaby *et al.* (2007) make a similar call for further research.

> Professional regulation, at the transnational level, is now a negotiated product from an increasingly broad and heterogeneous network of actors. [...] Accounting, particularly the Big Four firms, are at the center of these changes which continue to unfold. While this account identifies the creation of new transnational institutions of professional regulation, we have little insight into how this new and dispersed network of actors collectively or independently interpret and use them nor do we fully understand the implication of such changes for those local and regional actors who continue to occupy roles in the traditional model of professional regulation. Future research should address these issues. (Suddaby *et al.* 2007, p. 357.)

Greenwood *et al.* (2002) emphasize the importance of professional associations in formations of shared meanings and understandings by investigating the development of the accounting profession in Canada. In this study, the interplay between the professional organizations and the (then) Big Five firms are found to limit the CICA's ability to set the agenda for the major accounting firms. However, even though the CICA's agenda-setting abilities are shown to be limited, Greenwood *et al.* nevertheless still emphasize that the professional association constitutes an "arena" for interaction.

In addition, by theorizing what it is to be a "chartered accountant", (Greenwood *et al.* 2002) show that professional associations contribute to a process of changes in professional identities, where "accountants" were turned into "business advisors".

2.4.2. The construction of "identities"

Within a specific regulatory space, Young (1994) argues that pre-existing expectations for how different actors shall act influence what will come to be considered "appropriate resolutions". She finds that the actions of the standard setter are related to a "logic of appropriateness" (March and Olsen

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1989) in two different ways. As the standard setter is affected by this logic in its choosing amongst different possible actions, the standard setter simultaneously also contributes to the creation and maintenance of this "logic of appropriateness". At least, this is the case when the actions in question remain uncontested. (Young 1994)

Similarly, MacDonald and Richardson (2004) find that a "logic of appropriateness" is relied on when the *Public Accountants Council of Ontario* became introduced into the Canadian accounting regulatory structures. In this case, the "logic of appropriateness" guided the creation of a "social identity" for the new regulatory actor.

This identity developed in negotiations within the regulatory space. In the end, the created identity came to influence the division of this space amongst the new and the already existing actors, including the accountants, professional associations, and the courts. Whereas the legal mandate was argued to allow for a number of powers, the Council was found to have developed and manifested only some of these assigned powers, whereas others were disregarded. In particular, the power to include or exclude accountants into the profession was found to have rendered the Council a significant position within the regulatory space. After the introduction of a new actor, a new regulatory space was argued to have been created in four different stages: i.e. through the "establishing", the "defending", the "attempting to enlarge", and the "affirmation of" a new regulatory space. (MacDonald and Richardson 2004)

Suddaby *el al* (2007) emphasize that there has been a shift in logics of accounting regulation, where an "ideational change" has shifted the regulatory logics from "professional logics" (with a focus on "public interest") to "market or economic logics". In addition to this shift, Suddaby *et al.* (2007) concluded that other "elements of field structuration" (p. 335) also have contributed to a creation of an emerging "transnational regulatory field in professional services" (p. 333). This shift in "structural boundaries" has delineated the members and non-members of the field, where new actors (such as the Big Four, the WTO, and EEC) have become influential regulatory actors. The active formation and change of "identities" (where regulatory logics influence "identification") are constitutive of the actors' positions within the "regulatory field", and this new positioning, Suddaby *et*

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al. conclude, represents a shift in powers. Where the power was previously "coercive", it is now "soft" power (based on identification and memberships). The Big Four firms, they find, "occupy a strategic structural position in the emerging field in that not only do they interact with all the key players, but they also remain connected to key players in the 'old' field of nation states and professional associations" (p. 355). The strong position of the Big Four gives them a "'powerful ideational role as translators of meaning systems within the field" (p. 355).

As a result of this transformation, a "regulatory gap" has developed between the traditional national regulators and the "increasingly influential" international firms. "Professional regulation, at the transnational level, is now a negotiated product from an increasingly broad and heterogeneous network of actors." (Suddaby *et al.* 2007, p. 357)

Seeing the "accountants employed by the Big Four accounting firms" as "the most elite representatives of the accounting profession" (p. 424), Suddaby *et al.* (2009) argued that the value commitments of these Big Four accountants differed significantly from those of other accountants. In particular, accountants employed at top levels of the Big Four firms were found to have a relatively low commitment both to "independence enforcement" and to their clients. This finding is taken as an indication that working conditions will affect values and attitudes of the individual and implies that there should not be assumed to exist a common value system (nor a common profession) for accountants independent of their working sites.

Covaleski *et al.* (2003) illustrate how a number of actors, including the Big Five, the AICPA, the *Institute of Internal Auditors* (IIA), the U.S. SEC, and the U.S. Congress through a "heated dramaturgy of exchange relations" transformed the jurisdiction for internal auditing. In this process, the Big Five firms regained their rights to provide internal audit services for their external audit clients. Numerous expressions (such as the creation of the "knowledge expert"), and the characterization of the Big Five as occupied with "interdisciplinary professional service" (rather than with "accounting") were drawn upon in enabling of transformation.

Suddaby *et al.* (2015) emphasize that processes of professional change can be understood as the unexpected outcomes of "processes of endoge-

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nous change" (p. 66), rather than the results of strategic intentions and conflicts. In the case they investigate, professional change is a result of how accounting professionals have come to use social media.

2.4.3. The construction of "problems" and "solutions"

Studying the creation of an accounting standard-setting body, Robson (1991) argues that the accounting profession's regulatory discourses created in retrospect a narrative around the set-up of this body framed as finding a "solution" (i.e. self-regulation) to a perceived "problem" (i.e. the problem of creating legitimate accounting practices). This translation of the events occurred even though no corresponding problem formulation existed when work to establish the standard-setting body was initiated. Robson (1991) therefore described the "accounting constellation" as the bringing together of different sites where problematizations occur.

In her study of the U.S. FASB, Young (1994) explored how accounting issues are constructed as "accounting problems", and how certain responses are interpreted as "appropriate" for the standard setter. These construction processes are central in how accounting issues become parts of the standard setter's technical agenda. She emphasized that although different actions and events may move onto the FASB agenda, the precipitating actions and events must not have been carried out with the intention of influencing the standard setter or with the aim of obtaining a specific standard setting outcome. Rather, accounting change can be the "unanticipated consequence" of disparate events intersecting with the standard-setting process. The accounting standard is therefore understood as created within a regulatory space, rather than by the standard setter as a sole actor. On this view, the process of accounting change consists of several phases, including the construction of an accounting issue or an accounting condition as an "accounting problem", the construction of this problem as an "appropriate" area for standard setting, and the construction of a "solution" to this specific "problem". These phases can occur either simultaneously or sequentially.

Studying the developments of accounting in relation to the savings and loan crisis of the late 70s and early 80s, Young (1995) found how "account-

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ing practices changed as the demands placed on accounting changed and as the perceptions of a 'right' accounting changed" (p. 58). When accounting was deemed to have failed in its ideal function of being "representational", belief in this ideal (and in "getting the accounting 'right'") was not abandoned. Rather, actors "rallied around other accountings to re-promote and maintain the ideals of accounting" (p. 59).

Young (1994) emphasizes the importance of accounting concepts (as "relevance", "reliability" and "representational faithfulness") in processes of accounting change. These concepts come to constitute elements of the regulatory space, creating the boundaries for accounting change by delimiting the range of issues that can be the object of standard setting. Whenever there is a perceived difference between actual accounting practices and ideas on what "appropriate" accounting should be (i.e. consistent with these concepts), those perceived differences have repeatedly come to generate accounting change. These accounting concepts are therefore vital in the construction of accounting issues as "accounting problems". Similar to how these claims about appropriate accounting, "expectations about standard-setters" (p. 105) will also come to affect the constitution of the regulatory space.

2.4.4. The role of enforcement bodies

In the 90s, some researchers came to emphasize the disconnections between what enforcement bodies claimed to do, and what they were actually doing. The enforcement activities were mainly understood as tools that provide legitimacy for the enforcer as a regulatory actor. Investigating the U.S. SEC, Bealing (1994) shows that enforcement activities increases the funding available to the SEC. Bealing *et al.* (1996) show that the legitimacy of SEC is more dependent on this organization's ability to "institutionalize its role in the financial markets and in the financial reporting and auditing communities" (p. 317) than on the actual effects of the enforcement actions. Fearnley *et al.* (2002) on the other hand argue that the U.K. FRRP has contributed to increasing auditor independence and to change U.K. auditors' attitudes to compliance, even though they argue that the level of impact is dependent on the individual auditor's level of ethical cognition.

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By analyzing archival data (including U.S. Congressional legislation, press coverage, proposed new regulations, public speeches and comment letters submitted to the U.S. SEC) Bozanic *et al.* (2012) find that actors that should be regulated by the SEC's insider-trading regulations were instead "empowered" (p. 477) to influence these regulations. Thus, the regulatory process is "mutually endogenous" (cf. DiMaggio and Powell 1991, p. 11 and Edelman and Stryker 2005) where both the SEC and the regulatees obtained something valuable: "SEC had codified the 'knowing possession' standard and regulatees had obtained room to maneuvre within the new regulation" (p. 475). The regulated actors were simultaneously affected by their "institutional environment" and able to influence it despite the regulation in this case originating at a non-local level. So, although the regulation was not "ambiguous" and actively enforced, there existed possibilities for influence. From this Bozanic *et al.* conclude that regulatees may "depending on the context" prefer either "ambiguity" or "stricter specification" within regulations, as both can, under certain circumstances, increase the "room to maneuver" (p. 475). In addition, they emphasize that not everyone was equally successful in affecting the regulation and that some comments were not taken into account by the SEC. This speaks to a point made by Cooper *et al.* (2008) and Bozanic *et al.* (2012), that not all voices in a social/institutional environment receive attention. Investors, for example, whom regulations should aim to protect, were not listened to and thus "disempowered" (Bozanic *et al.* 2012, p. 476).

Malsch and Gendron (2011) claim that the increased focus on the oversight of the auditing and accounting firms has resulted on that audit is "no longer understood as a self-regulated professional activity". They also question whether attempts to move power and control from the accounting firms to other regulatory organizations actually is "consistent with the claim that audit quality is being reinvigorated" (p. 457) by this change. They study how the introduction of independent surveillance over auditing (the *Canadian Public Accountability Board*, CPAB) affected the existing regulatory space. Malsch and Gendron (2011) conclude that their study supports that oversight bodies and the largest accounting firms are developing a mutual "form of allegiance" (p. 473, cf. Humphrey *et al.* 2009, p. 817). Whereas the complexity of the "diffusion and implementation of regulatory innova-

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tions" are downplayed in "official discourses" (Malsch and Gendron 2011, p. 473), the logic of self-regulation is found to be far more influential than the official sources lead one to expect. Modes of thinking around regulation along with active agenda-setting and selective confrontation with the new regulatory organization combined to preserve the earlier self-regulatory structures despite the formal regulatory changes.

Other factors also combine to make the Big Four firms "far from […] powerless in the face of audit regulators" (Malsch and Gendron 2011, p. 357), including the size and economic resources of the auditing firms and the "regulatory gap" (cf. Suddaby *et al.* 2007, p. 357) that follows from supervision which is national or regional of firms which are international firms. The Big Four firms have their international desks, but the supervisory organizations have no counterpart, and it is therefore argued "very unlikely that highly efficient forms of regulatory power will develop to oversee, control and question the increasing expansion of professional service firms' jurisdiction".

Investigating the creation of the enforcement body the *Irish Auditing & Accounting Supervisory Authority*, IAASA in Ireland, Canning and O'Dwyer (2013) conclude that the creation of this body and the powers suggested for the authority were heavily questioned by the accounting profession, as the new body was regarded a threat to the previous self-regulation. Regardless of the resistance, the enforcement body was found to establish itself as an authority with substantial powers and avoided renegotiation of its mandate with the accounting profession.

Investigating financial-market regulations, Williams (2013) concludes that the "regulatory technologies" used in enforcement activities (including "surveillance technologies", "datamining and risk profiling tools", and "data visualization and graphing programs") are shaping "the boundaries of enforcement and thus the scope and depth of the regulatory vision" (p. 52). As these technologies are most commonly statistical tools reliant on algorithms, the technologies will direct attention to what is "atypical", or "abnormal" in large samples of data. Practices that are industry norms will thereby never come to enforcers' attention (p. 556). There is therefore a "failure to 'problematize the norm'" that, Williams argues, serves to narrow down the practices that are considered "legally sanctionable" (p. 556).

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While Malsch and Gendron (2011) and Canning and O'Dwyer (2013) investigate enforcement bodies with a focus on how they became parts of a wider regulatory space and Williams (2013) focuses on the influence of enforcement technologies on behaviors of other financial market participants, other research has investigated enforcement as an isolated activity, focusing on how "effective" different enforcement bodies are in their tasks of finding breaches of accounting standards. This made from the assumption of enforcement actions against "fundamental" accounting issues (such as measurement and recognition, cf. Tweedie and Whittington 1990) is evidence on effective enforcement. Dao (2005), for example, concludes because it "difficult" or "even impossible for a regulator to determine whether the company under review complies with a particular measurement and recognition practice required" (p. 120) only non-compliance that is visible in financial statements will be detected. Less visible issues, Dao argues, are found in relation to providing pre-clearances when additional information is directly presented to the enforcer. Similarly, Brandt *et al.* (1997) and Fearnley *et al.* (2000) are indicating that to a large extent "non-fundamental" accounting issues are addressed by the UK Financial Reporting Review Panel (FRRP). Later, investigations of the FRRP along with the Australian Securities and Investments Commission (ASIC) by Brown and Tarca (2007) found that for both these studies about half of the issues criticized were issues of measurement and recognition.

Previous research has shown that the Big Four accounting/auditing firms are important actors in shaping accounting practices. Far less is known about the roles of enforcement bodies. This thesis will contribute to previous research by investigating this role.

In the following, the theoretical perspectives outlined in this chapter provide a lens for understanding enforcement activities. Thereby, the theoretical framework will be a means for focusing and directing the attention of the research project.

Two analytical concepts in particular will be invoked within this thesis. First, accounting regulation is understood as a *regulatory space*. This implies

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that different actors ("regulators" as well as "regulatees") are expected to jointly shape accounting practices. Second, *regulatory conversations* function as organizing forces in the creation and maintenance of regulatory spaces.

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Chapter 3

The making of the study

Although the efforts to harmonize accounting and enforcement of accounting standards are international in origin, this book will study local practices performed in relation to the international developments and aims to provide deeper insight into a case of accounting regulation.

In the following, the assumptions underlying this research and the design choices made on that basis will be described. Thereafter, a description of the important steps taken in the making of this study (including the collection and analysis of empirical data) will be presented.

3.1. Designing the study

Hopper and Powell (1985) argue that as "certain fundamental theoretical and philosophical assumptions underlie any piece of research" (p. 429), it is important for researchers to acknowledge their own assumptions or beliefs. Commonly, these are divided into beliefs about how the world is constituted (ontology), and beliefs about how knowledge is constituted (epistemology).

In accounting research, it has been common to differentiate between different types of research based on different combinations of assumptions held by researchers, in terms of whether the world and/or knowledge is understood as subjective or objective. (See for instance Burrell and Morgan 1979, Morgan and Smircich 1980, Guba and Lincoln 1994, Hopper and Powell 1985, Tomkins and Groves 1983) If the world is believed to be en-

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tirely subjective, there is no one world to learn about. This worldview could imply that everyone is looking solely at his or her individual world. What I perceive to be the world could just as well be only a dream.

If the world however is believed to be objective, the world is understood as constituted in a specific (and stable) way. Hence, there are facts. Nevertheless, we might have different epistemological beliefs about the possibility of getting to know these facts, i.e. the knowability of this objective world. Our abilities to measure and to stay objective in scrutinizing this world will here determine for the outcome of our search for knowledge. Naturally, if the world exists objectively, statements are true or false. Classical hypothesis-testing quantitative research is thereby resting on the later assumptions.

3.1.1. Interpretative research

This thesis will follow a research tradition commonly labelled as "interpretative research". Interpretive research is often described as relying on subjective worldviews (see e.g. Hopper and Powell 1985). The "epistemology that views reality as a social construction" has a focus "on analyzing the specific processes through which reality is created. Here, reality resides in the process through which it is created, and possible knowledge is confined to an understanding of that process." (Morgan and Smircich 1980, p. 497) Not only reality but also our knowledge about reality is constructed and changeable. What is sometimes emphasized is the temporary stability of what has become knowledge. The world could hence be perceived as objective even if was not from the beginning. (See e.g. Berger and Luckmann 1967)

In later years, the dichotomy between researchers as "subjectivists" and "objectivists" has repeatedly become challenged (see e.g. Boland 1989, Kakkuri-Knuuttila *et al.* 2008, Ahrens 2008). Boland (1989) argued that the "hermeneutic turn" of social sciences undermined the attempts of making separations between these two categories.

> [O]ur knowledge of accounting and organizations is not guaranteed by a method that separates the objective from the subjective in order to penetrate to the

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> 'laws' of the social universe. Instead, our knowledge of accounting and organizations is constructed through a social practice in which such distinctions are not meaningful. (Boland 1989, p. 591)

Investigating "interpretive research in management accounting" Kakkuri-Knuuttila *et al.* (2008) suggest that although interpretive research traditionally has been labelled subjective, an example of interpretive research (i.e. Dent 1991) displays both distinctive subjective features and features usually labelled objective. From a constructivist approach, Law (2004) argued the importance of abandoning the idea of "singularity" in research (p. 9), where appropriate research methods ensure that you can study reality as it is. This is due to the influence of the methods themselves, where any method used will serve to construct reality. Thereby, scientific knowledge and technologies are parts of society as a whole, both being shaped by the social world and contributing to the shaping of the social world. (Law 2004) The subjectivity of knowledge cannot therefore be circumscribed through a changed research method, as knowledge created when relying on quantitative methods must be considered equally dependent on how the investigation is performed. (Kvale and Brinkmann 2009)

Case studies

With a different set of assumptions than usually relied on within quantitative research, interpretive work calls for different methods.

> Meanings are themselves built on other meanings and social practices. As such, "thick" case studies conducted in the life-world of actors are preferred to distant large-scale sampling or mathematical modelling of human intention. (Chua 1986, p. 615.)

Similarly, Dent (1991) foregrounds interpretive research as field research, arguing that interpretive research is always qualitative, and never engages in hypothesis testing. A focus on the sense-making of individuals is considered central. The analysis of empirical data is described as an attempt to "theorize through the data in an inductive manner", where the analysis is "itself an emergent process" where "empathy" with the data builds up, en-

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abling the researcher to see events through the eyes of the participants of the study.

I have chosen to make a single case study of one country in order to understand the role of the newly appointed enforcement body on a deeper level than would otherwise be possible. (Cf. Dyer and Wilkins, 1991, criticizing multiple case studies for their loss of depth.)

When having decided to study one country, I also had to decide which country to study. For practical reason, I chose Sweden as a case country, as I here had the possibility to stay close to my studied object during a sufficient amount of time. I must however emphasize that any case could have been interesting in its own right (cf. Kvale and Brinkmann 2009). Therefore, (in theory) any EEA state could have been chosen for a case study, and I do not argue that Sweden is a better, or worse, choice than its alternatives.

Within case studies, it is common to rely on several different sources of empirical data, including documents, interview data, and data from participant observations. As the events studied here took place in past time, participant observation was not a possibility as this method can only be applied when studying events in real time. In addition, it is very rare to get access to observe the kinds of events studied in this book. Therefore, the case study here undertaken relies only on documents and interviews as empirical data.

The interviews were performed to get access to information about past actions and events about which there was no public information available, and/or about which no written accounts had been made. Another reason to perform interviews was to create an understanding for how individuals made sense of these actions and events, as the interview provided them an opportunity to talk freely. Decisions to rely on relatively open interview questions and to grant anonymity for interviewees were here aimed at further enabling interviewees to have their own say in relation to the area researched.

On the other hand, this research method carry a potential drawback in that interviewees do not remember past events or tell about these events in the light of current knowledge. Nevertheless, this method provides a

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unique possibility to gain access to first hand observations on how interviewees retell past events and how they currently understand these.

Kvale and Brinkmann (2009) acknowledged that the impossibility of generalizing from interview data is a common critique against interviewing as a research method. They argue however that the ability to generalize from any kind of data is equally dependent on that observed phenomena are explainable in universal terms and sharing common features which may be discovered. Given that this may not be the case, the possibility to generalize becomes less of a concern. As different cases are supposed to differ, that is all cases are supposed to be (at least to some extent) unique, the cases become interesting in their own right and should not be considered mere samples from a wider population. (Kvale and Brinkmann 2009) This way of understanding case-based research follows from with Tsoukas (2009), who argues that different cases may share overlapping features but no features should be expected to be characteristic for all cases of any thought population.

The role of theory

Macintosh and Scapens (1990) argue that theory can be understood as a "sensitizing device", which enables the researcher to "make sense of accounting practices". Rather than being a source from which testable hypotheses can be deduced, theory is thereby seen as a tool for generalizing between different settings. Drawing on Giddens (1984), Macintosh and Scapens (1990) argue that generalizations are not to be understood as natural laws which may "explain and predict", but rather shall be understood as "explanatory propositions", which are "both temporally and spatially circumscribed" (pp. 469-470). Theories are hence are not to be considered fixed entities that might be defined and applied to produce the one account of the studied object, but rather as interlinked ideas which may be manifested in a particular use in different studies. Notably, none of these studies can be assumed to determine the essence or correctness of theory. For research, this implies that reality cannot be captured "as it is" (as there is no such thing) but what can be done it to provide one (out of several) possible account(s) of what we are looking at. (Tsoukas 2009)

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In this thesis, the theoretical concepts of the "regulatory space" and "regulatory conversations" will be relied on analytical tools. In line with the above arguments, these theories will not be tested as true or false but will rather be mobilized in order to enable one (out of several possible) understandings of the empirical data.

Evaluating interpretative research

Several researchers have stressed that the methods used for assessing quantitative research may not simply be borrowed for the assessment of (interpretative qualitative research. Ahrens and Chapman (2006) highlights how the traditional notions on validity and reliability fit poorly with qualitative research where the research results in fact cannot be assumed to be independent of either the field researched or the researcher. On the contrary, as "social reality" within interpretive research is "emergent, subjectively created, and objectified through human interaction" (Chua 1986, p. 615), the requirement that research results should replicable (elsewhere and by someone else) becomes inappropriate.

> Objectifications of social reality are context specific. Actors in the field can, and do, strive to undo their history and invent new concepts, images, and ways in which they want them to infuse action. Valid and reliable accounts of the role of accounting in social reality cannot pretend to study this reality without reference to the agency of actors in the field and independently of the researcher's theoretical interest. (Ahrens and Chapman 2006, p. 833.)

Dent (1991) argues that although different interpretations of data could always be made, the researcher should strive to provide "a faithful account", by assuring that interpretations are "grounded in context and consistent with the chronological ordering of events and interactions". In addition, it is important to present the data in a fashion that allows the reader of the research results to "independently judge their credibility, as far as is possible" (p. 711).

Lukka and Modell (2010) argued that the notion of validity must be developed to better align with contemporary interpretive research. They argue that two considerations can be used to assess the validity of research findings: "authenticity" and "plausibility". Conveying "emic understandings of

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actors' meanings" (p. 462) will raise the "authenticity" of research, the applying of theories to further the understandings of what has been investigated enables "thick explanations" in the service of "plausibility".

I interpret the statements above as an indication that interpretative-research must be written in such a fashion that makes possible its evaluation by those reading the research report. The presentation of the empirical material must thereby be "thick" enough to provide the reader with a sufficient understanding to judge whether the analysis made is reasonable or not.

In the following, the practical steps taken in the making of this study will be described.

3.2. Collecting empirical material

The collection of empirical data for the execution of a case study of the newly assigned enforcement body in Sweden included two activities, the collection of documents, and the making of interviews. These two main activities were performed in four different phases:

- Publicly available documents on the European harmonization of enforcement of accounting standards and on the related Swedish enforcement activities were collected.
- 6 pilot interviews were made.
- Additional public material was collected (based on a decision to focus on a limited number of accounting issues).
- 33 primary interviews were conducted. Parallel with these interviews, some additional (publicly and non-publicly) available documents were collected. The documents collected in the last phase were for the most part documents received from interviewees, but others were public documents referred to in the interviews (such as annual reports of specific entities).

The activities performed and choices made during these four phases will be outlined further below.

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3.2.1. Collecting publicly available documents

The initial step was to gather information about activities related to the harmonization of enforcement of accounting standards within the EU. This included a review of the *IAS Regulation*, the *Transparency Directive* and the documents published by CESR (and later ESMA). In addition, the EECS extracts of enforcement decisions provided an overview of the accounting issues addressed by different European enforcers.

The next step was to collect all publicly available material concerning the activities related to enforcement of accounting standards in Sweden as performed by the competent authority (*Finansinspektionen*) and the enforcement bodies (*Nasdaq OMX Stockholm* and *Nordic Growth Market NGM*). The documents included enforcement (and other) reports and enforcement decisions. These documents catalogued both what activities had been performed, and what statements had carried out. In addition, articles in the Swedish accounting and auditing journal *Balans* (issued by the Swedish association of the audit and accountancy profession, FAR) criticizing the Swedish enforcement activities provided an insight into how these activities had been perceived by others and indicated whether any specific accounting issues addressed within an enforcement report or an enforcement decision had gained public attention.

3.2.2. Making the pilot interviews and collecting additional documents

After the initial collection of public documents, research interviews were carried out to learn more about the activities and individuals behind the documents found in the initial collection of empirical material. As a pilot study, three writers of different articles published in *Balans* were contacted and interviewed in six different interviews in December 2012 and in January 2013. The interviewees were explicitly asked to recommend other individuals who could participate in an interview study on enforcement of accounting standards.

The pilot interviews were relevant in relation to the overall project and became part of empirical data in the study. In addition, the pilot interviews

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supported two different conclusions regarding the research design. First, the interviews with non-enforcers about the accounting issues subject to enforcement provided a valuable context. Second, the interview segments addressing specific accounting issues provided valuable insights into how the interviewees reasoned about the enforcement of these accounting issues. Therefore, I decided to focus the study on some specific accounting issues.

In line with Young (1994) and Hatherly *et al.* (2008), I wanted to focus on issues that were a part of every day accounting practices, and therefore did not specifically try to chose issues that were seen as "scandals" or as exceptional events. Instead, I sought to choose issues that had been a part of the work life experience for my interviewees. As the focus of the study is the enforcement body, the issues occurring in the enforcement reports were my prime candidates to include in the study. However, I wanted to ensure that there were enough data to be gathered for each issue to be able to make an empirical story out of these. Therefore, I regarded issues that were devoted much attention within the enforcement reports and/or that were recurring topics within these reports to be most interesting to study. The presence of other empirical data on specific accounting issues, such as debate articles in *Balans* and/or in the pilot interviews, were taken both as indications that there were sufficient material on the issues to make them possible to study and as indications that these issues were a part of the work life experiences also for non-enforcers.

The decision to study a number of specific accounting issues led to a thorough examination of these issues in public sources such as *Balans*, annual reports, accounting standards, exposure drafts and comment letters. These documents were studied in order to learn about the topics prior to conducting the primary interviews, which were initiated in May 2013.

3.2.3. The primary interviews

Potential interviewees were found through four different sources. The first source was the documents gathered as empirical material for the study (see above), where the writers (or producer) were all looked on as potential interviewees.

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The second source was accounting related organizations, where all the members/employees were seen as possible interviewees. Based on the information in the documents, the information gained in the pilot interviews, and in previous research, the organizations relevant were:

- National enforcement organizations (*Finansinspektionen*, Nasdaq OMX Stockholm, and Nordic Growth Market NGM).
- The national standard setting body for listed firms (the SFRB).
- Listed entities.
- The Big Four accounting and auditing firms (PWC, EY, KPMG, and Deloitte).
- Interest associations (the association of the audit and accountancy profession, FAR, the Swedish Enterprise Accounting Group, SEAG; the Swedish Bankers' Association, SBA; the Swedish Society of Financial Analysts, SSFA; and the Swedish Society of Actuaries, SSA).

As a third source, keynote speakers of the Swedish event *Redovisningsdagen* [Accounting Day][5] in 2010-2012 were (based on the topic of their speeches) considered possible interviewees. The presumption here was that speakers at this event were both willing to make public comments on accounting, but were also considered by others to have something valuable to say (as the conference is a commercial event with a registration fee for visitors).

Finally, the interviews provided leads on additional interviewees, i.e. "snowball sampling". This sampling method "uses a small pool of initial informants to nominate other participants who meet the eligibility criteria for a study", and is beneficial when the total populations is unknown (Morgan 2008, see further Goodman 1961, Atkinson and Flint 2004, Patton 2002). This method has been widely used within constructionist research during the last decades (Noy 2008). Greenwood *et al.* (2002) provides an earlier example of a study relying on snowball sampling.

[5] *Redovisningsdagen* is an annual conference, marketed by Informa IBS Sweden as a forum for discussions of practical accounting issues and how to apply new accounting standards.

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> Snowball sampling is a useful way to pursue the goals of purposive sampling in many situations where there are no lists or other obvious sources for locating members of the population of interest, but it does require that the participants are likely to know others who share the characteristics that make them eligible for inclusion in the study. This method is particularly useful for locating hidden populations, where there is no way to know the total size of the overall population […]. The typical process for a snowball sample begins with interviewing an initial set of research participants who serve as informants about not only the research topic but also about other potential participants. (Morgan 2008)

Morgan (2008) warns of the risk of only capturing a "subset of the total population", as there might be participants who are not directly linked to those identified, and who thereby will be left outside the sample. Trying to start the sampling with initial informants that could be expected to be as diverse as possible could counteract this. (Morgan 2008) This thesis relies on the sampling of interviewees identified through the channels 1-3 above along with the snowball sampling to create diversity amongst interviewees and to counteract the risk for biases imposed by using this sampling method on a standalone basis.

In a way similar to that described by Morgan (2008), I initiated my interview study with some interviewees that I assumed were initiated in the field. These were then asked to suggest new possible interviewees. This request was also repeated in the later interviews. As the number of completed interviews increased, the number of new recommendations decreased significantly. Thereby, neither the exact number nor the identities of interviewees were fully decided when the primary interview study began. When interviewee subjects started to repeat information and arguments that was already encountered in several previous interviews, interviewing came to an end.

Snowball sampling was found very suitable for this thesis, as the total population was not only unknown, but indeed could be said to have been formed (and reformed) as the study developed. To the extent that individuals could be seen as members of a population that I sought to study, no one was better suited to identify other members of this population than the members themselves.

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In relation to the first three channels for identifying potential interviewees, this last channel ensured that I did not miss out of any important individuals. Notably, there were significant overlaps among the individuals identified in the public sources and the individuals identified by snowball sampling. However, some of the individuals from the public sources were recommended (and otherwise mentioned) far more often in the interviews.

Scheduling the interviews

I contacted possible interviewees by telephone and asked them to participate in a research interview. I also provided short description of the study and a date and a time were decided (either directly over the telephone or in some cases later via e-mail correspondence). Generally, there was a great willingness to participate. However, two individuals initially identified as potential interviewees proved to be very difficult to reach via telephone. Therefore, when individuals in similar positions agreed to participate, I abandoned these candidates. Likewise, when another participant cancelled a booked interview other individuals (with similar positions) were viable substitutes. In addition, one individual was unwilling to participate in an interview (due to time constraints), but recommended instead a colleague, who was deeded better suited to answer my questions. As this colleague was already on my list of possible interviewees (and had agreed to participate), I found this to be a viable substitution.

In the few cases where only a company name had been mentioned as a recommendation by other interviewees (i.e. not a specific individual to contact), I called up the telephone exchange of the entity and asked to talk to someone who was responsible for the consolidated annual reporting. Commonly, the first individual I reached did not feel well suited as an interviewee, but instead recommended a colleague. When I reached an individual that acknowledged having the appropriate expertise (based on the interview topics), participation followed in every case.

The interview guide(s) and the interviewing

When formulating interview questions, I sought to strike a balance between acquiring information on topics of interest for the research project and remaining open for topics that the interviewees found relevant, but which

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were unknown to me. To achieve this, I relied on a semi-structured interview approach when forming the interview guide (see for instance Kvale and Brinkmann 2009). Within this, I focussed on selected accounting issues, but sought to formulate the interview questions about these issues as openly as possible. When introducing a new topic within the interview, I tried to tell as little about "the issue" as possible in order to let interviewees formulate "the issue" as they understood it. Here, I stated the accounting area (e.g. accounting for carryforwards), mentioned (briefly) what the enforcement reports stated about the issue (if applicable), and thereafter asked: "Can you please explain if and how you have come in contact with this accounting issue". In addition, I included a last interview question. Each interviewees was asked whether he or she wanted to address some other issue, which had not yet been covered within the interview, but was deemed relevant for this.

In preparation for each interview, I adapted the interview guide to better suit each individual interviewee. For instance, when I knew that the interviewee had made certain public statements (as for instance within journal articles), I added questions about this. In addition, where the interviewee mentioned that he or she had worked with a specific accounting issue and/or found something especially interesting, I encouraged the interviewees to focus on these issues. Thereby, the content of each interviews was (intentionally) affected both by my previous knowledge about the interviewees and by the interviewees' knowledge about (and willingness to talk about) different issues.

The primary interview study included 33 interviews, carried out between May – June and August – October 2013. The interviews lasted on average 1 hour and 13 minutes, with the shortest 31 minutes and the longest 2 hours and 13 minutes. I performed almost all interviews in person, mostly at the office of the interviewees and occasionally at the facilities of the Stockholm School of Economics. Due to practical circumstances, I performed two of the interviews via telephone.

As an introduction to each interviews, I made a short description of the study and its purpose. In addition, I explained my intention to use the interview as empirical material for a thesis, and possibly for research articles. Thereafter, I asked the interviewees for permission to record the interview.

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All but two interviewees agreed to this. For the unrecorded interviews, notes were taken during the interviews. Immediately after the interviews, I tried to extend these notes in line with my memory of the statements made. Nonetheless, the unrecorded interviews provided much less information than those recorded. All the recorded interviews were fully transcribed.

During the course of the main interview study, some modifications to the issues were made. Several interviewees indicated that they did not remember the events surrounding one issue, so it was removed from the interview guide. One issue that several interviewees brought up during the interviews was added to the interview guide. This issue had not been commented on within the enforcement reports and was therefore not included in the study initially. As several interviewees referred to this issue, I decided to include the issue in the thesis as an example of a much discussed accounting issue that had (at least) not (yet) been addressed by the enforcer. In the final writing up of the thesis, one of the accounting issues included in the interview guide (concerning the income statements of real estate entities) was excluded from the study, as the conclusions reached by studying this issue were already available through other issues.

The amount of information obtained about the different accounting issues studied in the end varied. This was a result of the open structure of the interviews, which allowed interviewees to devote their time to the issues they found most interesting. In later analysis this unevenness was understood as an empirical finding, i.e. an expression of certain accounting issue being considered "accounting problems" (worthy of attention) whereas other issues were not seen as problematic. Some interviewees explicitly remarked that some issues had received more attention than others.

> No issues have become as huge as the issue of the mortgage bonds. There are almost no other areas that have been discussed as much, so it is very difficult to compare that issue with something else. It has been discussed to such a large extent. There are other issues that have been discussed intensively, but they have never ended up, and will certainly never end up, in the enforcement reports. That could be the case. For instance, there is the issue of the tax on returns on pension funds. (Interview 4)

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In total, this thesis rests on transcripts from in total 39 research interviews, including interviews with individuals who can be termed standard setters, preparers, employees of interest associations, accounting specialists of Big Four firms, enforcers, financial analysts and actuaries. However, as many interviewees can be characterized as belonging to two or more of these categories (especially over time but also in the same point in time) no exact number of interviewees for each category is provided.

3.3. Analysis of the empirical material

As theory in this thesis is understood as a sensitizing device, abduction was considered the most appropriate approach for the analysis of the empirical material. A deductive research approach would be more suitable for theory testing research. An inductive research approach would be more suitable given a belief of the possibility to free oneself from previous knowledge. Purely inductive approaches, for instance grounded theory, often rely on the assumption of reality as "hidden" within the empirical data, ready to be detected by a careful investigation and analysis performed by a researcher. (See for instance Glaser and Strauss 1967) If however one accepts that there might be multiple realities and that any piece of research must be understood as interlinked with the social world (see for instance Hopper and Powell 1985, Law 2004), the explicit "showing of cards" within a theoretical framework will be important. Abduction here allowed a starting point in the theoretical framework (as presented in chapter 2) to direct my attention in the analysis of data, while the coding sought to stay as "empirical" as possible. In practice, this was done by coding the empirical material of the thesis to capture the questions: "What?", "Where", "Who?", and "How?". These were all questions that had been highlighted as important questions in the study of a "regulatory space" (Hancher and Moran 1989, Black 2002, see chapter 2).

The "What?" dimension was here understood as the accounting issues investigated. A grouping of the empirical material based on these issues enabled an understanding of both the events that had taken place in relation to each issue and also how the issue was understood and talked about by the interviewees.

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The "Where?" dimension was understood both as geographical places (e.g. the enforcement body, the Big four firms), and as sources of statements made (e.g. the enforcement reports, *Balans* article). Thereby, anyplace where statements were made or discussions were held created a separate category. This was thought to enable an understanding of the "arenas" in which the investigated events took place.

The "Who?" dimension was understood as the actors of the regulatory space. These categories included both groups of actors (for instance "enforcers") and individuals referred to on a first or full name basis. These actors were traced in order to understand when and how different individuals were active within regulatory space.

The "How?" dimension was understood as arguments used when individuals (or organizations) made statements in regulatory conversations. Arguments used were found to centre around different themes and similar arguments were used in relation to different accounting issues.

Here, it must be emphasized that the theoretical underpinning of this book entailed an assumption that there was no one right answer in relation to the accounting issues investigated. I did therefore not try to evaluate the empirical statements made or the opinions held, but only sought to outline them, and (when relevant) stress the expression of divergent views. Therefore, it was *not* a part of the research aim to "settle" the accounting issues (in terms of finding out how accounting should be performed), nor to argue in favour of one accounting or the other in relation to any specific accounting standard. Concordantly, I made no efforts to convey my own view on the accounting issues investigated.

Although the coding described above provided a foundation for the writing up of the empirical chapters, this coding on a standalone basis may by no means be equated with the entire analysis made (cf. Anderson-Gough *et al.* 2005). Instead, analysis occurs as a continuous process during the entire research project (cf. Christner 2015, p. 78). Inevitably, already in the interview situation, I as a researcher will start to make sense of what is said. I will already here start to construct my own view of the happenings by relating what is said to earlier interviews and to my previous readings (both in terms of empirical material but also in terms of previous research and theoretical literature).

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The writing process implied that yet another round of analysis had to be made in order to create empirical storylines. Although alternative layouts could have been possible, I chose to organize each empirical chapter around one accounting issue (or at least one accounting area as some areas could be seen as encompassing several accounting sub-issues). My main guiding principle was here to use the chronology of events to structure the data and each chapter strives to tell "what happened" and what was said about this accounting issue. However, I assumed that several and conflicting descriptions of the same event may be equally valid and each story therefore sought to convey these differences when present.

Furthermore, the writing up of chapter 2 of this book (on theory and previous research) implied a third round of analysis of the empirical data. Although most literature was read in advance of the execution of the empirical study, the revisiting of this literature made it possible to understand this in a new way and to connect it to the empirical material gathered. For instance, statements that I had rarely taken notice of when reading them the first time became important when I was able to relate them to my material.

3.4. Limitations of the empirical study

The findings of this study will be affected by its limitations in both time and space. The empirical investigations will take a starting point in the incorporation of the requirements of the *Transparency Directive* into Swedish law (*Lag (2007:528) om värdepappersmarknaden*). This implies that the Swedish enforcement activities taking place prior to this regulatory change will only constitute a background to the investigated enforcement activities. (This background will be presented as a part of chapter 4.) As the last research interview was made at the end of October 2013, events taking place after this point in time will not be investigated within this thesis.

In addition, this study will also be limited geographically. Despite that these regulatory evolvements were a pan-European concern, this study will only investigate one specific country, i.e. Sweden. The choice of studying a single country (and this specific country) is based on the assumptions outlined above. However, to the extent the events were traced into other countries, these were of course also included in the study.

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It must also be noted that "enforcement of accounting standards" is an expression that may be used to denote many different things. For instance, auditing, supervision over auditors (in Sweden *Revisorsnämnden*) and the court system may be seen as examples of enforcement of accounting standards. However, this study is limited to investigating enforcement in line with how this is understood within the European cooperation of the 00' and forwards (where CESR, later ESMA, and EECS are central organisations). Therefore, external enforcement bodies are in focus in this thesis.

Furthermore, although three organizations in Sweden could arguably be seen as "enforcement bodies", I will only investigate one of these. Therefore, a further limitation of this thesis is that the study takes its focus on the activities performed by Nasdaq OMX Stockholm. NGM is not included in the study due to its size. As NGM had only 13 listed firms in 2014, it would be peculiar to include this stock exchange as comparable with Nasdaq OMX Stockholm. In addition, the direct supervision of *Finansinspektionen* is also excluded as this organization only supervises about ten entities in total (i.e. those having Sweden as their home country but being listed at non-Swedish EEA stock exchanges). For both these organisations, only 2-3 entities may be expected to be included in the yearly sample, making the issues addressed very dependent on these small samples. From now on, the expression "the enforcement body" will (if nothing else is stated) be used to signify Nasdaq OMX Stockholm. *Finansinspektionen* will instead be referred to as "the competent authority".

Finally, it must be noted that I only have direct access to the public enforcement documents, such as the enforcement reports and enforcement decisions. Non-public documentation of the enforcement process (such as the letters exchanged between the enforcement body and the listed entities) I only have access to through the references made to these in journal articles or research interviews.

This chapter has presented the methodological considerations weighted in the making of this study. Both the assumptions underpinning the study, as

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well as the activities of collecting the empirical material for it, have been described.

In the following, chapter 4 introduces the empirical setting studied in this thesis by presenting the relevant EU regulations and by providing an overview of how enforcement of accounting standards had been performed in Sweden (prior to the EU harmonization efforts). Thereafter, chapters 5 – 8 tell the stories about a number of accounting issues, how actors have addressed and discussed them and how the issues evolved. The subsequent chapters 9 and 10 will provide an analysis of the preceding chapters.

When I go on to refer to chapters 4 – 8 as "empirical chapters", I do so to iterate that these chapters present the empirical data of this study. This does not imply that these chapters consist purely of empirical data. On the contrary, these chapters are inevitably formed and informed by my analysis (presented in detail in chapters 9 and 10). Unavoidably, the organization and presentation of a story about any "empirical background" or any accounting issue is itself an analysis.

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Chapter 4

An international accounting standard and a call for enforcement

This chapter presents the background (in terms of events and legislations) that have bearing for the enforcement of accounting standard as performed in Sweden from 14 June 2007 and up until 1 January 2016.

4.1. The IAS Regulation and the Transparency Directive

In 2000, the European Commission made the following statement about the importance of supervision for assuring that listed entities would comply with the accounting standards.

> Securities supervisors […] have a critical role in ensuring that listed companies comply with financial reporting requirements. There is clearly a major interest in ensuring accurate and consistent application of accounting standards in the securities markets they oversee. In the EU securities markets regulators must be actively involved in enforcement issues. In particular, the Commission looks to European securities markets supervisors […] to develop and implement a common approach to enforcement. Such an approach would establish a level playing field and avoid the danger of regulatory arbitrage. (Commission of the European Communities 2000, p. 9.)

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Through the so-called *IAS Regulation* (Regulation (EC) No 1606/2002), the European Union required listed firms to apply International Financial Reporting Standards (IFRS) for consolidated accounts as of January 1, 2005. In addition, member states could determine whether to allow listed entities to use IFRS in their individual accounts (i.e. the financial statements of the legal entities) or for non-listed entities to apply IFRS. The IAS Regulation was aimed at maintaining the confidence in capital markets by providing investor protection, and the adoption of a common accounting standard was a part of efforts made to reach the goal of creating a common internal market (with a free flow of capital within the EU). The IAS Regulation also highlighted "enforcement" as important for the achieving the aims of this regulation.

> A proper and rigorous enforcement regime is key to underpinning investors' confidence in financial markets. (Regulation (EC) No 1606/2002:16)

In December 2004, the *Transparency Directive* (Directive 2004/109/EC) was issued[6], emphasizing the importance of transparency for investors' confidence in financial market. It makes clear that investors should be guaranteed "accurate, comprehensive and timely information", as this enables investment decisions to be made on a well-informed basis.

In order to achieve transparency, the laws and frameworks regulating the provision of financial information were to be enforced by a "competent authority" with surveillance responsibility. This should be a governmental body, but the Directive granted a possibility to delegate supervisory authority during a limited time of at most eight years. An exception was made for accounting (i.e. the supervision of annual and quarterly reports), for which no limits in time were stated.

Before the attempts to harmonize European enforcement structures, enforcement bodies were in place in some European countries but were absent in others. Austria, Finland, Germany, Ireland, Luxembourg, Netherlands, Hungary, and Slovenia all lacked enforcement bodies. (Fédération des Experts-comptables Européens 2002) By 2009, all EU and EEA countries had allocated enforcement responsibilities to some type of organiza-

[6] This directive was later changed by Directive 2013/50/EU, issued 22 October 2013.

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tion(s). Most countries had placed this responsibility with a securities regulator. (Committee of European Securities Regulators 2009e)

4.2. CESR, ESMA and EECS

In 2001, the *Committee of European Securities Regulators* (CESR) was established, with responsibilities that included the co-ordination of European securities regulators. As of January 1, 2011, the *European Securities and Markets Authority* (ESMA) was established, replacing CESR, which by then ceased to exist. ESMA was intended to promote supervisory convergence among European securities regulators and to assist in the development of a single European rulebook for securities regulation. (European Securities and Markets Authority 2015)

The *European Enforcers Coordination Sessions* (EECS) was formed as a working group under CESR-Fin and continued to work under the *Corporate Reporting Standing Committee* (CRSC) of ESMA. The EECS was set up to promote convergence in the enforcement decision-making (CESR 2001, 2003, 2004a) by providing a forum where European enforcers could meet and discuss their respective enforcement decisions. In addition, EECS was intended to provide enforcers with the possibility of discussing "general matters such as use of selection methods and enforcement methodology" and to exchange "practical experiences" (CESR 2004a, p. 2).

In practice, EECS meetings took place about seven to eight times a year, and enforcement decisions discussed at these meetings were presented in a prescribed format and made available to EECS-members in a common database. (Berger 2010) From 2007 were selected decisions published as extracts from this database.

ESMA (and previously CESR) stressed that accounting issues were thought to provide "market participants with useful guidance", and that only enforcement decision with "accounting merit" should become included in the EECS extracts of enforcement decisions. Thereby, no "simple or obvious accounting matters" should be published, even though these could be material for specific firms. (CESR 2009b,c, 2010a,b, ESMA 2011b, 2012, 2013)

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> Publication of enforcement decisions will inform market participants about which accounting treatments EU National Enforcers may consider as complying with IFRS; that is, whether the treatments are considered as being within the accepted range of those permitted by the standards or IFRIC interpretations. Such publication, together with the rationale behind these decisions, will contribute to a consistent application of IFRS in the European Union. (Committee of European Securities Regulators 2009b,c, 2010a,b, European Securities and Markets Authority 2011a,b, 2012)

4.3. CESR's and ESMA's standards and guidance on enforcement

Some years after its establishment, CESR published two different standards on enforcement (Committee of European Securities Regulators 2003, 2004b) and subsequently monitored their implementation (see for instance Committee of European Securities Regulators 2009d-f). The CESR standards on enforcement included principles regarding the scope and definition of enforcement, regarding methods to apply for sample selection, and for regarding the co-ordination of enforcement performed on the national levels and on the pan-European levels.

CESR's first standard on enforcement describes the roles envisioned for preparers, auditors and enforcers.

> The completeness, accuracy and truthfulness of the financial information is under the responsibility of the issuers' relevant bodies (mainly the board of directors). Where applicable, auditors are required to act as a first external line of defence against misstatements by expressing their opinion on the financial information based on their audit. Enforcers should monitor this financial information with the aim of ensuring actions where infringements are detected. (CESR 2003, p. 6.)

Both these standards address the responsibility for making interpretations of the accounting standard, distinguishing the role of the standard setter and the role of the enforcer.

> Principle 20 […] Material controversial accounting issues will be conveyed to the bodies responsible for standard setting or interpretation. No general appli-

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> cation guidance on IFRSs will be issued by the enforcers. (Committee of European Securities Regulators 2003, p. 10.)

In particular, the right to issue interpretations is reserved for the interpretative body of the standard setter: the *International Financial Reporting Interpretations Committee* (IFRIC, which later became the *IFRS Interpretation Committee* (IFRS IC). This second standard further explains that a need for interpretation may arise when an issue is not covered by IFRS.

> Issuing general interpretations of the existing standards is part of the standard setting process conducted by the relevant bodies, such as IFRIC. Enforcers may contribute to this process by providing their experience to the interpretation debate. However, harmonization requires that they should not attempt to create a parallel body of interpretations. (Committee of European Securities Regulator 2003, p. 10.)

In addition, the introduction included in the (later) EECS's extracts of enforcement decisions underscores that the published decisions do not provide "generally applicable interpretations" as this is the responsibility of the IFRS IC. Instead, the database is sought to supply a "source of information to foster appropriate application of IFRS" for national enforcers. The publication of extracts from the database is supposed to provide similar assistance for preparers and users of financial statements. Here, all interested parties are urged to consider the individual circumstances of the published enforcement decisions, as the IFRS is principles-based and "there can be no one particular way of dealing with numerous situations which may seem similar but in substance are different". (Committee of European Securities Regulators 2009b,c, 2010a,b, European Securities and Markets Authority 2011a,b, 2012)

In July 2014, the *ESMA Guidelines on enforcement of financial information* (European Securities and Markets Authority 2014) were issued, superseding the previous CESR standards on enforcement. In the comments on draft versions of the ESMA guidelines, interviewees emphasized that enforcers should not publish interpretations of the accounting standards, as this would "contradict the 'principles-based' approach of IFRS or close options for encouraging best practices where different accounting treatments are

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allowed by IFRS" (European Securities and Markets Authority 2014, p. 10.) The response of ESMA was to emphasize that the role of the enforcers remained similar to what it had been in the previous standards and in the introduction to the EECS's extracts of enforcement decisions.

> ESMA considers that the publication of enforcement decisions provides useful information to market participants on whether an accounting treatment is considered within the accepted range of treatments permitted by IFRS. […] such publications, together with the rationale behind the decisions, contribute to promoting a consistent application of IFRS. In their decisions, enforcers only examine the compliance of the financial information with the relevant financial reporting framework and do not provide generally applicable interpretations of IFRS, as this remains the role of International Financial Reporting Standards Interpretation Committee (IFRS IC). (European Securities and Markets Authority 2014, p. 10.)

The final guidelines underlined that neither pre-clearance activities (Guideline 4, see comment 45, p. 46), nor the issuance of enforcement decisions would result in the issuance of interpretations of IFRS. Again, it was emphasized that interpretative issues should be referred to IASB or IFRS IC. However, it is also concluded that "judgment" must be applied in the course of the enforcement activities. (Guideline 11, see comment 71-72, pp. 50-51).

4.4. Enforcement of accounting standards in Sweden

In some form, enforcement of accounting standards has been around in Sweden since the late 80s, i.e. long before the European harmonization efforts. The start of enforcement in Sweden could be said to be a number of publications issued by the stock exchange of Stockholm (Stockholms Fondbörs, which by the time of the last publication had become OM Stockholmsbörsen). The publications were titled *Tendenser i börsbolagens årsredovisningar* [*Tendencies of annual reports of listed firms*] and were written by Rolf Rundfelt. The *Tendencies* were published on a yearly basis, starting with *Tendenser i börsbolagens årsredovisningar 1987* published in 1988 and ending with

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Tendenser i börsbolagens årsredovisningar 2000 published in 2001 (with 1989 as an exception as no report was published for this year). Thus, in total 13 *Tendencies* came out during these years. In addition, Peter Malmqvist wrote *Tendenser i börsbolagens delårsrapporter* [*Tendencies of quarterly reports of listed firms*] between 1997 and 1999, which were also published by the Stockholms Fondbörs.

As Rolf Rundfelt took part of the IASC standard setting meetings the *Tendencies* were considered a way to disperse information about accounting concerns discussed within the standard-setting process of this organization. Simultaneously, the *Tendencies* were a forum for highlighting areas where the financial reporting was seen as deficient. The formulation of the observations as "errors" contributed to the attention they received. The *Tendencies* were looked on as having both their advantages and disadvantages. Although the reports were considered an "effective" way of providing enforcement (as no one wanted to be publicly criticized), it was simultaneously seen as questionable that individuals had gained the power to judge whether a specific accounting treatment was appropriate or not.

> Both Peter Malmqvist and Rolf Rundfelt wrote very freely, expressing their opinions within these books. […] So this was a really good way […] of making the entities change accounting treatments […] because the listed entities did not want to end up in this book, having their accounting described as strange. But the entities and the auditors considered this to be somewhat uncertain with regards to the rule of law. (Interview 17)

In the beginning of the 00s, when enforcement of accounting standards was not yet a legal obligation, the stock exchange stopped its practice of enforcement through Rundfelt's *Tendencies of annual reports of listed firms*, but instead started to send out letters addressed directly to the listed entities. By then, the enforcement letters included no requirements to change financial reports, but the letters instead conveyed "observations", which pinpointed issues where "readers" of the financial reports might need some further information.

However, the enforcement letters was not fully appreciated by everyone, and there was criticism of the accounting issues addressed. The issues were criticized for being too "trivial" and too focussed on disclosures.

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> We were met with criticism, which was repeated almost every year, that many of the observations conveyed in our letters to the entities were perceived as trivial, as they concerned almost exclusively missing disclosures. In combination, the entities being criticized for their accounting and that criticism dealing in part with issues the entities deemed immaterial led to some letters and arguments on the need to change this somehow. It is hard to know what is cause and effects, but anyhow [the number of people involved in enforcement grew]. (Interview 2)

In 2003, the practice of enforcement through letters to listed entities was formalized through the formation of the Swedish *Panel for Monitoring of Financial Reporting* (PMFR), which reviewed the entities listed on the Stockholm stock exchange. Unlike the stock exchange, the PMFR issued formal enforcement decisions and thereby not only formulated their observations as criticism but also made this criticism public. The PMFR continued to publish enforcement decisions between 2003 and 2006. During these years, in total 28 enforcement decisions were published, the majority of which was published in 2004 and 2005. (See Panel for Monitoring of Financial Reporting 2014) However, also the PMFR was criticized for dealing with "trivial" accounting issues and for addressing matters of disclosure.

4.4.1. The regulatory change in Sweden

When the Transparency Directive was implemented into Swedish law, different organizational solutions were possible. It was required that a governmental "competent authority" was appointed, but this authority was not required to carry out the actual enforcement. Therefore, that enforcement could have been delegated to the PMFR or the stock exchanges, or any other private organization.

Although it was seen as possibility to allow for the Swedish securities regulator *Finansinspektionen* to take on enforcement duties, the governmental investigation of this issue characterized it as "unfortunate" to expand the powers of this authority into the supervision of non-financial entities. Rather, the current self-regulatory system was described as a well-functioning system with many advantages. (SOU 2003:22, pp. 83-84.)

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> To start with, for the same reasons as could be brought forward also for other markets, it could be concluded that there are many advantages with far-reaching self-regulation of the securities markets. Self-regulation implies closeness to and knowledge about the market and its functioning, and agreements amongst those being active in and being constituencies of the industry will create anchoring, commitment and legitimacy. When it comes to Sweden, it could be concluded that the system is built, that large values have been invested in it, and that its anchoring with leading decision-makers of the business sector have enabled a large impact. At large, the system has also worked out very well. (SOU 2003:22, p. 86.)

However, the white paper also warned that the Swedish self-regulatory model could be perceived as unsatisfactory in comparison with enforcement regimes for financial reporting in other countries. A number of disadvantages to self-regulation are also mentioned, including insufficient knowledge about how the self-regulatory structures work for outsiders, risks for conflicts of interests, risks for cartel building, lack of transparency, and weaker sanctioning possibilities. In particular, it questioned whether it is possible for a stock exchange to perform regulatory duties, including monitoring, along with the business goal of increasing turnover by enhancing the number of traders and the number of listed entities. However, it was concluded that the stock exchange's long-term interest of securing confidence sometimes could bridge conflicts of interests. (SOU 2003:22, p. 86-88.)

In 2006, the Swedish association of the audit and accountancy profession, FAR, argued in favour of keeping as much of the self-regulatory structures as possible, emphasizing that the experiences gained within the PMFR should be taken advantage of. FAR also underlined the need for a dialogue on the extent and orientation of the future enforcement activities and argued against allowing enforcement to become a second audit. (FAR 2006)

The final solution was that *Lag (2007:528) om värdepappersmarknaden* (issued at June 14, 2007) appointed *Finansinspektionen* "competent authority" but assigned the actual monitoring duties to the Swedish stock exchanges (*Lag (2007:528) om värdepappersmarknaden*, chapter 16). Further specifications of the responsibilities of the stock exchanges were provided in FFFS 2007:17 *Finansinspektionens föreskrifter om verksamhet på marknadsplatser*. The

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FFFS stated that "the aim of enforcement of accounting standards […] is to protect investors and promote the confidence in financial markets, through contributing in an enhanced transparency of financial information which is relevant for investor decision making" (FFFS 2007:17, § 12.)

The obligation for stock exchanges to monitor financial reporting came into force as of July 1, 2007. This implied that Nasdaq OMX Stockholm and Nordic Growth Market (NGM) became enforcement bodies for the entities listed on their respective stock exchanges. NGM issued its first public enforcement decision in 2008 (Nordic growth market 2008), and Nasdaq OMX Stockholm issued its first public enforcement decision in 2009 (Nasdaq OMX Stockholm 2010). However, comprehensive enforcement reports were published even earlier, starting with reviews of the annual reports of the financial year of 2006/2007 (Nasdaq OMX Stockholm 2008) and annual reports of the financial year of 2007 (NGM 2008).

At the Nasdaq OMX Stockholm, both external and internal accounting specialists are working with the enforcement issues. In addition, a number of accounting specialists constitute a reference group, which may be consulted if needed. Every year, a sample of listed entities is investigated. This sample is selected both through rotation (1/5 of the entities each year) and by risk. Reason for inclusion in the sample due to risk may be for instance that the entity has recently become listed or that it previously has received enforcement criticism. The entities that are included in the yearly investigation will be informed about this at the beginning of the year. The resulting observations are then communicated by mail. Four different outcomes of the enforcement investigation are possible: 1) no remark or minor remarks, 2) remarks, 3) criticism, or 4) referral to the Disciplinary Board. The sanctioning abilities consist of that the entities may be required to change their accounting in the future financial reports, be required to issue a separate rectification, or to change and reissue already published information. In addition, for severe infringements the Disciplinary Board may issue warnings, impose penalty fees of at maximum 15 times the annual listing fee, or even delist entities. (SOU 2015:19, pp. 56-58.)

NGM makes use of external accounting specialists for reviewing financial reports. Market surveillance is responsible for the communication with the listed entities and the head of market surveillance is responsible for

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making enforcement decisions. Similar to Nasdaq OMX Stockholm, NGM also makes its sampling based on risk and rotation. As an example, it may be noted that in 2014, three out of the thirteen listed entities were included in the investigated sample. NGM uses three different levels of enforcement actions: 1) written remarks, 2) written criticism, and 3) referral to the Disciplinary Board. For written criticism, the stock exchange requires the criticized entities to change their accounting in the future. If the infringement is severe, the stock exchange may request entities to issue a written correction or even to reissue already published financial reports. The Disciplinary Board may impose penalty fees of at maximum 2 000 000 SEK or decide to delist entities. (SOU 2015:19, pp. 58-59.)

When the new enforcement structures were at place, it did not take long for the new set-up to receive criticism. Already in 2009, *Finansinspektionen* issued a review of the Swedish system for enforcement of accounting standards. It was reported that a number of deficiencies (common for both the stock exchanges) had been detected. It was concluded that the system had not demonstrated the advantages expected and an organizational change was called for "as soon as possible". (*Finansinspektionen* 2009)[7]

In 2010, a number of different constituents within accounting (including representatives from the Nasdaq OMX Stockholm, the Swedish Association for Generally Accepted Principles in the Securities Market, the association of the audit and accountancy profession, FAR, and the standard setter the Swedish Financial Reporting Board, SFRB) published an opinion piece in *Dagens Industri*. They argued for a change in enforcement structures, and suggested a self-regulatory solution relying on an independent enforcement body as more favourable. They stressed that the scarcity of individuals having both the accounting competence and the willingness to perform the enforcement tasks had made it difficult to create intra-organizational enforcement structures, and both the stock exchanges had instead come to rely on the hiring of external consultants to perform the enforcement tasks. The article argued that in terms of "authority, compe-

[7] For "secrecy reasons", the text describing the detected deficiencies was deleted in the public version of *Finansinspektionen*'s report. (*Finansinspektionen* 2009) The main conclusions of this publication were later communicated through an article in the journal of the association of the audit and accountancy profession: *Balans*. (See Heneryd 2010.)

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tency and continuity", this solution was less beneficial. A co-ordination of the enforcement activities within one single organization was also proposed to remove the competitive disadvantage imposed on Swedish stock exchanges due to enforcement duties and to enable Sweden to gain "a voice" within the European co-operation. (van Haartman *et al.* 2010) In 2011, this suggestion for change was also formally submitted to the Swedish Finance Department. (Lennartsson 2013)

In a 2013, dissatisfaction with the then current enforcement structures was again expressed publicly. In an interview in a *Balans* article, the head of Nasdaq OMX Stockholm's market supervision in the Nordic region Annika Poutiainen emphasized the competitive disadvantage imposed on the Swedish stock exchanges and stressed that a co-ordination of enforcement activities would enable Sweden to gain a stronger voice in international forums. (Lennartsson 2013) In addition, there was a commonly held view of that the stock exchanges only enforced immaterial disclosures issues.

> The enforcement body has a major focus on disclosures. […] Personally, I would say that it primarily should be issues affecting profit and financial position that ought to be in focus. But that is a much more demanding enforcement task, as deeper investigations must be done. […] It is always possible to find some disclosures that should have been provided. The question is whether this will have any impact on the larger picture for the possibility to understand the profit and financial position of the entity. (Interview 8)

In March 2015, a new governmental investigation suggested a law amendment that reallocated the enforcement duties from the stock exchanges to the competent authority *Finansinspektionen* as from January 1, 2016. It was argued that the current organization of enforcement of accounting standards had not exhibited the advantages that had been anticipated, had lacked unity and had caused problems for the Swedish participation in the European cooperation. (SOU 2015:19) However, when January 1, 2016 arrived, there were still no decisions taken neither to relieve the stock exchanges from their enforcement duties nor to place the enforcement responsibility entirely with *Finansinspektionen*.

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This chapter has outlined by the main regulatory documents issued and the main regulatory bodies formed (or assigned enforcement duties) in the developments surrounding harmonization of enforcement structures in the European Union as occurring since the 2000s.

The following empirical chapters, 5 – 8, describe the Swedish enforcement activities carried out in response to the regulatory changes described above. In practice, this will be done through presentations of different accounting issues raised (and not raised) within Swedish enforcement reports and of the events and arguments surrounding these issues.

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Chapter 5

A pre-tax discount rate for goodwill impairment testing

During recent years, the Swedish enforcement body has commented on the discount rate for goodwill impairment testing in a number of different enforcement reports, and within several enforcement decisions. Some Swedish firms disclose the pre-tax discount rate, others instead disclose the post-tax rate, and still others do not indicate whether a disclosed discount rate is a pre- or post-tax rate. The enforcer argued that only the first of these accounting treatments complies with the accounting standard IAS 36. (OMX Nordic Exchange Stockholm 2007, Nasdaq OMX Stockholm 2009b, 2010b, 2011g, 2012c) This chapter investigates these enforcement statements to illustrate an accounting issue that has repeatedly been the topic of enforcement criticism, and where divergent views remain on how to identify the relevant accounting issue and how to define what accounting practices comply with the accounting standard.

5.1. The accounting standard requirements

The standard that regulates the accounting issues concerning impairments is IAS 36 Impairment of Assets. This standard includes a paragraph regulating the discount rate for impairment testing. The accounting standard text states that the discount rate "shall be a pre-tax rate". This rate must take

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into consideration "the time value of money" as well as risks tied to the asset tested for impairments.

> **Discount rate**
>
> **55 The discount rate (rates) shall be a pre-tax rate (rates) that reflect(s) current market assessments of:**
>
> **(a) the time value of money; and**
>
> **(b) the risks specific to the asset for which the future cash flow estimates have not been adjusted.** (IAS 36:55, bold face in original.)

In Appendix A, the standard explains how to calculate when the basis for the discount rate is a post-tax interest rate. In this case, the standard requires adjustments to ensure that the discount rate used reflects a pre-tax rate. (IAS 36:A20)[8] IAS 36 also includes a number of disclosure requirements. (IAS 36:126-137) For goodwill and other intangible assets with indefinite useful lives, a number of disclosures shall be made on impairment testing regardless of whether the test has resulted in a write-down. (IAS 36:134-137). The recoverable amount, i.e. the value that in the impairment testing shall be compared to the book value of the asset, is in the accounting standard defined as the higher of value in use or fair value less costs of disposal (IAS 36:6). The discount rate used shall be disclosed both when the recoverable amount is calculated as a value in use (IAS 36:134(d)) and when it is calculated as a fair value less costs of disposal based on a discounted cash flow technique (IAS 36:134(e)).[9] When there has been a write-

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[8] The accounting standard text is formulated as follows:

A20 Paragraph 55 requires the discount rate used to be a pre-tax rate. Therefore, when the basis used to estimate the discount rate is post-tax, that basis is adjusted to reflect a pre-tax rate. (IAS 36:A20)

[9] The accounting standard text is formulated as follows:

134 An entity shall disclose the information required by (a)–(f) for each cash-generating unit (group of units) for which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that unit (group of units) is significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives:

[…]

(d) if the unit's (group of units') recoverable amount is based on value in use:

[…]

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down, additional disclosures about this are required. (IAS 36:126-133) Specifically, disclosure of the utilized discount rate is required when the recoverable amount is calculated as a value in use (IAS 36:130).

Attached to the accounting standard, there is a "Basis for conclusion" (BC) that explains a rationale for the standard prescription and develops the content of the standard in some other respect. BCZ85 "Determining a pre-tax discount rate"[10] provides some further comments on how to calculate a discount rate. This BCZ paragraph emphasizes that impairment calculations made pre- or post-tax should result in the same value in use, given that the calculations are consistent, and given that the theoretically correct pre-tax discount rate is used. It is also emphasized that a pure grossing up of the post-tax rate would not necessarily result in a correct value in use, as it is only under some very specific assumptions that calculations performed with a grossed-up tax rate will provide the same end value as the post-tax calculations will.

> In theory, discounting post-tax cash flows at a post-tax discount rate and discounting pre-tax cash flows at a pre-tax discount rate should give the same result, as long as the pre-tax discount rate is the post-tax discount rate adjusted to reflect the specific amount and timing of the future tax cash flows. The pre-tax discount rate is not always the post-tax discount rate grossed up by a standard rate of tax. (IAS 36:BCZ85)

The BCZ paragraph provides an example illustrating that a grossed-up post-tax rate will not be the "appropriate" pre-tax rate. This example includes the presumption of that the "discount rate for the asset can be determined only on a post-tax basis". Using non-constant cash flows and a finite useful life (of five years), the example illustrates how the value in use calculated with the grossed-up discount rate will be different from the value in use calculated on a post-tax basis. To remedy this, the standard requires

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(v) the discount rate(s) applied to the cash flow projections.

(e) […] If fair value less costs of disposal is not measured using a quoted price for an identical unit (group of units), an entity shall disclose the following information: […]

(v) the discount rate(s) applied to the cash flow projections. (IAS 36:134, bold face in original.)

[10] Basis for conclusion paragraphs labelled BCZ are paragraphs originally written by the *International Accounting Standards Committee* (IASC), the body preceeding the IASB.

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the use of a pre-tax rate produced by iteration (based on the value in use achieved in a post-tax calculation). (IAS 36:BCZ85)

> *A pre-tax discount rate can be determined by an iterative computation so that value in use determined using pre-tax cash flows and a pre-tax discount rate equals value in use determined using post-tax cash flows and a post-tax discount rate.* (IAS 36:BCZ85, italics in original.)

The standard then includes a numerical example illustrating how usage of the "appropriate" pre-tax discount rate (i.e. the discount rate arrived at by making the iterative calculation) will produce the desired value in use. The standard also argues that the differences between the "real" and the grossed-up pre-tax rate depend "on the tax rate, the post-tax discount rate, the timing of the future tax cash flows and the useful life of the asset". (IAS 36:BCZ85)

Based on the accounting standard requirement, the Swedish enforcement body has commented on the annual report of some listed firms in a number of enforcement reports.

5.2. Statements by the enforcement body

The 2007 enforcement report by OMX Nordic Exchange Stockholm is the first report published after the introduction in Swedish jurisdiction of a legal requirement for enforcement of accounting standards (*Lag (2007:528) om värdepappersmarknaden*). The enforcement report emphasized that IAS 36:134 requires a disclosure of important assumptions made in relation to impairment testing. The report included an observation that almost all companies investigated disclose the discount rate and mentioned that the levels of the disclosed rates differ significantly between firms, but that this is "natural, as the discount rate shall reflect differences in risk". A brief remark is made that one entity has disclosed the discount rate for goodwill impairment testing on a post-tax basis, which the report argues is wrong according to IAS 36:55. (OMX Nordic Exchange Stockholm 2007, p. 10.)

The following year's enforcement report, 2008, includes a comment that there are insufficient disclosures in relation to goodwill impairment

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testing (referring to IAS 36:135) and write-downs (referring to IAS 36:130) (Nasdaq OMX Stockholm 2008b). After this more general remark on disclosures, the discount rate for goodwill impairment testing then reoccurs as a specific topic in the 2009 enforcement report. In the appendix to this report it is concluded that only one of the companies investigated failed to disclose a discount rate. It reiterates that the discount rate shall be a pre-tax interest rate although several entities (8 out of the 21 entities investigated) have used a post-tax rate in their calculations. (Nasdaq OMX Stockholm 2009b)

The accounting issue of the discount rate returns again the following year, when the 2010 enforcement report concludes that there are insufficient disclosures regarding the discount rate for goodwill impairment testing (Nasdaq OMX Stockholm 2010b, p. 9, referring to IAS 36, paragraph 130(g)). The same report observes on that some companies are disclosing the post-tax discount rate, which it argues again to be in non-compliance with IAS 36:55. There is also criticism that some firms are disclosing an interest rate without stating whether this is a pre- or post-tax rate. (Nasdaq OMX Stockholm 2010b, p. 10.) The same year, two enforcement decisions criticize (amongst other things) the absence of disclosures on the discount rate for goodwill impairment testing (referring to IAS 36:134(d) v) (Nasdaq OMX Stockholm 2011c: *Beslut 06/10*) and the failure to explicitly mention "that the utilized discount rate is pre-tax" (Nasdaq OMX Stockholm 2011b: *Beslut 05/10*).

The following year, 2011, the discount rate for goodwill impairment testing is still on the enforcement agenda. The enforcement report concludes that a third of the entities investigated are still not stating whether the disclosed discount rate is a pre- or post-tax interest rate. (Nasdaq OMX Stockholm 2011e, p. 17.) In addition, the published 2011 enforcement decisions include remarks related to the discount rate for goodwill impairment testing. Decision 05/11 (Nasdaq OMX Stockholm 2011d), criticizes a company that has disclosed only the post-tax interest rate in its annual report. It argues that: "to fulfill the requirement of paragraph [IAS 36:134] d (v), the discount rate shall be stated pre-tax in accordance with IAS 36, paragraph 55". Decision 06/11 (Nasdaq OMX Stockholm 11e) directs criticism at the use of a previous year's WACC as the basis for the discount

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rate. The enforcement decision also reports that the investigated company claimed that the choice of rate had been affected efforts to act prudently. The enforcer however rejects this claim and insists that the interest rate must be estimated with reference to the contemporary market circumstances.

The 2012 enforcement report, there includes a remark on accounting practices in relation to IAS 36:55. This report concludes that of the 43 entities investigated, four entities fail to specify whether the rate disclosed is pre- or post-tax. In addition, five entities are found to have disclosed only a post-tax interest rate. Further, there are remarks that the spread between disclosed interest rates is large, and that sometimes ranges are "too broad". (Nasdaq OMX Stockholm 2012c, p. 16.)

In the 2012 report, the enforcement body also encourages listed entities to read the ESMA extracts of enforcement decisions, to see whether the decisions included there might be of relevance for their accounting. It makes particular reference to the four decisions concerning impairment testing published in the then recently issued 12th extract. (Nasdaq OMX Stockholm 2012c, p. 10.) One of the four decisions referred to criticizes the discount rate used in calculating value in use for goodwill impairment testing. (ESMA 2012b: *Decision ref EECS/0112-06 – Impairment of Assets: Discount rate used in determining value in use*) The decision criticizes an entity for using a discount rate calculated not in compliance with IAS 36. In particular, there were "errors" related to the inputs of the estimate performed, and the discount rate, it argues was understated. The decision goes on to criticize the "treatment of cash flows denominated in a foreign currency, determination of market risk premium, use of beta, calculation of the cost of debt, determination of the debt/equity ratio and the determination of a discount rate for each CGU".

5.3. A journal article

In the spring of 2013, another statement made joined the enforcement body's efforts to draw attention to the issue of the discount rate for goodwill impairment testing. At this point in time, three academics (affiliated with Lund University) published an article in the journal of the Swedish

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association of the audit and accountancy profession: *Balans*. In the article, they identify a need to discuss this accounting issue and ask why Swedish listed entities do not follow the prescription of IAS 36, paragraph 55, given, they argue, that the implications of this accounting standard are "unambiguous". The article notes that even though the standard regulating this area includes clear "rules" on how to account, there are divergent practices. The article starts by quoting a letter from the enforcement body.

> "Where goodwill is tested for impairment, a discount rate of 11.1 (11.9) percent after taxes has been used. Why has the pre-tax discount rate not been used, as per the requirements of IAS 36, paragraph 55?" This quotation is from a letter sent by the Nasdaq OMX Stockholm Issuer Surveillance addressed to a listed entity as a part of the 2012 monitoring of annual reports. The question is reasonable in relation to the requirements of IAS 36 – the discount rate shall be the pre-tax rate. In discussions with auditors and accountants there is an uncertainty over how to account. Should the pre- or post-tax discount rate be used in calculations? How is it possible, despite of unambiguous rules, that there is uncertainty on this issue? (Carlsson *et al.* 2013)

The authors concluded that the generally accepted accounting appeared to be performing the impairment-test calculations post-tax and in a later step to calculate the pre-tax discount rate as a separate exercise. The pre-tax rate is then disclosed in the annual report. When this is done, "compliance" is considered to be achieved. They suggest that the acceptance of this practice results from an absence of observable data that would enable a direct determination of the pre-tax discount rate. This absence, in turn, follows from a reliance upon a weighted average cost of capital (WACC) and the return-on-equity component of the WACC is only available post-tax. (Carlsson *et al.* 2013) To support this argument, Carlsson *et al.* (2013) include a reference to the accounting recommendations issued by the association of the audit and accountancy profession: FAR's RedU 7, *Bilaga* 1. RedU 7 concludes that although IAS 36 requires value in use to be calculated on the basis of pre-tax cash flows, measurement will normally be performed post-tax as the observable rates of returns of the capital market required for this calculation are expressed post-tax. Thereby, Carlsson *et al.* (2013) question whether a pre-tax discount rate, produced by iteration, can provide any use-

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ful information to the reader of an annual report, as it "lacks a point of reference that would enable an interpretation to be made". This makes it difficult to understand the "economic substance" of this figure.

Although they claim to be unwilling to challenge "compliance" as it has become established, the article's authors suggest that it increases the "information value" of the accounting to disclose the post-tax rate, as this is the rate most entities will use in their actual calculations. A disclosure of the post-tax rate, they argue, would increase "comparability" between entities as this rate is produced by equivalent methods across firms, and it also provides information about the entity's risk assessment. This argument rests on the assumption that the tax will be treated equivalently across firms.

> We do not suggest that firms shall account in non-compliance with the accounting standard, even if our opinion is that the standard has a questionable focus. On the other hand, it appears that most companies perform a post-tax measurement, utilizing a post-tax discount rate and thereafter (in a correct or in an erroneous fashion) produce a pre-tax rate. If the pre-tax rate is produced correctly, i.e. by iteration, this will not change the value; it will only make the information obscure. As we see the post-tax rate as having larger information value and being the rate that is actually used in calculations, this is the rate that should be disclosed. (Carlsson *et al.* 2013)

The authors thus introduce their discussion by aligning themselves with the enforcement statements, pointing to the unambiguity of the accounting standard, and thereby the unambiguity of "compliance", but end their discussion with acknowledging that another accounting method would provide more "information value" even though it differs from the method required by the enforcement body (and is therefore not "in compliance").

5.4. The enforcement issue as a disclosure issue

When addressed by the enforcement body, the "accounting problem" of the discount rate is foremost a disclosure issue, as this excerpt from an enforcement report illustrates.

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> In accordance with IAS 36, paragraph 55, the discount rate shall be stated pre-tax. The enforcement body has observed that there are still companies (about a third) that are not declaring whether the discount rate is pre- or post-tax. In a number of cases, information about the managed discount rate is entirely absent, which is in non-compliance with paragraph (v) [IAS 36:134(d) v]. (Nasdaq OMX Stockholm 2011g, p. 17, emphasis added.)

Similarly, enforcement decision 05/10 (Nasdaq OMX Stockholm 2011b) questions why the entity has not declared that "the discount rate *used* is pre-tax" [emphasis added], although the heading of this decision, "Information about impairment testing is insufficient in accordance with IAS 36, paragraph 134", refers to the disclosure requirements of IAS 36. Furthermore, while the criticism concerns what must be "declared", the information to be disclosed nevertheless concerns the "*treated* discount rate" [emphasis added]. This can be seen as signifying that the discount rate used and the discount rate disclosed must be the same one, i.e. the pre-tax rate.

In practice, the enforced "compliance" has come to be understood as being restricted to the disclosure issue. The proposed accounting change is thus taken as a requirement to disclose the pre-tax rate or a requirement to explicitly declare that it is the pre-tax rate that is provided. How the calculations are performed and whether the pre-tax discount rate disclosed is actually used within these calculations, is not seen as an enforcement issue. An example of this view is provided by an interviewee who describes the enforcement issue related to the discount rate for goodwill impairment testing.

> What the enforcement body is now pursuing is not that you must use it, but only that you must disclose a pre-tax rate. It is not that anyone needs it, but it must be disclosed. And above all, it has to be clear which rate you disclose: is it pre- or post-tax. That is important. (Interview 13)

Several other interviewees also describe the pre-tax requirement only as a disclosure concern, arguing that it is commonly accepted to do the calculations post-tax but to provide information about the pre-tax discount rate. The argumentation of the BCZ85 is seen as implying that the standard allows for making the actual calculations either pre- or post-tax.

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> It is all written unambiguously in BCZ85. Regardless of whether you are calculating pre- or post-tax you will end up with the same answer. In BCZ85 it is pointed out that this presumes that in certain cases you adjust the pre- and post-tax rate and do not simply gross up with the tax rate. This is "evidence" on that IASB […] accepted that you could calculate in different ways. With this as background, it is difficult to understand why IASB has not changed IAS 36.55. Many interpret the fact that the paragraph is unchanged as an indication that IASB (in paragraph 130 (g)) is demanding information about the pre-tax rate as a minimum requirement. (E-mail 09.09.2013, sent from interviewee to researcher after interview 19.)

"Comparability" is invoked as the main reason for disclosing at least the pre-tax rate. If firms want to supply a post-tax rate, they can disclose both interest rates.

> We want everyone to report this figure, avoiding that one says post-tax, another says pre-tax, and a third says nothing about whether the discount rate is pre- or post-tax. That is what we react to, that there is a lack of clarity. Then we will ask: Have you calculated pre- or post-tax? If they say post-tax, arguing that this is a more useful figure for the reader of the reports, then we say that they have to disclose both interest rates. (Interview 38)

5.4.1. The measurement issue

Although this enforcement issue now comes across as a disclosure issue, the initial focus of this accounting issue was on measurement, i.e. whether making the actual calculations on a post-tax basis was in compliance with IAS 36.[11] This was the focus of discussions within *Redovisningsrådet*, the predecessor of SFRB[12], and within the business community. Following the publication of the standard, there was some public discussions on the appropriateness of the use of the pre-tax rate, where Nyllinge and Winqvist (2001) argued in favor of a continuation of the practice of post-tax measurement and Johansson (2002) stressed the theoretical problems surround-

[11] In Sweden, the IAS 36 was incorporated in the accounting regulations as of 2000, when RR17 *Nedskrivningar* [*Impairments*] was issued. RR17 came into force January 1, 2002, but earlier application was encouraged (RR17:121).

[12] Redovisningsrådet ceased to exist by 2007, when SFRB was formed.

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ing both pre- and post-tax calculations.[13] At that point in time, the conclusion was reached that a post-tax rate could be used. The current enforcement issued is explained as being a remnant left from these earlier dis- discussions.

To the extent that the measurement concern was discussed within the EECS, the discussion appears to have centred on the different methods for arriving at the pre-tax rate, i.e. by iteration or by simply grossing up the post-tax rate. Here it was concluded that the first method was the correct one, as there will usually be both non-constant cash flows and some assumption on growth. However, the enforcers' view on the IASB's intention in formulating the standard is not shared by everyone. Rather, some critics argue that IASB indeed had a purpose with the pre-tax requirement of IAS 36:55 that rested on a belief that a pre-tax calculation would be more beneficial than a post-tax calculation.

> I have heard, or read – I don't really remember where – that the idea behind IAS 36 was that it should be pre-tax. I believe that IASC's idea was that using the pre-tax discount rate was rather different from using the post-tax rate. So the important thing should be that this has an effect on measurement. It was a secondary matter that the pre-tax interest rate should also be disclosed, enabling the reader to find out about the rate. (Interview 11)

Notably, measurement does not seem to have disappeared from the investigations performed by the enforcement body, even though this is not seen as an enforcement issue any longer. In describing these investigations, an interviewee concludes that the listed entities ought to be prepared to de-

[13] In a *Balans* article, Nyllinge and Winkvist (2001) go through the expected changes from the adoption of RR17 and conclude that RR17 requires the discounting to be performed on a pre-tax basis. They argue that this contrasts with the most common technique for corporate valuation (referred to as Discounted Cash Flow), where the post-tax cash flows are discounted with a post-tax interest rate. As the reason for requiring pre-tax figures was for entities to avoid having to forecast the tax cash flows, the authors suggest continuing the (by then) current practice of calculating post-tax. In response to Nyllinge and Winqvist (2001), Johansson (2002) in a later *Balans* article wrote that although the RR17 requires a calculation of present values on the basis of pre-tax cash flows, this accounting is surrounded by a number of difficulties. For instance, he suggests that as goodwill amortizations are not tax deductible, a comparison with a pre-tax present value is questionable. He argues that it is, nevertheless, even more complicated to perform calculations on a post-tax basis. The relationship between post-tax required rates of returns and the taxable profit is mentioned as but one of the problem sources.

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fend their accounting with regard to goodwill calculations as well. For instance, questions are asked about the headroom for each cash-generating unit, where the enforcement body sometimes argues that the headroom is too small. The body then demands sensitivity analyses. Another interviewee tells about how the enforcement letters often include questions concerning the goodwill calculations, demanding more information and material about how these have been performed.[14] Required material includes Excel spread sheets, minutes from the Board of Directors and from the auditing committee of the Board and reports from the auditor.

The measurement issue, according to one employee in the Swedish enforcement system, will not leave the discursive stage because it is inappropriate for an enforcement body to "redo" the assessments already done by the preparers and by their auditors as a correct answer cannot in any case be achieved. This interview subject explains the difficulty in enforcing the measurement question as arising not from the enforcer's external position, but from the fact that measurement rests upon a forward-looking judgment. The only way, therefore, to question the goodwill measurement is by questioning the assumptions on future profitability. A reluctance by enforcers to question those assumptions will, in the end, reduce the result of the investigation to a remark on the possibility of improving disclosures.

Similarly, another interviewee offers an opinion that it is very difficult for an enforcement body to question and challenge judgments. He is taking an ESMA enforcement decision on the discount rate used in goodwill impairment testing[15] as an interesting example of enforcement.

> [They wrote:] "Here you have used the wrong discount rate!" They had made errors in relation to a huge number of paragraphs! It almost appeared as they had not got one figure right. […] They say: "You took a Beta of 1.3. We think that it should have been 1.0!" Or 1.2? (Interview 15)

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[14] The excerpt from an enforcement letter as provided by Carlsson *et al* (2013) can be seen as an example of the enforcement body questioning why the pre-tax discount rate has not been "used" in the goodwill impairment testing.

[15] Most probably, the decision referred to within this interview is European Securities and Markets Authority 2012b: *Decision ref EECS/0112-06* (see description earlier in this chapter).

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On the issues of judgments, this subject emphasizes that the entities themselves must be allowed to, and are responsible for, making their own judgments. He considered it inappropriate to “simply accept what someone else has stated”. This is because enforcement decisions will not always be applicable to other cases. As an example, a specific assumption of growth that has been criticized in one enforcement decision could as well be defensible with regard to another entity. In comparison to the approach taken in the decision of the ESMA extract, the approach taken by the Swedish enforcers is seen to be more reasonable by this interviewee. While Swedish enforcers “have challenged some entities in quite a forceful way” asking “detailed questions” about the goodwill calculations, the Swedish enforcement body is not seen as making judgments “on behalf of the entity”.

On the other hand, some informants indicate that it would have been a good thing if the enforcement body had published decisions regarding measurement concerns. Enforcement statements are seen as providing guidance on how the standard should be interpreted. This guidance is seen as comparable to the guidance offered by an official interpretation issued by IFRIC/IFRS IC.

> As the enforcement body has not pursued any cases on the measurement question […], we have no support in this concern. Otherwise, you could state that the standard says this or that, but the interpretation has shown… That would be imaginable, as there are plenty of odd and specialized questions taken to IFRIC. This is a reasonably big and important issue. I have not seen it taken to IFRIC even once: What is the meaning of this? (Interview 11)

A recurring explanation for the enforcement body’s unwillingness to criticize the measurement is that the standard is deficient in its reasoning about measurement. The message of the standard is considered to be not “well thought through”, “strange” or even “nonsense”. The combination of the main standard requirement of performing calculations pre-tax (IAS 36:55) and the basis for conclusion example (IAS 36:BCZ85) on how the pre-tax interest rate might be iteratively produced based on post-tax calculations is also portrayed by others as an oddity in the accounting standard.

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> If you were to rely on the example [of BCZ85]… OK, that is not a part of the standard, but still it is included as a basis for conclusions! Then you take the post-tax rate and iterate. […] So honestly, what IASB are doing there is almost… maybe I should not say ridiculous, but [laughter] at least I think it gets strange as they talk about the pre-tax but then they do the calculations post-tax. (Interview 22)

As interviewees see no possibility to perform the calculations on a purely pre-tax basis, the standard is perceived as effectively being in void of applicable meaning if it requires this. A post-tax calculation must first be made, to enable a pre-tax calculation to be made as a later stage. The requirement of the standard is thus seen as engaged in "circular reasoning".

> [The standard] says that you should calculate with the interest rate [you disclose], I believe. But simultaneously they say that for arriving at the correct interest rate you first have to do the calculations post-tax. That is the only way to find out the correct pre-tax rate. And then they say that you shall arrive at the same answer for both calculations. So it all becomes pathetic somehow. First, you calculate post-tax to produce an answer. Then you produce the pre-tax rate. Should I then redo the calculations to arrive at the same answer yet again? In what way have I then calculated? I have calculated in both ways, and I started with the post-tax calculation, so that is how I really have calculated this. It all turns into some kind of circular reasoning, which I cannot see the logic of. How are they thinking? I do not believe that the IASB, from the beginning, understood what they wrote in this paragraph. (Interview 12)

Another interview subject provides a similar message on the standard lacking "logic" when it first requires a pre-tax rate to be used and later discusses what to do when no such rate exists.

> The standard says that you shall use a pre-tax interest rate. But then there are sub paragraphs about what to do when there is no pre-tax interest rate, which suggests that a pre-tax rate should be produced and thereafter the calculations should be done. We cannot really see the logic of that. (Interview 21)

Moreover, producing the pre-tax rate iteratively from the post-tax calculation is seen as mere "fiction" as this rate can never be observed in reality.

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> So it almost turns into a philosophical issue: What is a pre-tax discount rate? When you delete an expense that is an actual expense, i.e. the tax, it all becomes fiction. (Interview 22)

This interviewee points out that excluding tax costs contrasts with the way corporate valuations are normally carried out, as taxes will always be taken into consideration. Rather than being common, or even appropriate in corporate valuations, the use of pre-tax interest rates is recognized as having an origin in investment calculations, where single assets rather than entire businesses are valued. When single assets are valued the "textbook example" on investment calculations suggests pre-tax measurements. The interviewee sees this as "an obvious simplification". Several informants suggest that this formulation of the accounting standard follows from early standard setting activities, where a single asset was usually the point of reference. When the thinking evolved, and cash generating unit became the point of reference, IAS 36 was already written and it has remained unchanged. However, as long as separate units are valued, the logic of disregarding taxes remains reasonable, as these units might not be able to affect taxes in any case. When the entire corporation is valued, disregarding taxes is more questionable.

The accounting standard is, nevertheless, seen as being out of touch with reality because it does not align with how valuation specialists of today are reasoning. As it is seen as necessary to consult valuation specialists for accounting in compliance with IAS 36, this divergence will matter. It is suggested that the valuation specialists within the Big Four are always consulted for assistance in measurement issues as these questions cannot be managed by pure accounting specialists.

5.5. Divergent accounting practices

Even though the enforcement body has mentioned the issue of the pre-tax discount rate for goodwill impairment testing repeatedly, accounting practices still diverge (Carlsson *et al.* 2013). Three different ways to account appear to exist, i.e. the practice of calculating and disclosing pre-tax, the

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practice of calculating post-tax and disclose the pre-tax discount rate, and the practice of calculating and disclosing post-tax.

Amongst those choosing to calculate and disclose (only) on a post-tax basis, there were different views on whether this accounting treatment is actually in compliance with IAS 36 or not. One preparer argues that it appears to be an established practice to disclose only the post-tax rate, but that it is uncertain whether this accounting treatment will be possible in the future. "Much effort" has been devoted to this issue, even though it is suggested that the difference is not "material", and the treatment is chosen because only the post-tax rate is observable on the market. Others indicate that disclosing only the post-tax rate is "doing the wrong thing". Despite the enforcement statements, some preparers look on this issue as a situation where it is possible to account in "non-compliance" with IAS 36, given that the accounting is still transparent.

Yet others deny that only disclosing the post-tax rate is non-compliance with the accounting standard. Here the argument put forward is that it is not really a requirement of the IFRS to disclose the pre-tax rate, as IAS 36:55 does not, on this interpretation, treat disclosures. The actual disclosure requirement (IAS 36:134(d) v) is not seen as explicitly stating whether the disclosed discount rate should be pre- or post-tax. Further, the pre-tax is argued to provide less information than a post-tax rate, making it preferable to leave this figure out of the annual report. In this line of reasoning, the pre-tax interest rate has less informative value because it must be produced by iteration and because its size is dependent on the distribution of the future cash flows. This implies that it is difficult to compare pre-tax rates between firms. Moreover, the post-tax rate can be expected to be the usual point of reference for readers of an annual report.

The argument of that the enforcement body is requiring something that is not an actual "requirement" of the standard is a reoccurring one. An accounting specialist claims that the enforcement body must have made an "interpretation" of IAS 36, because it is not self-evident that the requirement being enforced is actually an implication of the accounting standard. As other actors of the regulatory space do not see it as a part of the enforcement body's role to make interpretations, they dismiss the enforcer's request. Notably, the view of that there is no explicit disclosure require-

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ment in IAS 36 has also been communicated to the enforcer in responses to enforcement letters.

> Paragraph 55 states that it should be pre-tax, and maybe you could discuss that; I do not remember the exact wording, whether the disclosure ought to be pre-tax. But I do know that the enforcer is of that opinion. […] Because if you are looking at the disclosures, it does not express that clearly, as in paragraph 55, that it should be pre-tax. […] But I guess that the enforcement body is making an interpretation, that is how I have understood it from the letters from the enforcement body. […] (Interview 22)

Others, despite of their scepticism over whether the standard really implies that a pre-tax discount rate ought to be applied, nevertheless express an acceptance for that this is generally the established position on how the standard shall be read, even though it is not evident from reading the standard itself. As actors consider IAS 36 somewhat unclear in this respect, the disclosure requirement is read as (possibly) being an indirect implication of what requires paragraph 55.

> The standard is written so that it is possible to interpret it as implying that the disclosure shall be pre-tax. Personally, I don't think that is so clear, that either. But they make a reference to some paragraph, […] 55, […] although it is not explicitly stated among the disclosure requirements. […] I think it is fairly taken for granted that paragraph 55 implies, indirectly, that the disclosure requirement is also pre-tax. (Interview 12)

The issue of whether enforcement requirements are "interpretations" or not is commented on within the 2011 enforcement report (Nasdaq OMX Stockholm 2011e). The report underscores that although "the market's need for information" is a sufficient basis for demanding information, the accounting standard will always be the "point of reference". European co-operation within the forum of EECS is emphasized as a guarantee of that disclosure demands will be "suitably formulated for the specific cases". The comment can thus be seen as acknowledging the enforcement body's awareness that there could be criticism if their enforcement decisions or enforcement reports are seen to be extending the requirements of the IFRSs. (Nasdaq OMX Stockholm 2011e, p. 3.) The distinction between

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interpretation and enforcement is a difficult one. In the course of working with enforcement, this is seen as practical problem.

> It [the prohibition on interpretation] is always lingering in the background. But simultaneously, to be able to make a decision it is necessary to create a meaning for the paragraphs of the IFRSs. That is a really tricky distinction. What is an interpretation, really? Of course, in one sense, I will have to interpret the text. As this issue about: How should I set the Beta value? To know that, I have to interpret the written text, in some sense anyhow. […] [When you enforce] you always have to make sure that there is a paragraph to point to, to say here it is written. You could never start with: "I think that" or "in my view" or something like that. (Interview 12)

Rather than refusing to disclose any pre-tax interest rate, some preparers instead simply disclose the pre-tax interest rate, as this figure is known to be required. The enforcer always returns to this issue, but auditors also require the pre-tax rate if it is missing. On this view, compliance with the accounting standard is achieved when the pre-tax discount rate is calculated and disclosed. The actual requirement is thus not seen as difficult to fulfil, and thereby there is no reason not to do so. Here it seems unnecessary to make "a fuss" on this issue although it is also seen as advisable to disclose the post-tax rate as well.

> I would address it and state that the enforcement body has said that the pre-tax rate must be disclosed. I would have done that because it is easy to bring it up and mention it. […] Why should you make a fuss with the enforcement body because of something like this? On the other hand, I would like to recommend also disclosing the post-tax rate because I believe that the pre-tax is a nonsense figure. (Interview 22)

The pre-tax discount rate produced and disclosed is seen by some actors in regulatory space as a mere "checklist" item because "it is not useful for any purpose". It lacks "relevance" in relation to goodwill as financial analysts and valuation specialists use the post-tax rather than the pre-tax interest rate since the WACC "by definition" is a post-tax rate.

Although many actors separate measurement and disclosures and understand the pre-tax requirement to affect disclosures only, this interpreta-

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tion is not shared by everyone. Some actors argue instead that the measurement, as well as the disclosures, should be made pre-tax, and see no reason to why a distinction should be made. Some preparers for listed entities claim that their calculations for goodwill impairment testing are always made on a pre-tax basis. Effectively, the issue is denied the status as "problem" because the current accounting of these preparers is considered to be consistent with both the accounting standard and what is perceived to be "natural" accounting. This accounting issue is denied "problem status" because the "theoretical" complexity of the issue is considered irrelevant to accounting practices.

> This discussion appears to be held by some utterly theoretical individuals. For most people, I do not think that this is a problem at all. […] The issue is whether you might turn a post-tax WACC to a pre-tax WACC simply by eliminating the tax (as people commonly think). And then there are some theorists who claim that: No that cannot be done as the tax payments are unevenly distributed (if I have gotten this right). To me, this is not an issue! You already have a number of uncertainties in the future cash flows and in the discounting as you are not certain of what the required rate of return really is. This is theoretical in itself! And then to add another theoretical uncertainty factor… I do not know whether this would lead to improved accounting. I have difficulties in seeing that it would. (Interview 27)

Other interviewees also question whether the suggested measurement problem can really make such a large difference in practice. They emphasize that the impairment testing includes possible sources of errors far greater than the issue of taxes. The budgeted numbers used as a basis for the future cash flows is a source of uncertainty. In comparison to this, the issue of pre- or post-tax is described as less relevant. As both calculations will end in the same value, the important issue is considered to be whether there will be need for a write-down or not.

5.6. Concluding remarks

This chapter chronicles the enforcement body's efforts to entities to disclose their discount rate for goodwill impairment testing on a pre-tax basis

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and to declare explicitly that the disclosed rate was a pre-tax interest rate. By doing so, the enforcement body could be seen as attempting to define this accounting issue as an "accounting problem".

In a *Balans* article, some academics joined into the enforcer's effort to highlight the practices in relation to this accounting standard. They expressed surprise at the existence of divergent accounting practices and divergent views on "compliance" with this accounting standard, given that the standard is "unambiguous" in its message.

The Swedish enforcement statements were aligned with the views on "compliance created within the co-operative European enforcement body. Within EECS, the view was that it was possible to calculate on either a pre- or post-tax basis and still to account in compliance with the standard. Thereby, disclosure of the pre-tax discount rate was the only enforceable issue. Even though these accounting standard requirements had been discussed previously as measurement requirements, the contemporary "enforcement issue" was thereby established as a disclosure issue. The statements of the enforcement body appear to have contributed to shaping an (at least partly shared) understanding of "compliance" for this accounting issue, where the standard was seen as requiring (solely) explicit disclosure of the pre-tax discount rate. These statements may have the other actors of the regulatory space not to accept this issue as an "accounting problem".

As the issue was not accepted as an accounting problem, the preparers could either change their accounting (as this could be done rather effortlessly), but could also refuse to make a change.

A possible explanation of why this issue was settled without further discussions lies in the actors of the regulatory space, and how they understood and anticipated this issue. Here, the enforcement body's (and the academics') attempts of to initiate a new regulatory conversation in the regulatory space were encountered with different kinds of arguments.

These arguments could be described as ideas on how relevant accounting or how relevant accounting standards will be. Notably, these arguments were possible to draw upon in relation to multiple accounting issues, and could sometimes even enable instant sense making of these (cf. Wittgenstein 1953:197). It is the attachment of each accounting issue to a common-

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ly known argument that creates the issues' identities. For the accounting issue investigated in this chapter, this process implied that these became established as "unproblematic" issues. Therefore, regulatory conversations constructed these issues as something they did not necessarily had to be.

A first argument that was drawn upon to make sense of the issue investigated in this chapter was the idea of that the accounting standard must be reasonable or logical if it is to be applicable in a consistent manner. Amongst the interviewees, there was a commonly held understanding that the accounting standard regulating the IAS 36 discount rate provided no reasonable guidance on whether measurement should be performed on pre- or post-tax basis. Because the combination of what was (possibly) required by the main accounting standard and what was explained in the *Basis for Conclusion* was regarded "illogical", IAS 36 was seen as not conveying a consistent message that could be taken into consideration. The understanding of this accounting standard requirements as providing a "nonsense" message helped to define this issue as "unproblematic".

Notably, because actors could not possibly interpret the standard to require *using* a pre-tax rate in calculations, IAS 36:55 was rendered meaningful (rather than absurd) by interpreting it as a disclosure requirement. However, the understanding of this "accounting issue" as a "disclosure issue" made it less relevant because this disclosure issue had no effect on the financial statements (cf. Tweedie and Whittington 1990, Brandt *et al.* 1997, Fearnley *et al.* 2000, Hines *et al.* 2001, Brown and Tarca 2007). Therefore, it was possible to pay less attention to it.

A second argument drew upon an understanding of this problem formulation as a "theoretical" issue (lacking "practical" relevance). This specific defining contributed in the overall defining of issues as unproblematic. This is clearly illustrated by how the interviewees emphasized how this was an issue of interest only for those engaged in "theory".

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Chapter 6

Accounting for tax loss carryforwards

In many jurisdictions, a negative taxable income (a tax loss) can be carried forward and used for reducing taxable income in future years. Different aspects of accounting for tax loss carryforwards have been commented upon within the Swedish enforcement system, including the requirement to provide "convincing other evidence" in order to recognize a deferred tax asset for carryforwards, and the possibility of partial recognition of carryforwards. Some of the publicized enforcement statements have met with criticism from other actors, who did not agree with the enforcement body.

In this chapter, the statements made by the enforcement body, and the criticism those statements have encountered illustrate how enforcement statements became the focus of (a partially public) debate. In addition, the chapter provides some indications of how accounting practices evolved.

6.1. The accounting-standard requirements

The IFRS standard regulating when deferred tax assets shall be recognized for tax loss carryforwards is IAS 12 *Income taxes*, paragraphs 34-35. Generally, carryforwards may be recognized when it is "probable" that there will be future taxable profits, against which the carryforwards could be offset.

> **34 A deferred tax asset shall be recognised for the carryforward of unused tax losses and unused tax credits to the extent that it is probable that future taxable profit will be available against which the unused tax**

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losses and unused tax credits can be utilised. (IAS 12:34. Bold face in original.)

The accounting standard states that the criteria for recognition of deferred tax assets are the same for carryforwards as for deferred tax assets based on deductible temporary differences (see further IAS 12:24-31). In addition, there is a further requirement for the carryforwards. These can only be recognized when "convincing other evidence" on future taxable profits is provided. This is because the existence of carryforwards constitutes "strong evidence" that there may be no future taxable profits. "Convincing other evidence" is especially important when there is a "history of recent losses". In this case, both the amounts of the assets and the evidence speaking in favor of the recognition will have to be disclosed. (IAS 12:35, 82)[16]

Paragraphs IAS 12:79-88 sets out and explains a number of disclosure requirements. For instance, it is required to disclose the amounts, and expiry dates for carryforwards for which there is no corresponding deferred tax asset recognized (IAS 12:81(e)). In addition, it is required to explain "the

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[16] The standard texts are as follows:

"35 The criteria for recognising deferred tax assets arising from the carryforward of unused tax losses and tax credits are the same as the criteria for recognizing deferred tax assets arising from deductible temporary differences. However, the existence of unused tax losses is strong evidence that future taxable profit may not be available. Therefore, when an entity has a history of recent losses, the entity recognises a deferred tax asset arising from unused tax losses or tax credits only to the extent that the entity has sufficient taxable temporary differences or there is convincing other evidence that sufficient taxable profit will be available against which the unused tax losses or unused tax credits can be utilised by the entity. In such circumstances, paragraph 82 requires disclosure of the amount of the deferred tax asset and the nature of the evidence supporting its recognition." (IAS 12:35)

"**82 An entity shall disclose the amount of a deferred tax asset and the nature of the evidence supporting its recognition, when:**

(a) the utilisation of the deferred tax asset is dependent on future taxable profits in excess of the profits arising from the reversal of existing taxable temporary differences; and

(b) the entity has suffered a loss in either the current or preceding period in the tax jurisdiction to which the deferred tax asset relates." (IAS 12:28, bold face in original.)

"125 An entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of:

(a) their nature, and

(b) their carrying amount as at the end of the reporting period." (IAS 1:125, bold face in original.)

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relationship between tax expense (income) and accounting profit". (IAS 12:81c), and to disclose assumptions made about the future as well as "other major sources of estimation uncertainty". (IAS 1:125)

At different points in time, requests have been submitted to the interpretative body of IASB asking for clarifications on how to read the standard. In June 2005, IFRIC rejected a request to provide further guidance on how to apply the probability criterion of IAS 12 and to state whether the probability criterion should be applied to the entirety or to parts of total amounts. In the rejection notice, IFRIC saw no need to initiate a project on the issue because "the criterion is generally applicable to portions of the total amounts" and because practices were not found to be divergent. (IFRS IC 2015: IAS 12-1) In 2013, a request was forwarded to the IFRS IC (former IFRIC) asking for an interpretation on recognition and measurement of deferred taxes for loss-making entities (IFRS IC 2013). The project ("Project IAS 12 Income Taxes – Recognition and measurement of deferred tax assets when an entity is loss-making") was addressed in three different IFRS IC meetings (November 2013, January 2014 and May 2014) and was finally rejected as the standard was considered "sufficiently clear". (IFRS IC 2014b, see further IFRS IC 2013, 2014a)

The accounting for carryforwards has been subject to several enforcement actions. A 2007 article in *Balans* by Rolf Rundfelt comments on an enforcement decision published by the Danish enforcer Fondsrådet. (Rundfelt 2007) That decision concluded that a deferred tax asset could be recognized for tax loss carryforwards only if it can be show that taxable profits will be obtainable within the nearest three to five years.

> It is the opinion of Fondsrådet that in order to comply with the regulations for the first half year report of 2005 and the annual report of 2004 the entity must provide convincing evidence that within a time period of 3-5 years the entity will be able to generate taxable profits covering the value of the deferred tax assets recognized in the annual report and in the half year report. (Fondsrådet 2006)

In his article, Rundfelt (2007) criticizes this decision. He concludes that the required time limit is not an actual implication of IAS 12, but an "interpretation" by the Danish enforcement body.

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> […] it is interesting to observe that Fondsrådet has made an interpretation of IAS 12 that goes further than the accounting standard. Fondsrådet requires that the entity shall make it probable that the deduction will be possible to utilize within 3-5 years. IAS 12, on the other hand, has no time limit. It is however not uncommon that Swedish entities make their accounting principles concrete by creating similar supplements to the standard. (Rundfelt 2007)

6.2. The initial statements by the enforcement body

A number of comments were made in relation to accounting for tax loss carryforwards in the Swedish enforcement reports. The 2007 enforcement report (reviewing annual reports of the financial years 2006/2007) claims that the issue of what to consider as "convincing other evidence" has been a concern ever since the introduction of IAS 12.

> In accordance with paragraph 35 in IAS 12 companies that have accounted for losses for either of the latest two years might not recognize a deferred tax asset attributable to tax loss carryforwards. A deferred tax asset might only be recognized when there is convincing evidence of future taxable profits. Ever since IAS 12 came in force, issues have been raised concerning whether the evidence entities refer to are actually "convincing". Judgments have been made on the basis that it is not sufficient that the entity refers to its own forecasts or to profit improvements during the most recent year. To be "convincing" something else is required, for instance that a loss making unit is disposed or that an order enabling future profitability has been received. (OMX Nordic Exchange Stockholm 2007, p. 7.)

Thus, this ability to identify specific events, e.g. a disposal of a unit or an order, is seen as "convincing", but mere anticipations of future profitability are not. The report stipulates that some of the investigated entities denied recognitions of carryforwards because no taxable profits are assumed to be available within the nearest three to five years. The enforcer contests this rule of thumb because it is doubted that it has support in the accounting standard. IAS 12 provides no time limit and the report states that the limitation "borders on an application of the principle of prudence", which is seen as having no place in the contemporary version of the accounting

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standard.[17] The report also mentions that the setting of time limits can be understood as a substitute for discounting, as tax assets are not to be discounted in accordance with IAS 12. This is, however, not seen as an acceptable practice. As a last remark on carryforwards, the report highlights that IAS 12:81 requires a disclosure of the amount of carryforwards that has not been recognized, and that insufficient disclosures "render minor possibilities for a reader to understand the tax situation of companies". (OMX Nordic Exchange Stockholm 2007, p. 7.)

The next year's enforcement report highlights the issue of carryforwards repeatedly. That report also mentions that information on unrecognized carryforwards must be disclosed. It offers too, a reminder on the standard requirement to disclose the relationship between the current year's tax expense and net profit. It is emphasized that this disclosure is important for understanding why the effective tax rate differs from the current tax rate. (Nasdaq OMX Stockholm 2008b, p. 7.) There is also a comment that insufficient information is often provided on "convincing other evidence" in relation to carryforwards originating from foreign subsidiaries. The report emphasizes that information about this evidence is important not only for those analyzing the subsidiary, but also for those analyzing the group as a whole. Further, a comment is made that carryforwards sometimes receive partial recognition but the report argues that this accounting treatment is only defendable "under very specific circumstances" because partial recognition requires, for instance, that the entity is assumed to produce profits during a limited period of time and then cease to be profitable.

> A common remark concerning the accounting for tax loss carryforwards is that only a part of the carryforward has a corresponding asset in the balance sheet. One reason could be that the entity's judgment of future taxable profits during the following X years only allows for a part of the carryforward to be recognized. In accordance with paragraph 34, carryforwards will only be recognized given that it is probable that the asset will be utilized for setting off a future tax expense. Of course, it is difficult to argue with certainty in favor of a profit that will be accounted for X years ahead. On the other hand, it must be even more difficult to argue that an entity will report profits during X years but thereafter

[17] The notion of prudence was removed in the 2010 years Conceptual framework. Previously, "prudence" had been mentioned in the IASB Conceptual framework:35. (See further Barker 2015.)

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> will report only losses. This speaks in favor of defending a partial recognition of carryforwards only under very specific circumstances. (Nasdaq OMX Stockholm 2008b, p. 7.)

The issue of carryforwards also featured in the 2009 enforcement report. While the first sentence remained unchanged from the comment made the previous year, the remainder of the message was altered. In 2009 emphasis fell on the difference in accounting treatments with regards to the carryforwards, and the insufficiency of disclosures made.

> A common remark concerns the accounting for carryforwards where only a part of these have a corresponding asset in the balance sheet. In some cases, the carryforwards are of a size implying that recognition of the full amount appears to be unreasonable. The opposite cases also exist, where companies choose to account for an increased amount of the carryforwards each year, thereby keeping the tax expense down. It is therefore of vital importance that companies choosing not to recognize all their carryforwards explain their principles for future recognitions. (Nasdaq OMX Stockholm 2009b, pp. 26-27.)

The criticism of partial recognition as something that will only be acceptable "under very specific circumstances" has now evolved to an acknowledgment that in some cases it would be "unreasonable" to recognize the entire unused tax loss. Further disclosures are also called for in relation to loss-making entities recognizing deferred tax asset for carryforwards.

> A recurring problem, which was also an issue in 2008, concerns the companies which despite of having made losses during one of the latest two years are recognizing tax-loss carryforwards without providing information in a convincing way about why they are expecting taxable profits during the upcoming years. (Nasdaq OMX Stockholm 2009b, p. 26.)

A remark similar to a remark from the previous year points out that it is not uncommon that profit-making entities are still reporting tax loss carryforwards that are located in foreign subsidiaries. In these cases it is (still) argued to be important to provide information on the "convincing other evidence" supporting the recognition. Similarly, a comment is repeated that the disclosure requirements in accordance with IAS 12:81 must be supplied.

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(Nasdaq OMX Stockholm 2009b, p. 27.) In a published enforcement decision of that year, insufficient disclosures in relation to IAS 12:81 are criticized. In this case, the enforcer argues that an entity has omitted to supply the amount of unrecognized carryforwards. The criticized firm is reported to have responded that the issue has been overlooked, but will be addressed in the next coming annual report.

> The stock exchange criticized the firm for its accounting. As the firm acknowledges the enforcer's statement that the information in question is missing, and this shall be taken into account in the next coming annual report, the enforcer will not pursue the issue further. Should the matter reoccur, the enforcer could reach another conclusion. The entity is ordered to take the remarks of the enforcer into account in its next financial reporting. (Nasdaq OMX Stockholm 2010a: Beslut 01/09)

The 2010 enforcement report makes a number of remarks on disclosures in relation to paragraph 81 of IAS 12 (IAS 12:81(a),(ab),(e)(g)), and the report requests explanations for some "descriptions and terms" of the tax reconciliation "even though these terms possibly being prevalent in some industries". (Nasdaq OMX Stockholm 2010b, p. 13.) That report also reemphasizes that IAS 12 does not provide a time limit for when future taxable profits must occur in order to allow for recognition of a deferred tax asset for carryforwards. This means, the report argues, that using explicit time limitations when making the recognition assessment is not in compliance with the accounting standard. Furthermore, the report points out that the Swedish tax system provides no support for any such limitation as the Swedish tax system has no expiration date for carryforwards. Finally, impairment testing of goodwill, where no time limits are set, is identified as a comparable case.

> Some firms state that the measurement of deferred tax assets is limited to a number of years. The enforcer has pointed to the discrepancy between such a limitation and the time range firms rely on in impairment testing of goodwill. In addition, the enforcer has made clear that a limitation of the number of years is in non-compliance with IAS 12:34 and furthermore lacks relevance for allowable uses of Swedish tax loss carryforwards. (Nasdaq OMX Stockholm 2010b, p. 13.)

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6.3. Two journal articles

In the spring 2009, two members of the accounting policy group of FAR wrote an article in *Balans*, publicly commenting on a number of different accounting issues raised in the 2008 enforcement report. The issues were seen as problematic either because these were claims that entirely lacked support in the IFRS or because the authors read them as "interpretations" of the standard. If the requirements of the enforcement body were to be regarded as supplements to the requirements of the accounting standard, this would imply that Swedish enforcement activities in reality constituted "standard setting". This, the authors argued, was not the role the European regulations had assigned to the enforcement bodies.

> The enforcement body has published the report "Summary of observations from Nasdaq OMX Stockholm's review of annual reports 2007". We argue that the report in some instances includes errors in relation to IFRS and elements of standard setting, which is incompatible with the EU requirements on enforcement bodies. (Arnell and Janzon 2009)

The article further emphasized that the IFRS' status as "principles based" merited extra attention in pursuing enforcement. As the enforcement bodies have an important role in "the development of practices", the article argued for preserving a distinction between the role of an "enforcer" and the role of a "standard setter", acknowledging, nevertheless, that there can sometimes be difficulties in separating these two roles.

> We believe that enforcement is important for the development of practice on a national as well as an international level. It is of utmost importance that this is done from a starting point in IFRS as a principles-based accounting standard. The enforcement bodies should avoid standard setting although it might sometimes be difficult distinguish between enforcement and standard setting. (Arnell and Janzon 2009)

With regards to tax loss carryforwards, Arnell and Janzon (2009) suggest that the Swedish enforcement body's criticism of partial recognition of carryforwards is contrary both to the actual requirements of the standard and

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to generally accepted international usage of the IFRSs. It was reiterated that IFRIC had remarked on the allowable use of IAS 12's "probability" criterion on portions of carryforwards. In relation to "principles based" IFRS, the enforcement body's "interpretation" of the accounting standard is characterized as "unfortunate".

> The enforcement body makes an interpretation of IAS 12 that does not allow for partial recognition of tax loss carryforwards other than in exceptional cases. It is unfortunate if the enforcement body will disapprove of the entities' possibilities of performing probability judgments concerning the amount of the carryforwards that they believe probable to become usable. Making judgments is an important aspect of the IFRS. This is something that might create a need for specific disclosures of the assessments made. Partial recognition of taxable values for carryforwards exists in international IFRS practices. It could also be noted that IFRIC, in relation to their assessments on whether to issue guidance for the application of the probability criterion of IAS 12, concluded that this criterion shall be applied to parts of the remaining carryforward, not only for the carryforward in its entirety. It is important to remember that IFRS is a principles based standard. (Arnell and Janzon 2009)

In a later issue of *Balans*, the enforcement body responded to the comments made by FAR. The article was signed by the General Counsel of the Nasdaq OMX Europe and by the head of issuer surveillance of the Nasdaq OMX Nordic exchanges. This article makes no comment on the specific accounting issues addressed by the association of the audit and accountancy profession. Instead, it emphasizes that Sweden had opted for an uncommon solution in comparison to other European countries. It also recalls that the enforcement body has suggested a law amendment to align the Swedish enforcement structures with those of other European countries, thereby relieving the Swedish stock exchanges from the duties of pursuing enforcement of accounting standards.

> A survey of Europe would conclude that the Swedish implementation of the Transparency Directive and the MiFID's (Market in Financial Instruments Directive) rules on allocation of enforcement duties is not in conformity with how the corresponding rules have been applied in the rest of Europe. Sweden is unique in its enforcement set-up. That Sweden has opted for a structure that is markedly different from those of other European countries is a disadvantage

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> for the Swedish financial market from several perspectives, and it will create an undesirable competitive disadvantage. (Billing and von Haartman 2009)

As no changes of the enforcement structures are yet ahead, it is emphasized that as long as enforcement of accounting standards remains the responsibility of the stock exchanges, the quality of this will be a prioritized concern. To that end, the article underscores, too, the importance of upholding the boundaries between standard setting and enforcement. Although these delineation problems are seen to always be present as a part of enforcement practices, dialogue between different accounting constituencies is brought forwards as a road to "improvements". Here, the association of the audit and accountancy profession and the Swedish enforcers (the other Swedish stock exchange and the competent authority) are mentioned as relevant counterparts in discussions.

> An important consideration in achieving high quality is the separation between standard setting and enforcement. The enforcement body is used to managing this dividing line in other areas of its market surveillance. Regardless of the structuring of enforcement, the straddling between standard setting and enforcement will be ever-present. There are always possibilities for improvements – so too in this case – and for achieving this we wish to have a close dialogue with other concerned parties in this area, as for instance *Finansinspektionen*, FAR SRS, and NGM. (Billing and von Haartman 2009)

6.4. The later statements by the enforcement body

The 2010 enforcement report also addresses the issue of insufficient disclosures on the "circumstances" motivating recognition of deferred tax assets for carryforwards reoccurs (referring to IAS 12:35,82). (Nasdaq OMX Stockholm 2010b). Moreover, this issue is also mentioned within two enforcement decision of the year. (Nasdaq OMX Stockholm 2011a: *Beslut 03/10*, 2011b: *Beslut 05/10*) Decision 03/10 concerns a company that has accounted for losses in recent years, but is still recognizing a deferred tax asset for carryforwards. The criticism here is that the entity has "not fulfilled the disclosure requirements of IAS 12, paragraph 35".

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> The enforcement body has in its supervision of the financial reports of the Entity observed that the Entity accounts for a deferred tax asset, which the Entity argues will be possible to use within the three upcoming years. The entity has in recent years reported a loss. Based on this information, the enforcement body has questioned whether the disclosures fulfill the IAS 12, paragraph 35, requirement that there must exist convincing other evidence that sufficient taxable profits will be available. (Nasdaq OMX Stockholm 2011a: *Beslut 03/10*)

The recognition is justified on the basis of expectations for profits to increase "within a business cycle". The entity has emphasized that additional information has been provided elsewhere in the financial report. None of these arguments, however, are acceptable to the enforcement body.

> The enforcement body is of the opinion that the disclosures of the annual report of 2009 do not fulfill the requirements of IAS 12 ("other convincing evidence") considering that the Entity, in contrast to its goal, has reported losses during several years. Information provided in the operating report cannot be seen as a substitute for information in the annual report without any references being made. (Nasdaq OMX Stockholm 2011a: *Beslut 03/10*)

The other enforcement decision concerning IAS 12 and the requirement of "convincing other evidence" published the same year (Nasdaq OMX Stockholm 2011b: *Beslut 05/10*) has a similar focus. That decision targeted a entity that reported losses during the previous two years, but is still recognizing a deferred tax asset for carryforwards. The entity concerned has in communication with the enforcer claimed that the previous losses were "non-recurring events" due to "a major down turn in the business cycle resulting in restructuring costs". The entity also argued that the forecast relied on in impairment testing indicates future profits. This enforcement decision accepted in the end the argument for recognition, but still criticized the entity for insufficient disclosures on this matter.

The comments on IAS 12 in the later enforcement reports are rather brief in comparison to the previous year's comments. In the preliminary letter reporting on the 2011 enforcement activities, IAS 12 is only mentioned in relation to insufficient disclosures on the amounts and due dates of unrecognized tax loss carryforwards (referring to IAS 81(e)). (Nasdaq OMX Stockholm 2011f, p. 1.) This criticism is repeated in the enforcement

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report published in the end of 2011. That report also mentions some additional disclosure requirements (referring to IAS 12:81(e),(g)). (Nasdaq OMX Stockholm 2011g, p. 22.) In 2011, there were no public enforcement decisions concerning IAS 12.

The preliminary enforcement letter of 2012 remarks again that the amounts and due dates of unrecognized tax loss carryforwards must be disclosed. It also comments that “disclosures are missing regarding the circumstances that motivate recognition of deferred tax assets” (referring to IAS 12:82 and IAS 1:125) (Nasdaq OMX Stockholm 2012a, p. 2.) The full enforcement report published later this year makes only a brief remark on disclosure requirements. (Nasdaq OMX Stockholm 2012c, p. 25.) No enforcement decisions regarding IAS 12 was published that year.

6.5. Two new articles and a letter from SEAG

After the publication of the 2010 enforcement report, the accounting policy group of the association of the audit and accountancy profession once again commented upon statements made by the enforcer. The comments address several different accounting issues, including the area of tax loss carryforwards. A letter dated January 21 2011 was sent to the enforcer, communicating some opinions of FAR. This letter was intended to form a basis for an upcoming meeting between the accounting policy group of FAR and the enforcer, which was held a week later, on January 28. (FAR 2011)

Subsequently, the main points of this letter were made public in an additional *Balans* article, published in the spring of 2011. The article criticizes the enforcement body for overstepping its enforcement duties by pursuing issues not supported by the IFRS regulatory framework. Principles based accounting standards, in particular, were seen as allowing for several interpretations, and the article argued that it was inappropriate for the enforcer to favor any one of these. Like the article of 2009 (see Arnell and Janzon 2009), this argued the importance of preserving the IFRS as a “principles based” accounting standard.

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> The enforcement activity report contains many important and well-grounded messages to the listed firms and their auditors. But in the report, there are also a number of claims, interpretations and formulations that we have some concerns about. In the enforcement report, there are generally few explanations supporting arguments on missing disclosures. This may lead the reader to make incorrect and generalized interpretations based on the report. As the IFRS is a principles based standard, there may sometimes exist several, fully reasonable, interpretations on the same issue. The enforcement body often uses expressions as "is of the opinion" where one of several possible interpretations is chosen, or where the enforcer wants to add a requirement in addition to what will follow from applying IFRS. We claim that the report should only include conclusions arising from the monitoring of financial reporting and shall not include acts of standard setting. (Abrahamsson *et al.* 2011)

The enforcer is criticized for adopting a "rules based approach" in relation to the accounting standard. This is inappropriate, according to the authors, as judgment is seen as necessary to determine whether the accounting issue may come to impact economic decision-making or not. If the enforcement body criticizes minor disclosure concerns, this increases the risk of creating a disclosure overload within the financial reports.

> We are critical of the enforcement body's adoption of a rules based approach in its interpretation of accounting standards. That an item of goodwill is material does not in itself imply that criticism should be raised as soon as any of the very detailed disclosure requirements of IAS 36 are not fulfilled. An overall judgment must always be made based on the character and extension of the shortcoming and whether these may impact economic decisions of users. The enforcer's definition of a material disclosure may render the financial reports unnecessarily dense with a risk of material information drowning in immaterial information. (Abrahamsson *et al.* 2011)

In relation to tax loss carryforwards, the enforcer's statement of IAS 12 does not contain explicit time limit for when future taxable profits must occur to allow for a deferred tax asset to be recognized, and Abrahamsson *et al.* agree. Despite this, they argue that the standard requirement prevents recognition of a deferred tax asset in cases when future profits are expected only several years in the future because entities will not likely be able to produce "convincing other evidence".

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> We share the opinion that IAS 12 provides no explicit time limit for when carryforwards might be used that would affect the recognition of an asset. However, we want to emphasize that an entity that has reported losses during the recent years has to provide convincing evidence that taxable profits will be generated in order to recognize a deferred tax asset. IAS 12 also includes a threshold for when a deferred tax asset should be recognized, i.e. this is not solely a measurement concern. The enforcement body claims that equivalent criteria shall the applied in calculations of cash flows for goodwill impairment testing as for recognition of tax values of carryforwards. Often, impairment testing of goodwill is based on perpetual cash flows. To base the recognition of deferred tax assets on cash flows expected in a distant future is questionable, taking into consideration that this in many situations will require convincing evidence on future taxable profits. Normally, this kind of evidence is difficult to generate for a distant future. (Abrahamsson *et al.* 2011)

The publication of the *Balans* article was later on countered by a response in the same journal. In this article, Peter Malmqvist (a financial analyst who was also engaged as an enforcer with the task of scrutinizing quarterly reports) expressed disagreement with the opinion of the accounting policy group of FAR on two different accounting issues, including tax loss carryforwards. He concluded that, contrary to the accounting policy group, it is "self-evident" that there should be a similarity in the time horizons applied for assessing goodwill and for assessing deferred tax assets. Further, he concluded that the use of limited time horizons for deferred tax assets is making reported tax rate unreliable when making forecasts. The use of time limits will create a lower degree of recognition of deferred tax assets than otherwise could be the case, resulting in use of unrecognized carryforwards. This accounting treatment, he argues, distorts the reported tax rate, as it will render the reported tax rate artificially low.

> In the financial reports for 2009, I have observed that more than half of the scrutinized firms reported a tax rate deviating from what may be considered a tax rate durable in the long run (25 – 37 percent on profit or loss). For the latest ten years the conclusions are similar – the reported tax rates cannot possibly be used for forecasting purposes. A predominant problem is that firms are avoiding recognizing deferred tax assets on losses. This may appear to be wise and prudent, but instead creates a lack of prudence in upcoming periods. The using up of tax loss carryforwards, which has not previously been recognized

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> as a deferred tax asset, will result in a reported tax rate that in the long run will be too low. The enforcer criticizes certain firms for limiting the measurement of deferred tax assets to some years, which will lead to the consequence described. The enforcer argues that criteria and horizons should be utilized here equivalent to those used in the calculation of cash flows for goodwill impairment testing. That, I believed, is self-evident. The three IFRS experts suggest it to be questionable 'to base the recognition of deferred tax assets on cash flows expected in a distant future'. This type of accounting will lead to that the reported tax rate will not be possible to use for forecasting purposes. (Malmqvist 2011)

Like FAR, the preparer's association SEAG also reacted to the content of the published enforcement reports. A letter sent from SEAG to the enforcer on February 24 2011 identified a number of issues as problematic. Similar to the criticism expressed by the accounting policy group of FAR, SEAG, too, criticized the enforcer for issuing statements regarded as "interpretations" of the IFRS. Although it was acknowledged that the enforcer could be forced to interpret the standard in order to enforce it, SEAG still argued that it is inappropriate to favor one interpretation where several interpretations are possible. The preparer's association also highlighted the risk that this kind of enforcement makes the IFRS less "principles based". To counteract this, the letter seeks to initiate "a dialogue between the enforcer, the entities and the users of financial reports". In addition, it remarks that the enforcement body sometimes appears to strive for "proactively increasing the quality of information". Although this is seen as "praiseworthy", there are at the same time doubts whether this should really be a task of enforcement, given that information can almost always be improved. (Swedish Enterprise Accounting Group 2011a)

As there had been earlier, in 2013 there were discussions within the accounting policy group of FAR on whether to write a letter in order to convey FAR's views on that year's enforcement report as well. There was a suggestion that an e-mail could be sent, informing the enforcer that it was the opinion of FAR that this year's report was fairly good, but that there were still deemed to be some minor issues left to consider. In the end, this idea was dropped, and there were no contact. At this point in time, it was

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no longer seen as an alternative to write a *Balans* article as the enforcement report was considered to be of a decent quality.

> There was a decision within FAR that we did not find the report to be of such low quality. We felt that we could live with the concerns there were. We chose our battles, so to speak. […] It does take quite a lot of energy to write things like these [articles in *Balans*], and to anchor them. We felt that we had loads of other things to work with, so we did not do this. […] There were some details that were not as well expressed in relation to pensions. (Interview 13)

Thus, the "standard setting" of the enforcement body as a diminishing problem over the years and saw the enforcement report as containing fewer "errors" today than previously. It was regarded as a possibility that the letters sent from the association of the audit and accountancy profession could have contributed to the development.

> [The enforcement report of 2012] was quite clinically written. It was brief. My opinion is that it did not include any major errors. Also the previous year was quite good. Some two, three years ago, I thought that there was too much standard setting. There were a lot of opinions, which I did not agree with. I think that has been reduced. This could be due to the letters [of FAR]. I don't know. Or, they are investing more time in the writing of the report. (Interview 3)

Another interviewee also stressed the communication between the association of the audit and accountancy profession and the enforcer as a possible reason the enforcement report had "improved". He concluded that he himself currently is less "engaged" in reading the enforcement reports than he was in previous years. The report is found less interesting as the views of the enforcer and the rest of the "accounting industry" have aligned.

> I see that it [the enforcement report] has improved over time when it comes to things I disagree with. And I could assume that this is an effect of the letters sent by the accounting policy group of FAR. Maybe we have started to get along, the enforcement body and us in the industry, the accounting industry. I would guess that it would be more difficult to find things that I disagree with nowadays. (Interview 12)

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6.6. Emerging accounting practices

Tax loss carryforwards is an accounting issue that accountants commonly describe as an issue of "judgment".

> In practice, when my accounting expert colleagues do this, they say it is a matter of judgment. As a preparer you will have to make a judgment, and in making this judgment you will have to consider all facts and circumstances, for example: What is the situation of the entity? How did the most recent years look? What are the expectations for the future? What is the size of the carryforwards? What is a foreseeable future in this industry, with this risk situation, and this competition situation? Within the frames of all this, you have to make a judgment. Exactly how to make this judgment, and which factors to deem more important than others, nobody knows for sure. Therefore, this is an issue where there will always be a discussion. (Interview 18)

Several interviewees see tax loss carryforwards as an issue that is difficult to make generalizations from one entity to another, as the conclusion will always be dependent on the circumstances of the specific case and because this is an issue of delineations. Because the conclusions are dependent on the circumstances of the specific cases, the enforcement decisions published by CESR/ESMA in the area are unreliable guides for assessing carryforwards of other entities.

> [The standard] is difficult. […] You will always get into issues of delimitations. Sometimes it is easy, when the future looks gloomy. But sometimes there might be some indications, but are they sufficient? Nothing is really stated in the standard. […] [It could], for instance, be that the there is a vast number of new orders the next year, or if you could show that you are able to stick to your budget during the first three months. At least you would require profits to be made. But the issue is: Where should you draw the boundary? You would always have to look at the specific case. (Interview 22)

Some interviewees perceive IAS 12 to be "vague" or "ambiguous", and describe the expression "convincing other evidence" as difficult to interpret. An interviewee characterizes this as an odd expression within the IFRS, which could preferably be replaced by the more commonly used "proba-

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ble". Others describe the word "probable", as it is now used within the standard, as difficult to interpret in itself. This concept is related to the concept of "going concern", which in turn is taken as implying that only a "foreseeable future" may be taken into account in judgments made.

> There is no general definition of "probable" in IFRS. It is defined in IAS 37, and maybe in some other standard, but I doubt that it is defined in IAS 12. I do not think so. But it is related to "going concern". Also in modern time, I have heard people saying: "As this standard is working with undiscounted values, and we have a going concern, it does not matter how we look on this 'probable'. As long as you earn one SEK a year, during a sufficiently long time, you will be able to use up the carryforward. It could take some 350 years, but nevertheless." But I always use to argue that this is not the meaning of "going concern". In relation to going concern, there is something written about "the foreseeable future", i.e. there is a period in time that shall be taken into consideration. So you cannot reason in the way I describe here. But there has been a failure in taking this into consideration within this standard. (Interview 18)

Still others refer instead to a "foreseeable future" as a concept that was in use before the adoption of IAS 12. Then, the concept was interpreted as a time period between three to five years. Applying this time limit is seen to be more "reasonable" than applying an eternal time horizon. The use of time limits is seen as increasing the certainty of the accounts, avoiding too much of "expectation values" in the annual reports. And this approach is seen as a European approach to accounting.

> I believe that we in Europe only recognize [an asset] if we consider it certain that we will have the asset, there is a higher certainty than if you have "more likely than not". I believe that we in Europe, maybe with the exception of the UK, are keen to consider the creditors foremost in our accounting. (Interview 7)

As the standard leaves "room for interpretation", there are actors that argue it results in divergent practices and in enforcement difficulties. Moreover, as this is an accounting issue concerning "a forward-looking judgment", there is no "correct" answer to reach.

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> The problem is that even if you could criticize something, it is difficult to reach the correct answer, given that this is a forward-looking judgment. It is not that simple to do. So of course, the enforcement body might have an opinion, but the issue is: At what level will the criticism be directed? How much substance is it behind it? Is it even possible to criticize this issue on a general basis? It is possible to make general conclusions about the interpretations of this standard or not? If the standard is vague, because it is a principle, could you then specify it further? [You will have to conclude] that there is room for interpretations and that practices therefore are divergent. (Interview 8)

This interviewee concludes that as long as there is a range of possible interpretations, and as this is an issue where the firm must make judgments, it is difficult for an enforcer to conclude that the company has actually done something wrong. Another interviewee stresses that this is especially difficult when the assessment has to be made retrospectively. Then, knowledge about events after the balance sheet date ought not to be taken into consideration.

An enforcer concludes that whereas enforcement questions are also asked about recognition and measurement of carryforwards, the final criticism will only become directed towards the insufficiency of disclosures.

> We ask questions and in some cases I have even asked for an overview of how the calculations have been performed, and over which years they range. This year, we have one case where we will come to say: "We will accept what you have done here, but you should have provided further disclosures. Without these disclosures, it is not possible to understand why you haven't recognized all carryforwards." Sweden is a special case here because there is no limitation on the time for carryforwards. If an entity says: "We assume that we will make profits into eternity". Then all carryforwards should be recognized. (Interview 38)

A wish is expressed that the accounting standard had provided some examples of "convincing other evidence", even though the manuals of the Big Four firms are seen as helpful in the interpretation of the standard.

> It would have been a good thing if they had provided some examples of what "convincing evidence" is. We read our [Big Four firm's] manual. We also read

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> the manuals of the other Big Four firms, but primarily we have to relate to our own guidelines, so that [our firm] has a shared view. (Interview 22)

The views of the Big Four, and especially of the accounting specialists in these firms, are described as important in the establishment of accounting practices. Actors emphasize that no individual accounting firm can pursue an opinion successfully, but the creation of consensus will matter.

> So in practice, it will be the experts of the larger firms, especially in the U.S., that will say: "If you can use up this during three years, then you may recognize an asset." Three years. But the standard does not say this. Not at all. Three years will be a handy rule of thumb that people in practice, right or wrong, will apply. And of course, if the center of excellence, the professionals you may pose questions to, at [one of the Big Four firms] is pursuing this treatment, it will affect how the accounting experts will convey messages to the entities. In that sense, it will affect practices. But it can't live on solely because one firm is pursuing it, but there needs to be consensus in how the firms look at this. So there will be interplay between KPMG, Ernst & Young, Deloitte and PWC and also others, at the expert level, both nationally and internationally, on how to reason in these kinds of difficult issues. (Interview 18)

Some actors stress that it is important to include as well the enforcement body in the creation of shared views of how to read the accounting standard. Talking about FAR's communication with the enforcement body, an interviewee emphasizes the importance of creating shared understandings.

> We thought that the enforcer possibly had not fully understood some views and some issues of the reports, and then we wanted to talk, or to understand each other. How did you reason? If we represent the auditing industry, we have to, as advisors in accounting, give advices that align with the views of the enforcement body. When we do auditing, we have to understand their views. (Interview 15)

Although the issue on whether there should be written additional guidance on this topic has been discussed, both within the Swedish accounting standard setter and on the European level, within EFRAG, the preference for keeping the standard "principles based" has over-ridden such a development. Preparers, especially make clear that there is no need for further

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guidance on this issue, but rather express a wish for preserving a "principles based" standard.

> We are generally positive to keeping this principle, or keeping the standard principles based, not turning it into the American system. […] You will never be able to cover all the variations anyhow. If you write overly detailed standards, you will only produce a lock-in because new things will always turn up that are not described. Then the issue will be: What do you do then? (Interviewees F and G, interview 9.)

Contrary to the statements referenced above, several preparers describe this accounting standard as unproblematic to apply.

> I can see the problem if you have large amounts. Then, at some point in time it is not reasonable to recognize even more. […] But I don't know. We have not thought about this, but convincing evidence is rather simple! It is only to look at: What profits will you make and how large are the tax loss carryforwards you have? Then you will see: Well, these carryforwards will be used up within two years! (Interview 31)

The question is seen "solved" as a practice has already become established in relation to this issue, and as this issue has already been well thought through. This implies that there exists today an understanding of how to treat the standard. The leading suggestion is that the issue is taken care of by tax specialists engaged in producing tax declarations, or working at the tax department. Some interviewees clearly indicated that taxes were not an issue that was managed by the group accounting department, but rather by another department (the group tax department) taking care of all tax related issues. Within the accounting firms, the issue is usually managed by in-house tax specialists in the auditing teams.

> Well, I have not been personally [involved in the issue]. It is like this, the tax accounting… We have a group tax department. They manage these things about recognition and deductions and so on. It is possible that they have been looking into these things. I do not recognize it. Actually, I have not been a part of this myself. So I cannot answer. (Interview 20)

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In relation to the issue of time horizons regarding future taxable profits, Swedish accountants in 2013 appeared to hold two different views on practice. At that point in time, some argued that using time limits was a part of previous Swedish practices, even though there were no corresponding time restrictions in the Swedish tax laws.

> Previously, in Swedish law practices were an important aspect. In IFRS, on the contrary, it is written that practices are not allowed to matter. I find that strange. I would much rather see that we still applied some kind of practice. But on the other hand, you could question whether practices still do not matter. […] The alternative would be that we would end up in some kind of U.S. GAAP situation where we would have an immense number of statements. Therefore, I am, almost by definition, against IFRIC statements. I don't remember how many they have published as yet, it is not that many, but as the years pass by, you will nevertheless end up in a U.S. GAAP situation. (Interview 27)

From this reasoning, the publication of IFRIC statements is an unwanted help in the applying of accounting standards. Although IFRIC is acknowledged as restrictive in accepting issues to its agenda, IFRIC statements about why issues are not put on the agenda will nevertheless become regulatory statements. In this sense IFRIC is argued to add regulations to the accounting standard despite the communicated intention of avoiding this.

> It could also be claimed that IFRIC is making statements on additional issues, insofar that they are keeping issues off their agenda. The reason why an issue is rejected becomes an interpretation in itself. […] They formulate it in such a fashion that you should understand why they are not accepting the issue, so that it almost turns into a statement. […] You have to read their non-statements as much as you have to read their statements! (Interview 27)

However, most interviewees argue that the use of time limits was not only a part of previous accounting practices, but that it remains a part of current practices. Some suggested that they use a rule of thumb ranging from three to five years, although there might be circumstances making it necessary to use longer time frames in the making this assessment. Other preparers explained that the current business plan is used as the basis for making the

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recognition assessment, implying that the time horizon considered will be equal to the number of years of this plan. This also effectively limits the time period taken into consideration to between three to five years. The time limit was described as a "practical rule of application", which provided an alternative to discounting the future tax savings although it is acknowledged that discounting is not a part of IAS 12.

However, some actors of the regulatory space argued strongly against seeing the time limits as an implication of the accounting standard. There were concerns in particular about enforcement bodies coming to see the time limits as a requirement. For instance, an interviewee expressed discontent with a European enforcement decision (most probably the decision published by Fondsrådet, 2006, later commented on by Rundfelt in *Balans*, 2007)[18] where IAS 12 is understood as being interpreted in a too narrow fashion. He questioned the use of a fixed number of years as a rule of thumb. Instead he argued important to make room for judgments, and for these to be trusted. He saw restrictions of possibility to make judgments freely as contrary to the objectives of IAS 12. The enforcement decision requiring an explicit time limit was seen as incorporating the time limit of the U.S. GAAP into the interpretation of IFRS.

> What I know is that there are things in our manual about the U.S. GAAP, and then I guess that has transformed into a guide for understanding how the IFRS should be interpreted. [...] If you just had this book, the standard, you would never come to the conclusions of ESMA, or of the national enforcement body, given that those were the criteria to use to come to this conclusion. (Interview 15)

Similar arguments were made also by others, concluding that the European enforcement decision is an "interpretation" of the IFRS. Although practical interpretations of how standards should be applied might develop, it was seen as problematic that an enforcement body issues views on this matter.

[18] Within the relevant period in time, there are two decisions concerning deferred tax assets in the CESR's extracts of enforcement decisions. However, neither of these stipulates a specific time limit for when the future profits will have to occur. (See further CESR 2007: *Decision ref.EECS/1207-04: Deferred tax asset*; and CESR 2008: *Decision ref.EECS/1208-10: Deferred tax asset.*)

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> I know that we felt that is was entirely wrong by CESR to issue an interpretation, and to set a limit in time. […] Principles and expressions within IFRSs, such as "material", "probable" or "virtually certain", are subject to interpretation. Some accounting firms, and the entities as well, have developed percentages or time spans and so on to turn these words and expressions into something that is easier to manage. But we believed it to be entirely wrong by CESR to force such a limitation on all entities. We believe you should keep the principle as it is described in the standard. This was something that was discussed, and talked about, which people did not felt was a good thing. (Interview 29)

A Swedish enforcer argues that because IAS 12 supplies no explicit time limit using such a limit (rather than not doing so) is seen as an enforcement issue. From the viewpoint of this enforcer, the questioning of time limits has apparently led to a change of accounting practices as it had become less common to write about a time limit in annual reports. The issue was however regarded difficult to enforce whenever nothing is explicitly written about application of a time limit. As the formulations of the annual reports are regularly similar to the formulations of the accounting standard, it is difficult for this enforcer to know whether the entities are applying time limits. The annual reports fail in clarifying this.

> What we will react to foremost is when a description is written in a fashion where we might assume that they have used a very narrow time frame. It is a tricky issue because if you write more or less what is written in the standard, it might still be a limited period in time. You cannot tell from reading the annual report because this will show the best estimate made of the possible use. (Interview 38)

There is a discontent common amongst preparers that resembles the discontent Malmqvist (2011) identified amongst financial analysts which stems from the inconsistency between time horizons applied for goodwill and for carryforwards (as mentioned in Nasdaq OMX Stockholm 2010b, p. 13). It is not deemed reasonable that these two future looking assets are treated differently accounting wise. For preparers it is "strange" to write down deferred taxes earlier than goodwill as the expectations about the values of these two assets are interlinked.

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> The strange thing is that the deferred tax [asset] will be written off as impaired sooner than will goodwill as the rules are as blunt as they are. Or blunt? They are prudent when you have made losses. Then you are not allowed to recognize deferred taxes unless there is convincing evidence. And for the impairment testing of goodwill, it is only required that future cash inflows are probable. So the entities are really having a hard time accepting that although there will be no write-down of goodwill based on the impairment test, we nevertheless say that they will have to write down their deferred tax assets. They feel that […] this reveals a deficiency. But then it is up to them to explain. And some has done this, stating that as the IAS 12 rules being what they are; we are now making a write-down of our deferred taxes. The requirement for convincing evidence implies that it is not sufficient with a probability above 50 percent for being able to use the tax loss carryforwards, but rather it is almost up to… you have to be certain about bringing this home either through a contract or something else, implying that there is almost no remaining uncertainty. (Interview 13)

The problems are attributed to IAS 12 being out of date as an accounting standard. Whereas most parts of IFRS are portrayed as modernized, IAS 12 is not. For instance, one perceived problem is that discounting is not allowed within IAS 12, although this is contrary to other IFRSs.

> [The standard] is so prudent and sometimes it is a bit blunt, having the deferred taxes without discounting and so on. Everything else in the IFRSs is more modern, but it feels like they have forgotten to do something about IAS 12. (Interview 13)

Others see IAS 12 as having changed the thinking around deferred taxes, allowing for less prudent ways of reasoning. While these assets were previously better left outside the balance sheet, these are today recognized to a larger extent.

> Before IAS 12 came in force, the perceptions were that tax loss carryforwards could be a good thing to have, but that they should not show up in the balance sheet. That was the philosophy of most auditors. We have this, but we ought not to value it. We shall be prudent because you never know what you can really use. But that was taken away by IAS 12. (Interview 38)

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6.7. Concluding remarks

In this chapter, we saw how the enforcement body in several enforcement reports addressed accounting issues related to tax loss carryforwards.

In one enforcement report, the enforcement body stated that the accounting standard expression "convincing other evidence" proves difficult to apply. Here, the enforcer did not demand a specific change in accounting practices but rather tried to emphasize the accounting issue as worthy of attention. The statement can thereby be seen as an attempt to formulate this issue as an "accounting problem" because there may have been uncertainties about "compliance".

In addition, the enforcement body criticized partial recognition of carryforwards and argued that time limits should not be used to assess the amount of carryforwards to recognize as deferred tax assets. For both these issues, the enforcement body required changes in accounting practices. In the end, however, neither of these issues were accepted as "accounting problems" within the regulatory space although one of them became a topic of conversations in the context of "compliance".

The enforcement statement on "convincing other evidence" elicited divergent views on this accounting standard prescription. While some actors tended to agree with the enforcement statement, several others instead rejected the problem formulation. Preparers, for the most part, argued that know-how had been developed in how to apply the standard, especially among within-firm tax specialists. However, there had been discussions on how to apply the standard when IAS 12 was incorporated into a Swedish accounting standard. This issue had, therefore, been understood as an "accounting problem" previously although it was not at the time of this enforcement report.

For the other two accounting issues, the enforcer's problem formulation was actively rejected. In a journal article, the accounting policy group of the association of the audit and accountancy profession criticized the enforcer for stating that partial recognition of tax loss carryforwards defensible "only under very specific circumstances". The article argued that this statement ran to counter an IFRIC statement on the issue and counter to the internationally established accounting practices that apply the standard.

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The article's authors, and other actors, criticized the enforcer for publishing "interpretations" of this accounting standard and thus unduly engage in standard setting.

In a later journal article, and in direct communication with the enforcer, the accounting policy group of the association of the audit and accountancy profession also criticized the enforcement body's statement on the use of time limits. The accounting policy group argued that the statement lacked support in the accounting standard as time limits were inherent in the accounting standard's requirement to provide "convincing other evidence" of future profits. Both these articles can be understood as a rejection of this accounting issue as an accounting problem.

In later enforcement reports, there was no criticism directed towards partial recognition of carryforwards. However, the enforcer continued to criticize the use of time limits. In practice, views diverge over whether the time limits actually conflict with IFRS or whether their use may continue. The empirical material of this thesis indicates that the time limits are still in used in practice, but not necessarily written about in annual reports.

In the previous chapter, no regulatory conversations evolved on how to treat the discount rate for goodwill impairment testing. This was also the case for the enforcement statement on the "convincing other evidence". This, too, appears to be a result of earlier regulatory conversations that affected the understandings of the accounting standard. This issue was not an accounting problem because it had already been resolved.

The understanding of "convincing other evidence" as a "specific" rather than "general" accounting issue may provide an alternative explanation for the absence of a regulatory conversation on how to understand this standard. The enforcement decisions are thus not seen as having any general implications for accounting practices, but rather their influence is expected only in the one-to-one communication between an enforcement body and a specific entity. Therefore, the definition of an accounting issue as "a specific issue" creates boundaries for the (possible) role of the enforcement bodies.

For the other accounting issues in this chapter, brief regulatory conversations did evolve, but came rather quickly to an end. In the next chapter, we will see examples on accounting issues for which this was not the case.

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Chapter 7

IAS 19 Revised and "taxes payable by the plan"

In 2011, IASB issued a revised version of IAS 19 *Employee benefits*, which was to come in force from 2013. The revision of IAS 19 brought about a number of changes to the text of the accounting standard. One of these was the explicit mention of taxes in the revised version of the standard. In Sweden, the implications of this accounting standard change were much debated. One question was whether accounting practices had to change because the revision, and if so what changes were required. There was a suggestion that further guidance was needed regarding how the Swedish taxes should be treated. However, it was not clear who the appropriate party was for taking on this task. This chapter investigates the treatment of taxes in accordance with IAS 19 Revised as an example of an accounting issue that received much attention amongst accountants and motivated much discussions, but about which the enforcement body made no statements.

7.1. The accounting-standard requirements

At a time when the earlier version of IAS 19 was in force, IFRIC received a request for an official interpretation on how to treat the special wage tax in accordance with IFRS. In March 2007, IFRIC rejected this request and thus

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keep the issue off its agenda. When doing so, the "issue" was formulated as follows:

> **Special wage tax** The IFRIC was asked to consider whether taxes related to defined benefits, for example taxes payable on contributions to a defined benefit plan or taxes payable on some other measure of the defined benefit, should be treated as part of the defined benefit obligation in accordance with IAS 19 *Employee Benefits*. (IFRS IC 2015: IAS 19-3)

It is possible to regard these taxes as "income taxes within the scope of IAS 12, costs of employee benefits within the scope of IAS 19, or other costs within the scope of IAS 37", and the assessment of how to classify each individual tax was a "judgment" to be made. The following remarks were provided:

> - Taxes paid by a defined benefit plan are included in the definition in IAS 19 of the return on plan assets.
>
> - Income taxes paid by the entity are accounted for in accordance with IAS 12.
>
> - The scope of IAS 19 is not restricted to benefits paid to employees. It includes some costs of employee benefits that are not paid to employees. (IFRS IC 2015: IAS 19-3)

Given the multiplicity of possible taxes that could exist it IASB argued that it was impossible to produce any further guidance beyond the "observations" above within a "reasonable period of time". (IFRS IC 2015: IAs 19-3) Nevertheless, questions of how to treat the special wage tax remained. In a comment letter to IASB's *Discussion paper on preliminary views on amendments to IAS 19* in September 2008, the actuarial association SSA remarked that additional guidance with regards to the special wage tax would be "helpful". (Swedish Society of Actuaries 2008)

In Sweden, the Swedish standard setter dealt with the question of how to treat two specific taxes. The SFRB, the setter had issued UFR 4 *Redovisning av särskild löneskatt och avkastningsskatt* [*Accounting for tax on returns and special wage tax*] to supplement IAS 19 to provide guidance on how to

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treat these two Swedish taxes. In accordance with UFR 4, the tax on return would be accounted for as an expense in each reporting period, i.e. there shall be no provision recognized for this tax. The tax on return could be taken into consideration when the expected return on plan assets was calculated. When a difference was found between the pension expenses of the reporting period calculated in accordance with IAS 19 and the sum of the pension expenses of the reporting period for the legal entities, an asset or a provision for the special wage tax should be recognized in the balance sheet. If IAS 19 expense was the higher figure, a provision was recognized. On the other hand, an asset was recognized if IAS 19 expense instead was the lower figure. When there was a provision, it was not allowable to discount the provision to its present value. If actuarial gains and losses were deducted against equity, the effect of the special wage tax should also be deducted. UFR 4 was withdrawn when IAS 19 Revised came in force. (Swedish Financial Reporting Board 2012a)

In the revised IAS 19 (issued in 2011 and applicable from January 1, 2013) the description of what might be "Actuarial assumptions" included a long list of different areas, such as demographic assumptions (IAS 19 Revised:76a) including for instance mortality (IAS 19 Revised:76a(i)) and early retirement (IAS 19 Revised:76a(ii)), and "financial assumptions" (IAS 19 Revised:76b) including for instance the discount rate (IAS 19 Revised:76b(i)) and "taxes payable by the plan" (IAS 19 Revised:76b(iv)). Specifically, it is only those taxes that are related to "service before the reporting date or on benefits resulting from that service" that can be considered as actuarial assumptions.

Taxes "payable by the plan" that have not been incorporated within the pension liability must instead be taken as a reduction to the "return on plan assets".

The *return on plan assets* is interest, dividends and other income derived from the plan assets, together with realised and unrealised gains or losses on the plan assets, less:

(a) any costs of managing plan assets; and

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> **(b) any tax payable by the plan itself, other than tax included in the actuarial assumptions used to measure the present value of the defined benefit obligation.** (IAS 19 Revised:8, bold face in original.)

Under the heading "Remeasurements of the net defined benefit liability (asset)" the treatment of taxes is again mentioned.

> 130 In determining the return on plan assets, an entity deducts the costs of managing the plan assets and any tax payable by the plan itself, other than tax included in the actuarial assumptions used to measure the defined benefit obligation (paragraph 76). Other administration costs are not deducted from the return on plan assets. (IAS 19 Revised:130)

7.2. "Taxes payable by the plan" as an accounting problem

Given the final version of IAS 19 Revised, the issue of how different kinds of taxes should be treated appears to have been immediately regarded as an accounting problem. Previously, IAS 19 had not mentioned taxes (or how they should be accounted for in relation to employee benefits), but the revision made clear that taxes should be taken into consideration in the measurement of the pension liability. Although there could have been a question of which taxes should receive this consideration, early agreement formed in Sweden that two different taxes warranted discussion: the special wage tax and the tax on returns.

> The new standard stated that a provision ought to be recognized for taxes. This was written quite vaguely because there was an awareness of that the taxes might be coming in many different shapes in different countries. And in Sweden, quite immediately the tax on returns and the special wage tax were identified as the relevant taxes. (Interview 32)

The lack of guidance was not seen as a deficiency in the standard because the "principles based" nature of the standard was taken as implying that these kinds of matters will be dealt with locally. However, making a local interpretation called for comparisons with other countries. The bases for

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such comparisons were whether there were similar taxes elsewhere, and if so how they were treated. These are difficult questions because taxes that might at first appear as "similar" could turn out to be different on closer comparison. Therefore, a question that received a great deal of attention was whether any party could issue additional guidance on how to treat the special wage tax and/or the tax on returns.

The crucial issue for the tax on returns was to understand what kind of tax this really was. Was it a tax related to the pension payments or was it a tax related to the returns? In the first case, the effect of the tax would be to increase the liability, and in the latter, the effect would be to reduce the returns. If there could be an agreement on how to understand this tax, then the accounting in itself was not seen as problematic.

> It is not an issue specific to Sweden that there are taxes. But nevertheless, for the tax on returns, with the rules surrounding this, there has to be a shared view. What kind of tax is this? When a shared view has been achieved, then the accounting is not a problem. (Interview 27)

In relation to the special wage tax, primarily two different issues were discussed. One was whether the special wage taxes should be incorporated into the pension liability. In this case, the apparent alternative was to recognize a separate provision for the special wage tax elsewhere in the balance sheet. This had been a common accounting practice before the adoption of IAS 19 Revised. Although many actors argued that the tax should now be a part of the pension liability, not everyone considered this a necessary implication of IAS 19 Revised. Some argued instead that also other interpretations could be valid as well. An interviewee described the standard as delegating the decision to preparers and auditors, and he argued that the text of the accounting standard was not "sufficiently clear" or "sufficiently detailed" to state that one way or the other would be "wrong".

> My interpretation is that you should include this in the IAS 19 numbers. But if an entity approached me and argued: "We have discussed this with our auditors, and we will continue as before. IAS 19, that is only pensions. We have a tax provision, but we will locate it elsewhere in the balance sheet." I would not say: "No, you are wrong. I will not sign my actuarial report. I refuse to approve

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> with the figures." I am not of the opinion that IAS 19 provides clear enough answers [to enable that]. (Interview 37)

In a similar spirit, the statement of the Basis for Conclusion, which explains that further guidance on how to treat the taxes will not be provided as this issue is best resolved between the preparing entities and their auditors, is also read as an indication that different ways of accounting can be in compliance with IAS 19.

> If you read the Basis for Conclusion: It is explicitly stated that there is no intention of going into issues regarding taxes that are specific for a company or for a country, but rather this is something that ought to be discussed amongst entities and auditors, or something like that. [I do not remember exactly] how they formulate this, but it is expressed very clearly in the Basis for Conclusion, that IFRS will not regulate this, but that it must be discussed, and that it *should* be possible to reach conclusions on this matter. (Interview 37)

The second issue discussed in relation to the special wage tax was how to measure an item for this tax. This issue was independent of the discussion of whether the special wage tax constituted a part of the pension liability or not, because the value, once arrived at, could be accounted for both as a separate item or as a part of the pension liability. Earlier, a provision for the special wage tax had commonly been calculated as the rate of the special wage tax (i.e. 24.36 %) multiplied with the difference between the Swedish pension liability and the old IAS 19 liability. The question was now whether this simplified method could still be kept or whether a more precise measurement method was required.

This issue attracted much attention amongst some preparers, who devoted many working hours and meetings to considering it. A number of meetings took place in the forum of SEAG. There was a commonly held conviction amongst preparers that the simplified method of previous practice could remain in use despite the change in the accounting standard. They saw this as the most "practical" solution, given that this method provided, in their view, a "fair presentation" and compliance with the standard. This was also the view of SEAG.

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However, not all preparers felt it necessary to participate actively in the discussions of this accounting issue. Some preparers explain that they awaited the establishment of a practice, having the intention to follow this practice, whatever it turned out to be. Given that they saw the issue as having no economic impact, these preparers tried simply to understand what everyone else would do. The SBA, for instance, was a tool for understanding the accounting of others and for ascertaining a common interpretation of the accounting standard. Even among preparers who hoped that the simplified method would become the established practice, no efforts were made to impact the actual outcome. Instead, they waited for guidance from the SFRB or from the actuarial association, the latter because the measurement of pension liability is usually a service purchased from an actuarial firm and thus an actuarial concern rather than an issue for the preparing entities.

> That competency, we do not have. We do not calculate, I don't think that anyone… I should not speak for the others, but at least we do not calculate our IAS 19 liabilities on our own. Instead, we have external actuaries do the calculations. Therefore, when it comes to the technical issues of the calculations, we accounting experts have not so much to contribute. Rather, it will be up to the actuaries to clear things up, and to make a statement on how to do this. (Interview 35)

7.3. The possibility to issue statements

The pension committee of the actuarial association SSA initiated an investigation on the issue. They produced some drafts on the issue that were subject to comment by the Swedish association of the audit and accountancy profession, FAR, by the preparers association SEAG and by the Swedish standard setter SFRB.

FAR, especially, expressed in their comments discontent with the drafts formulations. During the ongoing work of the pension committee of SSA, FAR made a request to the SFRB, urging the standard setter to make a statement on the issue. However, the SFRB was uncertain whether the taxes in question could really be seen as "specific to Sweden". This was decisive because the SFRB could only make statements on exclusively Swedish

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concerns. An interviewee concludes that it was would have been preferable for SFRB to have taken on this issue as this was an interpretative question where the international standard setter was not likely to make a statement.

> I think it is appropriate that SFRB enters with their unique competence about Swedish circumstances to make an interpretation rather than IFRIC doing so. Of course, it would have been a good thing if IFRIC would have dealt with the issue, but I doubt that they ever had the intention of doing that. And you have to trust SFRB to do nothing that would counter the IASB. Just as IFRIC statements are interpretative statements, statements from SFRB can also constitute some kind of interpretations. I know that the major concern for SFRB is to carve out whether exceptions from IASB ought to be made, for instance due to the linkage between accounting and taxation, or due to the Swedish Annual Accounts Act or something like that. That is their primary [duty]. So there might be them who argue that SFRB should keep to that duty. But I believe that there is a value in SFRB entering these kinds of issues as well. (Interview 22)

Having been approached by FAR with a request for making a statement, the SFRB in turn returned the issue to the pension committee of SSA, asking whether the actuarial association intended to provide a statement on any of the Swedish taxes. At the same time, the SFRB communicated to the committee that they, as standard setters, did not intend to publish a statement on any of the taxes under discussion. As the pension committee was already working on the issue, it signalled that they would publish statements for both taxes in due course. However, it was considered important to gain input also from auditors. This was considered vital as the issues were understood as accounting issues, and thereby seen as being outside actuarial competency.

> We had not gotten very far within the committee, but then we received reinforcement. […] I guess we believed it was wise to include an auditor in the committee because you have to distinguish between knowledge about auditing and accounting and the competence of actuaries, which is to calculate the liability of, for instance, the special wage tax. How it shall be accounted for is not our specialty. (Interview 32)

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After this "reinforcement", the pension committee made suggestions for recommendations on both taxes. In the beginning of 2012, an article was published in *Balans* presenting the SSA pension committee's suggestion on how to account for the Swedish taxes in accordance with IAS 19 Revised. The article was signed not only by actuaries but also by some auditors. The article emphasized that IAS 19 differentiates between two types of taxes: 1) taxes related to earnings made before the end of the reporting period, and 2) other taxes. The first type, the article argued, should be included as a provision, with the yearly expense of this item reducing profits. It argued that the second type of tax should be taken as a reduction of actual returns on plan assets, being reporting in other comprehensive income. It was suggested that the tax on returns should be accounted for as the first type of tax to the extent that it was unfunded and as the second type of tax to the extent that it was funded. (Jansson *et al.* 2012)

Moreover, the article proposed that the special wage tax was the first type of tax, i.e. a tax related to the earnings where pension rights earned before the end of the reporting period should be accounted for as a part of the pension liability. However, it also suggested that a present value of the provision for the special wage tax should be calculated only with regards to unfunded or partly unfunded plans. For funded plans, there was no need to recognize a provision, given that the returns on funded assets should be assumed to cover all future payments of pension rights as well as tax on returns. (Jansson *et al.* 2012)

Thus, the argument for both these taxes identified a difference in the accounting, based on whether the pension plans were funded or not. This solution was however not seen as entirely "elegant" and even "administratively quite bothersome" (interview 32) for those performing the calculations, as the degree of funding could normally be expected to vary across time. The solution was also considered too "theoretical".

> There was a risk of an utterly theoretical solution. […] How much time and resources should you devote to ensure that something is exactly right, when it really will be exactly wrong, as these are payments that will be payable in some 20 years' time. Plenty of things will happen before the time of the payments. What would be the purpose of playing it too subtle when the figure the next quarter, or the next year, nevertheless will be an entirely different one? (Interview 27)

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The suggestions of the article did not become an official recommendation, but the work in the pension committee instead continued. When the final statements from the pension committee of SSA appeared to be delayed further, other parties revisited the option of publishing guidance on how to treat these Swedish taxes. In particular, representatives of FAR argued that it was important that someone publish a statement on this issue. If no other party would issue a statement, FAR was open to taking on the responsibility.

Similarly, although the SFRB initially had stated that they would not publish standards on any of the taxes discussed, their investigations of the issues also continued. The view eventually formed within SFRB that the tax on returns really had nothing to do with earnings, but that it was more appropriately seen as a reduction of assets. That the tax on returns was payable regardless of whether the pension liability was funded or not was understood as a way to create equality between those choosing to have a pension fund and those choosing to have an unfunded solution. In the latter case, the tax was paid based on a hypothetical value of plan assets. There had also been further investigations of the questions of whether the tax on returns and the special wage tax were "specific to Sweden". A request had been furthered to a number of countries, searching for taxes comparable to the Swedish taxes. No tax was found that resembled the tax on returns, and this was judged to be "relatively unique" for Sweden. This conclusion enabled a SFRB statement to be made. (SFRB 2012b) A meeting was held between members of the SFRB and members of the pension committee of SSA. The SFRB members communicated that the Swedish standard setter had changed its intentions and would make a statement regarding the tax on returns. At the meeting, the SFRB members also presented their suggestion for a new recommendation. The actuaries saw the solution presented as "very reasonable" and "well thought through". Thereby, the issue was dropped from the agenda of the SSA pension committee. The recommendation presented later developed into a new public statement issued in September 2012 by SFRB: UFR 9 *Redovisning av avkastningsskatt* [*Accounting for tax on returns*]. This standard stated that the tax on return should be accounted for as a periodic expense and that no liability should be recognized in the balance sheet for the tax on returns. (See SFRB

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2012c) The UFR 9 became applicable simultaneously as IAS 19 Revised, i.e. from financial years starting at January 1, 2013 or later. (SFRB 2012c)

UFR 9 included a description of considerations made in the assessment of the issue. This description emphasized that it is the "character" of the tax that is determinative to how it should be accounted for. UFR 9 concluded that the tax on returns "in its character" is an income tax, targeting the returns on the assets of the pension fund or targeting the assets kept within the company in the case of (partly) unfunded pension plans. The tax on returns was thereby not seen as a result of earnings of pension rights, but rather what is subjected to taxation is the returns resulting from the having the employee benefits, regardless of whether these are funded or unfunded. The tax is therefore argued to be a tax on capital rather than a tax on work, implying that IAS 19 will not be the applicable accounting standard. This implies that the tax has to be taken as an expense during the period it concerns, thereby affecting comprehensive income. For funded plans, the tax will affect net profit whereas unfunded plans will be reported in other comprehensive income. (SFRB 2012c) With the SFRB issuing the UFR 9, this statement was generally perceived as solving the problem of how to account for the tax on returns. The discussion of this tax thereby came to an end.

> The tax on return, that one is solved, at least insofar that the SFRB will produce a statement that no provision needs to be made for the future tax on returns, but you can take that tax on an annual basis. (Interview 6)

However, while the issue of the tax on returns was "solved", the accounting for the special wage tax remained a problem. In its communication with the SFRB, the pension committee of the SSA proposed that the SFRB should issue a standard on the special wage tax as well. The pension committee suggested that this statement could preferably constitute of a recommendation to use a "simplified method" in the calculations of the provision arising from the future special wage taxes. Members from the expert panel of the SFRB meet up with some actuaries from the pension committee to discuss this remaining issue. There, the main question was

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whether a sophisticated model was necessary for the purpose of measuring the value of the special wage tax provision.

From the perspective of the SFRB, the issue was seen as more of an "issue of method or of calculations" than of an issue of "principles". Although the SFRB wanted to "keep track" of the question, there was no desire to issue a public statement on the issue. Rather it was seen as an issue where the actuaries were better suited to make a statement.

> [The actuarial association] wanted us to regulate this issue and to state that the simplified method should be used. […] But we said: No, you are the ones that must fix this. You read IAS 19, and you are the experts in the measurement of pension liabilities. You will have to manage this question. Because they know as well as we do what is stated in IAS 19. […] We, within the SFRB and the Expert panel, are not actuaries. The actuaries will have to take on the responsibility for determining how to perform the calculations. (Interview 33)

SFRB saw the situation as comparable to the area of fair value measurements. Where additional guidance is needed in relation to what is written on fair values within the IFRS, that guidance will be supplied by valuation experts rather than by accountants.

> We, as standard setters, cannot regulate how to calculate. How to calculate must be established by those who are knowledgeable about performing calculations. This could be compared to how the IASB says that you should recognize a financial instrument at its fair value. But the method for establishing the fair value is created by experts. If you, for instance, need to measure the value of a business combination, or intangible assets, then the IVSC [International Valuation Standards Council] has established a practice for how to do this, which hopefully is compatible with the view of the IASB. […] We cannot regulate this. We are not valuation experts. We are accounting people. (Interview 33)

The exclusive competency of the actuaries gives this profession "significant power" within the accounting sphere. When the actuaries claim something, accountants do not see a way to question it.

> Whenever you reach the area of pensions, there has always been a point when you say: "These are actuarial calculations, these we cannot say anything about." […] It is obvious that what the actuaries do is considered a black box for eve-

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> ryone else outside that box. And that gives them quite significant power within this area. If the actuaries have said that it shall be done in a certain fashion, no one outside the actuarial sphere seems to have the knowledge, or even the will, to oppose them. So I would consider actuaries to have an extremely strong position. Extremely strong. (Interview 39)

Thus, a statement from the actuarial association on how to treat the special wage tax was expected to be very influential. In particular, as there was nothing else regarded as providing reliable guidance on this issue.

> We had discussions. For instance, I asked our auditors, and they said that the actuarial association would soon publish something on this concern. And then of course, we are awaiting their conclusion. (Interview 36)

This position was not however appreciated by all actuaries. Instead, they emphasized that although actuaries are asked for advice in accounting related questions, this is really outside the scope of the actuarial profession.

> The actuaries, they are good at calculating the present value of these payments, how they should be valued. That we know! But the next issue is: How shall all this be accounted for? Well, we don't know! Of course we have some knowledge in how pensions should be accounted for, but we are not experts! It is not our profession to be accounting experts. (Interview 32)

Even though statements issued by the SSA are commonly taken as a part of the accounting regulation, this is not the intention. The statements are meant to provide assistance for actuaries and are directed neither towards preparers nor towards auditors.

> The actuarial association, the pension committee, we are not standard setters. We are giving advice. We are offering our opinion, or our interpretation. […] It is the companies and their auditors that are making the decisions. […] I think that this is wrong, […], but many will say: "This is how the rule has become interpreted. Now this is written. Now this is the rule." (Interview 37)

However, where the SFRB's investigations identified the tax on returns as "unique" for Sweden, the opposite conclusions was drawn with regard to

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the special wage tax. There were several examples of taxes deemed "similar" to the Swedish special wage tax (SFRB 2012b), so SFRB ruled out any possibility of it making a statement on this tax. Thereby, the special wage tax remained on the agenda of the pension committee of SSA. The indecisiveness persisted surrounding a recommendation of a simplified or a more complex method. The simplified method was the only one known to be used in current practices, and it was argued that the simplified method provided as good an estimate as a more complicated one. From a SEAG statement, the pension committee knew that the entities favored the use of a simplified method. It was also deemed unlikely that the preparing entities, purchasing the actuarial services, would be willing to pay for the actuarial time required to perform more precise calculations. Nevertheless, there was a reluctance to exclude the possibility of using another more complex method if some actuaries would like to do so.

At a number of meetings in 2012 members of the pension committee of the SSA and members of the accounting policy group of FAR discussed the special wage tax. From the perspective of the pension committee, the complex method (trying to make as exact calculations as possible, and taking into consideration data on the individual basis) was regarded to be a bit "too complicated"; the simplified method (as suggested in UFR 4) on the other hand appeared to be a bit "too crude". The pension committee did however see a reasonable approximation in a simplified method based on the difference between the present value of the defined benefit obligation calculated in accordance with the previous Swedish GAAP and accordance with IAS 19. The pension committee, thereby approached a suggestion that a simplified method could become the recommended method. From the perspective of the policy group of FAR, this was a peculiar recommendation because for them a simplified method was normally an alternative, not the primary rule. Otherwise, FAR accepted that two different methods could both be seen as acceptable. The pension committee responded to FAR's criticism by abandoning the notion of a "primary rule", and accepted both methods as equals. Although the association of the audit and accountancy profession did not see it as entirely unproblematic to simply grant two methods equal status, the solution received acceptance from SEAG. Within

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SEAG, the suggestion was seen as a workable because it allowed for what was preferred, i.e. keeping the previous practices.

> From the perspective of the auditors, it was not possible to interpret when the one or the other method should be used; it was not possible to draw any conclusions from the statement. The entities quite rapidly draw a conclusion: The simplified method! […] [The auditors] did not find the statement to be sufficiently clear to provide support in their conclusions. (Interview 27)

Further, the pension committee suggested that the special wage tax could be included in the defined benefit obligation, but that it did not necessary had to be included in this. FAR did not want there to be an option and argued that it should be stated that the tax should be included in the IAS 19 liability. FAR also suggested that it should be explicitly written that the suggested simplified method was equivalent to the suggested method in the withdrawn UFR 4. This request was however rejected as it was not deemed correct: UFR 4 "is looking at the expenses of the current period whereas we are looking at the present value of all future expenses". Although both UFR 4 and the actuarial suggestions included a "simplified method", the extents of the simplifications were judged to differ.

In the end, it was largely the passage of time that put an end to any further developments of the actuarial statement. Although FAR still disapproved with the written drafts, the time for the issuance of the first financial reports prepared in accordance with IAS 19 Revised approached. In October 2012, the actuarial calculations for the special wage tax were soon to be executed. Thereby, it was not seen as feasible to further postpone the publication of an actuarial statement on this issue. Within the pension committee of SSA, there was a feeling of being "content" with how far the discussions had progressed, and it was considered unlikely that they would progress much farther as a number of adjustments had already been made. Although it was seen as important to take FAR's viewpoints into consideration, it was even more important to be able to supply the actuarial calculations to customers in due time. The committee agreed on a final version of the actuarial statements and closed the case of the special wage tax. This draft later became the official statement of the pension committee of SSA (see Swedish Society of Actuaries 2012).

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> We had worked on this issue during such a long time, sending different drafts back and forth, and we never came to any agreement. So in the end, we had to say: "OK, we are making some adjustments in accordance with what they are writing, but then it will have to suffice." Because by now the game had already started, as we were doing measurements for our customers. [...] We cannot continue to discuss this while producing the calculations. Otherwise we could have to redo the measurements. That would be an expense, and the customers would become unhappy. (Interview 32)

Within the final actuarial statement on the special wage tax, the pension committee recommended and described a simplified method for calculating a provision for this tax. That suggestion was that this provision should be calculated as the difference between the "defined benefit obligation net of assets according to IAS 19" and the "net pension liability according to Swedish GAAP". It also recommended using the actual rate of the tax in the calculations. However, it was acknowledged that there could also be justifiable to use a more complex and detailed method in the calculations as a simplified method could run the risk of "misestimating" the size of the provision. This was not adopted in the statement, however, because the committee saw this as "a minor problem" in most cases. (Swedish Society of Actuaries 2012)

Uncertainty over whether anyone would use the more complex method, due to the time constraints, led the committee to emphasize the simplified method and simultaneously to mention that there could be other, more precise, methods that could also be acceptable. Moreover, communication with FAR emphasized that the final statement was written as practical guidance for actuaries performing the calculations, and not to provide regulations for preparers or auditors. To this intended purpose, the final statement was appropriate. Despite this claim, reactions to the statements were sometimes rather sceptical. It was "unfortunate" that the actuarial association issued a statement allowing for two different methods, while only one of these was seen as possible to use in practice. If the more complex model was applied, the actuarial model for doing this would have to be developed.

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> What is unfortunate is that the actuarial association came up with some sort of statement where they talk about two different models. One of the models is the one that is used in practice. Then they talk about another model, but in order to utilize that model you will need an actuarial model or something similar. So you could expect that the actuarial association would come up with such a model. (Interview 22)

Other interviewees argued the simplified method suggested in the actuarial statement to be too simplistic. The costs of developing a more complex model for the calculations nevertheless led to the simplified method becoming the preferred one.

> Personally, I believe this to be a very simple way out. I am not sure of whether this is linked to a cost issue for them, as it would not be cheap to develop such a model. [...] They state that you may use the simplified method as long as this would not materially deviate from the more precise method. The problem is that there is no method available that is precise. There is no developed model for this. So how could we be able to define what to see as material, when only God knows how that should be done? There is no model to calculate this. So there is all a bit of Catch 22. (Interview 33)

The reasoning about how accounting practices should develop was not influenced by possible reactions of the enforcement body. As the focus was on making "the right" interpretation from the start, the question of what the enforcement body might say did not even arise. As IFRS is used for both management and financial accounting purposes, the goal is described as achieving a "fair presentation", regardless of the enforcement body.

> We are striving to do the right thing. [...] We have IFRS in our management accounting as well, so we want our reporting to provide a fair presentation. So, we are not talking in terms of: "What will the enforcement body say about this?" or that we would feel that we are on the outskirts of a specific interpretation. Rather, we are trying to make the interpretation that we believe is the right one. (Interview 29)

However, the importance of the enforcement body is expected to rise in the event of disagreements over accounting practices amongst different constituencies, such as SSA or FAR. If any one of these parties disagrees

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with the accounting practices it is seen as more likely that the enforcement body will disagree as well. Therefore, interviewees frame the creation of consensus on issues as important.

> We have not needed to reach a situation with differing opinions between the enforcer and the individual entities. We have never ended up in that situation. But of course, if the Swedish Society of Actuaries, who nevertheless are the specialists in the area, would make a statement in some specific direction, and the entities would want to do something else, then of course we all would recognize this as a bothersome condition. Of course, then there could be criticism if the entities were doing something else. [...] And also, if FAR would reach another conclusion than the entities, that of course would be very bothersome. Because then it would not be unlikely that the enforcement body would reach the same conclusion as FAR. So, of course, having a consensus is to be preferred, and we try to create that, in relation to issues that are specific to Sweden. (Interview 27)

Where the accounting issue has in fact been "solved", the entrance of enforcement will become less likely. Another interviewee concludes that it is "certain" that the enforcement body will not have to address the issue of the tax on returns. In the case of tax on returns, the issue is regarded to have been "solved" through the publication of the SFRB standard.

> There are issues that arise now and then around the accounting of the listed firms that are major concerns. But not all go to the enforcement body. In this case, the SFRB solved the issue, because the standard setter considered it to be an issue specific for Swedish. You could see that issue from different angles, and [the SFRB] found a solution. Then I believe that the enforcement body simply accepted that. I am certain that they will not write about that issue. (Interview 4)

An enforcer confirms that neither the accounting for the tax on returns nor for the special wage tax are likely to become enforcement issues. He concludes that the issue is not seen as material enough to become the topic of an enforcement investigation, given that the effect on the financial statements is only expected to be "minor".

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> To be honest, I think this is a trifle in the total picture, so I will not be looking into this. […] I know there was a debate on the standard's clarity with regard to administrative expenses, and especially with regard to the special wage tax. […] Earlier, FAR had made a statement on how to treat the special wage tax. If accounting is done in accordance with that statement, that is OK for me. We will not devote too many resources to that issue. (Interview 38)

7.4. Emerging accounting practices

When 1 January 2013 arrived, IAS 19 Revised came in force. The SFRB had published UFR 9 on accounting for the tax on returns, and the SSA had made a statement on how to treat the special wage tax. What remained was to see how the accounting treatments would be settled in practice. With regards to the tax on returns, the issuance of UFR 9 was taken as implying that no change in accounting practices was necessary for this tax. The previous accounting practices were kept despite the change in the accounting standard. With regard to the special wage tax, there was a separation made between two different accounting aspects: measurement and presentation.

With regards to measurement of the provision, the use of a "simplified method" became practice. This was also seen as the only option practically available, as there was no method developed for performing more precise calculations. However, some actors complained that the "simplified method" suggested in the actuarial statement was not identical to the simplified method suggested in UFR 4. Although it was recognized that measurement in almost all cases are based on some kind of "simplified method", there could still be differences in how the actual calculations are performed. Others argued that the "simplified method" suggested in the actuarial guidelines became in fact practice in the accounting for the Swedish special wage tax. Still others argued instead that practices remained unchanged, and that the "simplified method" recommended earlier in UFR 4 still constituted practice. Even other dissident voices argued that there were no differences between the simplified methods of the actuarial statement and that of UFR 4, i.e. that practices were not only unchanged, but also consistent with both the current actuarial recommendations and with the previous Swedish accounting standard UFR 4. Where measurement practices were kept, the

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justification was that this simplified method of UFR 4 was both "reasonable to use" and recognized in the actuarial association's official statement.

With regards to presentation of the provision for the special wage tax, several preparers speak of a change in accounting practices due to the adoption of IAS 19 Revised. Where the provision for the special wage tax had previously been included in "other liabilities", or had been accounted for as a "long-term provision", the special wage tax was, post-revision, accounted for instead as a part of the pension liability. Actuaries, as well as accounting specialists of the Big Four, confirm that it appears to be an established practice to include the special wage tax into the pension liability.

7.5. Concluding remarks

After the issuing of IAS 19 Revised, a number of actors became involved in discussions on how to treat two different Swedish taxes (i.e. tax on returns and special wage tax) in relation to the newly revised accounting standard. Active in discussions on how to read the requirements of IAS 19 Revised were representatives from SEAG, the preparers' association), FAR, the association of the audit and accountancy profession, SFRB, the Swedish standard setter, and the pension committee of SSA, the actuarial association. At different points in times, these three final organizations were candidates for providing implementation guidance on how to treat the Swedish taxes.

There was widespread belief that it was necessary to create shared views on how to account for the taxes in accordance with the revised accounting standard. Disagreement on the content of "compliance" was seen as increasing the risk of the enforcement body entering the regulatory space and criticizing accounting practices.

A necessary condition for the Swedish standard setter to make a statement on the matter was that the taxes discussed were "specific to Sweden". An international investigation concluded that the Swedish tax on return was "unique" to this country and thereby the SFRB found it could issue a standard on this tax: UFR 9 (Swedish Financial Reporting Board 2012b,c).

Unlike the tax on return, the special wage tax was not seen as "specific to Sweden" (as comparable taxes were also found in other countries) and

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could thereby not be treated by SFRB. Therefore, the accounting for this tax continued to be discussed amongst actuaries, preparers, and auditors. The main question for this tax was whether a simplified method for calculating the special wage tax liability could be retained or whether a new, more precise, method had to be developed. The SSA issued actuarial guidance on how to treat the special wage tax in the autumn of 2012 (Swedish Society of Actuaries Pension Committee 2012)

During the period investigated, the enforcement body took no active part in the intense discussions surrounding the accounting for taxes in line with IAS 19 Revised. From within the enforcement body, the concern was understood as being too insignificant to become a topic of an enforcement investigation. From an outside perspective, the enforcement body was not expected to take action in relation to this issue as the Swedish standard setter (SFRB) had resolved the issue of how to account for the Swedish taxes, making any enforcement action redundant. Similarly, the actuarial association (SSA) could be seen as resolving the issue of how to treat the special wage tax by providing guidance on this.

The explicit SFRB standard on the tax on returns was taken as indicating that the accounting practices for this tax could remain unchanged. The actuarial statement on the special wage tax was taken as an indication that the previous measurement and recognition practices for this tax could also remain unchanged. However, it was necessary to change the presentation of the recognized item, and from that point forward it has been a requirement to include the liability for the special wage tax in the pension liability.

A reason no measurement change occurred may have been that the more complex method was seen as too theoretical (and indeed virtually impossible to apply in practice). And as with similar issues, it was altogether possible to disregard calls for changes in accounting practices understood as made from a purely "theoretical" basis (i.e. lacking practical relevance).

In this chapter, we have seen how the perceived difficulty of pension related accounting issues incorporated the opinion of the actuarial profession into the determination of how to account in relation to IAS 19 Revised. Effectively, the actuaries were designated "accounting specialists" even though this designation conflicted with their own professional identity. Several actuaries emphasized that their expertise resides outside the

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sphere of accounting and that actuaries neither are nor wish to become accounting regulators.

It is often assumed that the regulatory space is a highly contested area, where possibility of participation and influence is both desirable and actively sought (Hancher and Moran 1989, Young 1994, Malsch and Gendron 2011, Canning and O'Dwyer 2013). The developments described in this chapter stands in stark contrast to this assumption. They signify instead a marked reluctance to step into the regulatory space when all actors looked to someone else to "regulate" this issue.

Within SEAG there was a clear preference for using a simplified method for measuring the special wage tax provision, and there was an equally strong belief that the actuarial association should confirm, and thus validate, this view. FAR was willing to make a statement on how to treat the tax on returns, but it was seen as preferable that the SFRB made a statement. SSA and SFRB both received requests on issue statements on how to treat these two taxes, but they each referred these requests to the other. The Swedish enforcement body was aware of the issue of the taxes, but regarded the issue as too irrelevant to require an enforcement statement.

Outside of the enforcement body, there was an expectation that the enforcement body should not make a statement because the SFRB had already solved this accounting problem and because that solution provided a fair presentation.

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Chapter 8

A discount rate for post-employment benefit obligations

IAS 19 *Employee benefits* requires the interest rate of "high quality corporate bonds" to be used as a point of reference for the discount rate of the measurement of post-employment benefit obligations, as long as there is a "deep market" for these. If no such market exists, the interest rate of the country's government bonds shall instead be used. Sweden has long been seen as a country lacking a deep market for corporate bonds. In the autumn of 2010, this view was challenged when a discussion arose over whether Swedish mortgage bonds were high quality corporate bonds and whether there was a deep market for these bonds. Since 2008, the issue of IAS 19 discount rate had appeared in a number of enforcement reports, where a number of statements have been made at different points in time. This chapter therefore explores this accounting issue as an example of how the enforcement body has come to treat an accounting issue that was at times considered a major accounting problem.

8.1. The accounting-standard requirements

IFRS regulates the accounting for post-employment benefit obligations through IAS 19 *Employee benefits*. At the time of this empirical investigation, IAS 19:78 was the paragraph treating the discount rate to use in measurement of pension liabilities. This paragraph stated that the discount rate

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must be determined on the basis of interest rates of "high quality corporate bonds". Where no "deep market" for such bonds exists, the interest rate of the government bonds should be used instead. There must be consistency in terms of both currency and duration between the referred to bonds and the measured liability.

> **83 The rate used to discount post-employment benefit obligations (both funded and unfunded) shall be determined by reference to market yields at the end of the reporting period on high quality corporate bonds. In countries where there is no deep market in such bonds, the market yields (at the end of the reporting period) on government bonds shall be used. The currency and term of the corporate bonds or government bonds shall be consistent with the currency and estimated term of the post-employment benefit obligations.** (IAS 19:83, bold face in original.)

In an earlier version of the standard, the standard text above can instead be found in paragraph IAS 19:78. The only change from IAS 19:78 to IAS 19:83 was a change from "balance sheet date" to "end of the reporting period" in the later version of the standard.

In addition to the bolded paragraph of IAS 19:78/83, some additional paragraphs provide further guidance on how to set the discount rate. Paragraph IAS 19:84 (former 79) states that the "discount rate reflects the time value of money but not the actuarial or investment risk". It also states that neither the "entity-specific credit risk" nor "the risk that future experience may differ from actuarial assumptions" shall be reflected in the discount rate. Paragraph IAS 19:85 (former 80) concluded that the "discount rate reflects the estimated timing of benefit payments". For cases where there are no bonds of maturity comparable to the pension liability, extrapolation can be used to remedy this. (IAS 19:86, former 81)[19]

Elsewhere in the accounting standard, IAS 19:120 includes a number of disclosure requirements related to defined benefits plans, amongst those a

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[19] Paragraphs IAS 19:84-86 are identical to paragraphs IAS 19:79-81 in the earlier standard with exception of what could be considered grammatical corrections (changing "which" to "that" in IAS 19:79 turned into IAS 19:84, and changing "shorter term" to "shorter-term" in IAS 19:81 turned into IAS 19:86). In the earlier version of the standard there was a final paragraph, IAS 19:82, under the section "Actuarial assumptions: discount rate" regulating how interest costs should be computed. This paragraph was deleted in the later version of the standard.

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requirement on disclosing "the principal actuarial assumptions" including the discount rate (IAS 19:120n(i)). There is no direct requirement to disclose the discount rate in the later version of IAS 19, but there is a general requirement to disclose "significant actuarial assumptions". (IAS 19:144) In this later standard, paragraph IAS 19:76 defines "actuarial assumptions", and includes the discount rate in its description of these.

> 76 Actuarial assumptions are an entity's best estimates of the variables that will determine the ultimate cost of providing post-employment benefits. Actuarial assumptions comprise: […]
>
> (b) financial assumptions, dealing with items such as:
>
> (i) the discount rate (see paragraphs 83–86) […] (IAS 19:76)

IAS 1:122 includes a general comment that management judgments shall be disclosed whenever these have a "significant effect" on recognized items.

> 122 An entity shall disclose, in the summary of significant accounting policies or other notes, the judgments, apart from those involving estimations (see paragraph 125), that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements. (IAS 1:122)

IAS 8 *Accounting policies, changes in accounting estimates and errors* includes a comment that any changes in accounting estimates shall be disclosed when "expected to have an effect". Where it would be too impractical to estimate the effect of the change, information about this will have to be provided.

> **39 An entity shall disclose the nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in future periods, except for the disclosure of the effect on future periods when it is impracticable to estimate that effect.**
>
> **40 If the amount of the effect in future periods is not disclosed because estimating it is impracticable, an entity shall disclose that fact.** (IAS 8:39-40, bold face in original.)

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In its Basis for Conclusion regarding the discount rate, IASB concludes that the most important decision to make is whether the discount rate shall be adjusted to reflect risk or not. (IAS 19:BC28) It reviews arguments for and against applying a risk-free versus a risk-adjusted rate (IAS 19:BC28-31) and concludes that the discount rate used should not be set with the intention to capture risks. (IAS 19:BC31)

> The Board has not identified clear evidence that the expected return on an appropriate portfolio of assets provides a relevant and reliable indication of the risks associated with a defined benefit obligation, or that such a rate can be determined with reasonable objectivity. Therefore, the Board decided that the discount rate should reflect the time value of money but should not attempt to capture those risks. Furthermore, the discount rate should not reflect the entity's own credit rating, as otherwise an entity with a lower credit rating would recognise a smaller liability. The rate that best achieves these objectives is the yield on high quality corporate bonds. In countries where there is no deep market in such bonds, the yield on government bonds should be used. (IAS 19:BC31)

It also discusses whether the chosen rate should be a current rate or a long-term average rate, and arguments are provided to support the former. (IAS 19:BC32-34)

8.2. Previous accounting practices

There was an enduring and commonly held perception that there existed no "deep market" for "high quality corporate bonds" in Sweden. (Rundfelt 2013) Therefore, the Swedish government bonds were assumed to be the only possible point of reference for the discount rate in applying IAS 19:78. As this rate was not taken as the actual discount rate but rather was seen as the basis for it, preparers made different adjustments to the rate of return for the government bonds.

In 2004, preparers commonly added a risk spread to the interest rate of the government bond in order to estimate an interest rate for corporate bonds. Inspiration for this accounting was taken from U.S. accounting, but it was considered uncertain whether this was allowed by IFRS as the stand-

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ard was unclear. Further, preparers commonly made an adjustment to compensate for inflation. This was an adjustment auditors accepted. Further, when the long-term inflation assumption of the Swedish *Riksbank* was higher than the current inflation rate auditors deemed it acceptable for preparers to extrapolate to reach this higher rate. Another alternative was to apply a swap-rate, although auditors were reluctant to accept this. All these accounting practices resulted in a higher discount rate than a usage of the unadjusted interest rate of the government bonds.

In 2005, a question was furthered to IFRIC asking whether "synthetically constructed equivalents" could be used as an alternative to the interest rate of government bonds. (IFRS IC 2015: IAS 19-1) In June 2005, IFRIC opted not to add this issue to its agenda. They argued that this was not an issue for interpretation as it was "clear" that synthetically constructed equivalents could not be used; the standard called for an interest rate determined with reference to the country's bond market. It added that "country" could be understood as a regional market as long as the currency of the country was equivalent to the currency of the region, as for instance within the Euro-zone. (IFRS IC 2015: IAS 19-1) Over time, the IFRIC decision affected views on how the standard should be read, and then current Swedish practices came into question. For instance, the IFRIC statement was seen as implying that a risk spread could not be added to the interest rate of the government bond. Basically, only the unadjusted interest rate of the Swedish government bonds was seen as a compliant point of reference for the discount rate. This rate was however seen as comparatively low, both in relation to historical interest rates of the Swedish government bonds, and in relation to interest rates of different corporate bonds. This was seen as a "problem".

> We have kept a close eye on this for a long time. This is a problem, of course, that the interest rates have been falling over a number of years and then the liability increases. (Interview 27)

When the spread between the interest rates of the government bonds and corporate bonds increased, so did the perceived significance of this accounting problem. The financial crisis of 2008 raised the interest rates on

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corporate bonds and lowered the interest rates on Swedish government bond, thus significantly increasing the spread between them. Where there had previously been a half percentage point between the rates, the crisis increased this spread to 5 – 7 percentage points. The use of a relatively low discount rate made the value of the Swedish pension liability "artificially high". The financial crisis was considered to have brought about a situation where the market could no longer be considered "normal". One solution was to freeze the interest rates utilized, disallowing the effects of the financial crisis to impact the measurement of pension liabilities.

> Then 2008 arrived. Everything turned into a crisis. The interest rates no longer reflected a normal market. The corporate bonds increased rapidly, and entities relying on these rates in their measurement would account for very low pension liabilities. The interest rates on government bonds approached zero, implying that entities forced to rely on this rate would instead account for enormously high liabilities. We concluded that this was impossible to handle, and that it could not be reasonable. So [our entity] froze all interest rates. We applied no interest rates, if you express it that way. We tried solely to adapt to the interest rates of the previous year. (Interview 27)

While there had long been a "discontent" with the requirement to use government bonds, this feeling evolved into a perceived need for a change in accounting practices. In 2009, this accounting problem received public attention in an article written by Rolf Rundfelt[20], published in *Balans*. In the article, Rundfelt pointed to the lack of "comparability" created by IAS 19, and identified the financial crisis as something that had exacerbated the problem.

> IASB has noticed that the rules stating that the discount rate could be established in two different ways have resulted in a lack of comparability between how the pension liabilities are determined in different countries. The differences have increased since the end of 2008 due to the financial crisis, which has resulted in a lower interest rate on government bonds while the interest rates on corporate bonds in the meantime have increased. Entities in Sweden

[20] Rundfelt at this point in time was active within the Swedish enforcement system, had a background in standard setting, financial analysis, and as an employee of a Big Four, the article identified him only through his Professorship at Linköping University.

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and Norway, which are deemed to have no deep market for corporate bonds, must therefore report higher pension liabilities than entities in other countries. (Rundfelt 2009)

As entities of countries without a deep market for corporate bonds would report higher pension liabilities, the accounting in accordance with IAS 19:78 was perceived "unfair" and "misleading" as it created substantially different measurements of pensions liabilities solely based on the country where an entity was located. The differences were seen to harm "comparability", and to make accounting less "useful" for decision-making purposes.

The interest rate of the Swedish government bonds had fallen significantly. It was at a very low level and the lower the interest rate, the higher the pension liability. So the companies became more and more upset about the unfairness of that we, the Swedish companies, must apply a low interest rate for government bonds while the competitors located in […] the Euro-zone, UK, and US apply the rate for corporate bonds. […] So a Swedish firm, using government bonds, and a discount rate that is 2 percentage points lower than the discount rate of a Finnish firm, will account for a 40 % higher pension liability, even though the pension plans make the same payments. This is because in Finland, or in the Euro-zone, there are plenty of corporate bonds and in Sweden there are, or were, none. We think that this is completely misleading. (Interview 3)

Similarly, it was "strange" that there should be accounting differences between Sweden and Finland, as the differences were solely due to Finland belonging to the Euro-zone and Sweden not. Thereby, the differences were not seen as corresponding to any actual differences in risks or other circumstances.

I think that the debate I took part in, and the reason why we were searching, was that it was perceived to be strange that the interest rate should be so much lower in Sweden, were government bonds were used, in comparison to for example Finland, being a part of the Euro-zone, and thereby using corporate bonds. It was not such a large difference, really. It was believed that a pension liability in Finland ought not to be as dissimilar from a pension liability in Sweden, due to this. (Interview 37)

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Even in entities where the impact of the issue on the financial report was relatively small in comparison to other listed entities, interviewees considered a change in the discount rate desirable because aligning the levels of the discount rates used would, they believed, increase the fairness of accounting.

> [The interest rate] was far, far below [the other interest rates], or at least rather much lower. So, if you could increase [the discount rate] that was a good thing, from the perspective that our financial position would be more fairly presented, as we perceived it. (Interview 20)

The absence of corporate bonds in Sweden follows from how Swedish entities raise their capital. Instead of getting access to capital by issuing corporate bonds (in SEK), Swedish companies tend to raise funds in other currencies in order to get access to larger markets. They then use the swap market to convert the money into SEK. Neither membership in the Eurozone nor the financing habits of Swedish firms, however, provided adequate reasons for defending dissimilar measurements of the pension liabilities between the two neighbouring countries, making it "reasonable" to correct this difference by searching for an alternative to the government bonds.

Given the consequences of applying IAS 19:78, the question arose of whether the current accounting differences could really be in line with the original intention of the standard setter. The large spread between these two rates at that time was believed to be an unexpected development not taken into consideration in the writing of the standard. A view emerged that the accounting standard was "faulty" because it treated as equivalents two rates that were functionally unequal.

> It is a faulty standard because IAS 19 says that if there are no corporate bonds you are to look at government bonds. These are not equivalents. But maybe they were when the standard was written. Maybe the risk premium between the government and the corporate bond was not as large at the time when this was written. But in the wake of the financial crisis, the premium has grown far larger. (Interview 3)

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In addition, the discomfort with the standard also grew, in part, from the view that the standard lacked any well thought-through foundation. It was not seen as "principles based" insofar that it was written from a specific idea about how accounting could contribute to fairness, comparability or any other desirable aspects of accounting; instead, it seemed to be simply a "rule". Together the perceived absence of an underlying principle and the absence of a discussion about how and why the standard is written as it is combined to create a sense of arbitrariness.

> I can't see how it is possible to have a rule that says that you should look at high quality corporate bonds and if no such bonds exist, you should look at the interest rate of the government bonds. I believe that rule is senseless! It sounds like these two would be equivalents but they are not. There is a vast difference between the interest rates for government bonds and corporate bonds. There is nothing principles based in this at all. To me it sounds like: "If there are no high quality corporate bonds, let's look at your shoe size instead." These two are not at all related to each other! […] Or why not: "Look at the square root of your shoe size." There is no principle behind this. And in the standard there is no explanation of what kind of risk they want to produce or remove. There is no discussion about that, or at least it is not well developed in the basis for conclusions. Why for instance are they not looking at a risk free rate? (Interview 4)

There was a perception of inconsistency between what was argued in the basis for conclusion and what was required by the main standard. In particular, the conclusion's insistence that the utilized rate shall be risk free (IAS 19:BC31) is contradicted by the requirement to use the "high quality corporate bonds" (IAS 19:78/83) because the corporate bond is not a risk free bond. If a risk free rate is what is wanted, the government bond is a better proxy for such a rate.

In IASC's standard setting process, the meaning of the expression "corporate bond" was never discussed, but rather the debates concerned whether it should be required that the discount rate should be a risk free rate. As the risk free rate was acknowledged as being very low, there were disagreements on whether this was appropriate. Some instead argued in favor of applying a rate equivalent to the much higher interest rate of the actual holdings, which usually were shares. The requiring of the interest rate

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of the "corporate bond" could here be seen as a "compromise" (interview 2), as this rate will typically be higher than a risk free rate but lower than the rate of returns of shares.

8.3. The initial statements by the enforcement body

The first enforcement report published by the OMX after the introduction of the legal requirement to enforce accounting standards (i.e. the report of 2007, reviewing the annual reports of 2006/2007) included no remarks on IAS 19. (OMX Nordic Exchange 2007) Nor did the following year's report (Nasdaq OMX Stockholm 2008a, 2008b). In the subsequent year's enforcement report, the report of 2009, the accounting for defined benefit pension plans had however became a high priority topic because the financial crisis was expected to have affected markedly the measurement of pension liabilities. The report remarks on the disclosures required in relation to pension plans, and there is a section devoted especially to the discount rate of pension liabilities. It concludes that it has come to the attention of the enforcement body "that entities do not apply paragraph 78 of IAS 19". It continues that although there exists "a limited market both for corporate bonds and mortgage bonds" in Sweden, it "could be questioned" whether this market is "efficient". "The lack of an efficient market" is taken to imply that the discount rate shall instead be determined with reference to Swedish government bonds. (Nasdaq OMX Stockholm 2009b, pp. 17-19.) The enforcement report stated that the "problem at the end of 2008" was "unusually low" interest rates on government bonds due to the financial crisis. The ten-year government bond that had rendered a rate of return of 4.3 in 2007 had fallen to levels ranging between 2.4 and 2.6 as a result of the crisis. The enforcer found that none of the entities investigated had applied an interest rate as low as 2.4 percent. Although entities had overlooked the standard requirement of IAS 19:78, there was no direct criticism of the discount-rate assumptions because the low levels of the interest rates of the government bonds had resulted in an overstatement of Swedish pension liabilities. However, the report called for improved disclosures in the

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coming financial year and for the choices of discount rates to be explained better.

> The discount rate has a major impact on the size of the pension liability. A decrease from 4.3 to 2.4 percent will imply that the liability increased significantly. Compared to other countries with efficient markets for corporate bonds, this would portray the financial position of Swedish firms as weakened. Nasdaq OMX Stockholm has judged that a calculation of the size of the pension liability based on the currently low interest rate of the government bond would overstate the liability. The enforcement body has therefore not criticized entities for their choice of discount rate. Compared to 2008, the enforcement body will, however, expect that in 2009 the entities will improve their explanations of their discount-rate choice. (Nasdaq OMX Stockholm 2009b, p. 19.)

Discussing the situation at that point in time, one enforcer concluded that although the interest rate of the government bond was seen as the only compliant basis for the discount rate, it would be wrong to criticize this. The reason for this was that the interest rate of the government bonds was seen as "unreasonably low". Thus, the only new requirement was improved disclosures about how the interest rates were set, especially as it was "always" possible to demand additional disclosures.

The Swedish treatment of the discount rate also attracted attention within the forum of *European Enforcers Coordination Sessions* (EECS). Another European enforcer brought up this issue with the Swedish enforcers, arguing that the Swedish enforcer should have criticized the Swedish listed firms' accounting. Using discount rates exceeding the contemporary levels of the Swedish government bonds was seen as non-compliant with IAS 19, given that Sweden had no deep market for corporate bonds.

The opinion of the Swedish enforcers was that the using of the low interest rate of the government bond would give a "strange" picture in the accounts, and therefore argued that there should be a right to deviate. The Swedish delegation however found this opinion difficult to defend, because it was based upon what they perceived to be fair accounting and not solely upon what was compliance with the standard.

In retrospect, a Swedish enforcer saw it is as virtually impossible to argue in favor of making deviations from the IFRS, as this would require

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agreement on this not only on the national level but also on the European level. The entities however never argued that point; none of them described their accounting as a necessary deviation from the IFRS made to avoid "misleading" accounting. (Cf. IAS 1, paragraph 19.) The possibility of doing an override had been discussed amongst preparers, but the auditors strongly advised against this.

> It [the IAS 1 paragraph] has not been applied in that way. […] I have been thinking of it but, you know, there are almost no examples of an entity that did an override anywhere in the entire world. So it would be immensely difficult to argue in favor of doing that. (Interview 4)

After the criticism received at the EECS meeting, the Swedish enforcement body continued to comment on accounting practices in relation to IAS 19:78. The 2010 enforcement report includes a statement that the information disclosed on the discount rate is not sufficiently clear. To remedy this, the enforcer once again demanded the listed entities to supply additional disclosures. This time, there are no comments on the whether the pension liability would be overstated or not, only a comment that there is not deemed to exist a "deep market" for corporate bonds in Sweden. In addition, there is a remark[21] that the discount rate is a management judgment and therefore shall be disclosed in accordance with IAS 19:120An (also comparing IAS 1:122). (Nasdaq OMX Stockholm 2010b, pp. 13-14.)

8.4. An attempt to change the accounting standard

In 2009, a number of parties including the preparers' association SEAG, the auditors' association FAR, and the Swedish standard setter SFRB approached the international standard setter IASB to change the accounting standard prescription for the discount rate. This effort was made to counteract the differences arising from applying the standard. The IASB was

[21] The enforcement body differentiates four categories of severity: "Without remark", "Remark on disclosures", "Criticism", and "Statement forwarded to the Disciplinary Board". (Nasdaq OMX Stockholm 2010b, p. 4.)

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contacted through different channels, including approaching the Swedish member of IASB (Jan Engström) to facilitate communication with IASB staff members and mediation of a head actuary from a London-based actuarial firm engaged by a Swedish listed entity. The latter resulted in a telephone meeting. In this meeting, the issue and the reasons for change were explained.

> Our head actuary […] is based in London and he […] knew the project leader who was responsible for this specific issue. So we had managed to get a telephone meeting where we from SEAG, it was myself and [two others], talked to the project leader at the IASB. And I believe that this was where we managed to convince her about how good this was. Or good? That this was correct! And then an exposure draft was actually published. I believe that it was our meeting that made the difference. (Interview 20)

In August 2009, *Exposure Draft ED/2009/10 Discount Rate for Employee Benefits* was published, suggesting deletion of the requirement to use the interest rate of the government bond in the absence of a deep market for corporate bonds. This would imply that the discount rate used should always be based on corporate bonds. The argument was that this would increase "comparability" because fewer rates were used and facilitate accounting by removing the need to assess whether markets should be considered "deep". (IAS 2009:BC4) The increased spread between the interest rates of government bonds and corporate bonds, further amplified by the financial crisis, was also said to have resulted in similar liabilities being accounted for dissimilarly. (IASB 2009:p. 4, BC3)[22] The exposure draft also suggested a deletion of IAS 19:81, referring to how extrapolation might be needed if there were no deep markets for bonds of maturities equivalent to the measured pension

[22] The following amendments to paragraph IAS 19:78 were suggested: "78 An entity shall ~~The rate used to~~ discount funded and unfunded post-employment benefit obligations ~~(both funded and unfunded) shall be~~ using rates determined by reference to market yields ~~at the end of the reporting period~~ on high quality corporate bonds at the end of the reporting period. ~~In countries where there is no deep market in such bonds, the market yields (at the end of the reporting period) on government bonds shall be used. The currency and term of the corporate bonds or government bonds shall be~~ An entity shall apply the principles and approach in paragraphs AG69-AG82 of IAS 39 Financial Instruments: Recognition and Measurement* to estimate such rates by reference to yields on high quality corporate bonds denominated in the same currency and whose term is consistent with ~~the currency~~ and estimated term of the post-employment benefit obligations." (IASB 2009)

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liabilities. (IASB 2009, p. 6.) The period for submitting comments was shortened from the normal 120 days, as the matter was considered "urgent" and "straightforward". The period for comments was set to end at September 30, 2009. (IASB 2009:BC13)

A number of Swedish organizations (including the standard setter SFRB and associations of preparers, auditors, and actuaries) submitted comment letters to the IASB. The Swedish comment letters all expressed support for deleting the government bond requirement. (FAR 2009, Swedish Bankers' Association 2009, Confederation of Swedish Enterprise 2009, Swedish Society of Actuaries 2009) However, this support was not shared worldwide. In some countries, the interest rate of the government bond exceeded the interest rates of the local corporate bonds. In these countries, there was on the contrary a wish to keep the current requirement unchanged. Although the change had been expected to be "straightforward" (IASB 2009:BC13), the standard amendment was not approved, and no changes were made to IAS 19 with regards to the discount rate.[23] When the IASB announced that there would be no amendments to the standard on this matter, the news in Sweden was received with a sense of "huge disappointment for many within the business sector". In a letter addressed to IASB, the association of the audit and accountancy profession FAR reemphasized the need for a change in the accounting standard, and expressed discontent with IASB's withdrawal of the exposure draft. The letter argued that the withdrawal was unfortunate as there were no differences in risks between countries with and without a "deep market" for "high quality corporate bonds". Thereby, there was no justification for using dissimilar discount rates. In place of the IASB requirement to use government bonds, FAR advocated estimated derived from corporate bonds. (FAR 2010)

In addition, SFRB submitted a comment letter to IASB on another pension related issue, which also mentioned the issue of the discount rate. (Swedish Financial Reporting Board 2012d) At that point in time, mentioning the discount rate was seen mostly as "a symbolic action" (interview 4), because there were no longer any expectations that the accounting standard would change. The withdrawal of the exposure draft made it clear that

[23] Neither was any material changes made to IAS 19:78 along with the full review of IAS 19 (see the introduction of this chapter for details).

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IFRS was a truly international standard and very difficult to influence. In retrospect, the hope of changing the standard was described as somewhat "naïve".

> We believed we had a solution, but we did not. So we were disappointed. If this relatively minor change had been gone through with, it would have been a very good thing for Sweden. But this illustrates that IFRS is an international regulation even while we in Europe sometimes believe that Europe is the world. […] It is the downside of having an international regulation. We use to say that we are naïve if we believe that we might impact the IFRS. That would be like impacting UN regulations. (Interview 21)

When changing the standard was no longer considered an option, the search for solutions continued elsewise. At that point in time, attention turned to the interpretation of the accounting standard.

> It was not possible to change [the standard]. The focus will then turn instead to the interpretation of the standard, taking the standard as a given. Then you have to return to square one and see what can be done about the interpretation of the standard. The focus quite rapidly turned to: What is a corporate bond? (Interview 8)

8.5. A debate on mortgage bonds

In 2010, the long-standing consensus that there was no deep market for corporate bonds in Sweden came into question. The search for a "corporate bond" had been initiated.

In Sweden, government bonds had been used for a long time. But then people started to look into the issue. Was there any other point of reference that could be used instead of the government bonds? Are there any corporate bonds?

The emerging market for mortgage bonds, with increasing levels of trade at that time, started to look like an alternative point of reference. There are many different suggestions on how the idea of using mortgage bonds arose. They are mentioned as early as in the 2009 enforcement report of Nasdaq OMX Stockholm, which treats them as equivalents to cor-

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porate bonds (Nasdaq OMX Stockholm 2009b, p. 18). An enforcer also described how this active effort to find a substitute for the government bonds and to convince others on that the mortgage bonds could be a viable option. Informally, he approached representatives of the Big Four to discuss this possibility. The mortgage bond was also brought to the Big Four accounting/auditing firms by some preparing entities.

> The issue arose, as I heard it, from some customers, or clients, that they were interested in discussing the mortgage bonds. […] They believed this to be a good idea and they brought it forward to us: "You auditors, will you approve this?" Then you feel a profound uncertainty because no one had ever used the mortgage bonds in Sweden at that point in time. If we as auditors were to approve this, there ought to be a debate in Sweden. We have to check with all kinds of people. (Interview 3)

According to one interviewee, the distribution of a memo produced by an actuarial firm played an important role in diffusing knowledge on the mortgage bonds as an accounting alternative. The document circulated amongst preparers and came up for discussion within SEAG. The actuarial firm had initially discovered the possibility of using mortgage bonds by seeing it in the annual report of a listed entity.

> This [memo] is something that started all this; the [actuarial firm] wrote a paper where they discussed whether mortgage bonds could be used instead of government bonds. We received this paper in 2010 in different ways, I do not remember exactly how. But then we had a discussion within SEAG about this issue. (Interview 20)

In the autumn of 2010 the suggestion to use the mortgage bonds resulted in a widespread debate. There were three important issues to consider in relation to the mortgage bonds. One was whether these were "corporate bonds". If this was the case, a second was whether these "corporate bonds" were of "high quality". Finally, there was the issue of whether the market for the mortgage bonds was "deep".

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8.5.1. Some accounting-standard expressions

The accounting standard IAS 19 provided no definitions, examples or explanations regarding the "corporate bond". This suggested initially that the definition was unproblematic and that the mortgage bond could fall into the category of corporate bonds. At a later stage, the question of definition became a problem when some individuals argued that this usage was in conflict with the intention of the standard.

> This was not [an issue]. The issue arose later when some debaters started to argue that this was not what [the standard] intended. (Interview 27)

One aspect of the problem was that mortgage bonds are covered, having a security in real estates. There was initially some uncertainty whether it mattered that the mortgage bond had a security tied to it. This would impact the credit rating of the bond, as the security lowered the risk of the bond.

> The first issue was: Are mortgage bonds "corporate bonds"? We were somewhat unsure of that one. These bonds have somewhat different characteristics. A regular corporate bond usually has no security. And the mortgage bonds have a security in form of the underlying real estate. This will give the bond a much higher credit rating. We wondered whether this [mattered]. […] So there were plenty of discussions about: Was this a corporate bond? (Interview 3)

Some interviewees argued that it did not mattered that the mortgage bonds were covered as there were other examples of corporate bonds that were covered, and as the standard did not state that corporate bonds ought not to be covered. Others, saw it as self-evident that a covered bond could not be seen as a corporate bond. IAS 19:78/83 was seen as a clear "rule" with no possibilities for interpretations.

> What spoke against this usage is very simple. There is a rule that states: corporate bonds. Possibly, you could read already from this label that the mortgage bonds have a somewhat different association than a corporate bond. Even if it is corporations that issue the bonds, mortgage bonds have another source of security than the corporate bonds. And the standard says: corporate bonds. So

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> there was people, at least in our organization but certainly also in others, who argued that it is clear that it is corporate bonds. (Interview 15)

Later, in light of growing information on the mortgage bonds, and on the market for them, a conviction arose that there nevertheless were good reasons to equate mortgage bonds with corporate bonds. Knowledge was gathered from individuals who were familiar with the mortgage bonds. These individuals were found outside the accounting profession, for instance amongst those who issued and traded mortgage bonds. Further, the collection of statistics played an important role. This collection was a joint effort made by accounting specialists of the Big Four firm and by preparers of the listed entities.

> When I had learned more about mortgage bonds, and how they worked, I felt that there were many characteristics of this instrument, and of the Swedish market for corporate and mortgage bonds, which provided extremely strong arguments that the mortgage bonds could fulfill the criterion for being corporate bonds as these are… *undefined* by the standard. Because it is not defined what these bonds are. (Interview 15)

Another dimension deemed possibly problematic was a distinction sometimes made between corporate and financial entities. The question was whether the use of the expression "corporate bond" implied that bonds issued by financial entities (as are the mortgage bonds) would not meet the criterion.

> I did some research into that issue, I did, but I saw it as difficult to understand the implications of IAS 19 in this matter. It says "high quality corporate bonds". I don't know what a "corporate" would be. Sometimes you talk about corporate and financial companies, where corporate would be the opposite of financial companies. It is only financial companies who issue mortgage bonds. So are these really "corporate bonds"? (Interview 12)

Some participants in this discussion took the distinction between corporate and financial entities to preclude the use of mortgage bonds in applying IAS 19. Others emphasized instead that the standard makes no such distinction, as there is no mention on that corporations must be non-financial

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firms only. Rather, the term "corporate" is seen as differentiating the issuer from the government. A common argument was that the entities issuing the mortgage bonds must be corporations as they are not "government", implying that the mortgage bonds are "corporate bonds" by definition.

> It is a corporate bond. […] It is not a government bond. That is the easiest part to draw a conclusion about. It is not issued by the government. That we know. It is issued by corporations, by banks. It is issued by banks, and banks are also corporations, so this is a corporate bond. There is nothing in the IFRS that states that if a corporate bond is issued by a financial institution you may not use it. The financial sector is as relevant as the industrial sector. It will not matter if the bond is issued by a financial or an industrial company. They are companies to the same extent, both of them. (Interview 4)

Nevertheless, it was not sufficient that the mortgage bonds were considered to be "corporate bonds"; they also needed to be "high quality" corporate bonds. This was however easier to agree on, as there was already a common perception that "high quality" bonds were bonds with at least double A rating and the existing mortgage bonds were double A or triple A rated. The high rating was a result of the security provided by the real estate, putting a holder of mortgage bonds in a more privileged position in cases of issuer bankruptcy. Whereas the security tied to the mortgage bonds had created questions about defining the mortgage bonds as "corporate bonds", this security (and its lowering of risk) facilitated an understanding that the bonds in question were of "high quality". This requirement was thereby described as straightforwardly met.

> We do not have this issue in Sweden. As the mortgage bonds are triple A rated, we do not even have to think about this issue. The mortgage bonds will be triple A almost automatically as they (in contrast to a regular corporate bond) have a security in real estates. (Interview 4)

If the mortgage bonds were "high quality corporate bonds", these could nevertheless only be used if there was a "deep market" for these bonds. IAS 19 provided no criteria that characterized a market as "deep" and no definition of this concept. The expression was not familiar other IFRSs, so no further guidance was to be found elsewhere in the IFRSs.

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> The second issue was: Is this a deep market? There was no guidance within IAS 19 about this issue. (Interview 3)

The expression "deep market" was described as a word lacking any specific meaning within the sphere of accounting. Instead, the concept was argued to have a meaning elsewhere, amongst other professionals, or within "theory of finance".

> Deep is apparently a word that exists out there, I believe. The implications of deep are rather taken for granted amongst those occupied with the market. It is not an accounting term really but it is rather a term that appears to exist on the market, that those people have a certain feeling for. But it does not exist elsewhere in accounting, as far as I know. (Interview 12)

Parallel to the belief that this was an expression commonly used within the actuarial profession, there was no consensus that this expression was actually recognized amongst actuaries. Some interviewees argued that the expression was not commonly used; others argued the opposite.

> ["Deep market"] is something that we use frequently. It is not an uncommon expression in any sense. I do not believe that. There is no definition, but I do believe that people have an idea of its meaning. (Interview 37)

Another interviewee argues that there are two different schools of thought amongst actuaries in Sweden: one which consider it important to assess the depth of a market and one that consider than any existing market can be considered "deep" on the basis of its mere existence, regardless of actual trading.

Since there were uncertainties amongst accountants over how to understand the meaning of the expression "deep", there were different ways to make sense of this expression. One was to compare the market for mortgage bonds with the market for government bonds. The reasoning was that if the market for the government bonds was the alternative, the market for government bonds must constitute an example of a sufficiently "deep" market. It made it unreasonable to deny usage of the mortgage bonds based on lack of depth if the other benchmark market was not "deeper". There-

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by, the characteristics of the market for government bonds were taken as reference points, even though it was acknowledged that there was no explicit requirement of "depth" for this market. By comparing statistics on these two markets, it was concluded that although the volumes were not exactly the same, the difference between the two markets could not be considered substantial.

> There is no definition of a deep market, but the market [for mortgage bonds] is large. At one point in time we compared the market for mortgage bonds with the market for government bonds. It was not that different. […] So it feels like: If you could refer to the government bonds, you could as well refer to the mortgage bonds because this is a market that is not that different in size. Although nothing is stated about the depth of government bonds, I do not perceive it to be difficult to make that coupling: If something is as large as the market for government bonds, then you could state that it is a deep market. (Interview 37)

Another way to make sense of the expression "deep market" was to relate this unknown expression to the more familiar expressions, i.e. "active" or "liquid" market. Most interviewees, however, argued that the expressions "active" and "deep" markets could not be equated because there were differences in how strictly these terms were understood. One view was to assume that a standard requiring a market to be "deep" demanded more than one requiring a market to be "active". One explanation is that an "active" market is a market with "a sufficient amount of trade and a sufficient frequency in trading making the prices reliable", ensuring prices of "arm's length transactions", and providing a fair value of the shares. In addition, given this reasoning, for a market to be "deep" it would be able to endure large amounts of trading without any price reactions. Notably, others understand "deep" and "active" in the opposite way, arguing that the latter is stricter than the former. Based on that reasoning, it is argued that the market for mortgage bonds would not satisfy the requirement of being "active" whereas it could be seen as satisfying the less strict requirement of being "deep".

Comparisons were made with IAS 39, and to the expression "liquid" market, which was seen as a market with a high turnover rate. On the con-

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trary, a "deep market" was seen as a market with a large number of outstanding papers, but where there was not necessarily a high turnover. The point was made that although "many wanted to see that is should be a liquid market" the standard only required the market to be "deep". Others appears to equate the terms "deep" and "liquid" markets, relating both either to the volume of outstanding shares, or to turnover.

To enable of an understanding of whether the market for the mortgage bonds could be considered "deep", accounting specialists reached out to corporate market specialists and treasury departments.

> It was not an issue we solved like that [snaps with fingers] but rather there was quite a bit of analyzing different aspects. For instance: What is a deep market? And how do things looks for these specific bonds? […] We had quite a lot of help from the corporate finance department in this analysis: How was the trade pursued? (Interview 22)

Notably, the "characteristics" of the market for the mortgage bonds were deemed to change during the time of their assessment in relation to the text of IAS 19. Initially the market for mortgage bonds had not been accepted as "deep" because the low volume of trading, but this conclusion came into question with the growing activity on this market.

8.5.2. Aligning views and changing accounting practices

An accounting specialist of a Big Four firm initiated a meeting with some actuaries to discuss mortgage bonds. At the meeting, he took an active stance in favor of accepting the mortgage bonds.

> I initiated a meeting. I believed that could be a good thing. I told everyone that the question had been asked, whether the mortgage bonds could be accepted, and I said that I believed this to be a good idea. So I took a stand. (Interview 3)

At the time when individuals from the Big Four firms were approaching the actuaries, individuals from the actuarial profession were also trying to initiate meetings. After having discussed the topic with preparing entities, actuaries saw the use of the mortgage bonds as an accounting "improve-

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ment". Therefore, meetings were held to actively pursue the acceptability of mortgage bonds in accounting as per IAS 19. Clients of the actuarial firm, auditors and other actuaries were approached for discussions. The meetings held between accounting specialists and actuaries are thus described as actively initiated by representatives of both professions.

The Swedish standard setter SFRB was also approached with a request for the standard setter to make a statement. The SFRB choose not to make a recommendation on this issue. Only issues that were "specific to Sweden" could be subject to statements, and there was uncertainty about whether this was such an issue.

> The question was asked of SFRB […] whether they could issue a statement on this. You could feel that the Board should have taken a stance on this question, so that it could have been resolved once and for all, but the Board declined to make a statement. […] They were uncertain about whether this was a question that was specific to Sweden. There could be similar situations in other countries, and IAS 19 is a global standard. Basically, my belief is that the Board was uncertain about whether this was an issue for them to resolve. They did not want to create an IFRS light, a simple, low quality version of IFRS here in Sweden. The risk is that that is what would have been created. So the Board dismissed the request and left the question to be resolved through the establishment of an accounting practice. (Interview 3)

Although a SFRB statement on this issue could have been "practically" a good thing, the issue was recognized as difficult for the SFRB to take on. The ambiguity of the accounting standard, where all that could be relied on was the choice of wording, and where no further guidance existed, made it far from obvious what a recommendation should say.

The policy group of FAR and representatives from SEAG

Amongst preparers, this was not seen as an issue that could be adequately discussed between the individual entities and their own auditors. The first step in reaching a more general understanding was to discuss the issue internally within the preparing entities. The next step was to pursue the question of whether all listed firms could do this and whether all auditors (auditing listed clients) would approve this accounting. When the preparers

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sought auditor approval, they met with representatives of the FAR policy group on November 18, 2010.

> Some [of the accounting specialists who were members of SEAG] knew about the issue, but we [the preparers] went through it, presented it you could say. Of course, we wanted an assurance from the auditors that they formally approved with that this was correct. The policy group, working with this kind of technical issues, were the ones we chose to meet and sit down and discuss with. Then we all agreed. They believed that this was appropriate. (Interview 20)

When "support from the auditors" was what was sought, the preparers identified the accounting specialists of the policy group as the natural alternative for discussing such a technical matter as the one at hand. The auditing team and the underwriting auditor were even described as irrelevant to technical and principle concerns as only the specialist departments had the necessary competence for these issues. The accounting specialists represented the view of the accounting/auditing firms. The expertise of the auditor is perceived to be arranging supervision rather than accounting in itself. This accounting expertise of accounting/auditing firms is thereby considered to be located to the specialist departments.

> Accounting today is so extensive and complicated, so normally we as preparers know more about accounting than do our auditors. Very, very often we have read more and know more about this type of very technical issues. But then the auditors have accounting specialists, whom they will have to consult, i.e. the specialist department of each accounting firm. And they will decide on an opinion on each issue and then that opinion will be the opinion within the firm. So, the underwriting auditor, they are not the technical specialists, but rather they administer supervision. So of course, it matters what the accounting specialists say! […] It is a very good thing if the audit firms embrace the same [opinion] in this kind of issue, and FAR is the representative. And their interpretation will be the correct one within the firms. (Interview 20)

From the perspective of the specialists accounting departments, the opinion of the accounting policy group of FAR is important. The preparers, but notably too the auditors, are recipients of guidelines. Both preparers and auditors are trained in how to interpret rules. The interest organizations of

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FAR and SEAG are important channels for coordinating accounting practices.

> If we have agreed on something in FAR and have a mandate of [Big Four firm], for instance, and something appears to be a reasonable solution, then we send out the instructions internally. […] And then they have guidance, and then I guess [the three other Big Four firms] did the same thing. Then you have some regimentation about how to handle it when an entity argues in favor of having a 4 percent interest rate, and we say: No, you cannot have such a high interest rate because you ought to reason like this. So I guess that what we have to ensure is that the auditors know how to reason and how to interpret the rules, and that the entities too understand how they should think when they set their assumptions. So in that way, it was beneficial to act through these organizations. (Interview 13)

In a description of "how it came about" that accounting practices could change, it is the joint approval of the Big Four, represented by the accounting policy group of FAR, that is described as the main stepping stone for enabling a change in accounting practices.

> This was not an issue were you yourself make a change without having support from somewhere. And when we received support from the auditors, we could do it. (Interview 20)

All SEAG members received an e-mail which explained that it was the view of the preparers' association that the mortgage bonds provided an acceptable starting point for establishing the IAS 19 discount rate. The actuarial memo was provided as an attachment to this e-mail.

> And then, in the end, it was SEAG that […] sent out an e-mail to all Swedish entities, where they stated that they had discussed the issue, that their opinion was that mortgage bonds was an acceptable basis for the discount rate in accordance with IAS 19. They included our memo with that e-mail. So this was how it all happened. […] As SEAG had sent out this e-mail […], this was no longer a question amongst the entities; then they could easily make the same decisions. If SEAG has uttered something, then there will be no problems. (Interview 37)

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From the perspective of preparers, the actuarial memo was seen as suggesting a solution to the problem of the discount rate. From the actuaries' perspective, the memo was intended it differently. The memo was perceived to be a discussion of the possibility of using the mortgage bond and was only seen as an educative effort, helping to frame the relevant issues that preparers ought to consider.

> This is a decision that ought to rest with the entities. They cannot solely say that our actuaries believe this to be a good idea, therefore we will account like this. The purpose [of the memo] was to provide information. It is a difficult situation because many will say: "You are the experts, and we will trust what you say." But to a large extent we try to place the responsibility with them, and explain that: "This is your responsibility. You ought to have a sufficient understanding of this issue." (Interview 37)

The memo referred to as support for the decision taken to by SEAG was originally sent out only to the customers of the actuarial firm writing it. It came as a surprise to the actuaries who authored it that the memo was attached to the e-mail sent to all SEAG members, as its later distribution and impact was not foreseen. The memo was only intended to make clear the position of the actuaries.

> Our opinion was: We believe that above all IAS 19 says that corporate bonds should be used. We believe it is better [to use mortgage bonds], as it is only in the cases where there is nothing else that you should switch to government bonds. That's how we understand this. (Interview 37)

The change in accounting practices

A number of larger listed entities simultaneously switched the basis for their discount rates from the government bond to the mortgage bond in the annual reports of 2010. Because they have few resources available to spend time on accounting concerns, smaller firms largely retain practices already accepted and utilized, i.e. this accounting practice was expected to spread also to smaller firms.

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> I do not remember exactly which entities it was, but I guess it was [three multinational listed entities] that changed [their accounting practices]. All these entities have the resources to evaluate and to contemplate these kinds of things! Most entities listed in Sweden of course do not have the resources to let people sit around and think about these things! They will follow what happens; they might notice some statements made by auditors, or articles in *Balans*, or whatever it might be. It won't be that they are actively working on the issues. For me, it is quite natural that there will be a number of entities that become followers, if you would like to call it like that, of the largest entities. (Interview 27)

This understanding of smaller entities lacking of resources to allow their employees to contemplate accounting concerns is shared by other preparers as well as enforcers.

Along with the acceptance of the use of the mortgage bonds, an additional accounting issue arose: How should the change in the basis for the discount rate be described in the annual reports? Was this to be considered a *change in an estimate* or a *change in an accounting policy*? The dominant opinion was that this must be considered to be a change in an estimate. Beyond that, the extent to which the issue deserved attention in the annual reports was understood as depending on how material the issue was for each individual entity.

In the assessment of the mortgage bonds, it was not sufficient that these bonds matched some specific words or requirements of the standard. Rather, the assessment hinged on the overall relevance of the interest rate. Discussing the use of the mortgage bonds, an interviewee concluded that although he was uncertain about how the paragraph discussed should really be interpreted, the use of the mortgage bonds appeared to be "good accounting" as it created more "comparability" than did the use of government bonds. Another interviewee concluded that not only do the mortgage bonds fulfil all the three important requirements of IAS 19, but their use will also lead to a "fairer presentation", as the "comparability" between countries is increased. Although acknowledging that there is always a risk of disagreements when it comes to accounting judgments, a third accounting specialist expressed confidence that when a conclusion is drawn from an inner "feeling" on what to consider "reasonable" accounting, this conclusion will also be shared by others. Similarly, a third interviewee describes

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the change in accounting practices as the "best" thing to do in the given situation as it was seen as an improvement to "comparability" amongst Swedish firms and between Swedish entities and other European entities.

> I believe that we have done, or the market has done, what was best to do here. A major concern of IAS 19, or of IFRS, is comparability. So as all the Swedish companies left the government bonds simultaneously, some years ago, then everyone accounts in a similar fashion. That provides very good comparability among the Swedish entities as basically everyone will use the interest rate of the mortgage bonds. Furthermore, you will have an increased comparability with the European entities, as you will eliminate the effects of Swedish entities utilizing the governments bonds, and applying a much lower interest rate than that of corporate bonds. [...] I believe something very good has been reached here: To increase the comparability between Swedish entities. That everyone is making the same decision. And that you have improved the comparability between regions. (Interview 37)

8.6. No statements from the enforcement body

When an agreement between the policy group of FAR and SEAG was reached, there were still uncertainties over what conclusion the enforcement body would reach as no one had asked for the enforcer's view. This accounting issue was perceived as being open for interpretation, making the enforcement body's response into an open and interesting question.

> How will the enforcement body treat this issue? They could say: "No, you cannot think this way. A mortgage bond is not a corporate bond. Can't you hear that in its name?" This you cannot know. IAS 19 is not an especially clear standard in its requirements for something to be a deep market. IAS 19 does not clarify this. So, you could interpret that any way you would like to. (Interview 1)

Some interviewees saw it as possible that the enforcement body would reach a divergent conclusion given that this was seen as a difficult issue with arguments on both sides. One preparer said that his a priori assumption will always be that the enforcer reaches the same conclusion as the preparers as the same circumstances are assessed. This assumption does not

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however imply that acceptance from the enforcement body is not important as accounting practices be maintained without acceptance. In this case, it was considered unusually open whether acceptance would be attained.

> You will always assume that the enforcement body will reach the same conclusion as you. Otherwise you would not account that way. That goes for any accounting issue: You are of the opinion that you are complying with the rules, and therefore the enforcement body will reach the same conclusion as you. In that sense, enforcement is always present and not present, simultaneously. But of course this time because there was rather a big difference in points of views, it was more of an open question. Will the enforcement body accept this? (Interview 27)

In any case, a statement from the enforcement body was always a post hoc event since the view of the enforcer only becomes known after an actual change in accounting practices.

> You have to realize that it is the entities that decide on their accounting! How we want to account! Then we are audited. And then, what we publish will be scrutinized by the enforcement body. So number one is to understand for ourselves whether we believe it is correct to consider corporate bonds as equivalents to mortgage bonds. […] The next [step] is to create assurance, or to bring up the issue with the auditors. And as this was an important issue, principally, we wanted to have support from the technical departments of the auditing firms, or from FAR. Then, what will the enforcement body think or not. That is an issue pretty much later. I have difficulties in imagining that in a very technical issue they would make an interpretation different from the interpretation made by the policy group of FAR. (Interview 20)

The first indication of how enforcement would react was provided by the preliminary document of observations for annual reports of 2010. This document was sent out in the autumn 2011 and included some remarks on insufficient disclosures for pension accounting. It mentioned that many companies disclosed their accounting principles, that high quality corporate bonds were used given that there is a deep market for them, and that government bonds otherwise represent the alternative, without providing any clarification on the discount rate actually applied. (Nasdaq OMX Stock-

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holm 2011f, p. 2) The full enforcement report of 2011 (published at the year-end) did not include this explicit remark on the discount rate. There was only a comment on the need to improve disclosures on accounting principles for gains and losses (referring to IAS 19:120Aa) and on "the most important actuarial assumptions made at the end of the reporting period" for defined benefit pension plans (referring to IAS 19:120An). (Nasdaq OMX Stockholm 2011g, p. 23.) This comment was included under the heading "Other comments", described as "remarks of minor importance" (Nasdaq OMX Stockholm 2011g, p. 20).

Many interviewees were surprised that the enforcement body did not comment on the change in the basis for the discount rate, given that a number of listed firms had made the change that year and that the change had a "material" effect on the financial statements. With the basis for the interest rates changing in 2010, interviewees anticipated a reaction in the 2011 enforcement report.

> [A reaction] could have been expected! I would also have expected that enforcement would have paid attention to the core issue. […] A discount rate will have a material effect on the pension liability. So this could have been expected to be an issue that would have been picked up early within the enforcement system because it will affect the reported profit and the financial position of the firm. (Interview 8)

The silence from the enforcement body was interpreted as acceptance of the use of the mortgage bonds. This created a feeling that the change in accounting practices had not been as "controversial" as initially assumed.

> We all believed that since the enforcement body had not jumped on this one, the issue had not been as controversial as one might have feared that the enforcer, or someone else, would perceive it to be. (Interview 13)

8.7. A journal article

Even though the enforcement body did not comment the change in accounting practices, someone else did. In the spring of 2012, the issue of the mortgage bond was re-raised within *Balans* when Jan Marton (from

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Gothenburg University) wrote an article contesting the way IAS 19:78 was used in practice. He argued that IAS 19:78 provided a "clear and unambiguous rule", leaving no room for interpretations on how to account: the interest rates of Swedish government bonds should be used as a point of reference for the discount rate of Swedish pension liabilities.

> In recent years, the discount rate of pension liabilities in defined benefit plans has been discussed in Sweden. Many Swedish companies apply the interest rate of mortgage bonds to calculate the size of the liabilities. It is difficult to find support in IAS 19 for using such an interest rate. The background to the discussion of the discounting is that IAS 19 states that the discount rate shall be based on high quality corporate bonds. If there is no deep market for such bonds (as is the case in Sweden) government bonds shall be used instead. (IAS 19:78). IAS 19 is neither principles based nor ambiguous. Rather, this is an example from the International Financial Reporting Standards (IFRS) where there exists a clear and unambiguous rule. (Marton 2012)

Marton also points to the comment made by the IASB at the end of their considerations on amending IAS 19 requirements, which he also reads as an unambiguous text.

> IASB initiated a project where a possible amendment of IAS 19 was discussed. The project was terminated without any action taken, and the IASB posted the following on their website:
>
> *"This means that entities will still need to refer to a government bond rate when there is no deep market in high-quality corporate bonds."*
>
> Similar to IAS 19, the IASB statement at the website is very clear and is not an issue of interpretation. What is then the rationale in using mortgage bonds as a basis in Sweden? (Marton 2012)

For preparers, Marton's article came as a complete surprise: "It was rather controversial and it appeared out of nowhere". There were discussions on how to understand the article. As the writer had a personal history at one of the Big Four firms, he was initially understood as not only representing the Gothenburg University but also as representing a Big Four audit firm in his

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statement. Within SEAG there were suggestions to respond to Marton's criticism by writing a *Balans* article. The idea of responding later fell from the agenda as the criticism ultimately was regarded as the "personal view" of an individual. This conclusion was drawn because the article statement was contrary to the accounting consensus, which was also shared by the Big Four firm. Accounting specialists also met Marton's article with a feeling of "surprise". The article arrived surprisingly late in the discussion, when this issue was regarded as already settled and as no longer on the current agenda.

8.8. The possibilities of issuing an enforcement statement

There had been an awareness within the enforcement body that something was "going on" (interview 38) within SEAG as early as 2010, but this personal knowledge was not seen as justifying an enforcement action when the mortgage bonds were not mentioned within the yearly sample of annual reports. In 2011 an interviewee urged the enforcement body to make a statement. Although the contemporary point of view of the accounting/auditing firms was that both government bonds and mortgage bonds could provide an acceptable basis for the discount rate, this individual believed that only one of the bonds could logically be in compliance. If mortgage bonds are corporate bonds, government bonds – the fallback position in the standard – are not in compliance. If mortgage bonds are not corporate bonds, government bonds are the only way to comply. Therefore, an official statement from the enforcement body was sought, but not obtained.

> [I argued that the enforcement body] should be more steadfast. This issue needs deep analysis. Is it OK with the mortgage bonds? Is it in compliance with IAS 19? Or should it be government bonds? […] During 2011, I believe it was, I talked to the enforcement body about that someone had to take a stance in this issue. What is correct? Either, *that* firm (who uses the government bond) is doing the wrong thing, or *that* firm (who uses the mortgage bonds) is doing the wrong thing. Both of them could not be correct, I felt. (Interview 12)

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In the next year's enforcement sample, it became evident that there were divergent practices. Some entities used the government bonds; others used the mortgage bonds. Others did not even specify their point of reference for the discount rate. Yet, there was, within the enforcement body, a perception of that the standard should only be taken as allowing for government bonds *or* corporate bonds. Thereby, divergent practices could not be seen as acceptable, and a statement was deemed necessary.

> I believed that we had to make a statement. Because the standard is that clear and unambiguous: it is either or. So we cannot say that we accept both. Really, we had no choice. (Interview 38)

Although it was clear that a statement ought to be made, it was not (immediately) clear what that statement should say. In the autumn of 2012, a request was sent to FAR, demanding information on how Swedish accounting/auditing firms, their international IFRS help desks, and FAR had reasoned in relation to the use of the mortgage bonds. The request also made reference to Marton's article in *Balans*. The demand triggered an intense period of work in the accounting policy group of FAR, which prepared a written analysis of the issue. As a starting point for this analysis, the group used documents written internally at one of the Big Four firms. These documents had been produced in the course of correspondence with their international IFRS Desk in London, which had posed questions about the Swedish usage of the mortgage bonds.

> There were discussions because we have had questions also from [Big Four] International. They had heard about this and wondered: How do you argue on this issue? So there had been a discussion with [Big Four] International. So we were rather tuned up at the time, but we do believe that this is an issue that is specific to Sweden. So I mean, IFRIC, or IFRS IC, never want to address these kinds of issues: special wage taxes, multi-employer plans and things like that. For the same reason, it might not be as easy for an international IFRS Desk in London to resolve these issues. But they got involved as this issue arose, and we answered them. So we reused parts of that correspondence within FAR, when answering the enforcement body. (Interview 13)

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FAR members shared the task of writing the paper. Although there was an agreement on the general conclusions to convey, authors nevertheless struggled to pull the document together. Different sources of statistics were available, and it was not self-evident which to use.

> I was somewhat afraid that [the enforcement body] would feel that we did not have convincing argumentation. The tricky thing was to get along in such a large group: How do we formulate this? To get the statistics, to agree on the statistics to use, and to agree on the sources. Different sources say somewhat different things. To agree on: Let's go for that source. […] It was not like there was a battle, but it was rather to get it all coherent, with so many individuals involved. […] We contacted the banks to get updated statistics for 2011, not only for 2010. […] We wanted to be ambitious and base our facts in statistics and not only on the accounting argumentation. We also wanted to check with our international colleagues to ensure a fair consensus in these issues. (Interview 13)

In November 5, 2012, FAR responded to the request of the enforcement body by delivering a document that explained FAR's position. It argued that the use of the mortgage bonds must be considered acceptable because these bonds were "corporate bonds" of "high quality" and because the statistics indicated that the Swedish market for these bonds was currently "deep". As the market for mortgage bonds was considered to have grown deep only quite recently, it also argued however that the use of government bonds should be seen as an acceptable alternative, at least during a period of transition.

In addition to FAR, the enforcement body also consulted the Swedish competent authority, where the issue of the mortgage bonds was discussed at one of the regular meetings.

> We relied on the competent authority insofar as we asked how they reasoned. Some years ago there was a similar issue for insurance companies, where the competent authority had an opinion on how to set the discount rate and how to compare actuarial provisions. So with the competent authority, it was largely a check-up: How do you see this issue? Are you of the opinion that we could accept the mortgage bonds? (Interview 38)

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The competent authority emphasized that it could not provide any formal approval of the usage of the mortgage bonds, as the enforcement decision must lie with the enforcement body. In addition to this "check-up", the enforcement body raised the Swedish usage of the mortgage bonds with the EECS. A Swedish enforcer described how the Swedish enforcement body submitted this issue to EECS "before the writing of the enforcement report and before the making of our decision". When the FAR document was received by the enforcement body, this was taken as further confirming that the use of mortgage bonds should be considered acceptable.

> After a while, I received quite a good paper that FAR had produced, where they explained how they had reasoned. Their explanation was underpinned by statistics. So we said: OK, this confirms our view on that you could use this. And then we took this stance. (Interview 38)

8.9. The later statements by the enforcement body

In the preliminary document the enforcement body sent out to the listed firms in the autumn of 2012, there was a brief remark that many entities had failed to disclose information on the basis they had used for their IAS 19 discount rates, and on the rating relied on for making the judgment on whether these bonds were of "high quality". These issues were seen as management judgments in accordance with IAS 1:122. (Nasdaq OMX Stockholm 2012a, p. 3.)

On November 29, 2012, the yearly enforcement seminar was held. This seminar regularly presents the current year's enforcement activities and the main content of the pending enforcement report. A number of representatives from FAR's accounting policy group were awaiting the enforcement statement on the discount rate.

> In the last year, many people were interested, so there were quite many people from the auditing firms, or from FAR, attending, listening with excitement […]. They addressed the pension issue and presented a solution in line with FAR's view. Otherwise I think there would have been a debate in that room.

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> At least we were prepared for that. […] We had really done our homework. (Interview 13)

The final enforcement report, published around 20 December 2012, included information that nine listed entities had been received "remarks" on their disclosures concerning the basis for the IAS 19 discount rate. (Nasdaq OMX Stockholm 2012c, p. 17.) There was also a general comment that disclosures were deemed insufficient if only quoting IAS 19:78 without supplying entity specific information. The report explained that clarifications had been demanded in cases where entities have been stated that "a market based interest rate" was used or where it was stated that corporate bonds "or" mortgage bonds were used. The report for these explained that clarifications were necessary because of the historical assumption that there was no deep market for corporate bonds in Sweden. As a part of the enforcement investigations, entities answered that they use mortgage bonds as a basis for the discount rate, either as "an alternative to corporate bonds", as "an alternative to government bonds", or as "high quality corporate bonds" for which there is a "deep market". (Nasdaq OMX Stockholm 2012c, p. 19.) Within the report, it is noted that IAS 19 does not provide a definition of high quality corporate bonds, but that the "common opinion" on how to understand this expression does not appear to preclude mortgage bonds being corporate bonds. Further, the report recognizes an understanding in practice, where bonds ranked AA or higher, or with another comparable ranking, are seen as "high quality" bonds. (Nasdaq OMX Stockholm 2012c, p. 20.)

The report also attends to whether the market for the mortgage bonds could be considered "deep". It carries out this assessment statistically. Three different graphs illustrated turnover of Swedish government bonds and Swedish mortgage bonds, where a trade in mortgage bonds appears to have emerged from 2008 and onwards. One last graph shows the turnover for mortgage bonds of different durations, with a clear peak for the 4-year bonds (representing about 45 % of the total turnover). It is argued that only the bonds with a sufficiently high turnover could be used as a basis for the discount rate. As the duration of the bonds must match the duration of the pension liabilities, extrapolation based on the bonds of lower durations or

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comparisons with other interest rates were argued necessary. (Nasdaq OMX Stockholm 2012c, pp. 20-21.) When the issue of durations was brought up at the November enforcement seminar, it was met with some scepticism. This was not an issue that was considered important enough to contest openly at the seminar, but a discussion instead was initiated after the presentation. One position was that the scarcity of bonds of lengthier durations was irrelevant as there were already well-established methods of extrapolating interest rates for long-term bonds, which were understood as having direct support within the accounting standard and which were also needed in relation to the government bonds.

> Often [the mortgage bonds] are of short durations. I know that [enforcer], in a seminar, complained about durations being so short. But then it is simply to extrapolate. There are established techniques for that. It is the same thing for the government bonds, where there is also a lack of bonds with longer durations. At least, with some single exception, there are no bonds with durations of 20, 25 years. So it is a small population. But there are techniques […], which makes it is possible to extrapolate. Regardless of who is doing the exercise, you will arrive at similar conclusions, mathematically. So this is nothing that makes [the market for mortgage bonds] impossible to rely on, and I raised that issue at the meeting as well. Why are you claiming that it is impossible to rely on short instruments and turn them into longer instruments? That is exactly what you are allowed to do within IAS 19. So there I believe he attacked the wrong thing. (Interview 13)

As no enforcement questions were sent out to entities based on the issue of durations the general assumption was that no significant disagreement existed on how to understand this accounting issue.

The overall conclusion of the enforcement report is that the Swedish mortgage bonds must be used as a basis for the discount rate.

> Based on the trading statistics and in comparison to the corresponding trading for government bonds […] it is the judgment of the enforcement body that the Swedish market for mortgage bonds is sufficiently deep and well-functioning, and that these financial instruments therefore from now on must be used as a basis for an estimation of the discount rate for Swedish pension obligations. (Nasdaq OMX Stockholm 2012c, p. 19.)

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Finally, the report also emphasized that entities must provide information on the basis for their discount rates for each material pension plan. This was pointed out as especially important given the then current situation of financial markets, where market efficiency may change rapidly. The report also concluded that a change in the basis for the discount rate is a management judgement that could be considered a change in an accounting estimate, and that information on this must be provided in accordance with IAS 8:39-40 and IAS 1:122. (Nasdaq OMX Stockholm 2012c, p. 21.)

Reactions varied to the content of the enforcement statement. Some felt that it was expected. Others were surprised that the enforcement body made such a "strong statement" on the discount rate.

> I was curious, as I know that enforcement had addressed the concern as we have customers who have received letters from the enforcement body. So we know that the issue was on the agenda. We know that the issue had been addressed at this year's seminar at the enforcement body, and we know what we believed we heard when they expressed it orally. Then it was interesting to see how they would formulate it in writing. […] Because, of course, this has a major impact in my, in our, daily work. It will become digital when you bring this to a head, which they did here. Of course, depending on how they would choose to formulate this, it will, or will not, become support for an interpretation of this specific issue. […] We do refer to it. […] So definitely, in this specific issue, we do believe that it indirectly became standard setting, to the extent you may talk about standard setting from an [enforcer]. (Interview 15)

Along with the enforcement body's acceptance of the use of the mortgage bond, the Big Four International desk that had questioned the Swedish accounting practices came to accept these as compliant with the standard.

> And [Big Four] International also closed the case and accepted FAR's view, noting also that the Swedish enforcement body approved of it. (Interview 13)

8.10. The continuing of accounting practices

However, after the publication of the 2012 enforcement report, some question marks remained. The enforcement statement was taken as implying that the mortgage bonds were now acceptable as a basis for the discount

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rate. However, there were divergent views on how to interpret the implications of this. One view was that when the enforcement statement approved the use of the mortgage bonds, the use of government bonds thereby was disallowed, as the standard was only seen as allowing for usage of either government bonds or corporate bonds. Another view was that the enforcer's acceptance of the mortgage bonds did not necessarily imply that government bonds could not be used simultaneously. Rather, the issue was seen as seen as "unregulated" and different interpretations were thereby still justifiable, and assessments were necessary on a case-by-case basis.

> For this issue, different interpretations could still exist. The entities might make their interpretation based on different things. […] But I believe there are only a handful of listed entities that still use the government bonds, so this is a minor issue. […] It is unclear if we have a client here, but theoretically this could happen. The question could arise, and then we will have to manage that. It is the principles of the entity that we will have to assess, i.e. if they have a solid motivation for their accounting. As this is unregulated territory, there could be two different solutions. (Interview 6)

As of 2013, the accounting practices were still not seen to be entirely homogenous, and some entities were still be using the government bonds. It was seen as unlikely that all entities would come to change their practices the same year, and it was argued that different practices must be expected during stages of transitions.

> If one entity chooses this and another chooses that? Or is there only one correct option? Question mark! And as I understood it, this was the opinion of the enforcement body: If there has been a change, all entities must change, i.e. practice shall be changed. But it does not appear very likely that all entities would change simultaneously! Societal development, just like the nation's economy, is in constant motion. That everyone would reach the same conclusion at the same point in time, that is just not probable. Maybe, you cannot see this lasting over 10 years, but during a number of years it could. (Interview 27)

Given that the enforcement body was seen as requiring an abandonment of the interest rates of the government bonds, a further issue was to understand when this change was required. The dates of the enforcement semi-

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nar and the publication of the enforcement report were too late in the year for the requirement to cover the 2012 annual reports.

> I do believe that most firms use mortgage bonds, but for instance there was an auditor who called me stating that he has a client that applies the interest rate of the government bonds. I received that question ahead of the publication of the enforcement report, I believe. I said that I believe it to be a mitigating circumstance that the enforcement body as late as at a meeting in the end of November goes out and explicitly states that they will accept the interest rate of the mortgage bonds. That is really late. And there were not many participants at that meeting either. There could have been some 40 attending. As the information was not spread more rapidly, it is hard to believe that the firms will be able to manage this issue in the current year's annual report. (Interview 3)

In addition to the issue of when the enforcement report came in force, there was also an issue of when its findings might cease to apply. The enforcement decision rested on current market statistics, there was uncertainty over how much assessed circumstances could change without making the 2012 enforcement statement obsolete.

> If the rule says that there ought to be a deep market, then you will have to try and define, or interpret, how many bonds, and the kind of liquidity in trade, there must be for a market to be deep. And the circumstances assessed will change from year to year. This is an empirical issue. So this issue will always live on. (Interview 8)

For entities that have switched to using mortgage bonds, there were still remaining issues in relation to actually setting the discount rate. Because many entities used a discount rate of 3.5 percent for the year-end financial reports of 2012, it was questioned whether it was reasonable that so many different entities would use exactly the same rate. Given that different entities should be expected to have different durations for their pension liabilities, the interest rates applied should also vary slightly among entities. When actual variances were considered unexpectedly low, this was considered an issue that needed further attention.

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8.11. Concluding remarks

In this chapter, we have seen how the enforcement body entered the regulatory space on several occasions. Initially, the enforcement body investigated whether the listed entities' use of a discount rate complied with IAS 19. The disclosed discount rates were judged to be unexpectedly high, given that their point of reference should have been the interest rates of the Swedish government bonds. The body explicitly noted that mortgage bonds could not be used as substitutes for government bonds as there was no "deep market" for them. By mentioning market depth, the enforcement body created a possible interpretation whereby mortgage bonds would be acceptable if there was a "deep market" for them.

At that point in time, the enforcement body clarified that no criticism was directed towards the actual levels of the discount rates applied, as the low levels of the interest rates of the Swedish government bonds were seen as resulting in overstatements in measurements of pension liabilities. The accounting was thus not seen as a problem because it functioned in practice. Others did not agree.

Another European enforcer, within the arena of EECS, criticized in turn this failure to criticize. The Swedish enforcement body was seen as taking into consideration general perceptions of "fairness" in its judgment, rather than assessing whether or not the accounting was in compliance with IFRS. In the subsequent enforcement report, the enforcement body did demand additional disclosures on this issue.

In a joint effort, individuals from the preparing entities, the accounting/auditing firms and the SFRB sought to change the accounting standard by approaching the IASB. The IASB subsequently issued an exposure draft, which was however met with criticism, and the change never came about.

When the interest rates of the government bonds fell further in the wake of the financial crisis, several actors began to treat this accounting issue as a problem in need of a solution. Again, attention turned to the mortgage bonds.

A number of actors began a conversation on how to interpret the accounting standard. Here, the wording of the accounting standard received close attention. The three issues discussed were whether the mortgage

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bonds could be seen as "corporate bonds", whether these were of "high quality", and whether there was a "deep market" for them. The actors strove for mutuality of interpretations in different steps. Initially, the preparers sought approval from their auditors. Thereafter, the accounting specialists of the Big Four saw it as important to enlist support from representatives of the actuarial profession for the proposed accounting. Finally, an agreement was reached between the accounting policy group of the Swedish association of the audit and accountancy profession and representatives from SEAG. Collective reasoning about how to interpret the standard resolved any ambiguities, and a conclusion followed that the use of the mortgage bonds was compliant accounting. Thereby, a number of listed entities changed the basis for their discount rates from government bonds to mortgage bonds.

However, it was still uncertain whether the enforcement body would accept this because the enforcers had not participated in these conversations. The next enforcement report did not include any critique of the use of the mortgage bonds, and this was seen as an enforcement acceptance. The problem of the discount rate was regarded as solved.

The later publication of a journal article that criticized the use of the mortgage bonds did raise the question of whether the issue had to be readdressed. There was, initially, a common perception that the article's author represented one of the Big Four firms. This was regarded as both unexpected and problematic. When it subsequently became clear that the author was conveying only his "personal view", the criticism became less important. The article did not re-establish the discount rate as an accounting problem. A later event however did.

When an enforcement letter later picked up the critical reasoning from the article, this criticism required an answer. As a part of its enforcement investigation, the enforcement body asked the accounting policy group of the Swedish association of the audit and accountancy profession and the European enforcers of the EECS to clarify their opinions on the issue. Both these groups expressed support for the current accounting practices.

In the end, the enforcement body accepted the use of the mortgage bonds. No further enforcement criticism was expressed, but the enforcement report did include a statement of acceptance. In addition, preparers

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who had not yet changed their accounting practices were urged to do so. With this statement, the enforcement body was seen as (re-)solving this accounting problem and codifying then current accounting practices as compliant accounting.

However, this solution opened new questions and transformed other accounting practices into possible "accounting problems". Even after these discussions a number of entities had changed their accounting practices and after the enforcers had accepted this change, some differences of opinion remained. Some actors argued that the acceptance of mortgage bonds had rendered the use of government bonds non-compliant; others argued that both the mortgage bonds and the government bonds were acceptable. The choice seemed to depend on the circumstances of the specific entities. This left a state of affairs where, for at least some actors, alternative "compliances" could co-exist.

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Chapter 9

Conversations on accounting practices

In the following, it is shown that the initial definition of accounting issues as being "accounting problems" or not is significant for the construction of a role for the enforcement body in the regulatory space. Issues that the main actors in the regulatory space do not accept as problematic can be left without further attention whereas issues seen as accounting problems cannot. For the latter, instances of "rule repair" will solve accounting problems either by focusing on the accounting standard or on it's application. The argument here is that accounting problems can be solved equally well by changing or by not changing accounting practices and that agreements on "fairness" are central in the establishment of accounting practices. The thesis concludes that the ambiguity of accounting standards cannot explain whether a specific standard are enforceable or not. Lastly, the implications of these above-mentioned research findings for the role of the enforcement body will be outlined.

9.1. Definitions of accounting issues

Hancher and Moran (1989) establish that the issues seen as open for regulation define the regulatory space. They argue that classification of issues as residing within or outside the regulatory space and the allocation of responsibilities for resolving individual issues comprise the central activities in that

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space. These activities have implications for how power is distributed amongst different actors.

> [I]ssue identification and definition are done largely unthinkingly as a result of customary assumptions and organizational routine. It could not be otherwise because, were it necessary to argue at length about the appropriate identification of every new issue, the activity of regulation would simply grind to a halt. (Hancher and Moran 1989, pp. 293-294.)

Young (1994) shows that a specific classification of issues was determinative for whether an accounting issue became the topic of accounting standard setting or not, i.e. whether the accounting issue became successfully established as an accounting problem. Adding to this finding, I argue that this classification also matters for whether accounting issues will become the topic of regulatory conversations (cf. Black 1998, 2002) on how accounting standards should be applied. Thereby, different actors' abilities to establish or reject accounting issues as accounting problems indicate their power to influence accounting practices.

9.1.1. Issues defined as "unproblematic"

In chapter 5, the enforcement body's repeated comments on the pre-tax discount rate of IAS 36 can be seen as an attempt to initiate a regulatory conversation in order to frame this accounting issue as an accounting problem. Responding to the enforcement statements, three academics joined the initiated conversation by writing a debate article in *Balans* (Carlsson *et al.* 2013). The article profiled this discount rate as an important accounting topic and can be understood both as an acceptance of the issue as an accounting problem and as a further attempt to establish it as such.

After the publication of this article, no further public comments were made on this issue, implying that no further conversations on how to account for this discount rate evolved. Hence, the issue never became an item on the common agenda of the regulatory space.

In this case, there was not only no shared understanding of the issue as an accounting problem, but there was not even any shared understanding of what to consider the "accounting issue". In fact, two different under-

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standings had been present over time. At the one hand, the issue was sometimes seen as a mere disclosure issue ("Shall the pre- or post-tax discount rate be disclosed?"). On the other hand, the issue was sometimes seen as a measurement issue ("Shall the pre- or post-tax discount rate be used in impairment calculations?"). Historically, this accounting issue had been discussed as a measurement issue (see e.g. Nyllinge and Winkvist 2001, Johansson 2002). Carlsson *et al.* (2013) also discussed the issue (at least partly) as a measurement issue. Nevertheless, the enforcement statements were seen as addressing disclosures only.

A similar instance of a conversation that was initiated but not continued is presented in chapter 6. In this case, the enforcement body highlighted the IAS 12 requirement of providing "convincing other evidence" of future taxable profits. The enforcement report stated that this accounting standard had given rise to application problems because of uncertainty over what "evidence" to understand as "convincing". By making this statement, the enforcement body could be seen as initiating a conversation on this issue as an accounting problem. In practice, there was little agreement on this view. Many actors were of the opposite opinion, feeling that the meaning of this expression was not difficult to understand. It was deemed straightforward to make the judgments required and to know when it was appropriate to recognize an asset or not. Preparers, especially, portrayed this accounting issue as unproblematic. This opinion was not however articulated publicly, but was expressed in the research interviews. This accounting issue, therefore, seems to have been rejected as an accounting problem. The reason for this may have been that there existed tacit knowledge in how to apply the accounting standard. This knowledge may have developed over time as some actors indicate that there had been discussions and debates on the implications of this standard at the time of its introduction. Thus, earlier regulatory conversations may have made any further conversations (at the time of this study) redundant. Nevertheless, some other enforcement statements relating to the tax loss carryforwards received more attention, i.e. the issues of partial recognition of carryforwards and the issue of whether time limits could be used to assess asset recognition.

Although these issues were also rejected as accounting problems, the rejections in these cases were more active. Both in a journal article and in

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direct communication with the enforcement body, the accounting policy group of FAR criticized the enforcement statements. They explained why the enforcement statements were inappropriate. On the issue of partial recognition, the conversations held appears to have resulted in an alignment of views, were both parties regarded this practice to be in compliance with IAS 12. On the issue of time limits, accounting practices (and views on compliance) were and remained divergent. This did not prevent that, after these conversations, none of the issues came to be regarded as accounting problems. Other issues, however, were.

9.1.2. Issues defined as "accounting problems"

For both the issues related to pension accounting in accordance with IAS 19, there were divergent views on how the accounting standard should be applied (i.e. on what to consider compliance). In these cases, the situations were not seen as sustainable, and the actors of the regulatory space actively worked on creating a common view.

Chapter 7 provides an account on these actors' uncertainty over whether the change of IAS 19 required that Swedish accounting practices also had to be changed. The issue of how to treat the Swedish special wage tax and the Swedish tax on returns became therefore an accounting problem at the centre of attention within the regulatory space. To find a solution to this problem, a lengthy regulatory conversation evolved on how to measure, recognize and present these two taxes.

A similar conversation arose in relation to the possible use of mortgage bonds as the basis for the discount rate used in measurement of Swedish pension liabilities. The establishment of this issue as an accounting problem did not happen with the immediacy of the tax topics. In the early 00s, multiple alternatives existed for what could constitute compliance in relation to the standard regulating this issue. At that point in time, the enforcement body was not criticizing the accounting practices in their public enforcement statements (neither in their reports nor in their decisions). However, a remark made in an IFRIC rejection called the then contemporary practices into question amongst the other actors of the regulatory space. The accounting standard was understood as only allowing for the use of the unad-

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justed interest rate of Swedish government bonds as a basis for the discount rate. A lingering discontent with this accounting treatment however increased with a special event, the financial crisis of 2008. The crisis increased the spread between the interest rates of European corporate bonds and the Swedish government bonds. Therefore, the difference increased between how Swedish pension liabilities and pension liabilities of other countries were measured. With this increase, the discount rate became an accounting problem that needed to be solved.

Many interviewees emphasized impact on financial statements as a reason for why issues became accounting problems. This was the case for the issue of the IAS 19 discount rate. There was however also examples on issues that became accounting problems where the impact on financial statements was not substantial. In relation to the issue of how to treat the taxes in relation to IAS 19 Revised this appears to have been the case for many entities. Here, it was instead the issuance of a new standard, and the difficulties in understanding the implications of this that was seen as making the taxes into problem.

9.2. Problem solving by standard repairs

Black (2002) emphasizes how the difficulties of formulating rules suitable for future and unexpected events often lead to a need for rule repair. Repair can be made either by *standard or guidelines formation*, i.e. by production of new rules or by amendments to the current rules. Alternatively, *standard application change* (i.e. changing the ways rules are applied and interpreted) may constitute a repair of the rules.

This thesis addresses several examples of the actors of the regulatory space attempting to solve accounting problems by relying on both these kinds of repairs. It must here be especially noted that only accounting problems invoke repairs because the issues that were not seen as problems naturally did not needed any further attention.

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9.2.1. Standard and guidelines formation

The possibility to issue statements on how to account crystalized as a focal point in the conversation on the treatment of taxes in accordance with IAS 19 Revised. These issues debated concerned both *who* should appropriately issue statements and *what content* these statements should include.

While some preparers, through SEAG, had on opinion on how to account for the Swedish taxes, it was generally regarded bothersome to account in any way without a common view on how to account. In addition, it was seen as important that any agreement reached ensured that a fair presentation of the pension liabilities would be reached.

Whether the issue could be defined as an actuarial issue or an accounting issue was crucial to the process of determining who would make the regulatory statements. Notably, accountants tended to define the issue as essentially an actuarial issue and actuaries instead commonly understood the issue as an accounting issue. This definition mattered because accounting standard setters could make a statement only if the issue discussed concerned accounting. However, that the international standard setter (the IASB or their interpretative body the IFRIC/IFRS IC) should make a statement was out of the question because this issue had previously been referred to IFRIC. By then, IFRIC had rejected it as an agenda issue (see IFRS IC 2015: IAS 19-3).

The Swedish standard setter, the SFRB, remained an alternative. Here, the decisive question was whether this issue could be seen as specific to Sweden as these were the only issues on which SFRB is formally qualified to act. It was not until the tax on returns was interpreted as a tax specific to Sweden, the Board was enabled to make a statement.

The Swedish standard setter's entrance into the regulatory space appears generally to be seen as solving the problem of how to account for the tax on returns. This standard allowed the previous accounting practices to continue. The national standard had effectively repaired the international standard and the conversation on this tax therefore came to an end.

Similarly, the statement from the actuarial association solved the problem with the special wage tax by regulating an issue that had previously been unregulated. The special wage tax, however, could not be considered

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an issue specific to Sweden. This disqualified SFRB from making a statement. Preparers looked instead to the entrance of the actuarial profession into regulatory space as a way of solving the special wage tax problem. For this issue, one widely shared view advocated a "simplified method" for calculating a provision for this tax. On the other hand, there was no shared view on what this "simplified method" really was. Many preparers and auditors understood the "simplified method" suggested by the SSA as equivalent to the method suggested in the withdrawn UFR 4 and as equivalent to the current and long-standing accounting practices. Not everyone however shared this view. Some actors believed that the SSA statement and UFR 4 referred to different (simplified) methods. The question of whether the current accounting practices were aligned with the new SSA statement did not became a topic of any further regulatory conversations as most assumed congruence between the new statement, the previous standard and the current accounting practices. The presentation of the special wage tax item however changed.

While a published interpretation can never be expected to eliminate the ambiguity of the original accounting standard (cf. Wittgenstein 1953:198), the treatment of Swedish pension related taxes shows that new statements, addressing a specific problem, can accomplish repair by suspending (for the time being) perceived ambiguities in the accounting standard. Future applications of the newly issued statements will by all matters be future issues, which will only be future problems if they are recognized (i.e. constructed) as such.

Notably, the first attempt at repairing the international accounting standard in relation to the IAS 19 discount rate (chapter 8) also constituted of an effort of standard formation. In this case, several actors tried to change the current international standard in light of the current national situation. This attempt thereby involved an effort to modify the original standard rather than to complement it with new standards or guidance. When the IASB issued an exposure draft suggesting an amendment to IAS 19, other national constituencies opposed this change and the IASB abandoned the idea of change. There was no worldwide agreement that this standard was problematic.

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The developments around IASB's publication of the IAS 19 exposure draft showed how voices that have initially garnered attention can at later stages be disregarded in the presence of other voices (cf. Hopwood 1994, Cooper *et al.* 2008, Bozanic *et al.* 2012). In this case, the experience appears to have led to a joint acceptance of that the international accounting standards could not be affected. Rather, the text of the accounting standard was taken as a given from that point forward. Repair by standard formation could thus only be performed if it was possible to issue national standards (or guidelines). Instead, efforts now become devoted to how the existing accounting standard could be interpreted.

Bozanic *et al.* (2012) contrasted "passive" efforts of influencing interpretations of regulations *after* that these are issued with the "active" efforts of influencing regulations *before* these are issued (p. 466). However, the empirical material of this thesis illustrates clearly that processes taking place after the issuance of standards are in no sense "passive".

9.2.2. Standard application

This thesis profiles the issue of the IAS 19 discount rate (chapter 8), which provides an illustrative example of how an intense and lengthy regulatory conversation created the meaning of a specific accounting standard. It is unclear who introduced the idea of using the mortgage bonds (as a point of reference for the IAS 19 discount rate) into the regulatory space. Some interviewees identified the preparers as the source of this suggestion and others the actuaries. Furthermore, an enforcement report mentioned the mortgage bonds as early as in 2009. This report recognizes mortgage bonds as a potential type of corporate bond.

Regardless of its origin, the idea of using the mortgage bonds was regarded strikingly "good" by multiple actors of the regulatory space. However, interviewees did not see it as sufficient to reach this conclusion on an individual basis (as a person or within an individual entity), but rather a more encompassing agreement ("consensus") was necessary. This in turn created a need for regulatory conversations. These developments illustrate how regulatory conversations serve to remove uncertainty or (inversely) to produce certainty (cf. Black 2002). Certainty is reached when there is mutu-

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ality of interpretations (Black 2002), i.e. when there is a common view on how to read the standards.

A first step in understanding whether the mortgage bonds were usable was to establish whether the standard text could accommodate this, i.e. a meaning had to be produced of the accounting standard prescription. IAS 19:78 was seen as including three important requirements that had to be fulfilled. As the standard said "high quality corporate bonds", it was addressed whether the mortgage bonds were "corporate bonds" and whether these were of "high quality". As the standard only allowed usage of corporate bonds when there was a "deep market" for these, the issue of whether the mortgage bond market was "deep" was also addressed.

In understanding what could be considered a "corporate bond", one important aspect was now to understand the meaning of "corporate" as used within this expression. In practice, the understanding of this turned out to be multifaceted. Some actors initially perceived no initial uncertainty on this meaning, but rather immediately understood mortgage bonds as corporate bonds. As banks (which were seen as corporations) issued these bonds, the bonds were understood as corporate bonds. On this interpretation, it was impossible to understand the expression in any other way, as "corporate" corresponded with expressions as company or firm. The expression "corporate bond" was therefore understood as referring to any bond not issued by the government. A more complex and active interpretation only became necessary when others expressed disapproval with the original interpretation.

While some actors instantly accepted the mortgage bond as a "corporate bond", others as instantly disapproved of this classification. They believed instead that the word "mortgage bond" in and of itself indicated that this was not a "corporate bond", despite it being issued by corporations. Critical here was the fact that the bonds were covered (having a security in real estates). This coverage was seen as making mortgage bonds and corporate bonds two different kinds of bonds, because their credit risks differed substantially

Other interviewees questioned instead whether the banks (or rather their subsidiaries, the Building Societies) were really corporations. The word "corporate" was seen as alluding only to industrial companies, in con-

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trast to financial companies. Therefore, corporate bonds were understood as a sub category of non-governmental bonds.

On both these interpretations, the meaning of the standard was perceived as obvious. The presence of different interpretations can be seen as an indication that this obviousness was (at least) not a result of how the standard was written. In addition to those actors who immediately saw the mortgage bonds as being (or not being) corporate bonds, some others had no initial feeling for the meaning of this expression. Instead, they treated this expression as effectively being devoid of meaning, implying that a meaning had to be created by an act of active interpretation. This interpretation took shape in discussions with others and included assessments of the positions described above.

Because there were no shared views on this accounting problem a common interpretation had to be created. This was the case despite the fact that the expression corporate bond at a first glance can seem to require no judgments to be applied and can come across as a rather unambiguous and straightforward rule. Contrary to this, the requirement of high quality may seem ambiguous and therefore to maybe call for interpretive judgments. In practice, this requirement needed however not to be interpreted to be applied. Instead, the issue of whether the mortgage bonds were of high quality was described as unproblematic in the Swedish context. This was because there was already an established meaning for this expression. High quality bonds were understood as bonds with credit ratings of (at least) double A. This established use made the conceptualization of this requirement unambiguous. As the mortgage bonds typically were double or a triple A rated, the high quality requirement was seen as fulfilled. Because there was a consensus that the mortgage bonds were high quality bonds, no further regulatory conversations on this topic evolved.

Similar to the expression high quality, the expression deep market could be expected to invoke judgments. In this case those expectations were met and the meaning of deep market was not seen as straightforward. On the contrary, the use of the term deep market within IAS 19 was described as a puzzling choice of expression as it commonly had no meaning for accountants. Instead, the word was assumed to have a meaning elsewhere. Wittgenstein (1953) indicated that a word is no more than its finite number of

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usages. A word can only have a meaning through its use within a specific language game. This position may be used to understand how the actors of the regulatory space conceptualized the expression "deep market". This expression was commonly assumed to have a meaning (i.e. to be used), albeit only outside of accountancy. Who the users of this expression were was quite unclear to most interviewees. It could be "those who are occupied with the market" or possibly the actuaries. This could be seen as an illustrating that only those belonging to a socio-linguistic community that is familiar with expressions used can apply regulations with certainty whereas those outside of these communities will remain uncertain in how to interpret the regulation. (Black 2002)

By assessing different dimensions of the market for mortgage bonds (such as outstanding volumes and trading frequencies), it was agreed on that this specific market could be characterized as deep. In addition, comparisons with the alternative market (i.e. the market for government bonds) were made. This market was taken as an example of a market that had to be sufficiently deep. As the differences between the markets for mortgage bonds and government bonds were not considered significant, the market for mortgage bond was also accepted as deep.

Notably, although a shared view emerged that the Swedish market for mortgage bonds was a deep market, no shared view emerged on a more general meaning (or definition) of the expression deep market. When interviewees explained how they understood a deep market, they emphasized different things. While some argued that it was the volume, not the trading frequency, that makes a market deep, others argued the opposite. In addition, while some argued that deep is a less strict requirement than "active", others argued the opposite. This shows residual differences in the internalized meanings of this concept. Remarkably, this non-consensus in actual understandings of the expression did not matter in practice because the expression could still (successfully) be used. In other words, the shifting understanding of the actual meaning of deep did not prevent agreements on its use.

The expression deep market was adopted from a world outside accountancy, but it was smoothly incorporated into the language game of accountancy when a specific use of this term had been agreed on and

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established. Here, it could be noted that there were two different reactions amongst those encountering a word, the meaning of which was believed to be located elsewhere. The first (less common) reaction was to treat the word as available to use freely (as it had no meaning within accountancy). The other (more common) reaction was to understand the word as "owned" by someone else, some "they" who would know the meaning of this word. Therefore, "we" have to sort out whether our suggested usage would be considered acceptable by those who tacitly know its meaning. On this view, the concept was assumed to have a meaning that could be searched and found.

The above illustrates that a number of judgments must be made in the application of accounting standards. Accounting research has also previously highlighted the necessity of using judgments in applying accounting standards (Brown *et al.* 1993, Bennett *et al.* 2006). Young (1994) and Bozanic *et al.* (2012), however, only focused on the processes leading up to a new standard or regulation. Although Young (1994) investigates several actors of a regulatory space, she still privileges the accounting standard by granting it a dominant position in this space (cf. Cooper and Robson 2006, Hatherly *et al.* 2008) when assuming that accounting standard change can be equated with accounting change.

9.2.3. The effect on accounting practices

This thesis has shown that the relationship between accounting standard change and changes in accounting practices is far from a causal one. In addition, this thesis has shown that there is no direct link between the understandings of accounting issues as accounting problems and any need to change accounting practices. Whereas an accounting problem may be solved either by standard or guidance formation or by investigating the standard application, any of these solutions may lead to changed as well as unchanged accounting practices.

In both chapters 5 and 6, we have seen how rejections of accounting issues as accounting problems (for reasons outlined above) led to that regulatory conversation initiated came to an end. Thereby, the accounting practices could (or could not) be changed. Despite the enforcement body's

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statements, this choice was nevertheless perceived to remain with the preparers.

In chapter 7, a lengthy regulatory conversation on what was defined as an accounting problem led to the repair of an accounting standard through the issuance of a new standard and of new guidelines. When these new statements were issued, the previous accounting practices could (largely) be kept. In chapter 8, an equally lengthy conversation was needed to ensure that accounting practices instead could be changed. In this case, the (unchanged) accounting standard became repaired through the conversation on how the standard could be applied and interpreted, even though there were some initial attempts of standard formation (both in terms of amending the international standard and of issuing a new national standard)

The empirical material of this thesis therefore shows that problems may (equally well) be solved either by changing, or by not changing current accounting practices. Here it must also be noted that whereas a new standard may provoke a change in accounting practices, an unchanged accounting standard may allow for changed accounting practices.

9.3. Accounting concepts and changes in accounting practices

For the issue of the mortgage bonds, the change in accounting practices gained acceptance because the accounting treatment discussed was deemed compliant with the accounting standard and because it was seen as leading to increased comparability and to the removal of unfairness. Thereby, notions of "fairness" and "comparability" matter in relation the establishment of accounting practices in multiple ways, i.e. in relation to establishing an accounting issue as a problem, in establishing an accounting treatment as acceptable accounting and in the further diffusion of accounting practices.[24]

Similarly, in relation to the pre- or post-tax discount rate of IAS 36, arguments on the appropriateness of accounting practices (in terms of how

[24] It may here be noted that the idea of accounting fairness (fair representation) and the idea of that something is fair (that different parties get equal opportunities) seems to be interlinked for at least some interviewees.

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well they aligned with desired accounting properties) also mattered for how the standard was interpreted. Contemporary ideas on proper valuation methods were especially important here. These ideas supported positions in favour of reading the standard as allowing for post-tax calculations because anything else would be nonsense. For instance, it was doubted that a pre-tax discount rate could reasonably be used in calculations when market based observations of WACCs are only available on a post-tax basis.

In relation to this accounting issue, perceptions of comparability also mattered. Carlsson *et al.* (2013) argued that disclosure of the post-tax discount rate improves comparability, given that this rate is the most commonly used in actual goodwill calculations. On the contrary, an enforcer argued that comparability is reached when all entities (as a minimum) disclose the pre-tax discount rate. These examples illustrate how the same accounting concept may be used to argue in different directions. Comparability may therefore be seen as devoid of meaning in the absence of agreements on how it is affected by different accounting treatments. In this case, the lack of agreement can persist since the issue was not accepted as an accounting problem within the regulatory space.

On the contrary, for accounting issues that are accepted as accounting problems the formation of agreements is central. The following quotation on the special wage tax illustrates this. Here, perceptions on compliance combine with perceptions on fairness and practicability.

> The entities were relatively convinced that this was still a good way to treat the issue and there was a wish to receive an answer from the actuarial association on that they could continue to deliver calculations based on the same methods as earlier. […] We thought that it both provided a fair presentation and was practical to continue to account in the same way we had done before. It was seen as being in line with what was required. (Interview 29)

In relation to this accounting issue, the decisive question was whether the simplified method provided a significantly fair view of the liability or whether it was necessary to create a more refined method to achieve fairness. Only the creation of agreements could assure this. Although one method was clearly preferred within the preparers' association SEAG, ac-

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ceptance from other significant actors (in this case the actuaries) was deemed necessary in order to account in the preferred way.

The conversation on how to treat taxes in accordance with IAS 19 Revised is comparable to the conversation on the mortgage bonds, as both conversations include multiple instances of agreement formation. For the issue of the mortgage bonds, a creation of an accounting consensus (with guaranteed support from the main actors of the regulatory space) enabled the change in accounting practices.

For the issue of the special wage tax, difficulties in reaching agreements extended the regulatory conversation on how to treat this issue. In the end, it was the passage of time (i.e. that time had come when the calculations had to be made) that forced the actuarial association to make a statement, regardless of that full agreement was not yet reached.

For this issue, similar arguments as those surrounding the IAS 36 issue were present in that the accounting standard was seen as conveying a nonsense message. Because the government bonds and the corporate bonds were no longer comparable (although they may have been at the time when the standard was written) the IAS 19 prescriptions were perceived as outdated and inappropriate.

When the Swedish government bonds were understood as the only possible point of reference for the discount rate for Swedish pension liabilities, there seemed to have been a general view that the situation was unfair because there were major differences in how pension liabilities were measured in different countries. Because the differences followed from the existence, or not, of a deep market for corporate bonds, the variation reflected no substance in terms of the real value of the pension liabilities. Further, the differences were seen to impair the possibility of comparing firms located in different countries. The accounting concepts of fairness and comparability were hence invoked to establish the discount rate of pension liabilities as an accounting problem.

The accounting concept of fairness in this study is an important element in establishing the discount rate for pension liabilities as an accounting problem. This establishment is a necessary step in the essential work of changing unfair accounting into fair accounting.

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In addition, the accounting claim of that accounting should lead to comparability between different entities (also across countries) provides another rationale for bringing about a change in accounting practices. This argument focuses on the purpose of adopting IFRS in the first place, i.e. an increased comparability across countries. Any accounting that makes the financial reports of different countries incomparable must be a problem.

The existing view of these aspects of accounting as valuable ensured that a change in accounting practices that increased these characteristics would be accepted as appropriate (as long as the treatment was also accepted as compliant with the standards). This finding is consistent with Young (1994), who showed that a perceived divergence between accounting practices and accounting claims and concept (i.e. a divergence between what accounting is and what accounting ideally should be) enabled accounting change. In a U.S. environment, she found that the concepts of relevance, reliability and representational faithfulness were repeatedly relied on in the construction of accounting issues as actual accounting problems.

In addition, the above findings may be compared also to Young (1995). She described actors within a regulatory space as changing their perceptions of what to consider right accounting, but never abandoning their belief in the possibility of "getting the accounting 'right'". In the empirical study of this thesis the idea of rightness appears to have been replaced with the idea of fairness. This idea is central both when issues become defined as problems and when problem solutions become defined as acceptable.

9.4. The concept of "ambiguity"

Following Wittgenstein's (1953) line of reasoning, the ambiguity of the law will not be a property (or a character) of some laws (rather than others), but rather ambiguity must be considered an ever-present problem in following any rule. If precision is not a property of the written regulation, it could be questioned whether laws and standards could really be divided into more or less ambiguous regulations or into rules and principles.

Accounting research has previously recognized that it is difficult to classify accounting standards as either principles based or rules based. Instead, all standards are argued to be a mixture of more or less precise regu-

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lations (i.e. rules and principles). (Schipper 2003, Bennett *el al.* 2006) In addition, the very concept of a principles based standard is also found to be used with shifting meanings (Dennis 2008).

This suggests that not only the understanding of regulations' content and implications may be subject to processes of meaning construction, but also their very nature, where one specific prescription can be understood as more or less ambiguous at different points in time.

This study illustrates how the perceived ambiguity of a certain accounting standard prescriptions are not dependent on whether it is (seen as) more rules based (in the sense that it is intended to specify how accounting shall be performed) rather than more principles based (in the sense that it is intended to invoke judgments). Remarkably, this ambiguity was not related to the actual ease or difficulty in applying accounting standards in practice.

For instance, the IAS 12 expression "other convincing evidence" was described by some practitioners as hard to interpret, a framing contested by others. Similarly, the expression "high quality" could be expected to require judgements, but no interviewees described it as difficult to understand in relation to the mortgage bonds. This was because a usage of this expression was established in practice (i.e. bonds with a credit rating of AA or AAA).

Where the accounting standard provided the expression "deep market" (rather than for instance specifying that the market shall have a certain volume of outstanding shares or a certain trading frequency for them), the standard could have been expected to require judgements, and in this case, an active interpretation of the expression was required. Where the communicated intention of the standard setter in IAS 19 Revised was to leave the judgments on "taxes payable by the plan" to the appliers of the standard, regulatory conversations were also needed and developed.

The IAS 36 regulation of the discount rate for goodwill impairment testing provides an example of an accounting standard prescription that may appear as unambiguous, but which nevertheless was interpreted in different ways. In relation to this standard, different conclusions had been drawn both in relation to whether the discount rate should be pre- or post-tax interest rate and on whether the requirements concerned disclosures and/or measurement. Even though the pre-tax interest rate seems to be a

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straightforward expression, its meaning in the end was described as a mere "fiction".

Similarly, the usage of the expression "corporate bonds" hardly comes across as an intended effort to provoke accounting judgments, and the paragraph where the expression in included (IAS 19:78) is described as rules based. Nevertheless, regulatory conversations were required to determine the meaning of corporate bonds in the specific case, i.e. whether it could encompass mortgage bonds.

The above examples illustrate that the need to interpret accounting standards may neither be tied to whether they are formulated as rules or principles nor to whether they are intended to require judgments to be applied. Independent of how the accounting standard is written, understandings of whether an expression is a problem or not appears to shift across time and space. Therefore, regulatory conversations on how standards shall be interpreted will occur only when and where an issue has transformed into an accounting problem.

This can be seen in the absence of a current regulatory conversation on how to understand "convincing other evidence", but where such a conversation had evolved earlier. While no conversation arose on the implications of "high quality" in relation to the Swedish mortgage bonds, some interviewees pointed out that this expression was much debated within the Euro-zone. Within this zone, the shrinking number of corporate bonds with high credit ratings had given rise to discussions on whether "high quality" shall be understood as an absolute (as in at least AA rated bonds) or relative (as the bonds with the best credit rating currently available) concept. Although the interpretation of this expression was not an accounting problem in Sweden, it was a problem in other European countries.

In light of this, ambiguity is a concept that does not provide much support in efforts to distinguish between different accounting standards. Rather than talking about standards as more or less ambiguous, vague or even principles based it seems more fruitful to describe a standard as open or closed for interpretation to the actors in a specific regulatory space at a specific point in time.

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9.5. The enforcement body's roles within regulatory conversations

Given that the same paragraph can be considered possible, and impossible, to enforce at different points in time, the level of detail of the accounting standard prescription is not decisive to its enforcement. Therefore, the possibility of making an enforcement statement based on a standard prescription cannot be expected to be dependent on how the standard is written.

The production of more guidance to clarify accounting standards may therefore be understood as an attempt to repair the standard in the presence of an accounting problem, rather than being a necessity in the process of making a standard enforceable. Notably, this conclusion has implications for the argument that enforcement bodies may only make statements in relation to clear rules. The enforcement of accounting standards cannot therefore be taken as an argument for creating more rules based accounting standards (cf. Schipper 2005, Alexander and Jermakowicz 2006, Ball 2009).

Independent of how the accounting standard is written, the role of the enforcement body instead depends on how the accounting issues were defined within the wider regulatory space. In particular, it is crucial whether accounting issues are accepted as accounting problems. This classification matters because the enforcement body only contributed to shaping accounting practices for issues defined as problems.

The enforcement body has actively tried to initiate new regulatory conversations on accounting practices. By doing so, accounting issues are highlighted as possible accounting problems. Examples of this are found in relation to the IAS 36 discount rate (chapter 5) and the tax loss carryforwards (chapter 6). In relation to the IAS 19 discount rate (chapter 8), the enforcement body mentioned a new and alternative accounting practice (use of the mortgage bonds) before these bonds become generally accepted as compliant with the accounting standard. By doing so, the enforcement body may have contributed both to constructing this issue as an accounting problem, and to solving this problem.

However, the role of the enforcement body is not only dependent on whether accounting issues are defined as problems, but also on whether

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shared views on compliance are formed. If a specific accounting practice complies with the standard, it cannot (by definition) be an "enforcement issue", as the task of the enforcement body is to criticize cases of non-compliance (cf. Committee of European Securities Regulators 2003). In this sense, determining the nature of an accounting treatment ("compliant"/"non-compliant") will define whether an accounting issue is an enforcement issue. Regulatory conversations on accounting practices ensure that specific practices comply with the accounting standards. Therefore, conversations may remove accounting issues from the enforcement agenda.

An accounting issue becomes an enforceable accounting problem only when there is agreement that the current accounting treatment does not comply with the IFRS and that the deviation is material enough to be worthy of attention. This implies that any uncertainty on the content of compliance appeared to restrict the possibilities of the enforcement body to make enforcement statements.

It must here be emphasized that when the enforcement body participates in regulatory conversations on the content of compliance it also participates in the construction of its own role by enabling removal of uncertainties surrounding how to read the accounting standards. With this removal, the enforcement body's scope for action increases as the delimiting uncertainties no longer exist. Both when initiating changes in accounting practices and when accepting current practices as appropriate, the enforcer formulated the content of compliance in relation to specific accounting standards and therefore actively contributed to shaping accounting practices. However, this shaping is made in communication with others. Notably, it was not until when the preparers (through SEAG), the auditors (through the accounting policy group of FAR) and the enforcers came to an agreement that the mortgage bonds could be used in compliance with IAS 19 that also the Swedish enforcement body made a lengthy statement, agreeing with this conclusion.

Similarly, conversations on what to consider compliance were important also in relation to tax loss carryforwards. In this case, conversations between the accounting policy group of FAR and the enforcement body appear to have resulted in agreements that partial recognition of tax loss carryforwards are allowed by IFRS. This agreement enabled the accounting

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practice of partial recognition to be continued and made further enforcement statements redundant.

Interviewees emphasized the importance of established accounting practices for the possibility of making enforcement statements. These practices enable enforcement bodies to make statements because it reduces the risk of making an "interpretation" of the standard.

> It could also be that there is [an established] practice by now. Previously, this was not the case. It is easier when the issue has been on the table for some years and you see that a number of companies have found a streamlined way of doing this. Then a practice is established. With IAS, this is nothing to take into consideration, but this was how things worked previously, with accounting practices as a part of GAAP. Many [entities] account like this and then that is the correct way to account. But that no longer exist. Now it is only the rules. It does not matter whether 100 firms in Sweden are doing one thing if this is wrong. Because then it is wrong, anyway. […] But in reality things are different. It will be much easier to accept an accounting treatment if 100 entities account in the same fashion, if they have agreed on doing it this way. (Interview 17)

In relation to the usage of time limits, FAR did not agree with the enforcement body on that the use of time limits failed to comply with the IFRS. FAR instead argued that a limit in time was an indirect implication of the requirement to provide convincing other evidence. Contrary to the FAR position, but aligned with view of the enforcement body, several preparers believed that the use of time limits may well not have complied with IFRS. The acceptance of the enforcement body's standing point may have contributed to that the enforcement body continued to criticize this issue. The remaining disagreements between FAR and the enforcement body, however, allowed the divergent accounting practices continue to co-exist.

The number of uncertainties surrounding the issue of the pre-tax rate (both in relation to what to consider the actual accounting issue and in relation to how to understand compliance) explain why the enforcement statements could essentially be ignored. The absence of shared views on how to account (and especially the absence of a shared view on the significance of how the accounting is performed) coincided with the enforcement body's difficulties to shape the accounting practices. Although some entities

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changed their accounting treatment it was still regarded possible not to do so.

Commonly, uncertainties over the content of compliance result in that the enforcement body criticized preparers for insufficient disclosures, but did not criticize their measurement and/or recognition practices. This could be illustrated by how the pre-tax discount rate for goodwill impairment testing become defined as a disclosure issue (although it had previously been discussed as a measurement issue) and by how the discount rate for pension liabilities was enforced initially as a disclosure issue but later as a measurement issue, when agreement on the content of compliance was created.

That the enforcement body was able to criticize the disclosures (despite remaining uncertainties) could be a result of the commonly held view on disclosure issues as being less important accounting issues. This view is common within enforcement research (see e.g. Brandt *et al.* 1997, Fearnley *et al.* 2000, Brown and Tarca 2007) and is also present in the critique of the Swedish enforcement system, recently as well as historically. Thus, a redefining of an accounting issue from an issue of measurement or recognition to an issue of disclosures could enable the enforcement body to make a statement, where a statement was otherwise not possible.

Furthermore, the enforcement body may contribute in removing the uncertainties of compliance by expressing its acceptance for current accounting practices and there through contribute to manifesting these practices as legitimate and appropriate. This is illustrated by the enforcement body's public acceptance of the mortgage bonds after they had become generally accepted and widely used in practice. The care taken in preparing the argumentation sent to the enforcement body and the willingness to defend the practices in debate show that an acceptance from the enforcement body was deemed important for a continued use of the mortgage bonds. This indicates that the enforcement body was regarded an important actor of the regulatory space whose opinion could not be disregarded.

This finding may be compared with Black (2002), who argues that certainty (in this case about how to account) could be created by assuring that there is mutuality of interpretations. Certainty is suggested to be most valuable in relation to the interpretations made by authoritative bodies, as these

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have "the power to determine interpretations and impose sanctions for breach" (Black 2002, p. 179).

An enforcement statement that accepts certain practices manifests the legitimacy of those practices. The lack of enforcement criticism on the other hand may also be seen as an acceptance. This was the case when the use of the mortgage bonds was not criticized in 2011. The enforcement acceptance can thus fulfil a similar role as can a statement issued by a standard setting body or other organization that has gained authority within the regulatory space (such as the actuarial association).

In addition, it must be noted that the enforcement body may have a position within the regulatory space without actively taking part in regulatory conversations. The thesis indicates that it may be sufficient that the enforcement body is thought about as possibly entering a regulatory conversation advocating a (presumed) standing point for the other actors of the regulatory space to regard this position. This is the case in the conversation on how to account for taxes in relation to IAS 19 Revised. Even though the enforcement body did not make any statements in this conversation, this body nevertheless was present within regulatory space. This is because the possibility that the enforcement body could act within this space made it important to create shared views on how to account. In that sense, the mere existence of the enforcement body appears to reinforce the need for opinions on how to account to be well thought through, publically defensible and shared with others. The introduction of an enforcement body can therefore be seen as strengthening the role of the accounting consensus within the regulatory space. The journal article criticizing the usage of the mortgage bonds could here be seen as illustrating how an expression of disagreement is not interpreted as a problem when seen in isolation, but later on becomes a problem when it is detected and highlighted by the enforcement body. The lengthy conversations on how to apply the newly revised IAS 19 thus illustrated how agreements on how to understand the content of compliance are (even actively described as) necessary in order to avoid enforcement criticism.

Generally, it could be concluded that the existence of consensus on how to account in compliance with a standard creates the possibility for the enforcement body to affect accounting practices. Conversely, a lack of such

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a consensus will affect how the enforcement decisions are looked upon and understood.

A central argument in the discussions on the enforcement reports is that the enforcement body shall not have the power to determine interpretations. In the critique of early enforcement reports, it was emphasized that the enforcement body should keep to enforcing the accounting standards, without making add-ons, withdrawals or amendments to them. This, according to the critique, put the enforcer in an inappropriate role as a standard setter. The same rationale also provides a basis for questioning the role of the European organization, ESMA.

> Sometimes the enforcement body has been able to defend its opinion by stating that ESMA supports this opinion, that there is agreement on the issue within this organization. That is somewhat scary because then they almost become standard setters […]. Likewise, the first publications from the enforcer also included some standard setting, with opinions on how to account. We expressed that we did not believe that they should do that, to mix up the roles. (Interview 13)

In particular, chapter 6 illustrated how contesting the implications of the standard linked with contesting the role the enforcement body. It was deemed "unfortunate" that the enforcement body acted as a standard setter.

The prohibition on interpretation is related to the idea of that enforcement should be pure enforcement. This is regarded an activity where it is assured that the accounting standards are followed, but where the standards are not amended (which would be the result of the enforcer choosing one of several interpretations or adding requirements). The idea of pure enforcement is present within CESR's and ESMA's standards on enforcement (Committee of European Securities Regulators 2003, 2004b, European Securities and Markets Authority 2014), which emphasize that enforcement decisions shall not be interpretations of accounting standards. The uncertainties surrounding when a decision is an interpretation created boundaries for the role of the enforcement body. Notably, in practice these boundaries may even have become stricter than expected when the European guidelines were formulated.

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Chapter 10

The actors and the arenas of the regulatory space

This chapter presents and discusses the actors of the regulatory space. It suggests that some actors are institutionalized participants of the space (cf. Young 1994) and others are only present in relation to specific accounting areas. Still other actors rarely take parts in conversations on any accounting issues and have a minor influence on accounting practices.

The chapter also raises questions about categorizing individuals on the basis of their present occupation. It argues that the relevant groups within the regulatory space are epistemic communities formed by individuals engaging in different accounting issues. These communities provide the coordination of actors and perceptions necessary to enable an establishment of accounting practices.

Furthermore, it argues that the empirical evidence of this thesis, which demonstrates how the enforcement body becomes included in previously created epistemic communities, highlights the importance attributed to this new regulatory actor by the actors already occupying the regulatory space. This analysis, finally, locates the role of the enforcement body in the interplay between the enforcement body's attempts to enter the regulatory space and other actors' reactions to these attempts.

In addition, the chapter argues that the local arenas are important within the regulatory space. As a result of this, the enforcement body's national location strengthens its potential to affect accounting practices.

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10.1. The actors of the regulatory space

Young (1994) emphasized how some actors are more frequently present within the regulatory space than others, as their participation is institutionalized through employment or through their membership on different committees.

This thesis identifies some of the employees of the accounting/auditing firms and some of the employees of the listed entities as holders of such institutionalized positions.

10.1.1. The ever-present actors

The Big Four firms are ever-present in the accounting issues investigated within this thesis, but the auditing team or underwriting auditors are not key actors in the conversations on these issues. Rather, when the Big Four firms enter the regulatory space, it is the accounting specialists that are the key actors. These accounting specialists are the recurrent participants in regulatory conversations on changes in accounting practices. In particular, the accounting specialists of the accounting policy group of the association of the audit and accountancy profession appear to have an institutionalized presence within the regulatory space. This thesis provides several examples of the activities of this accounting policy group, including their critique of the enforcement statements on tax loss carryforwards (chapter 6), their participation in the conversations on the IAS 19 Revised (chapter 7) and on the mortgage bonds (chapter 8). Notably, the secrecy agreements for the auditors may be an explanation for why these are not present within the public debates.

These findings confirm the importance of the large international accounting/auditing firms in establishing accounting practices, as has previously been emphasized and documented by Young 1994, Hopwood 1994, Greenwood *et al.* 2002, Cooper and Robson 2006, Suddaby *et al.* 2007 and Malsch and Gendron 2011. Previous research has also explicated the shift in professional identity within these firms (Suddaby *et al.* 2015), with a larger focus on commercial values and advisory services. (Greenwood *et al.* 2002, Suddaby *et al.* 2007)

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Similar to the accounting specialists of the Big Four, the accounting specialists of the listed entities appears to have an institutionalized position in the here investigated regulatory space. The significance of the preparers extends to their active (and successful) work in establishing certain accounting issues as accounting problems worthy of discussion (chapter 8) and in rejecting problem formulations (chapter 5). For accounting problems, the preparers also have significant roles in suggesting, discussing and manifesting solutions to these (chapters 7 and 8).

Although the accounting practices of the preparing entities have no formal role within the IFRS regime, the empirical material of this thesis provides evidence of how some entities appear to adopt the accounting practices used by other preparers. In turn, this adoption was seen as evidence that these accounting practices were appropriate. Thereby, the actual accounting practices of the preparing entities also matter in relation to IFRS. This can be illustrated by the following remark made by an interviewee.

> I believe our company was one of the first ones out. Since then almost everyone has chosen this accounting option. I guess the fact that everyone within this industry is in agreement indicates that this was the correct choice to make. (Interview 30)

In previous research, the accounting policy choice literature (see e.g. Ball *et al.* 2003, Daske *et al.* 2008) emphasizes the abilities of preparers to affect accounting practices. In addition, Young (1994) shows the importance of manufacturing and service entities in processes of accounting change.

10.1.2. The issue specific actors

Based on the empirical material of this thesis, it appears that various kinds of (non-accounting) specialists are prominent issue specific actors of the regulatory space. These specialists are organized into the regulatory space, as their expertise is regarded necessary for understanding how to apply the accounting standards. Primarily, three types of specialist competencies are

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drawn into conversations on accounting practices, namely the actuaries, the valuation specialists and the tax specialists.

The influence of the actuarial memo in the acceptance of the mortgage bonds (chapter 8) provides an illustrative example of the actuaries' position within the regulatory space.

> It is not the actuaries that are setting the assumptions, but this is the responsibility of the preparing entities. As we want them to take on this responsibility, we are always very clear in discussions and in meetings, stating where references have their origin and what the standard states. […] We wanted to provide them with some information, enabling them to make a decision and enabling them to be comfortable with their decision. It was a kind of education. Not many, or no one, who will make these decisions will be an expert in all these matters. It will be the CFO or someone who will sign that they approve of this and who will be setting the assumptions. They don't all have the knowledge. They have not all read IAS 19 on a sufficiently deep level. We tried to say: What is written [in the standard]? (Interview 37)

As the actuaries have access to knowledge that is unknown (described as "black-boxed") and therefore undiscussable for outsiders, the actors of the regulatory space consider the opinions of the actuaries to be of major importance. If the actuaries disapprove of a proposed change in accounting practices, this constitutes a major obstacle to that change coming about. Chapters 7 and 8 both included examples of how the opinions of the actuaries are actively sought. Both chapters also include examples of how other actors try to influence the opinions of the actuarial profession by presenting certain accounting practices as being preferable to others. Both these actions point to the perceived relevance of an actuarial opinion. In addition, it is clear that the actuaries play an important role disseminating of new accounting practices when writing about them and when discussing them with their clients, i.e. the preparing entities.

This finding may be contrasted to Power (1996) that acknowledges the actuaries as experts that auditors commonly rely upon, but who on the other hand argues that the auditing profession may partly have internalized the actuarial knowledge. The empirical material of this thesis does however not support this view, where the actuarial knowledge seems exclusively to be (seen as) held by the actuaries.

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When the accounting is related to valuation issues, the valuation specialist becomes the important counterpart. This is evident in the issue of the pre- or post-tax discount rate of IAS 36 (chapter 5). When the valuations issues are considered to be of a "theoretical" nature, the valuation specialist assumes a particular importance for translating theory into practice.

> If you get too far into theory, which you might need as a point of reference, then you will have to call to the experts. If you have [a problem] like this: What would theory state? How could you deduce this? The entities will make the decisions: This is what is written! We will apply it like this! [...] I cannot draw the formulas, deduce and see whether the answer will be exactly the same [as it is supposed to be]. I am not that into theory. But there are people who are and then you have to make use of them, making them do the judgment, enabling it all to end up in a practice. (Interview 7)

The importance assigned to the valuation specialist is also illustrated in how their views influence understandings of the accounting standards. When the valuations specialists argued that impairment tests could not be done on a pre-tax basis, the accounting standard requirement of doing so turned into "nonsense". Notably, the valuation specialist's role is not limited to making the necessary judgments in relation to valuations, but also include helping to assess whether the resulting accounting is compliant with the standard.

> The problem is that when you do these impairment tests, the corporate valuation models are based on the opposite: i.e. to include taxes. That is the prevalent starting point. The ones that do this in a high-quality and proper way will engage people who produce a reasonable discount rate. When I look at these issues myself, I always try to hand them to our valuation experts who work with this every day. They have to think about: If we make a cash flow valuation, how will I reach the rate to discount the future cash flows? And they do not perhaps always reason as in IAS 36, with the kind of tax adjustment that is made within this standard. So that is a problem to handle, to bridge. Certainly, there is a need for real specialists to get things IAS 36 compliant. (Interview 15)

The importance of the valuation specialist is also apparent in relation to the assessment of whether the Swedish market for mortgage bonds was a

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"deep market" or not. Here, the valuation specialists assisted by providing information on how the mortgage bonds were issued and traded.

> The judgment of whether this was a deep market and this issue of how to delineate it. […] This will depend on your background. I have not worked with financial markets in this way. I have not seen what kind of turnovers there will normally be. I don't live in that world. […] If the question is: "What kind of risk premium would it be reasonable to have within a specific industry?", I would not know that. I will have to consult experts to be able to make a judgment on those kinds of issues. Similarly, those who are preparing the accounts will also have to consult the experts: the valuations specialists. There is a need for engaging different kinds of specialists to be able to manage your accounting. (Interview 19)

Finally, tax specialists appear to be important in assessments of how to account for taxes. Some of the accounting issues brought about lengthy answers from the interviewees, but the accounting topics relating to tax loss carryforwards did not. Instead, several interviewees remarked that tax is a separate issue, largely taken care of by tax specialists. This thesis therefore indicates that tax specialists can have gained a position within the regulatory space, where they are able to shape accounting practices for tax related issues.

The way the above-described specialists enter the regulatory space however contrasts with how the regulatory space is commonly understood, i.e. as a battlefield over power and influence (see e.g. Malsch and Gendron 2011, Canning and O'Dwyer 2013). The actuaries in particular appear to be rather involuntary occupants of the regulatory space. Several actuaries express unwillingness to be regarded as accounting specialists and to exercise influence on accounting practices because they consider accounting outside their expertise. Nevertheless, their opinions are repeatedly sought and set boundaries for how to account.

The above findings confirm the suggestion made by Robson and Cooper (2006), i.e. that accounting practices are also influenced by non-accountants. In addition, the above findings are similar to Young (1994), who also found that different actors occupied the regulatory space in relation to some accounting issues, but not in relation to others.

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10.1.3. Academics and financial analysts

Both Marton (2012) and Carlsson *et al.* (2013) are examples of academics entering the regulatory space to discuss the validity of some current accounting practices, but where there is no (direct) effect on accounting practices of statements made.

According to Hancher and Moran (1989), admission to the regulatory space is restricted to individuals that represent organizations that already occupy the space. "The only realistic mode of entry into regulatory debates is as a bearer of organizational interests – indeed, usually of the interests of corporations or government departments." (Hancher and Moran 1989, p. 296) This explains why Marton's effort to enter the regulatory space was eventually disregarded. When Marton is initially taken as representing the official view of one of the Big Four firms, his statement is seen as problematic and necessary to respond to. However, when agreement emerges that Marton's statement represents only a "personal view", it is no longer necessary to afford the statement any further attention. A similar explanation accounts for the lack of impact from Carlsson (2013). Their statements garnered no public reaction, as neither of these debaters represented an organization (acknowledged as important) within the regulatory space. In contrast, when the enforcement body started to ask questions regarding the usage of the mortgage bonds (after the publication of Marton, 2012), these questions could not be left unanswered. The enforcement body was seen as a legitimate actor in the regulatory space.

Within this thesis, the only example of (what could be labelled) a user making an entrance into the regulatory space is when the financial analyst (and also enforcer) Peter Malmqvist (Malmqvist 2011) responded to the article from the association of the audit and accountancy profession (Abrahamsson *et al.* 2011). Although the professional association of financial analysts or shareholders (e.g. the Swedish Society of Financial Analysts or the Swedish Shareholders' Association) could be legitimate platforms to speak from, this thesis shows no empirical evidence that this is done in practice. The "technical" nature of IFRS is described as one reason why financial analysts seldom engage in accounting issues.

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> Nowadays, issues are so specialized, so it will not be long until I have lost track with them. […] Otherwise, I would really have to get to understand the issue and I do not have any time for that. Often, it just gets too technical. (Interview 17)

The IFRSs are described as impossible to discuss except by those working with them on a daily basis. The accounting specialists' practice of talking about accounting by making references to different IFRS paragraphs creates particular obstacles to communication with financial analysts.

> Because when the financial analyst meets an accounting specialist, the accountant will start juggling with numbers: "You know, IAS 19, the 4th paragraph, the 3rd section, where they state that a deep market is…" The financial analyst will react: "What is IAS 19? Wait a minute!" This is not at all a part of the reality of a financial analyst. "Isn't IAS 34 exciting?" Which standard is that? Was it impairments or quarterly reports or what? So it will take a while before you start juggling with these numbers, but it is typical for the accounting specialist. And there the financial analysts will say: What is this guy talking about? Why can't he not just speak Swedish or English? […] But the ones who are deeply engaged in this, […] they do not speak the same language as the financial analysts, who are not accounting specialists at all. Financial analysts are definitely not accounting specialists! […] Although the standard creates a sense of safety and a basis for the financial reports that financial analysts consider useful, they do not willingly discuss this basis. (Interview 39)

The creation of a specific language game for talking about accounting issues (where detailed knowledge about the accounting standard is both assumed and required), thereby creates barriers to entry into the regulatory space. Conversely, for those familiar with the terms and expressions of this language game, this opens access to this space. This explains the position of the actuaries.

The issue of "missing" (Cooper *et al.* 2008, Bozanic *et al.* 2012) or "silent" (Hopwood 1994) voices in regulatory processes has been recognized also previously within accounting research. In particular, academics (Young (1994) and the appointed users of the financial reports (for instance investors and creditors) (Hopwood 1994, Young 2006) are highlighted as actors that rarely occupy the regulatory space. This is despite the fact that the users at least are commonly called into this space by others (Young 2006).

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10.1.4. The individuals as actors

Above, some specific actors of the regulatory space have been described. In the description, these actors have been addressed as belonging to different professions. What has not yet been examined is the extent to which these professions can really be regarded homogeneous groups of actors.

Previous research has acknowledged that although it is common to refer to parties or groups assumed to have a specific and joint interest in accounting, these groups are often far from coherent in practice (Laughlin and Puxty 1983, Young 2006). The empirical material of this thesis supports a similar observation.

While some preparers are very active within the regulatory space, far from everyone is. Rather, it is some specific individuals from the preparing entities that occupy important positions within this space. For them, a responsibility to take part in accounting conversations seems to be an integrated part of their professional identities. Their participation in discussions does not depend on the importance of the issue discussed for the entity they represent, as long as the issues have general importance. This remark made by the head of group accounting of a larger listed entity may illustrate such a position.

> The special wage tax and the new IFRS; that was an issue we worked with for a long time and where I also took an active part. […] I worked with that issue at least a year! […] It was, or became, a huge concern. For us, it is not a big thing, but for some entities it is. (Interview 20)

Other individuals from the preparing entities describe their the willingness to devote attention to accounting issues as dependent on whether the issue will affect their financial statements or not.

> If another interpretation would have been made, then the figures would not have looked very differently. And then, you do not pursue that issue as forcefully. […] If on the other hand we would have switched from mortgage bonds to government bonds that would on the contrary have affected us severely. That issue is more important for us. (Interview 35)

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Hopwood (1994) stressed that only a relatively small number of individuals are involved in accounting on the international level. Undoubtedly, the same could be said about the local accounting regulatory space. During the research interviews, the names of some key individuals where repeatedly referred to. These individuals were almost exclusively employed by one of the Big Four firms or by a listed entity, but they were also active within the Swedish Financial Reporting Board (SFRB), the accounting policy group of FAR, the Swedish Enterprise Accounting Group (SEAG), the Swedish Society of Actuaries (SSA) and/or the Swedish Bankers' Association (SBA). In relation to the accounting issues described in chapters 5-8, these individuals identified issues as accounting problems to pay attention to, suggested solutions to these problems and participated in events where different actors create agreement on what counts as compliance. Thereby, these individuals (rather than the professions or organizations they represent) could be understood as the actual actors of the regulatory space.

Notably, different individuals are often recognized as an expert within different accounting areas. Within the area of pension accounting, this is one of several similar recommendations that identifies an individual preparer of a larger listed firm as important.

> The one that was most engaged in this [the discount rate of IAS 19] within SEAG, was [Name] at [listed entity]. […] If there is something that is happening around these issues, he is the one that is active and makes the presentations. […] He is active, knowledgeable and more outspoken than most people. (Interview 11)

Another way to impact accounting practices seems to be to further a specific concern to one of these key individuals, whom will then actively take part in conversations.

> This industry is immensely thin, so there are some individuals who occupy many different chairs. [Name] is one of these individuals. He is employed by [a listed entity]. He participates in the preparer's association. He participates in the SFRB. I don't even know, but he is present in different places. So sometimes, you may talk to him and he may pursue the issues [at different places]. (Interview 35)

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The empirical material of this thesis illustrates the interlinkages between what otherwise could be seen as different and separate actors. In the following, it is argued that these interlinkages constitute arenas of the regulatory space.

10.2. The arenas of the regulatory space

The standard setting activities must be understood as a joint effort not only because many actors interact with the standard setter, but because indeed (some of) these actors are the standard setter. For instance, the expert panel of the SFRB (assigned the duty of preparing and presenting issues for the Board) consists almost exclusively of representatives from the preparing entities and from the accounting/auditing firms. Thereby, it is questionable whether it makes sense to talk about the standard setter as a homogenous actor.

Foremost, it could be argued that the SFRB constitutes an *arena* of the regulatory space by providing a forum for discussions amongst different *actors*, enabling regulatory conversations to take place. This could be illustrated by the following summary of the local discussions preceding the decision to approach the IASB in relation to IAS 19:78.

> In this case, there was an exchange of views between SFRB, the Confederation of Swedish Enterprise and FAR. And then you also have to consider who serves on the SFRB and its expert panel. To put it simply: half the expert panel consists of representatives from the entities and half of the expert panel consists of representatives from the auditing firms. […] So naturally, as accounting Sweden is so small, this really facilitates communication. […] The possibilities for exchanging views informally are very strong, as this is a small country with well-established contacts and connections. (Interview 8)

The empirical material of this thesis indicates that the main arenas where regulatory conversations took place were the preparers' association (SEAG), the accounting policy group of the association of the audit and accountancy profession (FAR), and the local offices of individual preparers, the Big Four accounting/auditing firms and (for pension related issues) the larger actuarial firms. Individuals with clearly established views on what

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they considered compliant (and fair) accounting entered the regulatory space by making statements in these arenas. To that extent, the change in accounting practices was initiated by active efforts of convincing the not yet convinced on the appropriateness of the suggested practices.

The empirical material of this thesis supports a conclusion that what is central within the regulatory space is not so much organizations in the form of individual firms (for instance an individual Big Four accounting firm or an individual preparing entity) but rather the interconnections between them. Beyond the accounting policy group of FAR and the preparers' association SEAG, the Swedish standard setter (SFRB) and the pension committee of the actuaries' professional association (SSA) are important within the regulatory space investigated here. Notably, for the banking firms the SBA appears to fulfil a role similar to SEAG's, although this thesis shows fewer direct examples of activities within SBA. Thus, this thesis extends the view that accounting regulation is produced by multiple actors (cf. Young 1994, Bozanic *et al.* 2012) by illustrating how this is done in practice.

Despite this, it is clear that these professional associations matter although it remains to be seen in what sense they matter. Specifically, it is open to question whether these organizations matter as actors or as arenas of the regulatory space. Miller (1991) argued that an "accounting constellation" (which could be compared with a regulatory space, cf. Young 1994) consists "of a multitude of different actors operating in possibly separate arenas" (p. 736). Greenwood *et al.* (2002) emphasized professional associations as important arenas for interactions amongst different actors. Based on these ways of describing arenas, it could be suggested that it is foremost as arenas, rather than as actors, that the above-mentioned professional associations are important components of the regulatory space.

Although the preparers' association SEAG is described by interviewees as an actor (when solving the accounting problem of the IAS 19 discount rate by stating that the mortgage bonds are acceptable), it could be questioned whether this was really a joint action taken by the entire organization. Rather, it should be acknowledged that some individual SEAG members actively took part in enabling acceptance (through a formal document being sent out) whereas other members solely awaited a message on whether the mortgage bonds were acceptable or not. Thereby, different

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fractions of this larger association are distributors whereas other are receivers of information, which frames the association as both an arena for conversations on accounting and also an arena for diffusion of accounting practices. As SEAG includes working groups for different accounting areas, it must here be noted that the roles taken on by different members (as distributors and receivers of information) can be expected to change in relation to different accounting areas.

Young's (1994) perspective on regulatory space problematized the role of the standard setting body, FASB, by equating this body with other actors in the standard setting process. Although formally issued by the standard setter, Young understands the accounting standard as a creation produced by a larger constellation of actors. With a similar approach, Bozanic *et al.* (2012) shows how those entities expected to be regulated by the U.S. SEC effectively took part in the creation of regulations.

While the national standard setter includes by design a mixture of professions, this thesis provides evidence that organizations which may be assumed to be intra-professional, in practice are not. This can be illustrated by how representatives from the Big Four have started to take positions in the preparers' association, SEAG. The inclusion of Big Four firm representatives is described as a phenomenon of the 00s. An event that was brought forward as important for this development was when one of the front figures of SEAG went from being a preparer (employed by a listed entity) to becoming an accounting specialist of one of the Big Four firms. It was seen as "self-evident" that he should keep his position within SEAG, despite this change. This event is described as something that manifested an attitude of that there was nothing strange about Big Four employees participating in the activities of the preparers' association. When SEAG was founded, the attitude had been otherwise.

> At the time […], the attitude was that here, within SEAG, we are talking, without the presence of any auditor. It was not supposed to be any auditors here, but we are talking to each other. […] But then, with the transformation of SEAG now during the 00s or something like that, they abandoned that restriction. Now there are representatives of all the Big Four within SEAG. They contribute in different manners, for instance by making presentations and so on. So there has been a change from the time when auditors were not allowed

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> and until now when it is more or less a given that the auditors are participating in meetings, are included in mailing list and so on. (Interview 11)

This evolvement indicates that the actors within the regulatory space is not only organized in accordance with their employments or assumed professions but also in accordance with their interests in different accounting issues.

10.3. Espistemic communities

Black described epistemic communities as "networks of knowledge-based communities with an authoritative claim to policy-relevant knowledge within their domain of expertise". Within these communities, values and beliefs are shared. (Black 2002, p. 189.) Those who are not a part of these communities will "not share the same validity claims, tacit understandings, or socio-linguistic register". (Black 2002, p. 178.)

Given the findings above, it could be concluded that the actors of the regulatory space could be understood as gathered and organized as epistemic communities of accounting specialists employed in different organizations. Notably, as different actors are involved in different accounting issues, different epistemic communities may well arise in relation to each issue that is accepted as an accounting problem.

For instance, the actors involved in the discussions on the mortgage bonds (chapter 8) formed an epistemic community, with a shared view of how to interpret the accounting standard. This shared view enabled the change in accounting practices. Notably, outside the sphere of this community there can still exist conflicting views on how to account.

Communication also takes place between preparers and accounting specialists of the Big Four firms outside SEAG. For instance, the meeting between some accounting specialists of the Big Four and some SEAG representatives is described as a crucial event when the use of mortgage bonds gradually gained recognition as an accounting practice in compliance with IAS 19.

The *Balans* article published in conjunction with the introduction of IAS 19 Revised provides another example of different professions interact-

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ing in practice. Though introduced as a statement made be the pension committee of the actuarial association, SSA, the article was signed both by actuaries of this committee and by representatives of the larger accounting/auditing firms. The further evolvement around this issue provides yet another example of inter-professional linkages, as FAR and also SEAG provided comments on the draft statements (on how to treat the Swedish special wage tax) written by the pension committee of the actuarial association.

Finally, on several occasions the accounting policy group of FAR and the Swedish enforcement body regularly communicate with each other (e.g. in relation to tax loss carryforwards and in relation to the usage of the mortgage bonds).

The formation of an epistemic community consisting of preparers, accounting specialists of the Big Four, and actuaries (within which mutuality of interpretations was reached) enabled the change in accounting practices. To assess the "depth" of the market for mortgage bonds, this community called upon valuation experts and people working in financial markets (by issuing or trading financial instruments) to share their knowledge on mortgage bonds and the market for them. This consultation affected opinions of how the bonds should be understood for accounting purposes, and thereby, the valuations specialists became actors in the regulatory space, even though it was emphasized that the accounting judgment stayed with the accountants.

Notably, coordination of views was created primarily in two different ways. First, coordination began with the arrangement of meetings, with invitations going to actors perceived as important. Notably, the accounting specialists of the Big Four firms (represented by the accounting policy group of FAR) and some actuaries were invited to meetings. This implies that these actors were seen as able to influence the possible acceptance of this accounting practice. Further, as both actuaries and accounting specialists initiated meetings with each other, the need to seek approval must have been mutual.

Second, coordination was achieved through the production of written documents addressing the topic. Here, a memo written by an actuarial firm served to produce coordination when SEAG members took notice of this

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memo and saw it as providing support for a change in accounting practices. A SEAG e-mail (with the actuarial memo attached) also served to produce coordination by providing SEAG's point of view. This was important, as the SEAG acceptance was seen as manifesting the change as legitimate.

As the examples above indicate, the actors of the regulatory space are in no sense isolated, but have many arenas for interaction. This interaction is even further facilitated by the overlapping responsibilities of some actors, partly due to having multiple engagements in one point in time but mostly due to having moved among different employments and professional occupations across time.

Because of this, most individuals in this study are difficult to classify as a "standard setter", a "preparer", an "auditor" or an "enforcer". The perceived professional identity might also differ from the actual occupation at a given time, where for instance an accounting specialist at a Big Four firm described himself mainly as a "financial analyst" and two preparers of a listed entity concluded that they are also partly "standard setters", as they are writing guidance on how to account within the group.

In addition, the actual tasks performed do not seem to match the presumed roles of the different actors in financial accounting (as described in the introduction to this thesis). Instead, the empirical material supplies examples of reversal of the presumed roles.

When an enforcement body is introduced to monitor the accounting of the listed entities, the enforcement body in turn is monitored when accounting specialists the Big Four firms and preparers from the listed entities review and assess the quality of enforcement.

When the enforcement body criticizes accounting practice, the body was sometimes seen as taking on the role of a "standard setter". Similarly, an interviewee concluded that although the enforcer is criticized for acting as a standard setter, the auditors themselves issue guidance on how to account (*FARs Rekommendationer*) and could therefore also be seen as standard setters.

In addition, there are actors that are not assumed to be playing any role in relation to financial accounting, but who in practice do. The most prominent example here are the actuaries, who are not only issuing guidance (that is read and taken into account in the preparation of financial reports),

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but who are also engaged for making the actual measurements of reported items.

10.4. The local and global aspects of the regulatory space

It can be noted that the (presumed) international regulatory space appears to be surprisingly distant. Although the accounting standards are international and many of the organizations involved are international, the local arenas still appears to play an important role as these are sites where many regulatory conversations are held.

10.4.1. The national and international standard setters

While Suddaby *et al.* 2007 and Malsch and Gendron (2011) describe how a "regulatory gap" between the national (or regional) supervisor and the international accounting and auditing firms created advantages for the latter, this "gap" is less evident in the current study. Although the newly introduced enforcement body is a national one, its main counterparts are, primarily, also other national (rather than international) organizations. Even though the Big Four firms and some of the listed entities are international organizations, the organizations that are most active are the local accounting policy group of FAR and the local preparers' association SEAG.

For the accounting specialists of the Big Four, their international help desks come across as a party to influence, rather than as an influential force. This does not however imply that the opinion of the help desk is regarded unimportant. The efforts to convince the help desk of the appropriateness of a chosen path clearly indicate that the opinion of the help desk matters. In addition, there is also empirical evidence that "the international" matters when "international colleagues" are consulted to ensure "a fair consensus" in the accounting issues before the submission of a letter to the enforcement body (chapter 8) and that "international IFRS practice" is invoked as a reason to keep current accounting practices (chapter 6).

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This thesis highlights the role of national and international standard setters in constellations formed after (rather than before) the issuance of accounting standards. With the adoption of the IFRS, interviewees appear to assume the international standard setters (the IASB) to have replaced the national standard setters, except for country specific issues. The repeated requests to the SFRB to make statements on issues perceived as accounting problems can be understood as (attempts of) re-establishing a position for the SFRB within the regulatory space. Doing so foregrounds the question of whether an issue is "specific to Sweden". This is evident in the conversations on how the Swedish taxes should be accounted for in accordance with IAS 19 Revised. The determination that there exists elsewhere taxes comparable to the Swedish special wage tax effectively eliminated the option that SFRB should make a statement on this tax. When the tax on returns was believed to be unique for Sweden, SFRB was able to make a statement and thereby to solve this accounting problem.

Notably, the entrance of the standard setter was seen as making it unnecessary for the enforcement body to make a statement. It is thus evident that the national standard setting body and the national enforcement body in this sense were conceptualized as alternative means for solving accounting problems, because both these organizations were seen as capable of manifesting (or changing) accounting practices by approving (or disapproving) with them.

In relation to how mortgage bonds should be treated in relation to IAS 19, the question of whether the Swedish standard setter could make a statement also became a part of discussions. Here, uncertainty over whether this was really an issue "specific to Sweden" resulted in no national standard being issued. Thereby, the perceived ambiguities over how to understand specific to Sweden created a barrier to the standard setter entering the space. The unwillingness to create an "IFRS light" (or a "Swedish IFRS") provided one reason for restricting the standard setter's entrance.

Chapter 8 provided an example of the international standard setters taking active part within the regulatory space. Here, a number of Swedish actors made efforts to communicate with the IASB in order to promote a change in the current accounting standard. Although IASB issued an *Exposure Draft* (IASB 2009) with suggestions for a change, the project later end-

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ed with no change to the standard. The lobbying experience seems to have led to a common conclusion by the actors involved. Communication with the international standard setter proved in that case not to be a viable alternative for creating changes in accounting practices. In the end, the global standard setter was seen as less relevant within the local context, although their standards were not. In each and every accounting issue investigated within this thesis, the question of how to read the text of the accounting standard. What differs between the issues is instead whether the interpretation of the standards is considered troublesome or not. In terms of rewritings, the international accounting standards were however accepted as difficult to affect from the local level.

Notably, this is also the case for the official interpretations issued by IFRIC/IFRS IC. Within this thesis, there are no empirical examples of any Swedish efforts to approach this body for official interpretations of the IFRSs. Likewise, the actors of the local regulatory space do not see this as an alternative for changing (or establishing) accounting practices, although it is sometimes recognized that it would be beneficial if interpretations could be issued (as in relation to the pre- or post-tax discount rate of IAS 36). A common opinion is that the possibility of the international interpretative body accepting an issue onto its agenda is so low that efforts to that end would only be a waste of time. Others argue that guidance from IFRS IC/IFRIC is not sought because it is not wanted because they see the issuing of official interpretations as a step toward creating a more "rules based" accounting system, which they see as disadvantageous.

Although the IFRIC/IFRS IC is considered an unapproachable or even unwanted actor within the local regulatory space, their official interpretations are nevertheless very present within the regulatory space. In fact, this thesis shows an example on that IFRIC affects accounting practices even by not making a statement. In the absence of a "deep market" for Swedish corporate bonds, it was, for a time, considered legitimate to adjust the interest rate of the Swedish government bonds to produce a discount rate more similar to those of foreign corporate bonds. When IFRIC refused to add to its agenda the issue of whether synthetically constructed equivalents complied with IAS 19, this refusal nevertheless affected accounting practices. Because the official refusal made clear that synthetically constructed

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equivalents were not allowed (IFRS IC 2015), some then current Swedish accounting practices were shown to be inappropriate and had to change.

Thus, where Bozanic *et al* (2012) shows that accounting standards written and produced at a non-local level (by the U.S. SEC) can be influenced before their issuance, this thesis instead shows the difficulties of affecting non-local standards. The fact that IFRSs are applied not only internationally but also virtually globally may have contributed to these difficulties.

10.4.2. The location of epistemic communities

The empirical material of this thesis included several instances of epistemic communities that formed, but proved over time to be too local. The community then had to grow to include additional actors.

A first example is the Swedish attempt to affect how the international accounting standard was written. Although the proposed change in accounting standard was believed to be unproblematic and straightforward (even by IASB), others constituencies strongly opposed the suggested amendment.

The second example is the criticism directed towards the Swedish delegation in the arena of EECS. The Swedish enforcement report had stated that use of the low rates from the Swedish government bonds resulted in overstated pension liabilities. Although many preparers of the Swedish listed entities shared this view, enforcers of other nationalities did not.

A third example of outsiders' lack of understanding for the current accounting practices is the clarification requested by the international office of a Big Four firm on the local office's position in relation to the use of the mortgage bonds.

The epistemic community thus is foremost local, but with necessary links to the global. Those linkages will set boundary conditions for a community's statements and actions, by accepting or not accepting what is said and done. While the acceptance granted by the Big Four International desk allowed the auditing practices to continue, the criticism within EECS contributed to the criticized position not being repeated in later enforcement reports.

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These findings may be compared to previous research, commonly emphasizing the international dimension of regulation. In their discussion of the regulatory space, Hancher and Moran (1989) accentuated the role of large and multinational firms as regulators in modern societies. As discussed previously, a number of researchers have stressed the importance of the large accounting/auditing firms in accounting regulation (Hopwood 1994, Greenwood *et al.* 2002, Cooper and Robson 2006, Suddaby *et al.* 2007). In particular, the international basis and networks of these firms have received emphasis (Loft *et al.* 2006, Suddaby *et al.* 2007, Humphrey *et al.* 2009, Malsch and Gendron 2011). The agency of large and multinational organizations could thereby be seen as a common theme of previous research. In contrast, both the agency of organizations and the importance of their international structures come across as far less prominent in the empirical material of this thesis.

10.5. The enforcement body's role within the regulatory space

This thesis has shown that the organizations of auditors, preparers and actuaries, as well as the Swedish standard setting body, can be understood foremost as arenas of (rather than actors of) the regulatory space. It is instead the (knowledgeable in accounting) individuals that must be understood as the main actors of the regulatory space. In relation to each accounting issue in the regulatory space, these individuals form epistemic communities that share views on how specific accounting standards should be read and how accounting could be performed in relation to these.

This finding indicate the need for being situated within the regulatory space, actively taking part in regulatory conversations, in order to be able to shape accounting practices. When the enforcement body was seen as present within the regulatory space also when not participating in regulatory conversations, this presence was formed due to its previous participations in other issues.

Generally, being actively present within the relevant arenas of the regulatory space thereby increases an actor's possibility of shaping accounting

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practices. This explains why enforcement decisions seem to have larger possibilities of shaping accounting practices if someone actively (and locally) argues in favor of them.

The general disregard of the EECS enforcement extracts as authoritative sources of information illustrates the difficulties of influencing practices from arenas that does not seem to have been incorporated into the regulatory space. When the international enforcement decisions do not become intertwined in current regulatory conversations, they are considered merely as examples of possible opinions, rather than as authoritative answers to accounting questions.

Nevertheless, the EECS arena appears to be important for the national enforcers. Therefore, actual accounting impact is facilitated when the distant actor influences the opinions and actions of an actor present at the local level.

Thus, the role of the enforcement body will be formed not only by it's attempts to be present on the global and local arenas in the regulatory space, but also by how this presence is regarded and understood by the other relevant actors in these arenas.

Whereas the earlier enforcement reports had been met with criticism, the common opinion in 2013 (when all but one of the research interviews of this thesis was performed) was that the enforcement reports had "improved" with time, as there were fewer (or no) examples of "mistakes" or "strangeness" in the later enforcement reports.

An interviewee concluded that the unappreciated habit of the enforcer using the enforcement report for conveying "opinions" without support in the accounting standard had disappeared. By then, the enforcement reports were considered "shorter and more to the point".

> Some two or three years ago, our opinion was that the comments of the enforcement body were of quite low quality. There were mistakes in relation to factual matters […]. You could question whether they had the competence and employees necessary to handle these issues. […] Sometimes I think that the comments have been too much of the opinions of an individual. […] Lately, I think it has improved. This report, the latest report, I have nothing to complain about, nothing at all. (Interview 20)

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When the enforcer suggested that partial recognition and setting time limits are problematic accounting practices, these statements were challenged. These challenges argued that the practices were in fact not problematic as partial recognition was international practice (Arnell and Janzon 2009) and as the requirement to provide objective other evidence itself created a time horizon because such evidence did not exist for events in the distant future (Abrahamsson *et al* 2011). In these cases, the inclusion of the enforcement body in already existing epistemic communities (with shared views on appropriate accounting practices) created certainty (about how to account) at the same time as it created an understanding that it was not a part of the enforcement body's role to change accounting practices that were commonly accepted as compliant with the accounting standard.

In relation to the accounting for taxes in accordance with the newly issued IAS 19 Revised, the new standard and new guidance on how to account for Swedish taxes on pension plans both appear to provide the occupants of the regulatory space with a feeling of knowing how to account. Thereby, SFRB's standard and SSA's guidelines in this case provided a sense that consensus had been created, although it is arguable whether this consensus existed in practice. Thereby, the (perceived) consensus could be seen as a reason why the enforcement body was seen as unlikely to enter the regulatory space in relation to this issue.

In relation to the IAS 19 discount rate, the epistemic community (sharing a view on how the standard could be applied in relation to the Swedish bond market) could be said to have evolved gradually. Along with the developments surrounding this issue, it became apparent that parties outside the existing epistemic community did not share the views held within it.

In the beginning of the events surrounding this accounting issue, the enforcement body was included in the local epistemic communities, sharing a view on that the interest rates of the Swedish government bonds was an inappropriate basis for the discount rate. When it became evident that consensus within this local community was not sufficient, the epistemic community was forced to reform, this time without the enforcer, because it could no longer support the then current practices. It was within this reconstituted community that the central parties of the regulatory space created the consensus that was to become the solution to this accounting

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problem, i.e. replacing government bonds with mortgage bonds. The exclusion of enforcement from this epistemic community, however temporarily, made the status of this solution less certain.

Notably, before the change in accounting practices, there was no dialogue with the enforcement body in order to ensure agreements on the position taken. While some actors argued that the enforcer would of course agree with the new accounting practice, others saw this as an open question. However, most interviewees indicated that the position taken by enforcement mattered and could not be neglected. Here, it could be noted that whereas the opinion of the enforcement body was not actively sought, the enforcement body actively sought the opinion of the auditors (as the position taken by the association of the audit and accountancy profession was requested and taken as a source of input in the enforcement decision-making process).

However, mutuality of interpretations between the epistemic community formed in relation to the Swedish debate on the mortgage bonds and the epistemic communities formed in relation to the EECS activities could not merely be assumed, but rather had to be assured. This was done by submitting the issue of the mortgage bonds as an Emerging Issue for an EECS discussion. When it was agreed within EECS that the use of the mortgage bonds was in compliance with IAS 19, all (relevant) parties in the regulatory space had formed an epistemic community (with a shared notion of "compliance"). Thereby enforcement action became possible, and formal acceptance of the accounting practices was forthcoming.

Therefore, it can be concluded that the measurement aspect of the IAS 19 discount rate only became enforceable, when (pan-European) agreements on how to interpret the standards had been created and when the enforcers had become again active members of the epistemic communities formed.

While it is common to stress the importance of the enforcer (or the auditor) as an "independent" actor, this thesis indicates the practically important role of any regulator to also (or even rather) to be a positioned actor. This is because only actors that participate in the epistemic communities formed in the practical applying of accounting standards can reasonably be expected to influence accounting practices.

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In addition, the sharing of common professional identity (in this case the identity of being an "accounting specialist"), come across as important in order to (effectively) be able to participate in regulatory conversations. Notably, this identity is not so much about self-perception as it is about how the enforcer is understood by others, i.e. by from the viewpoint of those subjected to enforcement.

Thus, where a common picture of the "good" enforcer is one of an independent, external and objective supervisor, the understanding of regulation as a space, where the linkages and interactions between several different regulators are at the core of regulation, may provide a better picture of enforcement practice. Enforcers appear to be more "effective" as active participant within this space, rather than as isolated and distant observers.

Thereby, where Malsch and Gendron (2011) discussed the problematic notion of independence, it should be added that the question of regulators being attached or unattached, involved or uninvolved, is far more complex than the dichotomy of independent versus dependent suggests. It is the moments of integration, rather than disintegration, among the actors of the regulatory space that are determinative both not for the establishment of accounting practices and also for the positioning of different actors within this shared space.

The findings of this thesis thereby illustrate the importance for enforcement bodies to be if not dependent, at least integrated in a regulatory setting and to interact with other (influential) actors in order to provide enforcement statements that can influence accounting practices.

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Chapter 11

Summary and conclusions

The aim of this thesis was to create an understanding of the role of an enforcement body in shaping accounting practices. Empirically, this was investigated by studying Sweden as a case study of regulatory evolvements within the EU.

This study has assumed that enforcement bodies must be understood in their wider social context. This context has been formulated as a "regulatory space" (cf. Hancher and Moran 1989, Young 1994, 1995, MacDonald and Richardson 2004, Malsch and Gendron 2011, Bozanic *et al.* 2012, Canning and O'Dwyer 2013). The theoretical concept of the regulatory space shatters the usual distinction between the regulator and the regulatee as fixed categories with different roles in a given setting. This concept stresses instead the dynamic aspects of regulation, where different actors can interchangeably play different roles in regulatory processes. The formal position of an actor is not determinative for actual ability to influence practices.

In addition, this thesis assumes that "regulatory conversations" are an important part of regulatory practices. This assumption extends to the important role conversations play in creating certainty on how to apply regulations (here the accounting standards) and for positioning the actors of the regulatory space (Black 1998, 2002).

In order to create an understanding for the role of the newly introduced enforcement body in (Swedish) accounting regulation as a regulatory space, a number of accounting issues were studied. Foremost, these were issues included in Swedish enforcement reports. In addition, one empirical chap-

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ter concerns an issue that the enforcement body had not publicly commented on during the investigated period. The accounting issues investigated covered goodwill impairment testing, tax loss carryforwards and pension liabilities. In relation to each accounting issue, the study traces and analyses the role of the enforcement body.

The contribution of this thesis is twofold. First, I apply the theoretical framework to a new empirical area, where I highlight the role of enforcement bodies (rather than standard setting). The geographical and political setting is also new, as this study centres on Europe, with Sweden as a case. As the enforced accounting standards are the IFRSs, the thesis also contributes to our knowledge on IFRS implementation. The theoretical framework was found to be useful as it provided a tool for making sense of the observed events.

Second, my empirical data improves our understanding of this theory. In particular, the thesis contributes to our understanding of how regulatory spaces are constituted and transformed. I have confirmed the role regulatory conversations play for positioning actors within regulatory spaces, and I have outlined the key activities of these conversations.

Below, this thesis' main conclusions are summarized and its contributions in relation to previous research are outlined. The overview is structured by the three research questions presented in the introductory chapter of this thesis.

11.1. How the role of the enforcement body evolve in a time of regulatory change

This thesis showed that the definition (or not) of accounting issues as "accounting problems" determines the extent to which the enforcement body can shape accounting practices. The thesis confirms therefore that this specific definition has importance beyond issues subjected to standard setting (Young 1994, investigating the U.S. FASB), but also extends to the role of the enforcement body. Where the FASB only addressed accounting problems (Young 1994), the enforcement body here-investigated made statements about issues that the other actors of the regulatory space either

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accepted or rejected as accounting problems. These actors only regarded the enforcement statements on accounting problems as important enough to take into consideration. This implied that preparers retained some discretion in whether or not to change their accounting practices in response to enforcement statements. This finding confirms Black (2002)'s argument that agreement on problem definition is central to regulatory processes.

The thesis showed how (a perceived) divergence between accounting practices (what accounting is) and accounting claims and concepts (how accounting should be) contributes to the establishment of accounting issues as accounting problems. In particular, the idea of "fairness" played an important role in this process. This finding is consistent with Young (1994, showing the influence of e.g. "representational faithfulness"). In addition, this thesis highlights the importance of "comparability" when issues and treatments are accepted and formulated as problems and solutions.

Black (2002) argued that the ambiguity of rules and regulations lead to a need for their repair, either through "rule formation" or through "rule application" efforts. This thesis showed how these theoretical claims effectively describe accounting regulation, as the empirical material provided examples of both types of repair. In relation to Black (2002), this thesis adds that these repairs are unrelated both to changes in accounting standards (as amended and non-amended standards require repair) and unrelated to changes in accounting practices (as practices may or may not change after instances of repair).

The thesis also provides evidence of the shifting perceptions across time and space of whether a specific accounting standard is ambiguous. More general "principles" as well as more specific "rules" may be equally difficult (or easy) to interpret and apply (cf. Wittgenstein 1953). Therefore, ambiguity is not an inherent feature of some specific standards. This finding makes it possible to reject the idea on that additional rules or guidance is necessary to make possible the enforcement of principles based standards (cf. Schipper 2005, Alexander and Jermakowicz 2006, Ball 2009).

It is not the "nature" of the standard, this thesis indicates, that matters in shaping the role of the enforcement body, but rather the existence (or not) of agreements on how to use the standard. This is because uncertainties over how to understand what constitutes compliance create uncertain-

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ties about whether an enforcement statement is an interpretation (among several possible interpretations) or even erroneous. This thesis illustrates how the presence of these uncertainties delimits the enforcement body's scope for statement and action. It also illustrates that removal of uncertainties has the opposite effect. As regulatory conversations on accounting practices are the means for creating agreements on how to understand standards, enforcement bodies may expand their significance within regulatory spaces by participating in these conversations.

11.2. How other actors participate in the regulatory space

In this thesis, the accounting specialists of the Big Four firms and the accounting specialists (preparers) of the largest listed firms may be understood as institutionalized actors within the regulatory space. This finding is consistent with Young (1994), who argue that some individuals and/or organizations are such frequent actors of the regulatory space that they may be described as institutionalized occupants of this space.

The importance of the Big Four accounting/auditing firms has been much emphasized in previous research (Young 1994, Hopwood 1994, Greenwood *et al.* 2002, Cooper and Robson 2006, Suddaby *et al.* 2007, Malsch and Gendron 2011). In relation to this previous research, this thesis profiles the role of the accounting specialists of these firms (rather than the auditors) as important actors in the regulatory space. The role of the preparing entities within the regulatory space has previously been emphasized within the accounting policy choice literature (see e.g. Ball *et al.* 2003, Daske *et al.* 2008) and in Young (1994).

In addition, this thesis showed that actors who are not commonly taken to be relevant for financial reporting also contribute to shaping accounting practices. These actors are experts on areas that matter for financial accounting. In particular, the actuarial profession had a dominant position in the regulatory space. The importance of the actuaries in relation to accounting was acknowledged by Power (1996). In addition, valuation experts (or financial market experts) and tax specialists are important counterparts for

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accounting issues related to their areas of expertise. These observations confirm Cooper and Robson's (2006) claim that non-accountants take parts in accounting activities, as well as the finding of Mulligan and Oats (2015), who emphasized the influential position of tax professionals.

The presence of the above-mentioned actors within the regulatory space influences the enforcement body's possibilities to shape accounting practices. These actors must perceive the enforcement statements as legitimate claims in relation to accounting problems. Otherwise, these claims will not become issues in the regulatory space.

11.3. Implications for the enforcement body of the local and global aspects of the regulatory space

As the actors of the regulatory space will be those shaping accounting practices, the locations of the arenas of this space matter. This thesis concludes that accounting practices are shaped primarily in local arenas. In particular, this thesis argues that the Swedish preparers' association (Swedish Enterprise Accounting Group), the accounting policy group of the Swedish association of the audit and accountancy profession (FAR) and the Swedish standard setter (Swedish Financial Reporting Board) are the most important arenas of the regulatory space. In these arenas, regulatory conversations on accounting practices evolve, and epistemic communities (with shared interpretations of the standard) form. Ability to influence accounting practices depends, therefore, on presence in these arenas and participation in the conversations. Presence and interaction are therefore central features of regulatory abilities.

Because many of the arenas of the regulatory space investigated here are local, the national position of the enforcement body must be assumed beneficial (rather than detrimental) for this body's ability to shape accounting practices. This thesis indicates that the national enforcement body is able to fulfil a similar function as the national standard setter when providing support for current accounting practices (and thereby manifest them as

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being in compliance with IFRS) in relation to accounting issues that are not directly addressed by the international standard setters.

The above findings contrast partly with the findings of previous accounting research, which has emphasized how accounting regulation has grown global. (See further Hopwood 1994, Greenwood *et al.* 2002, Cooper and Robson 2006, Loft *et al.* 2006, Suddaby *et al.* 2007, Humphrey *et al.* 2009, Malsch and Gendron 2011.) In particular, the international presence of the Big Four firms and the larger listed entities as multinational firms feature prominently in arguments for a "regulatory gap" between these firms and the national accounting regulators (Suddaby *et al.* 2007 and Malsch and Gendron (2011).

However, the international dimension is not entirely absent within the regulatory space. The international help desks of the Big Fours firms are present, even though their role comes across as surprisingly peripheral within the regulatory space. In addition, the European co-operation between the national enforcers (within EECS) appears to affect the Swedish enforcement body's position. Diverging opinions from other European enforcers reduces the national enforcement body's scope for making statements while approval instead strengthens it. In brief, the international co-operation matters for the regulatory space, although indirectly through influence on the national enforcement body.

11.4. Practical implications

This study problematizes the common assumption that an enforcement body must be "independent" to become an effective regulator by emphasizing that the enforcement body is only one of several actors that are important for accounting regulation. An insight from this thesis is that the enforcement body must co-operate with other relevant actors rather than try to avoid interaction with them, in order to increase its influence on accounting practices. In relation to this, it has been concluded that national enforcement bodies can be expected to be equally well (if not better) positioned to shape accounting practices as international bodies. The reason for this is that actors who cannot actively voice their statements in the local community are less likely to gain the attention of these communities.

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This thesis has adopted a Wittgensteinian view on rules and rule-following as a tool for problematizing accounting regulations by the means of accounting standards. This perspective does not deny the role of the accounting standards in relation to the establishment of accounting practices. Instead, the study indicates that the standard text is central within regulatory conversations on accounting practices and that the standard places boundaries for the actors' abilities to state and act. However, this thesis also shows the extent of discretion that may lie also in accounting standards that otherwise may come across as straightforward or "rules based". Therefore, the effect accounting standards will have on accounting practices may sometimes be difficult to predict.

Where this thesis concludes that the prohibition for enforcement bodies to "interpret" IFRS delimits their regulatory powers, it remains to be assessed whether this is a good thing. This depends on whether it is seen as beneficial that enforcement bodies gain power in relation to other regulatory actors. To increase the regulatory power of enforcement bodies, the ideal of enforcement of accounting standards as an activity detached from accounting standard setting must be revisited.

If acceptance grows for that the enforcement body may have an interpretive role, it will be critical that the enforcement body is properly staffed. As the body have to interact with accounting professionals, it is of vital importance that those who execute enforcement of accounting standards are comparable to their counterparts, in terms of knowledge levels, professional backgrounds and familiarity with accounting issues discussed.

11.5. Limitations

A number of limitations have affected the results of this thesis. Most important are the limitations set by the choice of a specific time and a specific geographical area for the investigation. However, two additional limitations are important to mention here.

First, my usage of research interviews as empirical data implies that I have gathered information about events from retellings of those events. To remedy this limitation, I used archival data (in forms of documents) to include sources contemporary with the events studied into the empirical ma-

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terial. Even though participant observations generally may grant another opportunity to study events while they take place, this was not an alternative for this study because I studied events past. In addition, access for making participant observations of events as these studied in this book is seldom granted.

Second, the method for choosing the interviewees for the research interviews created another limitation for this study, as only a sample of individuals were interviewed. There is no claim or assumption that the total population of relevant actors has been interviewed. The total population is not only unknown but also a matter of negotiated definitions (taking place in practice).

It must also be noted that if other accounting issues had been studied, other empirical stories could have told, with other actors involved. Therefore, the here reported research results are dependent upon the specific accounting issues studied. In particular, the fact that issues were chosen primarily based on their occurrence in enforcement reports may have affected the research results. The inclusion of an accounting issue that had not been addressed by the enforcement body may have partly counteracted the possible bias imposed by this limitation.

The sampling method created a final limitation worthy of attention. I actively sought to interview representatives from the Big Four firms, but I made no active distinction based on different departments within these firms. The unintended result of this was that all the representatives interviewed of Big Four firms were accounting specialists rather than auditors. These accounting specialists had sometimes previously worked as auditors, but currently did not. In retrospect, I would have preferred to distinguish between (and interview) Big Four accounting specialists and Big Four auditors. However, it must here be noted that I used the snowball sampling method to detect individuals (or categories of individuals) whom I did not actively seek out, but that were important in practice. Therefore, even though the absence of the auditors within this study can be seen as a limitation it can also be seen as an empirical finding.

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11.6. Suggestions for future research

This thesis found that a number of actors were important within the accounting regulatory space. These actors included preparers (from the listed entities), accounting specialists (from the Big Four accounting/auditing firms) and actuaries (from the larger and international actuarial firms). Future research on any of these actors will increase our understanding of how different actors contribute to shaping accounting practices.

Further, this thesis indicated that several intra-professional associations (as the accounting policy group of FAR, the Swedish Enterprise Accounting Group, and the pension committee of the Swedish Society of Actuaries) constituted important arenas of the regulatory space. The inter-professional association the Swedish Financial Reporting Board was found to be another important arena. These organizations could therefore provide fruitful settings for further research. Such research would provide a deeper knowledge on how these arenas enable interactions amongst different actors of the regulatory space.

In this thesis, Sweden was studied as a case study of how an enforcement body become introduced into a specific regulatory setting. To be able to understand whether the findings of this study are possible to generalize also to other countries, further research on enforcement bodies in other countries is needed.

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