

IFRS Implementation in Listed Companies – Identification of Factors Leading to Inconsistent Application¹

Abstract. This paper presents an exploratory study of factors that lead to inconsistent application of International Financial Reporting Standards (IFRS). We study the reasons for diversity in implementation of IFRS. The literature suggests a large number of different factors that help explain accounting choices, both deliberate and non-deliberate. We use accounting practice as a starting point. Through observation two cases are studied. First, the entire process of IFRS implementation is studied, from local GAAP to full IFRS. Second, we study purchase price allocation in business combinations accounted for according to IFRS 3. The method used is participant observation, where the researcher participated in the actual application of IFRS in selected listed companies. All observations were done in a Swedish setting.

We relate our findings to those factors suggested in the existing literature. Consistent with the literature we find that bonus plans, national legal setting and existing practice are influential factors. Additional factors, not discussed much in the literature, are lack of resources and knowledge, and the development of local practice. We also find an interaction between existing practice and economic choice, suggesting that combining different parts of the accounting choice literature would be beneficial.

Introduction

With increased globalization of the world economy, harmonization of international accounting standards has become the focus of increasing attention among accounting academics, practitioners and researchers (Abongwa, 2005). Ball (2001) argues that there is a trend towards increased worldwide convergence in accounting standard practices.

The convergence is evident in many different ways. One step in the harmonization process is that the European Union has harmonized the accounting rules for consolidated financial statements for listed companies, with the introduction of the so called IAS-Regulation. Consequently, since January 1, 2005 all listed companies must follow standards and interpretation issued by International Accounting Standards Boards (IASB). The standards and interpretations also have to be adopted by the European Commission. Another step in the harmonization process is the convergence project between IASB and Financial Accounting Standards Board (FASB) where the two standard-setters agreed to work together to develop high quality, fully compatible financial reporting standards. In addition, in October 2007 the SEC decided to accept financial statements prepared according to IFRS for non-U.S. companies listed in the U.S. Outside Europe and the U.S., many countries use, or are planning

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to introduce, IFRS for listed companies. It appears that IFRS constitutes a de facto standard for global harmonization of accounting, at this point in time.

A problem, however, is that the application of IFRS in different countries and companies may not be consistent. Even if the same accounting standards are followed across Europe, e.g., there is still a problem of consistent application. This issue is increasingly discussed across Europe. It has been suggested that even if the standards are the same across countries, differences in their application will reduce comparability and transparency. There are ample signs that de jure harmonization of rules has not resulted in a sufficiently high degree of de facto harmonization. One possible reason for this is that different accounting traditions in different countries lead to different conceptions of accounting and its various concepts across companies, industries and countries. De jure harmonization is defined as harmonization of rules and regulations while de facto harmonization relates to the use of those rules. As a consequence, the European Commission has decided to start a temporary Roundtable for consistent application. The function of the Roundtable is to act as a simple and efficient forum for European accounting experts to identify, at an early stage, emerging and potentially problematic accounting issues in relation to consistent application (EFRAG, 2005).

Inconsistent application could be of different types. Companies may interpret IFRS in different ways, and still be in compliance with EU regulation. This could be possible to the extent that IFRS allows for differences in interpretation in their application. Alternatively, inconsistent application may entail at least some of the reporting entities being in non-compliance with regulation. In this paper we do not analyze which type of inconsistency that applies. Rather, we focus on identifying factors that may explain why reporting entities do apply IFRS in different ways.

Even if regulation is a high-level activity (done on a national or global level), de facto financial reporting is produced on the individual company level. The process of reflecting accounting regulation in actual financial reports involves accounting choices. Why companies choose to present a transaction the way they do is a topic that has been studied from many different perspectives. Is their objective to present the reader relevant information or could accounting choices be influenced by other incentives? Different studies show that there are many different factors that influence accounting decisions.

IFRS is often considered a principles-based system meaning that principles such as relevance should be guiding accounting choices (IASB). The advantage of a principles-based system is that it offers the accountant possibilities to adapt the reporting of transactions to their unique economic settings. A high portion of flexibility increases the possibility to provide a fair presentation of transactions (Wyatt 2005). However, there are risks and difficulties with a standard which is dependent on preparers interpretations and judgments. There is a risk that accounting choices are not homogenously treated across companies, affecting the de facto harmonization of financial reporting (EFRAG 2005).

Prior literature points to the difficulty of reaching consistent application of IFRS in this situation. Nobes (2006) gives a multitude of reason for why international accounting diversity will continue to exist after IFRS implementation, and points to the need for research in the area. Brown & Tarca (2005) and Dao (2005) point to challenges facing entities in charge of enforcement of IFRS in Europe. This lack of consistency results both in a decrease in accounting quality overall, as well as variation in accounting quality between European countries (cf. Soderstrom & Sun, 2007). Bradshaw & Miller (2008) suggest that similar issues arise in a US GAAP setting.

Currently, there is insufficient knowledge about the reasons for diversity in accounting choices. There are theories explaining choices based on rational choices (e.g. Graham et al, 2005; Fields et al, 2004; Godfrey & Jones, 1999), i.e. company management makes accounting choices based on utility maximization. Other theories suggest alternative rationales, such as following previous practice (Young, 1996), existing culture (Abongwa, 2005), or the effect of institutional frameworks (Ball et al, 2000).

At present, there is a unique empirical situation in many European countries, with the introduction of a new regulatory system for accounting (from previous local GAAP to IFRS), that in some countries involved fundamental changes in the inherent logic of financial reporting.

Given that there is a need for further research, and the unique current situation, we do an exploratory case study of the factors driving accounting choices in individual companies. The purpose of the study is to identify factors that may lead to inconsistent application of IFRS. The reason for doing an exploratory study is that there is currently limited knowledge about the specific factors, suggesting an open approach is preferable. Similar methods have previously been used in the accounting literature (e.g. Wiersma, 2008; Van der Meulen et al,

2007; Chenhall, 2005; Ashbaugh & Olsson, 2002; Malmi, 1999). Our findings are analyzed in terms of existing theories, such as institutional theory, resource based theory and positive accounting theory.

This study has relevance in two ways. First, it is useful in practice. It will provide insights useful for regulators in overcoming problems of inconsistent application. It is also useful for companies trying to achieve consistent application, as well as for analysts and investor, who need to understand where diversity in application could be expected.

Second, it is useful for research. The study will provide additional knowledge as to why companies make different accounting choices, by suggesting different possible factors driving the choices. As previously noted, there is a unique empirical situation at the moment, with a European-wide introduction of new financial reporting regulation. Due to uncertainty among preparers, and the principles-based nature of IFRS, we can expect substantial diversity in accounting choices. This will facilitate the identification of factors driving accounting choices.

The rest of the paper begins with an overview of prior literature, and the explanations given for diversity in accounting choices. This is followed by a discussion of the method used in the study, and the cases selected. Next, there is a presentation of empirical cases, followed by analysis and suggestions for further research.

Prior literature

In this section, we discuss prior literature from two perspectives. First, we discuss the explanatory factors behind accounting choices that have been identified in the literature. Second, we go through existing studies in the field of IFRS implementation.

Explanatory factors

As noted in the previous section, there are many different explanations for accounting choices suggested in the literature. They can largely be divided into factors which are often explained by and embedded in economic theory or factors which are explained by different theories within an institutional theory framework. In our study we have identified several factors and in this section we will describe the theories which may contribute to our understanding of accounting choices. Our understanding of phenomena can be enhanced if we entertain several theories instead of just one, at least so far as the theories do not contradict each other

(Groenewegen & Vromen 1996). The table below describes the fundamental perspective in the theories and why we have chosen to use them.

Theory	Specific viewpoint chosen in this theory	Perspective	Motivation for chosen theory
Institutional theory	New Institutional Economics (NIE): Organizations tend to make themselves more homogenous over time	Organization	To understand how preparers use other financial statements when they interpret principle-based accounting standards in their accounts
	Institutional thinking : Individuals think with(in) their institutional commitments	Individuals	To understand preparers ability to view accounting issues from different perspectives.
Resource based theory	Organizations own capacity to use their recourses	Organization	To understand how preparers mobilize and use their resources to interpret and produce figures in accordance with principle-based accounting standards.
Positive accounting theory	Individuals maximize their own utility and act opportunistically.	Individuals	To understand how preparers' individual goals influence the interpretation of principle-based accounting standards

New Institutional Economics (NIE)

Irvine (1999) has outlined an approach to understanding the social tradition of institutional theory. He claims that there are exogenous and endogenous forces acting on and in organizations, which tend to make them more homogenous over time. DiMaggio and Powell (1983) have divided these forces into coercive, mimetic and normative isomorphism. They suggest that institutions become more homogenous over time, due to the influence of the environment in which they operate.

In coercive isomorphism, external pressures such as the regulatory environment (Scott 1995) affect institutional choice. It has been suggested by DiMaggio and Powell (1983) that the impact of coercive isomorphism is greatest when the organization is subject to legislative initiatives, or economic or moral imperatives.

Mimetic isomorphism refers to the tendency of organizations to mimic the behavior of successful firms in their field. DiMaggio and Powell (1983) emphasize that organizations are more likely to mimic more powerful leaders in their field if there is a high degree of uncertainty in the environment: 'The more uncertain the relationship between means and ends, the greater the extent to which an organization will model itself after organizations it perceives as successful' (DiMaggio and Powell 1983: 160). Uncertainty is inherent when a new accounting standard is implemented, and this behavior can be expected among companies in general. That is, the uncertainty factor will drive the accounting practice towards standardization. These potential problems lead to uncertainty and incentive to copy more successful industry participants because 'established, legitimated procedures enhance organizational legitimacy and survival characteristics' (DiMaggio and Powell 1983). A corollary to this is that the authors also suggest that those institutions with confidence in their identity, their internal structures, goals and abilities to achieve their aims have little incentive to succumb to the pressures of mimetic isomorphism. In fact, it is these organizations, provided they are not overly complacent, that create change within the institutional environment.

The final endogenous factor influencing the accounting choices is normative isomorphism. When individuals are trained in the same educational settings and in similar disciplines and when they come from similar cultural and economic backgrounds and elect to work in similar institutional settings, they share a common understanding of 'normal' behavior and of what is acceptable and not acceptable (DiMaggio and Powell 1983). Given this normative isomorphism, institutions that draw from a standard pool of workers will find that their ability to improvise new or novel approaches to problems is compromised.

We have concluded that institutional explanations may contribute to our understanding of the accounting choices within organizations. There are several reasons for this. First, listed companies in Sweden constitutes of a limited group of companies. Second, uncertainty is a factor when implementing accounting standards something that, according to institutional theory, forces the companies into searching for role models or leaders to copy. Hence, the way in which IFRS should theoretically become more and more standardized. Third, new financial reports issued to the market would be expected to copy the practice already existing in the market.

Institutional thinking

In “How Institutions Think”, Douglas (1986) attempts to clarify the extent to which individual thinking depends on institutions. She maintains that individuals within particular communities draw upon a shared basis of knowledge and moral standards in making decisions which develops legitimized social groupings. Such legitimized social groups and social processes are referred to as institutions. In claiming that institutions think, Douglas does not maintain that institutions have “minds” of their own. She recognizes that individuals “think”. However, she argues that individuals think with(in) their institutional commitments. In recognizing social element within individual thinking, Douglas argues that individuals see answers as being “right” only if such answers sustain their institutional thinking. Thus, the institutional commitments of individuals inhibit their ability to be convinced by arguments that conflict with these commitments.

Institutions provide conceptual schemas or analogies that can be used in the decision-making or reasoning processes of individuals. Although individual thought constructs and attempts to resolve specific problems amidst particular social concerns, a tension exists between the incentives for individual minds to spend time and energy on difficult problems and the temptation to sit back and employ existing and accepted schemas and analogies in decision-making processes. Given this tension and temptation, institutions are often called upon to save individual time and effort in constructing and resolving problems. Thus, institutions may be seen as machines for thinking and decision making with “the effect of turning individual thought over to an automatic pilot” (Douglas, 1986, p. 63).

While institutions save us time and effort in decision-making, they also limit the types of solutions that we may recognize as “appropriate” and perhaps stifle our creativity in developing new and novel approaches to such issues as well as inhibit our ability to recognize particular issues as “problems” to be resolved. The “shadowed places” created by institutions arise in part because individuals draw upon institutions to classify “things” into categories or classes. In categorizing and classifying, we draw boundaries around those things that will be included and those that will be excluded from consideration within a particular context. Young (1996) explore an instance of institutional thinking – the emergence and development of an FASB project on financial instruments. The study illustrates the programmed ways in which accounting problems are constructed and resolved, a process that shadows certain questions while emphasizing the

traditional accounting concerns with disclosure, recognition, and measurement. The case presented by Young contributes to an understanding of the ways in which the institutions of financial accounting limits the types of changes which can be made to accounting practices as well as limits our ability to think critically about the effects of market innovations.

Resource based theory

Within resource based theory a company is viewed as a collection of resources. Amit & Schoemaker (1993) defines resources as a stock of available factors which are owned or controlled by the company. Penrose (1959) distinguish between resources and the use of resources. If a resource is used in different ways the benefit of this resource will be different. The competence of management can extract the benefit from different resources and the benefit is obtained by the activities within the company. The routines in the formal and informal organizational context express the benefit. This perspective of resources is the basis for viewing the capacity of the company (Bergmash & Strid, 2004). In the literature two categories of capacity are described. The first deals with the company's capacity to organize, co-ordinate and integrate the existing resources. The second category is dynamic and deals with learning and integration of competence within the organization (Foss & Foss, 2000). The dynamics of the company implies the ability to build up and integrate internal and external resources in order to meet the demands from the environment. This capacity of the company is difficult to buy and must be built up internally (Teece, 1982). To build up resources is not the same as collecting recourses. It can take a long time to develop capacity due to the fact that it implies complex integration of people and resources which learns by repeating (Grant 1991).

Furthermore, the capacity of a company could be seen as something which transforms individuals to a collective. It is a mechanism which coordinates the work and generates competence. This view does not leave out the importance of the individual but emphasizes the fact that individuals always act within an organizational context. The steering mechanisms in the organization influence the individual person's possibilities to act creative and constructive (Nelson & Winter 1982).

We have concluded that resource based theory may contribute to our understanding of the accounting choices within organizations. We can see that preparing accounts is a process which is dependent on the capacity the company. Resources not only from the financial

accounting department are important but also resources from other departments. To interpret an accounting standard and relate the standard to the company's specific situation is a process which needs the organizational capacity, as defined above, and which cannot easily be bought externally. It also takes time to build up.

A potential weakness of resource-based theory, however, is that it could be seen as simply a size factor. That is, larger companies tend to have more resources available for financial reporting, and thus more access to accounting expertise within the organization. Consequently, findings related to this theory should be tested for the impact of size.

Positive accounting theory

Fields et al (2001) define accounting choices as a decision whose primary purpose is to influence (either in form or in substance) the output of the accounting system in a particular way, including not only financial statements published in accordance with GAAP. Accounting choices can be made under existing laws and rules, because sometimes there is room for the companies to, for example, choose a method or management has to make subjective estimates. This definition includes real decisions made primarily for the purpose of affecting the accounting numbers. Managerial intent is the key to this definition of accounting choice, particularly with respect to real decisions; that is, whether the impetus behind the decision is to affect the output of the accounting system or whether the impetus derives from other motives. It is argued that accounting choices is used to personal benefits (Heflin et al, 2002).

As early as 1978 Watts and Zimmermann presented a theory that different element have an impact on the willingness to smooth out the result. They have developed a framework, so called "Positive accounting theory" (PAT). PAT attempts to understand and predict firms' accounting policy choices. That framework has been used by many researchers and they assume that companies' accounting is affected by different interests of the actors involved. The theory is based on the contracts that firms enter into, in particular executive compensation contracts and debt contracts. These contracts are frequently based on financial accounting variables, such as net income and the ratio of debt to equity. Since accounting policies affect the values of these variables, and since management is responsible for the firm's contracts, it is natural that management be concerned about accounting policy choices. Indeed, management may choose accounting policies so as to maximize the firm's interests relative to these contracts. Positive accounting theory attempts to predict what accounting policies managers will choose in order to do this (Scott, 2003). Watts & Zimmerman's (1978)

explanations are divided into economic, political and social motives. Examples of economic motives are management willingness to achieve a given result so they can receive loans and share based payments or to impact the share price. A political motive is the willingness to affect taxable income. Social motives can be management willingness to protect their own reputation and the career as a manager (Watts & Zimmermann, 1978; Fields et al, 2001; Graham et al, 2005). Proxies for the motives mentioned above can be debt-financing, covenants, owner structure, growth, companies' size, and the existence of research and development (Fields et al 2001; Stolowy & Breton, 2004; Graham et al, 2005).

From this agency theoretical perspective the company can be analyzed in relation to its owners. The company, and its management, act as agents of the owners. The company chooses accounting principles, but there is substantial self-interest that affects these choices with the purpose of affecting the situation of management. Three hypotheses have been formulated, in opportunistic form, i.e. that managers choose accounting policies in their own best interest, which may not necessarily also be in the firm's best interest. The hypotheses identify three areas that play an important role according to the accounting choices; bonus plans, debt covenants and political cost (Scott, 2003). The use of principal agent theory is one way to explain the interplay between individuals in different situations. For example, when owners are separated from management it is not clear that management in all situations puts the company and the owners' interest first. It has been empirically tested that there is a connection between management utility and accounting choices. Some studies show that people make accounting choices from their own perspective and ambition, choices that maximize their own utility. It means that accounting choices is influenced by the agents' own interest (Grinyer et al, 1991).

Behind this research is the observation that financial statements are an important information source in the relation between the company and the interested parties (Scott 2003; Fields et al 2001). Therefore management will try to affect the information in the financial statements (Watts & Zimmerman, 1986; Fields et al, 2001; Scott, 2003; Stolowy & Breton, 2004). The knowledge that financial statements serve as a basis for interested parties' decisions can give management an incentive to influence the content of the financial statements. The information in the financial statements is based on business transaction and accounting regulation such as laws and standards. In some cases the accounting standards leave room for the choices and subjective estimates (Watts & Zimmerman, 1978).

A concrete example of self-interested accounting choices is earnings management. This is made possible by the fact that GAAP do not completely constrain managers' choices of accounting policies and procedures. Such choices are much more complex and challenging than simply selecting those policies and procedures that best inform investors. Management use some forms of earnings management because management want to create the impression of smooth and growing earnings over time (Scott, 2003).

Summary of theoretical framework

To summarize, there can be different factors explaining accounting choices.

First, literature based on institutional theory argues that accounting choices are influenced by how the company relates to its environment. Other financial statements prepared by role model companies are a source of how a company chooses to interpret a new standard. Within the institutional theory the perspective can also be based on the individual preparer.

Individuals carry an institutional thinking which partly shadows their possibilities to see issues differently. Existing accounting practice is therefore also an important source to how companies interpret new accounting standards.

Second, in order to interpret and implement new accounting standards companies need to mobilize their resources in an effective manner. Lack of this capacity jeopardizes the interpretation of a new accounting standard.

Third, the literature within the positive accounting theory argues that utility can be defined in monetary terms, or reputation, etc., and that this can explain accounting choices. There are specific factors that have been identified in the literature, such as:

- The existence of bonus plans for management
- The existence of debt covenants
- Debt to equity ratio
- Company size
- Company growth rate
- Ownership structure
- Political costs, usually affecting very large companies

This should not be considered comprehensive. Other factors could have been identified. Next, we turn to literature using an alternative rationale for explaining accounting choice.

International accounting and IFRS implementation

Before the IAS-regulation, each country had its own national accounting standards, which lead to variation in accounting quality. The purpose of the IAS-regulation is to generate comparable and reliable accounting information to help investors, creditors and other users make investment decisions. Change to IFRS constitutes change to a GAAP that induces higher quality of financial reporting. The standards used previously reflected the culture, history, and other characteristics of accounting problems facing that country. In some countries, the professional bodies formulate the financial accounting standards, while, in other countries, the government and other regulators establish these standards. We can witness a high degree of variation between national accounting practices. Differences in accounting standards from nation-to-nation led to a call for international cooperation and communication among accountants from various countries to make accounting the language of business and the centerpiece of international trade and/or the global market. The harmonization goals have not been achieved fully, despite the IAS-regulation and the convergence project between FASB and IASB, due to differences in environmental factors and culture (Abongwa, 2005; Soderstrom & Sun, 2007).

Ball et al (2000) argues that there are differences between companies that derive from different accounting traditions; code law countries and case law countries. They have found that financial statements in code law countries are more conservative in comparison to those from common law countries. IFRS are developed for market-oriented financial systems. Considering the different purposes of financial reporting under two types of financial systems, financial reporting of firms with bank-oriented financial systems should be materially different from that of firms with market-oriented financial systems. Accountants in companies that come from one of these systems have different frames of reference than accountants in companies from the other system. This will affect how companies implement the same standard. As a result of the interdependence between accounting standards and the country's institutional setting and firms' incentives, the economic consequences of changing accounting system may vary across countries (Soderstrom & Sun, 2007).

Ball et al (2003) argues that if we compare different countries' accounting and the use of accounting standards there is too little discussion about countries' differences in institutional elements that affect the implementation. The purpose with harmonized accounting standards is to get comparable and transparent accounting. Ball et al (2003) discuss that it is very important to change management's and auditors' structure of incentives. They also say that implementation of IFRS requires complete harmonization of politics, economic structures and laws all over the world.

When companies implement a new standard, Young (1996) claims that previously used solutions, ingrained patterns, affect how companies report. Ingrained patterns can prevent the development and the willingness to do something else. With this in mind it is important that old traditions be changed. Country specific institutions beyond standards affect the characteristics of financial reporting processes and affect how companies implement standards. It is shown that there are differences in institutional structures across countries. Institutional elements have an impact on accounting harmonization and consistent application, such as different countries' accounting tradition. These elements can be more complex, than deliberate elements, to explain and also their effects on consistent application (Holthausen, 2003). How standards are implemented will be affected by a variety of different forces that reflect the multiple purposes of financial statements (Holthausen and Watts 2001).

Schipper (2005) argues that it is very problematic to implement one single set of standards in different companies and countries that vary considerably in size, ownership structure, capital structure, political jurisdiction, cultural and financial reporting sophistication. The implementation of IFRS in Europe will lead to increased demand for implementation guidance. If IASB does not answer to these demands Schipper (2005) thinks that preparers and auditors will turn to other sources of guidance such as their own jurisdiction-specific GAAP or jurisdiction-specific practices. The previously used GAAP, accounting traditions and so on have an impact on the implementation and affect the consistent application negatively. Soderstrom and Sun (2007) and Ding et al (2007) states that accounting standards, legal and political systems, and incentives of financial reporting all effect accounting quality. All these factors may interact with each other to affect earnings quality. The shift to IFRS is likely to affect financial reporting; it is only one of the determinants of accounting quality. Even after the IFRS adoption accounting quality will continue to differ across countries because other determinants will continue to differ across countries. Soderstrom and Sun (2007) think that using the same standards in EU, IFRS, may not improve accounting quality

uniformly for each firm and country because other factors, such as above mentioned, also affect the accounting quality and earnings quality. The authors argue that accounting quality after IFRS adoption will depend on three factors: (1) the quality of the standards; (2) a country's legal and political system; and (3) financial reporting incentives. How to reach consistent application of IFRS, and hopefully high accounting quality, depending on changes in country's legal and political systems and financial reporting incentives. However it can be difficult to change country's overall institutional infrastructure.

Abongwa (2005) argues that culture is a part of the reason for differences in accounting practices and a major factor preventing harmonization of IFRS. Accounting is not a "natural" phenomenon; rather, it is a man-made system that is based on a socially constructed reality and shaped by different socio-cultural systems. The need for harmonized accounting standards has increased because of increased interest in the stock market and the interest in companies' financial statements. The knowledge of cultural dimensions may help explain attitudes towards harmonization and how to reach consistent application among each country and between countries.

A theory that has been used in studies that explain how cultural elements and other elements affect how companies implement a standard is institutional theory (cf. previous section). These studies show how different elements affect how companies choose to report and the development of practice (Ball, 2000; Nobes, 1998). Part of the institutional theory can be useful for analyzing this issue. For example it can explain why it is hard to change accounting and why change happens slowly, both on a de jure level and a de facto level (Artsberg, 1992).

To summarize, the following factors can be expected to influence accounting choices, and thereby influence the application of IFRS in practice.

- National culture, although this is difficult to operationalize and measure empirically
- National economic, legal and political setting
- Existing practices and views on financial reporting that are taken for granted, either nationally or by organization.

Method

The purpose of this study is to identify possible factors that help explain how IFRS is implemented by preparers of financial statements. There are two important characteristics of the method used in this study. First, we study the actual individual preparers, in their own context. Second, the study is exploratory, in that the empirical material drives the structure of the analysis.

Much research on accounting choices to date has treated preparers as a black box. Either research has focused on the relation between accounting choices (as they appear in annual reports) and stock prices, or it has linked choices to exogenous factors, such as debt/equity ratios. We focus instead on how individual preparers act and think. A similar method, in other areas of the accounting field, has been used by e.g. Kamminga & Van der Meer-Kooistra, 2007; Herrbach, 2005; and Lillis, 2002. In agreement with Lillis we focus on relations of concepts rather than an in-depth study of one or few cases. The concrete method used is a form of action research, as discussed further below.

The exploratory nature of the study is evidenced by the fact that we structure the analysis based on the empirical material. We do not start with an a priori theory, but rather attempt to relate the data to different existing theoretical frameworks. A similar approach was used, in the field of management accounting, by Malmi, 1999, and to some extent by Davila, 2005. In this exploratory study we wanted to focus on actual practice, and actual actors. In the terminology of Jönsson & Lukka, 2005, we use an emic rather than an etic perspective.

The specific method used is participant observation. In an exploratory study it is important to base the study on actual practice. Previous studies have used participant observation in cases where it is important to understand practice in its context (e.g. Ahrens & Mollona, 2007; Berry, 2005; Barker, 2000).

The authors of this study have experience of working in practice, in combination with doing research. Several of the authors have substantial experience with accounting practice, as auditors and experts. The participant observation was done with the researcher acting as an accounting expert. In this role, the researcher was able to follow the implementation process first-hand, and to notice and observe the reaction and reasoning of the company management

and accountants up close. This is a type of action research, or interventionist research (cf Jönsson & Lukka, 2005). We posit that this leads to research with high relevance for the research issue at hand, but there could be problems with reliability. On the other hand, that is acceptable in exploratory research, given that the objective is to identify factors, not to measure them on a systematic basis.

The cases selected for study all involve Swedish companies that are either listed, or in the process of becoming listed in the near future. Sweden is selected as it is a country with a Continental accounting tradition, and historically a strong link between accounting and taxation. Thus, Swedish accountants can be expected to have a different accounting framework than the one envisioned by the IASB.

We have selected two cases. First, we look at an entire process of implementing IFRS, i.e. companies that go from local (Swedish) GAAP to full IFRS. This gives an overview of issues that can arise in the process. Second, we study the specific accounting area that had the most impact on the numbers in the financial statements, i.e. the implementation of IFRS 3 Business Combinations. An accounting standard with a potentially large impact is more likely to give insights into how management might try to maximize its utility through accounting choices. In addition, IFRS 3 was (together with IAS 39) considered by Swedish companies as the most challenging standard to implement.

To summarize, we have several case studies, and they are selected according to different dimensions. First, there is a selection based on implementation process. Second, there is a selection based on accounting issue, as suggested by Fields et al (2001) and Landry & Callimaci (2003).

After conducting the case studies, we analyzed findings in terms of the factors hypothesized based on prior literature, and identified any additional factors not previously studied or identified.

Empirical context

Sweden is historically in the Continental European accounting tradition, characterized by large owners, strong link with taxation, and accounting conservatism. Large private owners control many companies, leading to a reduced role for financial reporting. The strong link with taxation makes it profitable for companies to be conservative, and gives a larger role for governmental legal regulation. IFRS entails a new way of thinking, in terms of economic substance.

To some extent listed companies have gradually adapted to IFRS, as one Swedish regulator has introduced Swedish translations of some IAS's. Thus, the conversion to IFRS is a larger step for non-listed than for listed Swedish companies. However, in both cases, there is change in overall thinking for companies.

As discussed in the Introduction, inconsistent application may lead to non-compliance with IFRS and EU regulation. Theoretically, this could only happen in a setting of weak enforcement of accounting standards. Historically, Sweden has had a system most adequately described as self-regulation. Thus, external pressure on companies to comply with regulation has been weak, which would make non-compliance a possibility. Even though a system of stronger enforcement is currently being constructed, non-compliance could happen during the period that we empirically studied. As noted before, we do not specifically study to what extent this occurred.

It should be noted that tax may, indirectly, still have an impact on the interpretation of IFRS in consolidated accounts in Swedish companies. When the IAS Regulation was implemented in Sweden, full IFRS could only apply in consolidation. The parent company must follow IFRS, with exceptions relating mostly to tax requirements. In many areas, however, the interpretation of IFRS must be agreement between the consolidated and the parent company accounts. In addition, the parent company accounts form the basis for taxable income. Consequently, there is an incentive for tax-beneficial interpretations of IFRS in the parent company, and this could spill over to consolidated accounts.

Empirical Case Studies

Process of conversion from Swedish GAAP to IFRS

This case was done by one of the authors with experience of several conversions from Swedish GAAP to IFRS, both for listed and non-listed companies. The process varies from one company to another depending on their own situation. Some companies are more prepared than others. Below is a discussion of some cases that will help identify different elements that have an impact on how companies choose to implement IFRS. The findings are based on participant observation.

The effects on for example numbers in the financial statements, disclosure, and internal control, of implementing IFRS varies from one company to another depending on their earlier situation and to what extent they have previously followed Swedish GAAP, what transactions they have and what standards they therefore have to follow. In some cases the only differences between Swedish GAAP and IFRS were more disclosure, and no valuation changes. Even if there were no valuation changes it was a substantial effort for companies to go through everything.

One company that has prepared their financial statements according to Swedish GAAP for listed companies before they implemented IFRS in 2005 stated that they already nearly followed IFRS. Because of that, they did not start the implementation process in time and did not have the resources that they should have. The result should have been some valuation changes, which affect the equity, and higher disclosure requirements. Instead the company moved on with nearly the same accounting principles that have been used before with the argument that: *“We have always done like this and the standards in Sweden are nearly the same as IFRS”*. They underestimated the effects of IFRS, the effect on the numbers, disclosure, and the resources that they needed to understand and identify all IFRS-adjustments. This is a situation that has been shown in a couple of cases.

Some areas are more problematic than others. For example areas like accounting for financial instruments, where Sweden did not have a comprehensive standard before IFRS. IFRS requires identification and accounting for all financial instruments, including all derivatives. This is a situation that Swedish accountants are unfamiliar with. They are not used to and familiar with the thought of having a contract, such as a derivative, in the balance sheet and to record unrealized gains and losses in the income statement. The most effects and reactions

from Swedish accountants can be noticed in areas that earlier have been unregulated in Sweden, and also areas where the logic for the IFRS differs from that of the corresponding Swedish standard. In many cases Swedish standards relate to tax or corporate law. Therefore Swedish accountants are not fully familiar with a system like IFRS, based on an Anglo-American thinking, where the purpose is to give a fair presentation in the financial statements with no connection to tax and/or dividends.

In another case, companies from a specific industrial sector and geographic region, decided to follow a standard in a similar way, even though this is not was the way the IASB suggested. It means that companies in the same industry contact each other and discuss how to follow IFRS and what type of information they should leave disclosure about. Another situation that has been shown is when companies look at each other and follow each other. Some companies argument to do things in a specific way with the argument that other companies have done it the same way.

In Sweden, non-listed companies are allowed to voluntarily prepare their consolidated financial statements under IFRS. This can be of interest for companies when they get ready for a stock listing, or if the owner states that they have to follow IFRS and for example if they want to use more fair values then Swedish GAAP will accept. In these situations comments such as these are common.

“We just want to follow IFRS light”, “We are not listed yet so it is not so important”, “No one will be able to read all this information so we don’t have to write it” “We cannot afford the cost of printing all these pages”

For example they are not familiar with an accounting system with less focus on prudence. For example there were very strong reactions from one company with a lot of expenditure on research and development, which had been expensed because it is allowed under Swedish accounting and tax rules. Under IFRS it has to be capitalized, if certain criteria are met. The effect in this case was that cost generated by their own employees who work with the development phase, had to be capitalized. And their reaction was *“Where is the prudence concept?”* They also stated that it is very hard to make the distinction between research and development, useful life etc. and they wondered: *“How can someone be able to make decisions based on our financial statements with all these subjective assumptions?”*

In many ways it is harder to go from Swedish GAAP to IFRS for non-listed companies than it is for listed companies. Swedish GAAP for non-listed companies is more based on prudence and simplification. In these situations it is evident that the conversion from Swedish GAAP to IFRS is worse than they thought. Some reactions are “*if other companies in the same industrial sector can make it we can make it to, and we want to follow the same principles as the competitors*”. But the differences between one company and their competitors can be that the competitors have the resources such as accountants with time and knowledge of IFRS.

So, even in these situations it is shown that there is a deficient allocation of resources, an unwillingness to do enough, and a tendency to continue using the same accounting principles as previously used. Companies want to say that they follow IFRS but they are not willing to take the consequences of what it means to follow full IFRS. There is no IFRS light for these companies.

What conclusion can be drawn from these situations? The purpose of the EU IAS-regulation is to achieve harmonized accounting standards and transparency. To reach this we have to follow the same standards across the EU. It is known that it is not enough to follow the same standard; the problem is to follow them in the same way, and to follow IASBs intention. Based on the above mentioned situations it is shown that there is a problem with consistent application and to follow full IFRS depending on some factors/elements that have an impact of how companies choose to implement IFRS.

Elements that affect the implementation from above mentioned cases are lack of resources such as time, number of accountants; lack of knowledge of the regulation system and standards, lack of understanding the complexity of the standards and to follow up changes in the standards. Another important element that affect the implementation in most cases are old accounting traditions, were companies let arguments like conservatism and tax arguments² influence how companies choose to implement IFRS. Companies also look at other companies in the same industrial sector and come to an “agreement” between them on how they want to implement the standards. There are also rational arguments such as key ratios, bonuses etc that affect how companies choose to implement IFRS.

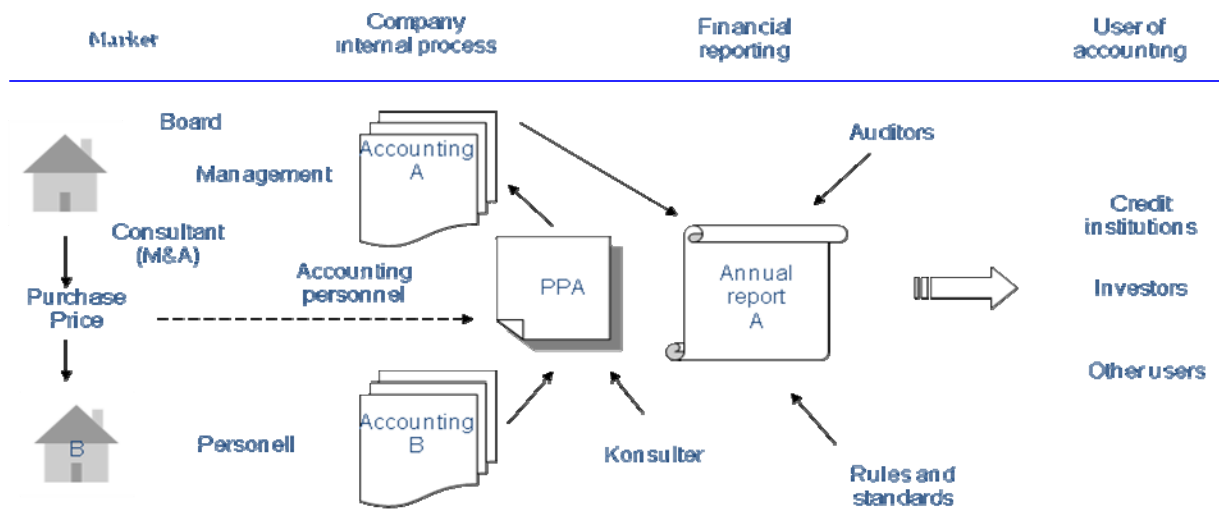
² In Sweden, full IFRS is only used in consolidated financial statements, due to the link between accounting and taxation on the individual company level. So, tax arguments are only relevant to the extent that companies attempt to minimize accounting differences between the consolidated and individual company levels.

Accounting for Business Combinations (IFRS 3)

This case is done by one of the authors with substantial experience of auditing, and with being involved as a consultant in several purchase price allocations in business combinations, where IFRS 3 was used.

As mentioned above Sweden previously had accounting standards somewhat similar to IFRS. However, referring to accounting for business combinations and intangible assets, the Swedish standard was not that precise on the requirements to identify and separate intangible assets from goodwill. Swedish practice allowed that goodwill included all different types of intangible assets. As goodwill was amortized, the issue was mainly related to presentation in the balance sheet and not to the P/L effects. When IFRS 3 was implemented in Sweden focus turned to identifying and valuing separate intangible assets. This changed the way an acquisition analysis was prepared and the term purchase price allocation (PPA) became known in Sweden. From one day to the other accounting for business combinations was complex and consultants were needed for the process. Another effect was that other people in the organization than accountants were important for the accounting process. And the outcome of the PPA could have material effects on the future P/L.

Below we have illustrated the acquisition process and identified different groups of people involved.



Starting from the right, it all starts with a market transaction. Company A acquires Company B. At this time, the board, management, owners, accounting personnel, consultants (M&A)

are involved. Accounting issues referring to PPA are normally not the central issue at this stage. However future cash flow of the target company is an important issue. Future estimated cash flow is at this stage aggregated and not matched to separate assets. As an auditor, the researcher was usually involved in the first step but mostly as an “observer” being informed of what is going on and discussing important issues with the client. When the transaction is finalized auditors and new consultants enter the arena. Together with accounting personnel the preparation and audit of the PPA starts. When preparing a PPA in accordance with IFRS 3, where the price exceeds the acquired booked net value, employees from market, supply channel, and R&D in Company B are valuable sources for information. Also the people involved in the actual acquisition possess important information.

It is observed how all these different groups of people add to the PPA process and noticed that many different “forces” are in action. The people behind these forces pull and push, discuss and argue for different final outcomes. In order to illustrate the forces, the cases are classified in five scenarios. These scenarios can represent two or twenty companies and each scenario is described exactly as it took place. The purpose is to point out forces identified and the effect they could have on the accounts.

Scenario 1

“What do other Companies do? If we identify 20% assets and allocate 80% to goodwill of the remaining positive difference, are we safe then? Is that what others do?”

In this case the company was very keen on knowing what others do when preparing the PPA. Before starting the PPA process it was discussed how the relation between goodwill and other intangibles could end up. This company had historically carried out a large number of acquisitions and was used to prepare PPAs under Swedish GAAP. Other intangibles were never identified when the Company reported under Swedish GAAP. The company showed an awareness of the new standard but their focus was turned to what others do instead of focusing internally on what values actually existed. The possibility that 100 percent of the positive difference could constitute other intangibles than goodwill was not taken as a realistic alternative. In this case we could identify a strong willingness to not being different and at the same time show that a new standard was implemented. On the other hand we could identify an unwillingness to post to high values of other intangibles which was explained by not feeling comfortable with new asset and a desire to avoid amortization costs in the P/L.

Scenario 2

“I have never in my career seen so much crap coming out from one consultancy engagement as this PPA. I throw it all away not reading it. What does this add, we know what we bought and the difference is goodwill”

In this situation the PPA was prepared by external consultants who went through different parts of the acquiree in order to identify and value intangibles. The drafted PPA was then questioned by the board of the acquirer and then somewhat adjusted. In this case the will of the board influenced the PPA. This might be correct, the board could know more about what they bought than the consultants. However the intention of the board could be questioned. Was it an unwillingness to adapt to new procedures or the willingness to avoid amortization cost in future P/L?

Scenario 3

“Let’s do things simple, we do not want to complicate things, intangible assets are not real and are artificial, we don’t want to have that in our balance sheet. Let us do this simple and call it all goodwill”

In this case no full PPA was carried out (meaning with a full PPA that you start with an empty sheet and step by step post assets and liabilities). In this PPA process focus was set to two different types of intangibles which were “suspected” to exist. These were valued and posted in the accounts.

Scenario 4

“We have hired consultants from a big4 firm and they know how to do this. We pay a high fee for this so we will receive a correct outcome”.

In this case the PPA was performed by consultants, with a very low involvement of the companies. Personnel at the acquiree were interviewed, a drafted PPA was presented to the accounting personnel which accepted it for accounting purposes. In this scenario we could identify a very strong reliance on external expertise. The reason for the low involvement of company personnel was, in their opinion, a lack of time and knowledge. However, it could be argued that the best knowledge of how a PPA should be set up must be found in the companies. What they need from the consultants are mainly the tools to package the values. In Sweden a very small group of people are working with the preparation of PPA at the Big 4 accounting firms. This fact could assure that PPAs are prepared in a very similar way, but

having a very limited involvement of the company could on the other hand jeopardize the goal of a true and fair view.

Scenario 5

“Why do we have this high amount posted in our accounts, how do we know that it is correct?”

The new overseas owners set up a new acquisition Co which bought an international group. The acquisition analysis was then provided by the new owner to the accounting personnel at the acquiree. A brand value was identified as the only intangible. The acquirer must currently support the brand value in the future reporting and criticize the new owner's. They argue that the acquisition analysis should have a different set up”.

In this case the involvement of the acquirer was very dominant. The PPA was prepared in advance in connection with the due diligence process. They did not communicate with management and other personnel of the acquiree. The incentives of the acquirer in this scenario are interesting.

What exploration could be drawn from these five scenarios? The reason for implementing an international accounting standard is to ensure that company accounts are more reliable, transparent and that they can be more easily compared. The experience from the scenarios presented lead to the question: “can IFRS 3 help us to harmonize accounting over borders”? In all scenarios we can identify programmed ways in which accounting problems are constructed and resolved. In the process of recognizing “new” assets certain questions are however not dealt with and earlier or traditional accounting treatments influence accounting choices. An issue is if the unwillingness to deal with an issue is greater when the new accounting treatment leads to non-desirable effects. And is there a higher willingness if the new accounting treatment implies attractive effects? Is it possible for companies to identify new assets if there is no willingness to see them?³

³ In addition to the case studies reported here, a statistical study was done, where we regressed various contextual factors on amount of goodwill recognized in business combinations. There is some indication that a higher debt/equity ratio is correlated with a high percentage of goodwill. This suggest that companies are unwilling to recognized assets that are amortized when they have a low level of equity.

Analysis and conclusion

In this section of the paper we summarize factors that explain diversity in implementation of IFRS, and discuss implications for future research. We continue by relating our findings to the previous literature.

There is some support for the factors suggested by the economic literature, i.e. the literature based on management as utility maximizers. Bonus plans do affect accounting choices. Also, desired ratios affect choices. In the literature specific factors such as the existence of debt covenants are tested. We found that companies want to obtain certain ratios, but that a variety of ratios and reasons exist. The owners might want to maximize EBITDA, for example, and then company management will focus on this ratio. It is more difficult to see a direct relation to the specific factors suggested by the literature.

Based on the institutional theory literature, we find more support. National culture is a factor that is very difficult to see in practice, as expected. But, we do see support for influence from national legal setting, such as the impact on taxation in Sweden. This effect seems to be limited, however. A very strong factor, on the other hand, is the existing practice. Companies are unwilling to change their current practice. They also tend to underestimate the change required when converging to IFRS. They are unwilling to change, and they are unwilling to see the changes. In the cases where there is a change, it is sometimes done in concert with other companies in Sweden, which may lead to the emergence of a local practice of IFRS.

We also identify some factors that have not been covered in the accounting literature. It seems that there simply is a shortage of resources and knowledge to implement IFRS. Companies do not achieve full IFRS because they are unwilling to pay for it. This is related to suggestions in the resource-based theory. In addition, we observe that some companies make their own cost-benefit analysis. Since they think the users are not interested in all disclosures, they do not think they have to provide all the information required by IFRS. In that sense, these companies take over the role of the IASB or the EU in making the cost-benefit analysis.

There is also an indication that the extent to which existing practice guides the IFRS implementation is dependent on the extent to which the changes are beneficial to company management. This suggests that there is an interaction between factors suggested by different strains of literature. Thus, we can learn more about accounting choices if there is more interaction in the literature.

There are thus several implications for future research. First, research based on institutional theory, e.g. as applied by Burns & Scapens (2000), appears to be fruitful for the future. Economics-based research appears less useful. Second, because of the unique situation of each company, in order to understand diversity in implementing IFRS we have to focus more on the individual company level. Third, there seems to be a good reason to combine research based on institutional theory with some of the prediction made in the economics-based research.

Fourth, lack of resources is an important factor that has not been studied in the accounting choice literature. It has, however, been investigated in other strains of research. So, there could potentially be useful to combine resource-based theory with accounting choice research. This could also, however, be a size factor.

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