



UNIVERSITY OF GOTHENBURG  
SCHOOL OF BUSINESS, ECONOMICS AND LAW

# Component Depreciation in Real Estate Companies

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Did the Outcome during the Implementation of K3 Meet the  
Expectations?

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# Abstract

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**Title:** Component depreciation in real estate firms - Did the outcome during the implementation of K3 meet the expectations

**Background and Problem:** In 2014 the transition to the K3 regulation became mandatory to many companies. Many companies in the real estate industry have been negative towards the change to component depreciation since it would demand a big increase in workload. Due to the dissatisfaction with the new regulation many comment letters have been sent, but the companies do not feel that they have been taken into consideration.

**Aim of study:** This thesis investigates how the perception of the advantages and disadvantages has changed during the implementation as well as what the effects of the accounting has been. It is also analyzed how the implementation process might have affected the perception towards the component depreciation in K3.

**Methodology:** Qualitative interviews have been conducted to study how the perceptions of component depreciation among the companies within the real estate industry have changed during the implementation and what the effects on the depreciation are. This information has then been analyzed with relevant theories.

**Analysis and Conclusion:** The component depreciation has advantages such as providing more information of the assets internally, enhancing the collaboration between different departments and enabling more maintenance. Still, these advantages are not seen as significant and do not overweight the administrative costs of the implementation of component depreciation and the comparability between companies has decreased. The lack of guidelines and coherent directions of how to implement the component depreciation has affected the credibility of the system and even though it has been accepted the companies are still not convinced that it is beneficial.

**Keywords:** Component depreciation, K3, Real estate, Change management, Perceptions, Implementation.

## Preface

This thesis has been an educative journey which has deepened our understanding of accounting. We would like to thank our tutor Thomas Polesie who has guided us throughout this process and taught us valuable lessons in both accounting and life. We would also like to thank all the companies who have taken their time to give us an insight into their reality. Another group who has helped us in the process is all the opponents have pushed us in the right direction through their feedback during the seminars. We would like to thank the department of business administration for a good education and for giving us the opportunity and possibility to write this thesis. We also would like to direct a big thank you to our language validator at the institution for languages and literature for a much needed proofreading and comments. Finally we would like to thank our families, friends and cat for their moral support

Gothenburg, 27<sup>th</sup> of May, 2014

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Erika Eklund

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Susanna Vuorela

## Abbreviations

BFL	Bokföringslagen, the Swedish bookkeeping law
BFN	Bokföringsnämnden, the Swedish accounting standards board
BFNAR	Bokföringsnämndens allmänna råd, the general guidelines by BFN
FAR	The professional institute for authorized public accountants approved public accountants, and other highly qualified professionals in the accountancy sector in Sweden.
FFE	Fédération des Experts Comptables Européens, Federation of European Accountants
GAAP	Generally Accepted Accounting Principles
IASB	International Accounting Standards Board
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standard
NRF	Nordiska revisorsförbundet, Nordic federation of accountants
RFR	Rådet för finansiell rapportering, the Swedish council for financial reporting
RR	Redovisningsrådets rekommendationer, recommendations by the Swedish financial accounting standards council
SABO	Sveriges Allmännyttiga Bostadsföretag, a Swedish branch- and interest association for public housing
SME	Small and medium-sized entities
ÅRL	Årsredovisningslagen, the Swedish annual accounts act

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# 1. Introduction

In this chapter we will present the background of the problem discussion which leads to the research question which will be studied throughout the thesis. The aims of the thesis as well as the limitations will also be explained.

## 1.1 Background

This year there are many changes in the world of accounting in Sweden as the new K-regulation is being fully implemented with the introduction of the last category of the regulation, K3 (BFN, 2014a). This means a significant change for many companies who have to change from the previous rules-based regulation to a principles-based regulation. One industry in particular which is being affected is the real estate industry that now has to implement the more comprehensive component depreciation for their investment properties (Lundström and Nordström, 2012).

The Swedish accounting system has been perceived as somewhat confusing with a lot of different regulations and recommendations to keep in mind when treating specific areas. A company that has to prepare an annual report and that does not follow IFRS has to take into consideration recommendations and norms from five different sources (KPMG, 2014a). BFN did not believe that this system was fulfilling their purpose and during the year of 2004 they decided to start developing a whole new regulation which would be divided in different categories depending on the size and other characteristics of the company (EY, 2014). The purpose of this category-based regulation is that each category should contain all regulations relevant to the companies within their category. The regulation consists of four different categories, going from smaller organizations and companies in K1 to listed companies in K4. The third category, K3, is for bigger unlisted companies who are required to prepare an annual report. This will also be the main regulation in the K-regulation. K3 is based on IFRS for SME with adjustments adapted to current Swedish norms, practice and the Swedish tax law. This will also increase the international harmonization in the Swedish accounting (BFN, 2014b). K3 also implies the biggest change since the companies implementing this regulation have to change from the previous rules-based regulation to a principles-based regulation (PwC, 2014). It is the first time in Swedish accounting history that a conceptual framework is required to be followed. This means that the companies have to adapt to a whole new way of thinking (KPMG, 2012b).

As mentioned before, one of the differences in K3 is that component depreciation has to be used for fixed assets. This affects industries such as the shipping industry, transportation industry and one industry in particular which has reacted strongly against this change is the industry of real estate. The change means that instead of depreciating on their investment properties with a fixed percentage on the asset as a whole, they will need to identify and evaluate each component individually (BFNAR 2012:1, Ch. 17). Doing this is expected to reflect the value of the asset better but also demands a big increase in the workload (Castellum, 2010).

The first exposure draft of K3 was sent out in June 2010 and around 40 instances responded with comment letters of a total of 180 pages (KPMG, 2012a). The responses were mixed and SABO stated that the complexity which the component depreciation will bring to a real estate firm will



not bring enough benefits to outweigh the increase of administrative costs for the implementation and upkeep of this method (SABO, 2010, p. 5). FAR on the other hand had a more positive approach towards the component depreciation but acknowledge the increase of administrative work and therefore suggests that component depreciation should only be applicable for bigger companies (FAR, 2010, p. 2-3).

## 1.2 Problem Discussion

The implementation of K3 has meant a lot of changes for the companies and one area within the regulation which has gained a lot of attention is the component depreciation. There is a clash in the perception of the method between the companies and the authorities behind the regulation and a lot of skepticism has been expressed by the real estate companies which has led to a lot of speculation around this topic. The accounting standards board BFN argues that the more detailed information given by the component depreciation will represent a truer and fairer view of the company's assets. The investment properties consist of several components which have different periods of utilization, but until this year the investment properties have been depreciated as one asset as a whole with one determined period of utilization. Implementing the component depreciation would therefore mean that each component is being identified, and instead of expensing maintenance when a component is being replaced the component would instead be activated. This will reduce the costs during maintenance and therefore represent the results better (Hellman, Nordlund and Pranhäll, 2011).

Still this means that the companies have to identify and evaluate each component in all their investment properties. An example given by Castellum shows that if a company owns 600 investment properties and each property contains ten components each and five investments are being made per each component, this results in 30 000 plans of depreciation and estimations that have to be made every year. Needless to say this will demand a great amount of administrative costs. The difference in the information that will be presented using the component depreciation does not bring any extra value to the users of the information, and the companies have therefore started questioning the relevance of component depreciation within their industry (Castellum, 2010).

For Sweden that historically has had a rules-based accounting system, changing to a principles-based system means that more evaluations of the companies own situation have to be made. There is not a clear set of rules which have to be followed word-for-word and in order to adapt to the new way of thinking guidelines will facilitate the transition. Still when the first finished version of K3 was introduced few guidelines were available of how to implement the component depreciation which caused a feeling of insecurity about how to proceed.

Today, we are in the middle of the first year where K3 and the component depreciation have become compulsory to follow for the companies within the category. A few companies have started a year ahead and a lot of the companies are in the middle of the implementation of the component depreciation. More insight into the method has been gained and previous speculations can be confirmed and new opinions are being formed.

## 1.3 Research Questions

The purpose of this thesis is to investigate the following:

- How has the depreciation in real estate companies changed with the implementation of K3?
- How has the perception of the component depreciation changed with the actual implementation of K3?

## 1.4 Scope

We have limited the focus of the thesis to Swedish real estate companies in the Gothenburg region. The limitation of real estate companies is based on the fact that this is a group that has been widely affected by the implementation of the new regulations and there have been a lot of negative responses to the exposure draft from their side. We have chosen to focus on how the component depreciation of K3 has affected the companies from their point of view. The thesis has been limited to responses from a majority of companies from the public sectors due to the fact that many companies within the private sector did not choose K3. We noticed this when we contacted companies regarding interviews, and was confirmed in our interviews.

## 1.5 Aims of the Thesis

K3 is a principles-based regulation which leaves room for evaluations and can result in a lot of different outcomes. Our aim is to explain how depreciation within the companies has changed in conjunction with the implementation of K3 and how this might differ depending on how they approached the component depreciation. We will also explain what the perceived benefits and disadvantages the component depreciation will bring as well as how this perception has changed from before the implementation until now and how the implementation process might have affected this perception. More insight will be given now that the implementation has started and the companies have more insight into what the work actually demands and they start to see the consequences.

## 1.6 Benefits of the Thesis

Since most of the companies value their assets according to K3 for the first time in the year 2014, there might be an uncertainty on how to value, which leads to differences between the companies and makes comparison between the companies harder. By investigating how different companies approach the implementation differences in the methods in use will be highlighted.

There was a quite strong reaction prior to the implementation of K3 specifically regarding the component depreciation with very different opinions on the side of the companies and of the legislative authorities. The main benefits of this thesis will be to gain an understanding of how the regulation really is perceived now that it is in use. This will show what real difficulties are experienced with the implementation as well as what the benefits actually are and how the

perception has changed throughout the process. This might give insight into how the implementation process of K3 could have been improved and can benefit for future implementations of new regulations.

## 1.7 Disposition

### Chapter 1 - Introduction

In the introduction we give a background to the subject, discuss the problem and present our research question. We also set a scope and discuss the aim and benefits of the thesis.

### Chapter 2 – Methodology

In the methodology chapter we describe our writing procedure, presenting our research method, data collection and how we are going to analyze the data. We also discuss the validity and reliability of the thesis.

### Chapter 3 - Theoretical framework

In this chapter we will present and discuss relevant theories to be able to answer our research question. We will describe tangible fixed assets, investment properties, depreciation according to the previous regulation, international regulations, components and component depreciation under the current regulatory framework. We will also discuss principles-based accounting, cost vs. benefit and change management.

### Chapter 4 - Empirical findings

In the empirical findings chapter we will present the result of the interviews as well as other collected data.

### Chapter 5 - Analysis

In the analysis we will analyze and interpret our empirical findings using the theories discussed in the methodology chapter.

### Chapter 6 - Conclusions

In this chapter we will present the conclusions we made during the analysis and provide the answer to our research question. We will also suggest areas for further research.

## 2. Methodology

The flow of a research starts with a question we want to investigate and speculations are being made. Empirical data is collected in order to answer the question and will also confirm whether the speculations were correct or not (Jacobsen 2002, p.14). In order to reach our conclusion we have gathered a frame of reference consisting of different articles, guidelines and the regulation as a basis to achieve a deeper understanding of what the situation is today. To look further into what the effects of the implementation have led to we have conducted a number of interviews within real estate companies that we together with the frame of reference have analyzed.

### 2.1 Research Method

The study has been done using a deductive method. In the deductive method hypotheses are made based on the theory and then studied closer by collecting data from the practice. The collection of theory is made first and will determine how the empirical material will be collected. In the last stage reflections are made of the gathered material and resubmitted to the previous knowledge (Bryman. 2011. pp. 26-27).

The choice of qualitative or quantitative method depends on the purpose of the thesis according to Trost (1997, p.31). We have chosen to do qualitative interviews with seven companies. The choice was made because the purpose of the thesis is to investigate how the companies experience the new regulations and how this has affected their evaluation and depreciation. The interview questions are simple but allow room to answer freely and give a deeper understanding of each situation (Trost 1997, p.25). This is important in order also to gain a deeper understanding of what the different effects are and why, which would not be possible with a quantitative method that only would allow a few already specified options of answers. We have chosen to do open interviews which are suitable when relatively few units are investigated. We chose to have a pre-structured interview, to which we wrote an interview guide with a theme, fixed sequence and only open answers (Jacobsen 2002, pp.162-163). This kind of interview gives room for individual viewpoints but also individual interpretations which is why it is important to take into consideration that different interpretations can be made. This helps us to concentrate on the research question but still allow flexibility depending on the respondent's situation and experience (Gillham 2008, p.103).

#### 2.1.1 Literature Review

Because of the full implementation of the K3 regulation that started this year, 2014, there has been an active discussion between the companies and BFN around the component depreciation based on the concerns of the real estate companies and how it should be implemented as well as the benefits from the new regulation. The material we have collected consists of secondary data from industry oriented magazines focused on accounting in Sweden and of the real estate industry, scientific papers and websites of organizations within the industry of real estate. We have also gathered guidelines and articles from different auditing firms and comment letters to the exposure draft from different companies and institutions which have been published during the development of K3.

### **2.1.2 Empirical Data Collection**

Empirical data has been collected through conducting qualitative interviews. The person being interviewed should not be affected by the questions or the interview itself and therefore the questions have been formulated in a way that is as neutral as possible, not containing any indirect statements that might lead the answer in a certain direction. The interview itself has been conducted at the respondents' company. Researches have shown that the place of the interview can change the way the respondent answers, which is the context effect. This is why the place of the interview has been chosen to be at an environment familiar to the respondent. This is an environment the respondent is used to and feels comfortable and relaxed in and will lead to a more natural interview (Jacobsen 2002, p.164). We have sent the interview questions to each respondent a few days in advance which will give the respondent some time to reflect over the questions and give better prepared answers. During the interview we will also ask unprepared follow-up questions if we find something interesting that we would like to know more about or to ensure that we understood the answer. In the end of the interview we ask the respondent if he/she wants to talk about something important in the field that we have not brought up during the interview. Jacobsen (2002) considers this to diminish the possibility that we omit something important.

The interviews are set to be about one hour long, as Jacobsen (2002, p.167) considers one to one and a half hours to be optimal. During the interview notes were taken and if allowed, a voice recording was made to be able to document the whole interview verbatim, which reduces the risk of misunderstandings (Jacobsen 2002, p.166). After the interview the notes and voice recording were transcribed. Thereafter a translated summary of the respondent's answers was written in the empirical findings.

### **2.1.3 Selection of Respondents**

The chosen respondents for the interviews were CFOs or accounting managers at real estate companies that in some way are working directly towards K3 and the component depreciation. Since they work daily with these questions this will give us a deeper insight in the different companies and what challenges they are facing with component depreciation.

The selection of the responding companies was based on the size of the company and the company form. We chose to interview bigger companies per ÅRL's definition since the changes of K3 do not affect companies with fewer properties to the same extent. Our main focus was companies who have chosen to implement K3 since they are the ones being affected by the component depreciation. In addition companies who did not choose to implement K3 were also interviewed in order to give a broader perspective and to get a better insight of what their motives were.

### **2.1.4 Presentation of Respondents**

Five companies within the public sector and two companies from the private sector were interviewed. All the companies has been made anonymous, partly as it has been requested by some and partly as knowing the names of the companies would not contribute to the content in any significant way. The companies of the public sector will be called A, B, C, D and E and the companies of the private sector will be called X and Y throughout the thesis.

- Company A is municipally owned and has about 5400 apartments. They started using component depreciation 2014 and started the implementing work in the summer 2013. We interviewed the project controller.
- Company B is municipally owned and has chosen to be anonymous so we will not specify the size of the company any further than that they own more apartments than our other municipally owned respondent companies. They started using component depreciation 2014 and started the implementing work in the summer of 2013. We interviewed the CFO.
- Company C is municipally owned and has about 3000 apartments and 250 premises. They started using component depreciation 2014 and started the implementing work in the summer of 2013. We interviewed the accounting manager and the controller
- Company D is a foundation and has about 7400 apartments. They started using component depreciation 2014 and started the implementing work in the summer of 2013. We interviewed the CFO.
- Company E is municipally owned and has about 3500 apartments and premises. The company started using K3 in 2013 and this year will be their second year using component depreciation. The respondents work as CFO and Controller.
- Company X is a subsidiary of a listed company and has been following RFR2 since 2013. The respondent works as CFO and has a background as an auditor. The company has about 70 commercial properties
- Company Y is the parent company in a group with several subsidiaries. All subsidiaries are following RFR2 and company Y is following IFRS according to the law since 2005. The company itself does not own any properties, but the group owns about 600 commercial properties

### 2.1.5 Analysis of the Data

The analysis is made by drawing connections between the collected empirical data and the theoretical framework. The empirical data consists of the conducted interviews with companies within the real estate industry and also quantitative data received from the companies in forms of examples of component depreciation that they use. This information has been summarized for each company and structured into different areas in order to make it easy to follow and compare the companies. The empirical material is our own translation of the respondents' answers and we have chosen to present the answers relevant to the research question. In order to minimize the risk of misinterpretation we have translated and summarized the empirical data as close as possible to the actual formulations made. Throughout the process the theoretical framework has been adapted and complemented as we have noticed additional theories being of relevance to the outcome of the interviews. In the second stage of the analysis we have compared the collected empirical data and theoretical framework to find connections which has been analyzed. The research question has been kept in mind throughout the whole analyzing process in order to ensure the relevance of the presented and analyzed material.

## 2.2 Validity and Reliability

The validity of a study is the study's success at measuring what the researchers set out to measure. Internal validity is a measure of whether the method is suitable while external validity

is a measure of whether the conclusion can be generalized. The reliability of the study is the accuracy of the measuring instruments, i.e. would the results be the same if the study were conducted again (Bryman & Bell 2011).

### **2.2.1 Validity**

Measuring the validity in a qualitative study based on interviews is hard since the results of an interview are affected by the questions asked during the interview, the scope and the veracity of the answers given and the interpretations of the answers (Erikson and Wiedersheim-Paul 2006). Before we conducted the interviews we spent much time on our predetermined interview questions to make sure we would ask the correct questions, and that they covered everything we would need. We also spent time on reading about interview strategy and theories to obtain better results from the interviews. The answers are fairly unflinching, but we chose to take notes and using good recording equipment as well as making sure that we understood by asking follow up questions, which according to Bryman & Bell (2011) gives high internal validity.

In a qualitative study with few interviews a high external validity is difficult to achieve, but using a representative selection of respondents will help to some extent (Bryman & Bell 2011).

### **2.2.2 Reliability**

To ensure that the thesis is reliable we tried to ask neutral questions, not to involve our personal opinions and used a mixed group of respondents. Our use of standardized interview questions will increase the reliability, while the open discussions will decrease it, as the interviews are controlled and have a high resemblance, the decrease in reliability will not be so big. We tried to minimize the interviewer effect as well as location effects, and used a reliable recording device, not to let coincidences and random events affect our reliability negatively (Bryman & Bell 2011).

The stability reliability of our study might not be very high because of the nature of the study which is based on our respondent's personal opinions. The fact that we are in a transitional phase, might cause the respondents to change their opinions about K3. This is something that has happened to some of them since the start of the implementation, and the changing environment increases the probability that it might happen again (Bryman & Bell 2011, pp. 157-158).

### **2.2.3 Non Response**

Some of the companies we contacted about an interview declined due to reasons such as lack of time, ignorance, unwillingness to participate and the fact that they do not report according to K3. In most cases the nonresponse barely affects the results as we found similar respondents. But the fact that no privately owned companies that deliberately chose to report according to K3 wanted to participate in an interview and results in a lack of an approach.

## 3. Theoretical Framework

In the theoretical framework the theories relevant for a further analysis of the empirical material will be presented. Relevant legislation will be explained consisting of the current and previous Swedish regulation as well as the international regulation in order to gain an understanding of what effects the different regulations have. Organizations that have a relevance to this topic will also be presented to clarify their importance and stance in the discussion. At last different theories will be described for further discussion in the analysis.

### 3.1 The Swedish Accounting

The new accounting system is divided into four different categories depending on the size and characteristics of the company. The following categories are:

- K1 - This is a simplified accounting system for smaller companies of different company forms which are required to do a simplified annual financial statement.
- K2 - This category turns to all company forms which have to do an annual financial statement according to ÅRL and which fulfill the requirement of being smaller companies, which means that the company cannot exceed more than one of the following three (ÅRL, 2013, 1:3, 6):
  - 50 employees
  - 40 million SEK in the balance sheet total
  - 80 million SEK in net salesK2 is a rules-based regulation and in that sense similar to the old Swedish accounting system.
- K3 - If more than one of the above mentioned criteria are being exceeded the company has to follow K3 instead. A company that can follow K2 also has the choice to report according to K3. K3 has been strongly influenced by IFRS for SMEs, but at the same time taking into consideration the relation to taxation and existing laws and norms. This has also led to a principles-based accounting system.
- K4 - The last category is for listed companies who are a part of a corporate group which is required to follow IFRS (BFN, 2014b).

A company which is following K2 can still make the choice to use K3 instead. This would facilitate a potential expansion of the company and would decrease the amount of work the transition would need at the day the company is required to follow K3 (EY, 2012). A company that belongs to a group whose parent company is listed is also able to follow RFR2 instead of K3 (Marton et al, 2013, p.19).

#### 3.1.1 Fixed Assets

Fixed assets are defined in BFNAR 2012:1, also known as K3. In par. 4.4 it is stated that a fixed asset is an asset that the company intends to keep for more than 12 months. 17.2 states that a fixed asset should be used for production or distribution of goods and services or rental to others or for administrative purposes or as a long-term investment.



### 3.1.2 Investment Property

16:2 in K3 defines an investment property as “a property held by an owner or a lessee under a lease to earn rental income or for capital appreciation.” Investment properties give cash flows regardless of other assets owned by the company. According to PricewaterhouseCoopers (2013, p. 533) an investment property could for example be:

- land held for long-term capital appreciation
- a building owned by the company and leased under one or more operating leases
- a building which the company owns as a lessee under a financial lease, and is leased out under one or more operating leases
- vacant building that is held to be leased out

Paragraph 16:4 explains that the company has to leave information about their investment property, at least on an aggregated level, which means for the company as a whole, regarding:

- book value
- fair value
- the methods and significant assumptions used to determine fair value
- the extent to which the fair value based on valuation is performed by an independent appraiser
- if there are restrictions on the right to dispose of the investment property or to appropriate rental income or sale proceeds
- significant commitments to purchase, construct, repair, maintain, or improve the investment properties

### 3.1.3 Depreciation According to Previous Regulations

Until the year 2014 the depreciation of fixed tangible assets was regulated in RR 12 and further regulations regarding investment properties in RR 24. According to RR 12 the value of the asset should be depreciated over the estimated period of utilization which is defined as the period of time which the asset is expected to be used for its purpose within the company (RR 12, par. 23). There are four different methods of depreciation mentioned in RR 12, which are the following.

- Linear depreciation: the value will be divided over the period of utilization and each year an equally big amount will be depreciated.
- Declining balance depreciation: starts with bigger depreciations and decreases each year.
- Progressive depreciation: the depreciation increases with each year.
- Units of production depreciation: based on the number of units produced during the year in relation to the total number of units which can be produced (Marton et al, 2013, p.229 - 232).

The choice of the method of depreciation that will be used by the company should be the one which will best reflect the reality of the company. It is shown that the most commonly used method in Sweden is the method of linear depreciation (ESV, 2004, p. 38).

The recommendations of RR 24 only allow the investment properties to be valued to the acquisition value, subtracting the depreciations. This is in accordance to the Swedish accounting law ÅRL which does not allow any other valuation of an investment property than acquisition value, although the fair value has to be informed about in a note.

### 3.1.4 Component

Since K3 is a principles-based regulation there are only guidelines of how to determine the components of an asset. In K3 they define two criteria that has to be fulfilled which are that the component has to be significant and that the consumption has to be substantial, that is, the period of utilization (par. 17.4). How to interpret what is meant by significant is unclear and there is not any definition in IFRS either. In order to determine whether it is significant or not there are different options. For example, PwC recommends using a lowest percentage of the total cost that has to be fulfilled in order to classify it as a component (PricewaterhouseCoopers, 2013, p.544). There are no clear guidelines of how to interpret the substantiality either. One way of seeing it is that the component should be exchanged at least one time during the whole period of utilization of the asset to classify as substantial.

Furthermore, Fastighetsägarna Sverige and SABO have given out guidelines to the real estate companies on how to interpret and treat the new regulations in K3. They have identified nine different components in a real estate, which are the following:

- Land
- Land development
- Building- and machine inventory/equipment
- Framework
- Roof
- Facade
- Inner surface condition (floor, wall, ceiling)
- Installations (electricity, pipelines, ventilation, elevator)
- Tenant improvements

These are only meant to serve as a base and depending on the unique situation of each company components can be added or subtracted (SABO, 2012).

### 3.1.5 Component Depreciation

Depreciation is the systematic allocation of an asset's depreciable amount over its period of utilization, which is the time the asset is expected to be used in the company (par. 17.12, 17.16). The cost of the asset should be allocated to components if there is a substantial expected difference in consumption in a tangible asset's major components (par. 17.11). If the asset has been divided into components, the components should be depreciated separately over its period of utilization and if the asset has not been divided into components the whole asset should be depreciated over its period of utilization (par. 17.13). The depreciable amount is either the acquisition cost or the acquisition cost minus residual value, which is the value the company is expected to get at divestment (par. 17.14-15).

In order to activate an asset it has to be more likely than not that the asset will generate future cash flows. A component that has a longer period of utilization which is essential in order for the whole asset to function and generate a cash flow would therefore be considered as an asset which should be activated instead of being expensed. The component depreciation is therefore essential in order to fulfill the criteria of an asset according to K3. The period of utilization will be evaluated for each component individually and the depreciation will be affected accordingly. This results in a steadier development in the profit-and-loss statement since an investment will not affect the year of the investment as heavily and will instead be spread over the period of

utilization. The balance sheet will give a better reflection of the real value of the assets since all components are taken into consideration and evaluated separately, which in a linear depreciation would at first show an overestimated value while after the component change would show an underestimated value (Hellman, Nordlund and Pramhäll, 2011). These differences can be seen in the appendix.

In their article Starova and Cermakova discuss the differences of linear depreciation and component depreciation in relation to the accounting and what effects it has. They confirm in their discussion that in a tangible asset where the lifespan of the component is significantly different from the asset, the wear and tear will be better presented by using component depreciation and this will provide a fairer view of the asset itself. On the other hand it does not take into consideration the tax regulation which has to be kept in mind (Starova et al. 2010, p.46).

Furthermore it is discussed in an article by Colyvas how the accounting of fixed assets has been problematic in South Africa. The reason is that the period of utilization was being decided in a way which is convenient for the taxation and that no follow-ups are done on how the period of utilization changed over time. This has resulted in a register of fixed assets which contains assets with a book value of zero that still has an economic value. It is important to take into consideration that there might be a cultural difference in the accounting. Colyvas discusses how this situation can be fixed with the help of component depreciation through contributing with a better overview of their assets and also assists as an extra tool in budgeting and resource planning. Although the implementation demands a lot of work and is expensive and because of the difficulty of understanding how the implementation process works it is important that the auditor is highly involved in the process (Colyvas, 2009, p.29).

In the article in Balans (Nordlund et al. 2013, pp. 32-35) three different ways of determining the company's components is mentioned. The first and easiest alternative is to use an existing asset register that supports the component depreciation method. The second alternative is to use the maintenance plan, which helps both seeing which components there are and what their useful life might be. Having the property inspected is also mentioned in this alternative.

In the table below you can see an example of the property that was bought year 0 for 15 000 thousand SEK. The assets are assumed to be changed at the end of their useful life to an equal.

Property	Acquisition value	Initial distribution	Period of utilization	Annual depreciation	Accumulated depreciation	Proportion of accumulated depreciation	Remaining book value	Proportion of book value
Component A (Main asset)	3750	25%	100	38	-938	14%	2813	34%
Component B	9750	65%	50	195	-4875	72%	4875	59%
Component C	750	5%	33	23	-563	8%	188	2%
Component D	750	5%	17	45	-375	6%	375	5%
Sum Property	15000	100%		301	-6751	100%	8251	100%

Table 1: Example from Balans (2013) with a property that is 25 years old at the transition to K3.

This gives a weighted depreciation relative to the acquisition cost of 2%. The more recent the company changed a component the larger proportion of booked value it gets.

The third alternative exists to facilitate the transition and is most suitable for companies that do not have an asset register. The property's booked value is divided into components based on the property's type and condition. A weighted depreciation percent is calculated instead of putting every component in an asset register. The calculated weighted depreciation percentages can be used for similar properties. When a component is changed it will be added to an asset register, and the weighted percentage have to be changed. Over time this will lead to an increasing proportion of the component is depreciated by their own depreciation time.

Property	Proportion	Proportion of book value	Remaining period of utilization	Annual depreciation
Component A (Main asset)	34%	2813	75	38
Component B	59%	4875	25	195
Component C	2%	188	8	23
Component D	5%	375	8	45
Sum Property	100%	8251		301

Table 2: Example from Balans (2013) with a property that is 25 years old at the transition to K3.

The example gives us a weighted depreciation relative to the acquisition cost of 2%.

## 3.2 International Accounting

All companies whose shares are admitted to trading on a regulated market need to prepare their consolidated accounts according to IFRS with the additions in RFR 1 (RFR 1). In category K4 the parent company must report according to IFRS with the additions in RFR 2 (RFR 2). For the subsidiaries there is a possibility to apply RFR2, K3 or K2 depending on their company size (PwC, 2012).

### 3.2.1 IAS 40 Investment Properties

Companies that own investment properties have the possibility to choose either the fair value method (par. 33-55:IAS 40) or the acquisition cost method (par. 56; par. 30:IAS 40). The standard requires all companies to value their investment properties at fair value. This is done in either valuation purposes if they value according to fair value or in disclosure purposes if they value at acquisition cost (par. 32:IAS 40). The profits or losses arising from a change in fair value of investment property are recognized in earnings in the period they occur (par. 35:IAS 40). If the company chooses fair value method, all investment properties should be measured in the same way as long as the fair value can be measured reliably (par. 33, 53:IAS 40).

The fair value according to IFRS 13 has to reflect e.g. continuous rental income and other commitments that the market would use when pricing investment properties under existing market conditions (par. 40:IAS 40). If the company chooses to use the acquisition cost method

they need to value all their investment properties according to IAS 16 which will be explained further down (par. 56; IAS 40).

IAS 40 does not comply with the Swedish ÅRL and additions are made in RFR2 for the legal entity, there are no additions for the consolidated accounts. ÅRL requires a careful valuation and it is therefore not allowed to value according to the fair value method (par. 33-55:IAS 40), the acquisition cost method (par. 56:IAS 40) should be used instead.

### **3.2.2 IFRS 13 Valuation at Fair Value**

At the initial valuation at acquisition, fair value is equal to the acquisition cost. Fair value is defined in the standard as: “The price on the valuation date would be received when selling an asset or paid upon transfer of a liability by an ordered transaction between market operators” (par. 9:IFRS 13). An alternative is to define fair value as the value for their own company, which is done by looking at what cash flow the asset generates. IASB favors valuation at fair value of investment properties but not for commercial properties (Marton et al 2013, p. 132-135; IFRS 13).

There are no additions to RFR1 or RFR2, which means Swedish companies that follow IFRS in the consolidated accounts or legal entity complies with IFRS 13 fully (Marton et al 2013, p.149).

### **3.2.3 IAS 16 Fixed Assets**

At the initial valuation the asset is valued at acquisition cost. At the subsequent valuations the asset is valued using the acquisition cost method or the revaluation model. All assets of the same kind have to be reported using the same principle (par. 29:IAS 16).

The acquisition cost method:

When using the acquisition cost method, the asset is valued at acquisition cost, less accumulated depreciation and any accumulated impairment losses (par. 30:IAS 16). In the acquisition cost method component depreciation is used where every significant part is depreciated separately (par. 43:IAS 16). The asset's depreciable amount shall be distributed systematically over the asset's period of utilization (par. 50; IAS 16).

The revaluation cost method will not be explained in our thesis as it is based on fair value and is not consistent with ÅRL, this however only affects the legal entities. Companies therefore have to choose the acquisition cost method. RFR2 allow the legal entities to make appreciations according to par. 4.6 in ÅRL.

## **3.3 Interest Organizations and Board**

In order to gain an understanding which role the interest organizations as well as board plays in the discussion of component depreciation a brief presentation is made below.

### **3.3.1 BFN**

Bokföringsnämnden (The Swedish accounting standards board) is an authority under the treasury department whose main responsibility is to develop the Swedish GAAP as well as inform about their recommendations and provide guidelines. They do this by developing the general advice,

BFNAR, of the Swedish accounting standard. The general advice cannot change or replace the law in any way. It is not legislated and therefore not binding by law. BFN has on the other hand the responsibility to develop the Swedish GAAP according to BFL, the law of bookkeeping, which in turn makes the general advice of BFN compulsory to follow.

The treasury department has regulated the activities of BFN, divided in three goals, for the year of 2014, which lays the foundation of the activities of BFN (Finansdepartementet, 2013):

1. Create norms and sustain a relation with authorities. They act as the expert body for the Swedish state in questions regarding accounting.
2. Provide information and improve the accounting for SME.
3. Make sure that the regulation is simple and up to date as well as adapted to the need of the user (BFN, 2014c).

### **3.3.2 FAR**

FAR is the trade organization for accountants in Sweden and was founded in the year of 2006 when the two audit associations FAR and SRS merged and became FAR SRS. Both SRS and FAR have a rich history and SRS was founded in 1899, four years after auditing of a company became legislated. FAR was later founded in the year of 1923 and both FAR and SRS have actively been working with questions regarding auditing in the business world. The merger went through because the two organizations shared the same vision and from 2010 they changed their name and are known as FAR. The purpose of FAR is to develop professional diligence, skills training and formation of opinions. They work both on a national and international level by engaging in comment letters of new regulations. They are a member of NRF and also actively engaged in FEE and IFAC (FAR, 2014).

The vision of FAR is “One step ahead - when trust counts” and their work is aimed to help the industry to benefit the business world and society. They have developed their strategic vision consisting of three points:

- Being valuable to stakeholders of the industry.
- Contribute to strong professions within the industry.
- Being attractive for current and future members of the organization.

In order to build trust of the organization within the business world as well as giving the best service to the interest of the members FAR is also currently collaborating with six different organizations such as SRF and the Swedish authorities of taxation, for example (FAR, 2014).

### **3.3.3 SABO**

SABO is the Swedish association for public housing companies and they support their members within different areas in order to develop sustainably and remain competitive on the housing market. The organization started in 1950 when the public housing sector was introduced in Sweden due to acute housing shortage in Sweden. Their vision today is to “be the natural representative, collaboration partner, source of knowledge and meeting point for the public housing companies in Sweden” and they strive to be a strong, professional and member oriented organization. SABO is acting both as an industry and interest organization and they give support through trainings, consulting, giving out guidelines and networking and also engaging in discussions of current topics. They also work with housing policies and they collaborate with different organizations where they see benefits for their members (SABO, 2014).

### 3.4 Principles-based Accounting

There are two different types of accounting systems, principles-based and rules-based accounting system. The two leading regulations in the world of today are IFRS which is principles-based and is being used in for example Europe, Australia and in parts of Asia (IFRS, 2014). The other regulation, U.S. GAAP, is mostly used within the United States and as a rules-based accounting system has a whole different approach. Advantages and disadvantages can be found in both systems.

The principles-based accounting system is characterized by being more flexible. There is not a strict set of rules, but there are fundamental understandings which are needed in order to apply the standard in the unique situation. There is more freedom to apply different techniques depending on what would best reflect the situation and this would lead to a better reflection of the company. This means that the accountant needs to have a better economical understanding in order to evaluate the situation. This also gives the auditors a more important role since they also have to make a judgment about whether the company has handled the accounting according to the principles. Although the flexibility of the accounting system might also give more room for earnings management. In relation with the implementation of IFRS in the EU, studies has shown that even though the aim is harmonization internationally in the accounting, the flexibility of the principles-based system enables companies to adjust their accounting to a similar way they used to before the implementation (Carmona and Trambetta. 2008, p. 456 - 461). The transition to a principles-based accounting system also affects stakeholders. This means that they will need to learn how to interpret the new regulation and how this is being reflected in the numbers produced in the financial statements. It complicates it further when a principles-based system is not applied to all companies and the stakeholders need to distinguish which system is used and what the effects are (Hlacijs et al. 2009, p.277).

The rules-based accounting system on the other hand has a set of specific rules and examples which has to be followed. It is more mechanical and form over substance is viewed, but it also gives advantages as increased comparability between companies since each situation is treated the same regardless of the circumstances (Collins, 2012, p.684). Even though the rules-based system limits the chances of earnings management the risk of transaction structuring still remains (Nobes, 2004, p.4).

### 3.5 Cost vs. Benefits

In the second chapter K3, the fundamental principles of the accounting that should be followed are discussed. There are four qualitative characteristics: comprehensible, reliable, relevant and significant. These are requirements which the information in the annual report has to fulfill. As K3 is a principles-based regulation where the company itself has to make an evaluation of each situation the qualitative characteristics are important in order to achieve the Swedish GAAP (PricewaterhouseCoopers, 2013, pp. 50-53).

In order to fulfill these characteristics the information has to be presented in a way which is understandable for a person who is assumed to have knowledge within the area. The information

has to be neutral and trustworthy in order not to affect the decisions in a misleading way. The time for presenting the information is also crucial since it may affect the decision. The company therefore has to evaluate the benefits of presenting the information at an early stage, where it might not be completed, towards presenting it at a later stage where the information is more trustworthy but might not be relevant anymore. The relevance and significance mean that if the information will affect the decision of the user, or if information that is not given affects the decision, these characteristics are fulfilled.

The characteristic of significant is relevant with regard to component depreciation since the implementation will demand a lot more detailed information of the fixed tangible assets, leading to the evaluation of if the absence of the information will affect the decision of the user or not. In chapter two of K3 it is further commented on the costs in relation to the benefits. The company has to estimate if the benefits gained by producing and presenting the information are greater than the costs of doing so. Here the total benefit of all the users has to be taken into consideration and often the benefits do not lie on the part that bears the costs (BFNAR 2012:1, Ch. 2).

Also included in the second chapter of K3 are the definitions of an asset indicating that it is a resource which can be controlled and that is expected to generate future cash flow. This is an underlying reason of why component depreciation has been implemented in K3 regarding depreciations of investment properties. Since an investment property consists of several components which have an important role in order for the whole asset as one to function and generate the cash flow it does, this would therefore mean that each component of a significant value fulfills the criteria of an asset according to K3 (Hellman, Nordlund and Pramhäll, 2011).

### 3.6 Change Management

Organizational change is a complicated area and throughout the years different strategies of how a change should be implemented have been developed. A critical factor which can either make or break the change is the level of organizational readiness for the change (Weiner, 2009, p. 2). The implementation of the change is equally important as the change itself and among the best known models of change often represented are the eight-step model for transforming organizations by Kotter, the tactical ten-step model for implementing change by Jick and the seven-step change acceleration process model (Mento et al. 2002. p. 45). Mento et al. has developed a twelve-step model for change based on these three models together with practical knowledge within the area. The model consists of the following steps: Step one - the idea and its context, step two - define the change initiative, step three - evaluate the climate for change, step four - develop a change plan, step five - find and cultivate a sponsor, step six - prepare your target audience/the recipient of change, step seven - create the cultural fit, making the change last, step eight - develop and choose a change leader team, step nine - create small wins for motivation, step ten - constantly and strategically communicate the change, step eleven – measure progress of the change progress, step twelve - integrate lessons learned.

This model treats organizational change but some steps can be seen as relevant for a national level as well. The fourth step in the model is about developing a change plan. This is a plan of the implementation which should include goals, responsibilities, the process and what the change



will be. The recipient can be either resistant or open to the change and the plan has to be adjusted to which approach they have and it must contain a balance between specificity and flexibility. For a fast implementation a more aggressive approach is needed although this will not convince the recipient in the long term. For a long-term implementation an approach which involves the recipient will facilitate the change process. The sixth step is to prepare the recipient of change and it treats the acceptance of the change. It is argued that a change cannot be implemented unless there is an acceptance and changes will receive resistance regardless of the perception because the unknown causes stress. It is therefore important to involve the recipients in the conversation to receive feedback. This way the form of resistance can be identified and it can be handled more easily. The tenth step is about communicating the change. The communication should aid in increasing the understanding of the change and prepare the recipient for the effects and to reduce the confusion (Mento et al. 2002, pp. 51 - 56).

Kotter discuss further common mistakes that are done when implementing change. Two of them are not to create an excessively powerful guiding coalition and not to remove obstacles to the new vision. In the first Kotter stress the importance of having a group of powerful people with a senior manager as the core who will initiate the change. With time this guiding coalition will grow as trust is gradually gained and the change is being implemented. Even though progress can be made, people will eventually resist the change unless the guiding coalition is powerful enough (Kotter, 1995, p. 62). In the latter it is being discussed that even if the employee wants to work for the change often obstacles in the organizational structure are perceived. Other obstacles can occur when self-interest is being prioritized because of a compensation system or when the actual boss will not adapt to the change. In order to achieve a successful change these obstacles have to be removed (Kotter, 1995, p. 64).

Other researchers have discussed that the resistance to change is not the natural reaction and contend that it is instead the change that is being imposed on the recipients that creates resistance. Another theory says that the resistance is such a big focus in the implementation of change that it is being expected. By looking for behaviors which would indicate resistance the expectations are being confirmed, when it was not necessarily a problem from the beginning. Change failures can also be blamed on the resistance of the individuals when in fact the actual problem might have been in the change itself (Choi and Ruona. 2010, p. 50).

## 4. Empirical Findings

The material gathered from the interviews will be presented here divided in companies who have implemented K3 and companies who chose not to implement K3. The material has been sorted into different areas relevant to the research questions which consist of their perception of K3, how it has changed their depreciation, advantages as well as disadvantages with component depreciation and what the reasons for not implementing K3 are.

### 4.1 Companies who Implemented K3

Almost all of the companies which have implemented K3 among our respondents are within the public sector. None of the respondents had the option to choose another regulation and it has therefore been a requirement.

#### 4.1.1 The Perception of K3

##### **Company A**

The respondent does not believe that K3 will improve the accounting in Sweden at this stage. At different networking events Company A has experienced that different companies do the component depreciation very differently, which is the opposite of their perception of the thoughts behind K3, that companies would be more aligned in their methods and that the comparison would improve. Instead, everyone use a method which suits them better and the results can vary. More recommendations would be appreciated of how to handle the component depreciation and it is very time consuming to work with K3 because there are always new questions that no one has the answer to.

In contrast the respondent does believe that with time component depreciation will give a truer and fairer view. Right now the values the company is using do not reflect the reality since a model has to be followed, but with time when all the components are changed the real values of the company will be reflected. Other people like project managers also have to get adjusted to the new way of thinking when projects are being planned and the change does not only affect the accounting.

The respondent would choose the old system over K3, because it was easier to handle when changes occurred. The old system has also provided the possibility to reflect a truer and fairer view.

##### **Company B**

Company B states that it is difficult to say if K3 will improve the accounting in Sweden. When it was introduced the company realized how much work the implementation of the component depreciation would take as well as maintaining it would be, which made them reluctant to adapt the new system. Now that the process is running the company has definitely accepted the component depreciation and advantages can be seen. Even though it is a big readjustment with a

whole new way of thinking and a lot of administrative work, it is seen as positive that the properties are better reflected by identifying the components.

The respondent believes that the component depreciation will give a truer and fairer view and that more information will be gained. For example, if the roof is changed, which would be a component, the company can check what the remaining book value is for the roof. If the book value is very high this would indicate that an erroneous investment might have been done, or that something has happened with the roof which has not been reflected in the book value.

### Company C

In the beginning most of the guidelines were based on how it was believed the implementation will be but this year it has become a lot clearer. To prepare for the implementation the company has read articles and looked at Mölndalsbostäder and Partillebo which started with the implementation earlier. There were a lot of insecurities and the company waited to get as much information as possible before starting. It would be very expensive to put down one and a half month of work and then have to redo parts of it. The companies who started earlier have had a lot of contact with the auditors and there have been a lot of trial and errors. There is a sense of security that their models have been confirmed by the auditors. Company C thinks that the guidelines from SABO could be clearer and the guidelines only consisted of how you could think but no concrete suggestions of how you are supposed to do.

There is a lot of documentation of how company C has done. It is needed for the auditors and also when the company change their auditor in order to see what has been done and why, and what the previous auditors said about it. With time this documentation can create guidelines for them by using them as examples as to how a similar project has been handled before. There has been a lot of collaboration with both Mölndalsbostäder and Partillebo who started with the component depreciation earlier and the company is using the model of Mölndalsbostäder which is shown an example of below.

Example of the model of Mölndalsbostäder			50's and earlier	Million programme	80's-90's	2000-
Component class	Component	Life-span	Proportion of component in %	Proportion of component in %	Proportion of component in %	Proportion of Component in %
<b>Foundation, supporting framework, staircase etc.</b>			<b>63</b>	<b>56</b>	<b>52</b>	<b>50</b>
2231	Concrete	100	63	56	52	50
2232	Wood	50				
2233	Steel	30				
2234	Mixed	50				

Figure 1. Example of the model of Mölndalsbostäder.

The respondent feel good about their work so far but there is still an insecurity of what the auditors will say in two years, considering the fact that everyone is doing differently. There is no cohesive message among the auditors either and different auditors have given different answers

to the same questions. The company has used three different auditors as advisors and has also been in contact with three experts.

The implementation has taken around one and a half month of extra work and a consultant has also been hired for one and a half week. There is a lot of work initially but with time routines will be made and the workload will decrease again. There will not be a need for Company C to hire an extra person because of the implementation of K3.

Company C preferred the previous accounting system where it was clear how everything should be done. Now it is very confusing with no clear directions and there are different ways of approaching the same situations.

### **Company D**

Right now K3 is very new and with everything new it takes time until it gets established, but once it is implemented and established in the companies, Company D can only see that it would affect the operation positively. It is obvious that a property of a value of 1 million SEK that is depreciated with 2% does not reflect the reality. Today, we have divided the property into ten components and this brings us closer to the truth. However when reading the annual report the external stakeholders need to have certain knowledge in order to identify which regulation is being used and in order to analyze the company. There are a lot of principles to keep in mind but the respondent think that in about five years the company will have adjusted to the new method. Internally the component depreciation gives a truer and fairer view. The company gets more exact information of how the costs have changed, how fast the property is consumed and it is possible to compare over time. When it comes to the comparison between companies, on the other hand, it is harder since the depreciation rate can vary a lot for the same component between different companies. It is very important to put down a lot of effort in the information in the annual report with regard to which principles are being used.

Even though there is a lot of work and it will not look productive economically for a while, this is how all changes are. It will probably even out with time. So far it has not been required to hire anyone for Company D and they are able to handle the workload.

### **Company E**

The respondents at company E finds it hard to see how the K3 regulations would improve the Swedish accounting at this moment, but believe that it will improve. One of the purposes with K3 was that it would lead to that all countries in Europe doing the same valuations and it would create a harmonization in the accounting. This would consequently make it easier for the market to understand the accounting, which is not the case today. The company would rather have chosen to use the market valuation and believe that this is the next step in the development of the regulations.

## **4.1.2 Effects on the Depreciation Before and After the Implementation**

### **Company A**

The company started the implementation after the summer of 2013 and it has taken approximately three weeks of full-time work. The most time-consuming part was that there are

no answers. Different questions pop up while working with the component depreciation and it demands a lot of thoughts and reflections for their company to find their own way. Company A considers that K3 was released relatively late and the auditors are not completely sure of how it works. The company can only say how others are doing and if it is reasonable or not. The respondent thinks that it is very difficult since accounting normally has clear rules and there are not many individual evaluations that have to be made.

Company A looked at SABO's recommendations when the components were decided. The company also looked at the planned maintenance and used a project list of future maintenance when choosing their components. For example, the windows are a component since these often are changed separately, but it is important to find a balance in order not to get a long list of components. The respondent mentions that some companies have very few components while others have a lot of components.

Before K3 was being implemented the company had a period of utilization of 50 years leading to a depreciation rate at 2%. Company A has not completed their assets register yet but when implementing the component depreciation the goal is to reach 2%. The respondent believes that it has been a depreciation rate which has reflected the reality well and it is not believed that the investment property will have a longer period of utilization just because the accounting method is being changed. This depreciation rate has given them relatively low book values in relation to the market value. Company A is restrictive with what is being placed in the balance sheet and this is a careful way of handling investments.

After implementing the component depreciation some properties have a depreciation rate of 3% while others only have 1%. The differences between these properties are the year of production. It is an interesting aspect that the properties built before the 60's have a relatively high depreciation rate while the properties built in the 80's have a lower depreciation rate. The respondent's manager calculated that at first the results will improve and the depreciations will not decrease much, but after about five to six years the depreciations will increase and this will even out the previous increase in the results.

### **Company B**

The company started the implementation of K3 in the autumn of 2012, which was quite early. There were no guidelines available when Company B started the work and their progress was gradually confirmed as more information was given. It would have helped if there were more guidelines from the start, but the respondent thinks the guidelines that are available today will be sufficient. Company B has put down a lot of work in the implementation but still within the usual operations. This has been their focus during the year and would not have been possible if there was another big project going on. External help has only been used when doing changes in the finance system.

Company B started with six components but then separated the subcomponents and today Company B has 16 components. When deciding upon the components Company B sat together with the technology department who had a quite clear idea of the components based on the cost-estimate. Afterwards, the company checked with other companies and confirmed with the group.

The collaboration between the finance department and the technical department has been very important.

Previously the company did the depreciation over 50 years for new constructions. The book value has now been apportioned in the different components. It is very important that it is only the accounting rules that have changed, the operations should continue the same way.

Before the implementation Company B's depreciation rate was 2% and it has increased. Their new constructions have the greatest impact on the depreciation since these consist of more components that consequently lead to more depreciation in the beginning. This was a surprise and the company thought since more will be activated the higher depreciations will come in the future instead.

The maintenance is decreasing and the depreciations are increasing which will lead to a growth in the results.

### **Company C**

The company started the implementation in September 2013. The company has gone through every property, component by component, and it has been a lot of work but the company feels it is worth it, knowing that the valuations are correct from the start.

Before Company C started with the implementation there were thoughts about using fewer components but when the company saw the model of Mölndalsbostäder which is quite detailed, the company also saw the benefits of the information it gives. Since there is insecurity as to how it should be done the respondent also see that too many components are better than too few. Dividing a component into several afterwards would demand a lot of extra work rather than just putting two components together.

Before the implementation Company C had a depreciation rate of 2% and the new depreciation rate will end up around the same, with a difference around 0,05%. This is what was expected and it has been a relief for the company to see that they are on the right track. There has been an effect in the short-term results, which has increased, but this will even out in the future when the depreciation increases. There is a long-term plan for the investments for 10 years and this has not changed but there is more room for maintenance now.

### **Company D**

Company D has eleven components including a residual post. In order to choose these components the company has looked at other examples and used the guidelines of SABO. Mölndalsbostäder who chose to implement K3 one year ahead have been a leading example. Company D divided their properties based on the year the year of construction, divided in four different periods where the properties were made quite similar and therefore also having similar components. Afterwards, Company D has identified the period of depreciation for the different periods. Company D has the following components: framework basis, framework completion, roof, facades, facade completion, interior construction, VVS, telecommunication system, control monitoring and a residual post. The company started by testing a few properties in this model and if it is working well they will continue with all their properties. The company checks with

auditors and experts within the area to make sure they are on the right track and that they will not have to start over.

Company D's depreciations were at 1,75% before the implementation of K3. Company D is in the middle of the working process and do not have the final depreciation rate yet, although they think that it will be higher than before. Even though the maintenance will decrease the depreciations will increase which in the end will somewhat even out the results. The evaluation will still be made of the market value by an external review, but this does not affect the balance sheet since it is only included in a note.

### **Company E**

The company started the implementation of K3 in November 2012 and finished the first 6 month period of depreciations in June 2013, long before most other companies. The respondents consider the early start as a hard but enjoyable journey, as there was a great need for guidance which did not exist. Today, Company E has made their own praxis and has been able to sell their model to five other companies.

The company collaborated with another real estate company and a technical engineering consultancy firm to be able to develop their model. Company E chose to have 18 main components with sub-components, which almost turn their component list into a chart of accounts. The company chose to have a broad range of components as they find it important to be very precise now to decrease the uncertainty around disposal.

Before the implementation of K3 their systematic depreciation was 1,75% on average. Now, after the implementation the depreciation has increased to 2,07% on average, with the majority ranging between 1,5%-2,5%. The maintenance cost will decrease as some of the maintenance will be activated as components. This will give them a better result and higher depreciations.

### **4.1.3 Advantages with Component Depreciation**

#### **Company A**

The respondent states that the company would not chose K3 if the law did not require it, but while working with the component depreciation the company tries to look for advantages and they can see a few. For them the changes have not been very drastic and there have not been any problems. Some companies with a longer period of depreciation get a high increase in their depreciations when changing to K3.

The respondent sees advantages with the component depreciation but considers that it might be a survival instinct; since the company has no choice they have accepted it. It will give them a truer and fairer view but not in comparison with other companies. A component like the roof, for example, can have recommendations of a period of depreciation between 30 and 60 years, which is natural since there are different types, but since the interval is quite big the companies can also use a depreciation period which does not reflect the reality but which would suit their situation.

One great advantage of the component depreciation is that since the maintenance will be activated the decisions for maintenance will not be as dependent on the business cycles as before.

Consequently, Company A will not be as dependent on the price anymore, the prices of renovation could vary a lot between the years but since it will be depreciated over a longer time this will not affect the operation as much and will not determine whether the company should do the renovation or not. The company might also be able to do more maintenance during the recession which could give them a better price.

Before the implementation of K3 the depreciation period of a property was 50 years. If the company change the windows from two glasses to three glasses this will be value-added and activated, which means that the windows will be depreciated over a period of 50 years when the windows obviously will be changed before that. The component depreciation will therefore represent the reality more accurately. Still, this will add a lot more work. In conclusion Company A says that there are some advantages but also a lot of work.

### **Company B**

Company B feels that the component depreciation gives more information about the properties. Previously it was only the engineers who had the information but now the finance department can also take part in this information. Even though there is a lot of administrative cost the respondent thinks that the benefits gained from it are worth it. Company B has managed to handle the work within the organization without hiring another person. There are also benefits perceived by other departments; for example, a project manager can more easily follow their estimations with the information provided by the components.

There is more room for doing maintenance now when it is activated instead of expensed. But it is still very important to think about if it is profitable and to think in a long-term perspective. It is also important to inform stakeholders that the company does not have more money even though the result is higher, the cash flow is still the same.

### **Company C**

There will be more collaboration between the financial department and the operating department. There are new opportunities to do maintenance and right now it is very beneficial because the Million Homes Programme, which was a government funding of new homes after a shortage of housing, needs to be renovated and this would be a cost too big for the companies to handle. With the component depreciation it will be depreciated over 25 years instead and it will be manageable to handle, although it is just a short-term solution. At an information day SABO held in Stockholm there was a company who said that without K3 they would never be able to handle the maintenance of the Million Homes Programme. It is important to keep in mind that even if it improves the results now and enables more maintenance the depreciation will increase over the years. The change of accounting system does not change the liquidity either and the cash flow still remains the same. It has a positive effect on the result in the beginning but eventually the depreciations will catch up and the decisions for maintenance will be about the same as it was before. Another party that will benefit from the component depreciation is the building contractors since the companies are enabled to do more maintenance on their properties. Company C also feels that it is good that they have gone through the assets register which is not done very often, and can be certain of that it is correct.



The focus for company C goes from the properties of the company to each property individually which gives the company better control. For a person who works with the properties it is a very good tool to get information that is needed.

#### **Company D**

The component depreciation might limit the possibilities of earnings management. It gives Company D a new viewpoint, better collaboration between the departments and better understanding for the finances among the departments and the properties get a better valuation.

#### **Company E**

The company can feel that the component depreciation gives an added value. However, the respondent does not find this in the accounting field. Instead, the respondent mentions the increased knowledge about their properties, better communication with the technology department and more detailed invoices that might help them keep construction costs at a slightly lower level. The respondent also mentions that there is a better contact with auditors and the fact that the company became well known in the SABO-world as benefits.

However, Company E considers that component depreciation gives a truer and fairer view compared to the old regulation. The new regulation reflects the properties better as they consist of different parts with different lifespans, rather than just use depreciation on 2% on the whole property.

### **4.1.4 Disadvantages with Component Depreciation**

#### **Company A**

A difficulty is that with regard to the taxation there are no differences, which means that the company will need to keep doing what they did before and also do depreciations according to the new regulation, so there will be double work. An example of this is the renovation of the framework which previously categorized as maintenance but now classifies as a component. Meanwhile in the tax declaration this is still a cost. There are no programs which handle this and Company A has to use Excel. The annual report can no longer be used for providing the authorities of taxation since the result for taxation no longer is enclosed. This must mean extra work for the authority.

Even though the difference between the accounted depreciations and the tax depreciation differed before, the difference as to the result is much more significant now. A stakeholder looking from the outside is required to look more at the balance sheet and the stakeholders also need to be updated as to how the new regulation will affect the results. The tenants' association, Hyresgästföreningen, will not be able to obtain the information about the maintenance per square meter anymore. Even though the result is higher because of the new accounting system it does not mean that there are more money.

#### **Company B**

There is a lot of administrative work and this is a lot more detailed. With time, routines will be developed with similar projects and similar components which will facilitate the work. If the company could choose between K3 and the old system they would probably choose the old

system. Company B has still not seen enough to be convinced that the extra work is worth it. Although the company has accepted the component depreciation.

Even though company B understands the component depreciation since they are working with it there are a lot of other stakeholders who also have to understand. The respondent explains that the company has been trained to operate in a certain way and now they suddenly have to think in the completely opposite way which is a big change.

### **Company C**

It is unclear how the tax will be handled and the respondent supposes two separate accountings have to be made which will make it complicated. The process is more complicated now and to start a maintenance project there is a need to identify if there is a change of component or not. The tenants will benefit since there will be more renovations, although since the rent will increase because of the value-added changes, it might get too expensive for some tenants. Also, the banks will benefit since more loans will be taken for doing the maintenance.

Previously, when Company C made an investment the company had to identify which part was maintenance and which part was value-added. Now, the company has to do identify the value-added for the taxation as well as identifying components. If the company, for example, change two glass windows to three glass windows there will be value-added, but now the windows might be a component and become an investment instead. The previous accounting still has to be made because of the taxation and at the same time the company has to do the component depreciation as well. From the perspective of the accounting there is a lot of extra work and the company would have done just fine without the component depreciation. This makes it harder to start a new project because of the double amount of accounting and it is harder to generalize. Each project has to be looked at separately.

The loans will increase with the extra maintenance and the interest rates will increase as well. There is a lot of extra work and as an accountant the component depreciation is not needed and the old system was better.

### **Company D**

The respondent finds it hard to say if the company has chosen the right components and if they have the right period of depreciation. There are uncertainties as to how the results will be and how the work in the organization will change, for example the budget process. Previously, the real estate managers only had to estimate the need for maintenance and then put the costs in their budget. If the manager have estates from different periods the manager need to check the depreciation rates with the financial departments, so the budget process will change. The respondent believes that it would take around five years both for internals and externals to understand the new regulation.

The implementation period was very short and the process was a bit strange. The respondent feels like the real estate companies were not taken into consideration and that BFN already had decided that this is how the company will do it. There were not many guidelines and if you are a traditional accountant it can be very difficult to go from a rules-based to a principles-based

system. The lack of guidelines made the implementation harder but on the other hand it enables Company D to shape it after the conditions of their own company.

Much time will pass until the component depreciation has been properly implemented within the companies and until there is some kind of security in how to use the method. For example, what will the operating net look like in ten years is unknown since it did not include depreciations before the component depreciation was implemented. Does this mean that a higher operating net will be accepted or will it be adjusted? If nothing changes the operating net will increase and the value of the property will increase drastically which is unacceptable. Just because the regulation is changed it does not mean that the property suddenly is worth more.

### **Company E**

The respondents consider the heavy workload during the transition year the biggest disadvantage, as the company estimates that they put 80% of the work on the transition year. To facilitate the implementation Company E believes that SABO should have given out their guidelines one year ahead. One difficulty with the implementation of K3 and the component depreciation was the disposal when a component is changed. Company E considers it is hard to know what is in the book value and what is really left out. It is difficult to feel sure about whether the disposal value is correct.

## **4.2 Companies that Opted Out K3**

In order to gain an understanding of what the underlying factors are for not choosing K3 we will present the interviews from two companies of the private sector that did not implement K3.

### **4.2.1 Reasons for Not Choosing K3**

#### **Company X**

As Company X is a subsidiary they did not have the opportunity to choose regulation themselves as the parent company made the choice for company X and the other subsidiaries. The respondent strongly believes the choice of IFRS was made to facilitate the accounting. The fact that the parent company already followed IFRS and that the company would be able to evaluate at market value instead of using component depreciation made the choice fairly simple to the parent company.

#### **Company Y**

Since Company Y is a listed company they have to follow IFRS by law on the corporate group level and as a parent company RFR2. For their subsidiaries on the other hand the company could choose whether to follow RFR2 or K3. The respondent states that K3 actually is a good regulation and if it were not for the component depreciation the company would have chosen it instead. The respondent explains that they do not see their investment properties as physical products but rather as a financial investment, which is why it cannot be broken down into components based on the acquisition value. Instead the company makes a calculation based on the cash flow. The transition to component depreciation is very complex and there is no direct

added value with the method, therefore Company Y does not want to burden their subsidiaries with the component depreciation.

#### 4.2.2 The Perception of K3

##### **Company X**

The company finds it hard to see that K3 would benefit the Swedish accounting. The recipient has to understand the new regulation, the respondent considers that k3 is more difficult to understand than the older regulation and that it takes time for stakeholders to learn the new regulation. Still, it will be easier for foreign stakeholders since it is similar to IFRS.

There are many practical problems with the transition to K3. The division of the components is a big difficulty since it demands a lot of technical competence that often does not exist among accountants.

##### **Company Y**

Company Y believes that K3 has a good concept and compare it to a handbook in accounting where all the different regulations and recommendations are gathered. On the other hand, the company sees the component depreciation as involving a lot of administrative work that gives information but with no added value.

The respondent consider the whole approach that a property is mortar and stones as very outdated, the company do not look at a property as a physical product, but as a financial investment. When the company buy or build a property they do not think about components, instead they calculate the property's future cash flow. The respondent thinks this mindset dominates the entire real estate industry. The main problem with component depreciation is that it is based on the acquisition value. The value is then controlled by how long you have owned the property and how big the acquisition costs were when it was acquired which is not relevant information. The respondent explains that the acquisition cost often is the fiscal residual value, which is much lower than the true value, and it therefore becomes completely irrelevant to allocate the value to the different components. An example of this is if you have an investment property with a market value of 100 million and the acquisition costs of this property might have been five millions. To then identify components based on these five millions would not give any valuable information since it does not reflect the true value of the property.

There are also a lot of complications with components and one example is if you buy an already constructed property and you do not have the construction worksheet. It is then difficult to do estimations of the period of utilization of each component since there is no specific information of the components. Other complications also occur when a part of a component is being replaced and there are also difficulties with the disposal. The information that would be provided from the components period of utilization can already be found in the maintenance plan. If the roof needs to be repaired there is no need to look for the information in the accounting but rather look directly at the roof and the maintenance plan. Company Y sees no point in putting extra work on their subsidiaries which gives no added value. The transition to component depreciation is also very complex and would require extensive work if there is a big asset register since depreciation plans has to be made for each component of every asset. They also mention the fact that new

guidelines were added later on to facilitate the implementation which indicates that the system was wrong from the beginning.

The fair value valuation, which is used by Company Y instead, is made by calculating a value based on future cash flows and is confirmed by external appraisers. It is important to ask what the purpose of the accounting is and what information is it that the stakeholders want to see? It is strange when the information would say that there are investment properties of a value of 39 billion and the balance sheet states that the value is 17 billion. Company Y thinks this gives a truer and fairer view, maybe not entirely true since it is based on estimations, but at least more correct than a depreciated residual value which Company Y knows is completely wrong.

When IFRS was implemented 2005 on the consolidated level the companies could either choose fair valuation or the component depreciation. At the time fair valuation was not completely accepted, still, everyone chose fair valuation which indicates that there are problems with the component depreciation.

Company Y sees the fact that K3 does not allow fair value valuation as a problem. K3 is based on IFRS for SME which allows it, which the respondent sees as a major reason to allow it in K3 too. Although, the problem lies in the Swedish law which does not allow a valuation to fair value and therefore cannot be an option in K3 as long as the law remains the same. Besides that, the company considers K3 as a good regulation which they unfortunately will not use.

## 5. Analysis

In this chapter the empirical data will be analyzed with the theories presented in the theoretical framework. The analysis is done based on the research question of the thesis.

### 5.1 What is the Perception of K3

The perception of K3 has clearly changed throughout the process. Before the actual implementation most companies had a negative approach towards K3 and the high increase in the workload was obvious while the benefits were questionable. The short time of implementation together with the lack of information and guidelines did not improve the situation. Several companies have thought about different options of using other regulations such as IFRS, because they do not see the component depreciation as beneficial, and many companies in the private sector has done so.

Even though the companies who started implementing K3 experience that their properties are reflected better in the balance sheet, as discussed in the article in Balans (Hellman et al. 2011), the companies are still not convinced that K3 will lead to a truer and fairer view. The main concern is the comparison between the companies. The numbers of components can vary a lot as well as the depreciation rate, and many companies are implementing the component depreciation in very different ways.

Being in the middle of the implementation of K3 it can be confirmed that the perceptions have changed and those using K3 have accepted the regulation and have started seeing more benefits with the component depreciation. There is a belief among the companies that when K3 has been properly implemented and become a habit it will improve the Swedish accounting. Although the benefits seen today still do not overweight the extra workload and many companies still prefer the old system over K3.

During the implementation most companies have also reacted to the lack of guidelines. Company C states that SABO, which is the association for public housing companies and partly act as a support for them, could have provided better guidelines which would have facilitated the implementation. Instead, the companies had to complement the information with articles and a close collaboration with Mölndalsbostäder and Partillebo who both started with the implementation of component depreciation ahead of the others. The implementation of K3, especially the component depreciation, has got a lot of resistance and as Mento (2002) discusses the importance of involving the respondents and getting feedback, is something that has not been done properly. Even though there were a lot of responses to the exposure draft none of them were taken into consideration and BFN decided to implement the component depreciation without involving the recipients in the discussion. The lack of understanding of the recipients' perspective has given BFN poor understanding of how to facilitate the change. Considering the fact that the change has been enforced upon the companies might have reinforced the resistance towards it according to Choi's (2010) theories who also states that resistance is not the natural reaction to change. There has not been created a strong guiding coalition on FARs side either, as Kotter (1995) discussed. The guidelines provided were very vague and there were mixed

messages from the auditors as well. Considering that the change has been enforced on the companies by law it is clear that the companies have sought other guidance and it can be considered that Mölndalsbostäder and Partillebo who started with the implementation earlier set the standards and have been acting as a guiding coalition towards the companies.

Furthermore, obstacles have also been perceived during the implementation which according to Kotter (1995) can obstruct the success of the change. These obstacles are mainly based on the lack of information. The companies have received different information from different parties which likely will create confusion in the change. Even though the implementation has started the supporting functions such as financial systems are still not able to handle the change. The business systems are not adapted to the component depreciation and cannot process the information.

Company Y on the other hand which chose not to implement K3 in their subsidiaries states that they actually consider that the K3 project is very good. Company Y sees that it is positive that all the different recommendations and norms which have to be taken into consideration are gathered in one place and function as a handbook. The main reason why Company Y chose not to implement it despite the benefits is because of the component depreciation. Company Y does not believe that an acquisition based valuation can represent a true and fair view, and component depreciation would therefore not add any value and only add extra costs.

## 5.2 Effects on the Depreciation before and After the Implementation

When deciding which components to use the companies have used the guidelines of SABO, their maintenance plans, looked at other companies and also confirmed with their auditors. Everyone has been very careful with doing correctly from the beginning in order to avoid the risk of having to redo everything which would result in a lot of extra work and costs.

All companies have confirmed that the depreciation rate has increased or is expected to increase after the implementation of K3. Most of the respondents felt that the depreciation rate reflected the reality well and the companies aimed and hoped for a depreciation rate similar to the one they had before. The difference in the depreciation before and after the implementation has shown to vary between 0,05% to 2,5%.

Since maintenance is being activated to a higher degree now in forms of components the maintenance costs has decreased and the results have increased (Hellman et al. 2011). Still, this is just a short term effect and it is expected to even out in the long term as the depreciations will increase. This means that the results have to be interpreted in a new way and in order to analyze the situation of the component the stakeholders are required to have knowledge of the new system.

The comparison between the depreciation rates has also been affected since the principles-based accounting system allows more flexibility. The same component in different companies can have a period of utilization varying between, for example, 30 to 60 years. This affects the comparability between companies depending on how they have valued their components and on

the number of components they have. In the previous accounting system the depreciation rate was the same for the whole asset based on the period of utilization and the companies could be compared more easily since everyone was aware of how the depreciations were done. This is one of the benefits from the rules-based accounting system, according to Collins (2012), which was used in Sweden before K3. With the component depreciation the calculations of the depreciation rate are more complex and cannot be found in the annual report alone.

### 5.3 Advantages with Component Depreciation

The implementation of component depreciation has become more accepted and different benefits have been experienced. It is perceived among the companies that a truer and fairer view is represented internally and that the component depreciation gives more information about the companies' properties. This is important since it is the main asset of the companies and the core for their business. The finance department has gained a better understanding of the properties now that it is broken down into components, which was information only the technological department had before. This has also increased the collaboration between the different departments since a higher understanding of the economic and technological aspects is required in the different departments. The more detailed information has facilitated the work for project managers among others who are working directly with the properties and they can plan more easily. The implementation has also given the companies a reason to go through their assets register and they can now be sure that it is up to date and correct. These benefits have been discussed both in the article of Balans (Hellman et al. 2011), who states that the component depreciation reflects the real value of the assets better and Colyvas (2009) states that the component depreciation will create a better overview and assist in budgeting and resource planning.

Another advantage is that the companies are not as dependent on the business cycles as before. The prices of the maintenance will not directly affect the results since the maintenance will be activated and depreciated over a longer period instead. This also means that the renovations will not be done based on the business cycles and the companies will also be enabled to do maintenance work during the recessions which might give the companies a better price. This is also a relevant point considering that the properties in the Million Homes Programme are in need of renovation which has been a concern since it consists of such a large number of properties. As one company expressed, these renovations would never be possible if it were not because of the component depreciation. Company C also explains that this will benefit the contractors since more companies are able to do maintenance and renovation the contractors will get more job opportunities.

Company D states that it might take around five years until the component depreciation is fully implemented and at that time many benefits are expected with K3. As in all changes the costs are bigger in the beginning but are expected to even out when everything is established.

Company Y consider that another positive aspect with K3 is that it is more similar to the international regulation IFRS. This is one step forward to a more harmonized accounting



internationally. International stakeholders can also more easily understand the financial information of the companies.

## 5.4 Disadvantages with Component Depreciation

The most experienced disadvantage of component depreciation among the respondents is the increased workload. Identifying and maintaining the continuous evaluations of the components demands a lot of work and instead of one depreciation plan for each property there will now be several for each component in the different properties. There are also many insecurities of how it is supposed to be done. No one knows for sure if it is the correct way the companies are doing, if they use the correct depreciation rate and if they have evaluated the components the correct way. There are also many internal insecurities of how the work within the organization will be affected, for example, the budget process. Company D states that the implementation process was very short and that the companies' thoughts were not taken into consideration. This complicated the transition, especially since the accountants are used to a very clear regulation of how the accounting should be done. Changing to a principles-based regulation means that a lot more evaluations has to be done on the company's side which means that the companies have to adapt to a whole new way of thinking. Not only to increase the understanding of the technical parts of the new regulation, but in order more easily to adapt to the new approach more guidelines should have been available at an earlier stage of the implementation. Once again, this can be connected to Kotter (2002) and lack of information and understanding of the process has been an obstacle for the companies and may have increased the resistance to the change. Company C states that from an accountant's perspective the component depreciation is not needed and instead complicates the working process. The old accounting system was sufficient and would have been preferred.

Another effect of the implementation which has increased the workload is the taxation aspect. The taxation still has to be done as it was before and this means that while keeping a model for the component depreciation another model has to be maintained for the taxation values and the workload doubles. The respondents see that this must complicate the process for the taxation authority as well since the taxed value no longer can be interpreted by looking at the balance sheet and the tax authority need to gather more information in order to do the calculations. This change also means that a better understanding of the accounting has to be achieved among other externals as well. The results will increase while the cash flow still remains the same and this has to be understood by the stakeholders in order to analyze the company. This can be a difficulty especially among those who do not have an economical educational background.

Company Y also explains that the component depreciation cannot add any value since it is based on the acquisition value. By seeing the investment properties as financial investments instead of an asset the information gained by the acquisition value is not of relevance because the market value in most cases is significantly larger. Taking this into consideration it would mean that even though component depreciation represents the value of the assets better according to the article in Balans (Hellman et al. 2011), this information would still be completely wrong according to Company Y. Looking from this perspective only the fair value method could provide information of any relevance which is not allowed by the Swedish law.

The reason why component depreciation is included in K3 is in order to fulfill the qualitative characteristics of the regulation according to the article in Balans (Hellman et al. 2011), but at the same time the companies feel that the qualitative characteristics are not being fulfilled in other areas. It is questioned how much the gained information actually will affect decisions, and therefore should not be implemented according to K3. Another area that has received heavy criticism is the cost in relation to the benefits. Even though some benefits have been identified the companies are still not convinced that those are strong enough reasons. It is commented in K3 that the costs of producing and presenting the information should not exceed the benefits. While BFN argues that the component depreciation is implemented in order to fulfill the criteria in K3, where the components are considered to be a crucial part in order to generate future cash flow and therefore should be activated, the companies feel that the costs exceeds the benefits. The definition of an asset might be fulfilled but the companies doubt the relevance when the qualitative characteristics are not being taken into consideration. Then again it is only in the implementation stage and as company D stated; once it is fully implemented there will most probably be more benefits with the new regulation. Once it is established the costs will also decrease and then the relation between the costs and the benefits will be completely different.

Many real estate companies have been negative towards component depreciation and the large workload in determining the components. Still none of the respondents are using the simplifying rules presented in Balans (Nordlund et al. 2013) months before most companies started the work towards the implementation. The simplifying rules would have reduced the workload around implementation drastically. There would have been no need to search for old numbers from earlier transactions etc., which is mentioned as very time consuming. Instead the workload would be spread over the future years when components are changed. It can be questioned if this is because Mölndalmodellen got famous and had gained a status in the industry, which many companies chose to use them as a guideline instead. Company Y also states that a need of adding these simplifications indicates that the whole system of the component depreciation is wrong from the beginning.

## 6. Conclusion

The conclusion is based on the analysis of the theories and the empirical data and will answer the research questions.

### 6.1 How has the Depreciation in Real Estate Companies Changed with the Implementation of K3

The respondents have experienced an increase in the depreciation rate of different degrees, although most of the companies ended up with a depreciation rate relatively similar to the one the companies used before. It can be discussed whether this is because the flexibility the principles-based regulation allows that has enabled them to adjust their method in order not to create too big of a difference.

With the implementation of K3 the results have also increased because of the component depreciation. The maintenance work is activated as a component instead of being expensed. This enables companies to do more maintenance since it no longer will affect the results as heavily and instead will be depreciated over a longer period of time. It is positive that external factors like the business cycle will not be a determinant of whether the maintenance should be done or not. Just because the accounting system has changed does not mean that the liquidity has changed and it is important to plan the maintenance work. The long-term effects also have to be taken into consideration when the depreciations will affect the result more heavily in the future because of the maintenance. The component depreciation might enable the companies to be more flexible with their maintenance and renovation plans, but there is a risk of the long-term consequences and it is yet not known whether the companies will recognize the true effects at this stage or not.

The respondents have explained that more benefits have been seen and that they definitely have accepted the change. The companies are positive towards the future and it is believed that component depreciation will give a truer and fairer view. However, the companies still question whether this information is needed or not. There are different opinions in this question which depends on whose perspective that is being assumed. Looking from an accountant's perspective the component depreciation does not give any concrete extra value and the component depreciation is only a lot of extra work. Meanwhile the people working with the properties, like project managers, appreciate the more detailed information that is given which facilitates their work and planning. The reason why the companies are more positive towards the component depreciation might be because they have to accept the situation, since whether they like it or not, the component depreciation will be implemented. Company Y on the other hand which does not have to implement the component depreciation see no value at all with the component depreciation because it is based on the acquisition value.

This leads us to another aspect that is if a value based on acquisition costs, regardless if it is the component depreciation or according to the previous regulation, can show a true and fair view at all. A property being sold for, for example, 40 million SEK with a book value of 18 million SEK does not per definition reflect the reality of the property. From this perspective neither

component depreciation nor the old system provide any benefits in relation to the accounting, and with the component depreciation in mind it is only an increase in the administrative work which adds costs with no value gained. This would without a doubt go against the second chapter of K3 which states that the benefits gained must outweigh the costs. Depending on which perspective this is seen from different opinions can be formed. Seeing that a value based on the acquisition value cannot reflect the reality, the cost in relation to the benefits criteria will not be fulfilled. If on the other hand, the acquisition-based value is accepted and if benefits are being experienced among the companies, it will then be a question of interpretation if the benefits outweigh the costs. There is no way to measure the actual benefits in a quantitative way and as long as this cannot be done it will be difficult to make the companies fully accept and appreciate the component depreciation. It might take several years until the component depreciation has fully replaced the old way of thinking and become the new ordinary method which is not much reflected upon.

Still, it is questionable how this will affect the comparison between the companies. Looking at which methods the different companies are using the number of components varies a lot and the depreciation rate on the same component can differ significantly. The companies strive to properly implement the component depreciation but with a lot of confusion and different messages given from different auditors it is likely that the methods will vary a lot. If the method chosen by the company is believed best to reflect the reality of the company it can be argued that it would be substantial grounds for a comparison.

## **6.2 How has the Perception of K3 Changed with the Actual Implementation of K3**

The perception of the component depreciation has clearly changed throughout the implementation process. Before the implementation the approach was very negative and close to no benefits was seen by the companies and the costs for implementing and maintaining the work would increase immensely. A lot of companies looked for possible ways of avoiding the component depreciation and we did not encounter a single company who by free will chose to implement K3. Even though the authorities believe that component depreciation will improve the Swedish accounting it has never been accepted by the companies. When the listed parent companies had to implement IFRS there was an option of either using the fair value method or component depreciation and yet again no company chose the component depreciation.

The companies who are in the middle of the implementation process are a lot more positive and they have started to see more and more benefits in relation with the component depreciation. There is an increased collaboration between the departments and the information gained from the component depreciation facilitates the work for planning projects. It also opens up the possibility to do more maintenance on their properties and the companies are no longer limited by the economic climate. Even though there are a lot more benefits perceived now than before the implementation the companies are still not convinced and the old system is still preferred. For the accountants there is an immense increase in the workload when the accounting has to be done according to both the old method because of the taxes and to the component depreciation and no significant benefits are gained.

The way K3 was being implemented has also been questioned. The implementation period was fast and there were not a lot of supporting guidelines of how it should be done. This has been frustrating for many companies and when they turn to experts different answers are given to the same question and sometimes there is no answer at all. The fact that information of how the implementation should be done have been presented in this way might have affected the credibility to the system and would not be beneficial when the component depreciation is implemented against their will. This will was expressed in the comment letters to the exposure draft where the component depreciation was criticized. Different suggestions were presented where component depreciation could be optional or implemented depending on the size of the company, but BFN still chose to proceed with the full implementation. Afterwards simplifications of the regulation has been presented, this might indicate that the component depreciation was not as well thought-out by BFN as it should have been before implementing it.

Even though BFN has been determined from the start that component depreciation will be a part of K3 there has been a lack of guidance. This has created a lot of uncertainties about how the regulation should be implemented and the fact that it is principles-based, which gives a lot of flexibility to adapt to the company's reality, makes it harder for the companies to be sure whether they are doing it correctly or not. With a mixed message from the auditors and the confusion caused by the lack of guidelines, this has led to a variety of methods being used for the component depreciation. The quality of the comparison is being questioned and even though the internal information is believed to represent a truer and fairer view the question is how sufficient this is when the information cannot be put in relation with other companies. Enforcing the component depreciation onto the companies even though they were resistant to this method, more guiding would have been needed. This would have reduced the obstacles of the uncertainties perceived with the new method and it would also reduce both time and costs for searching for the information and puzzling all the pieces together.

If BFN had involved the respondents more and taken their opinion into consideration the acceptance of the new system might have increased. Considering that this is a major change from a rules-based to principles-based accounting system, by providing more guidelines it would create more security among the companies which would facilitate the transition and might have decreased the reluctance.

It can be confirmed that benefits are gained but from an accountant's perspective only extra work is being added. The fact that the majority of the respondents still prefers the old system shows a clear sign that even though benefits have been pointed out, the companies are not convinced that these are of enough relevance. Taking into consideration that the implementation has started and that the component depreciation still receives resistance it can be questioned if the authorities have misjudged the benefits or if it is just a question of time until a real evaluation can be made when the benefits can be compared to the true costs.

### 6.3 Suggested Future Research

The implementation of component depreciation is still relatively new and it would be interesting to study the differences in the annual reports from the year before the implementation took place compared to after the implementation and look at the impact on the results. It would also be interesting to investigate how component depreciation has affected the Swedish accounting in five years from now when the new method has been established and routines within the companies have been developed. Interesting aspects in that study would be to look at how the true and fair view is being represented compared to the previous accounting system, how the comparison between the companies has been affected as well as looking at what the benefits and the costs are when the system is fully implemented.

Another possible research question would be to take a deeper look into why a lot of companies have chosen RFR2 instead of K3. It would be interesting to see what the consequences are and also to look into why there is such a wide gap of the perception of component depreciation between the authorities and the companies.

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## **Personal interviews:**

Company A - 12 March 2014

Company B - 27 March 2014

Company C - 20 March 2014

Company D - 9 April 2014

Company E - 27 March 2014

Company X - 22 April 2014

Company Y - 28 April 2014

# Appendix

## Interview questions

### The K3 companies

- What is your position on the company? A short brief of your tasks.
- Do you think that the K-regulations will improve the Swedish accounting?
- How did you value your investment properties before K3?
- How do you value them now?
- Are your depreciations different from before? Larger/smaller?
  
- What components are used in your investment properties?
  
- Can you see any uncertainties or difficulties with the new valuation method?
- Do you think there are any direct problems with component depreciation? What?
- Do you think the component depreciation gives a true and fair view? More or less than before?
- Do you see possibilities to value in a different way, i.e. make other accounting choices?
  
- Does the component depreciation give you any added value?
- Does this effect disappear due to the increased administrative burden? How much time has the increased administrative work taken? Does it take more time to work with valuation than before? What makes up the cost? Do you think it is better now or before (benefit vs cost)?

If it is possible it would be interesting to see a numerical example of how the depreciation have changed on a property, with few changes, before and after the implementation.

### The other companies

- What is your position on the company? A short brief of your tasks.
- Do you think that the K-regulations will improve the Swedish accounting?
  
- Can you see any uncertainties or difficulties with the new valuation method?
- Do you think there are any direct problems with component depreciation? What?
- Do you think the component depreciation gives a true and fair view? More or less than before?
  
- What are the reasons for not choosing K3?
- When did you implement IFRS?
- Did the amount of available guidelines affect your choice?
- How is the workload after the implementation?
  
- How are the depreciations now compared to before in the legal entity?

- In IFRS 13 different methods of valuation are mentioned, which method of valuation are you using now? To what extent do you use external appraisers?
- Which are the advantages and disadvantages with IFRS?

## Regulation per K-category

Company type	BFN's K-category	Regulation	Options
Listed companies	K4	IFRS/RFR	-
Larger companies (over the limit)	K3	BFNAR 2012:1	IFRS/RFR
Smaller companies (under the limit)	K2	BFNAR 2008:1 BFNAR 2009:1	BFNAR 2012:1 IFRS/RFR
Sole traders and non- profit organizations	K1	BFNAR 2006:1 BFNAR 2010:1	BFNAR 2012:1

(PwC, 2012). *Accounting update oktober 2012*

## Effects of the Component Depreciation

Figure 2.

This figure illustrates how the change of a component is reflected in the results when using the linear depreciation method and the component depreciation method.

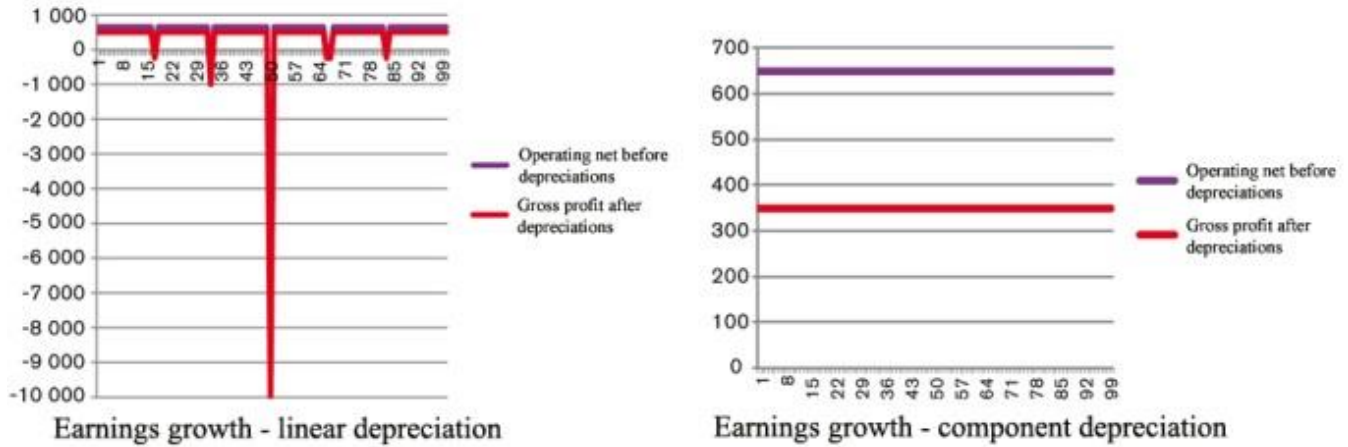
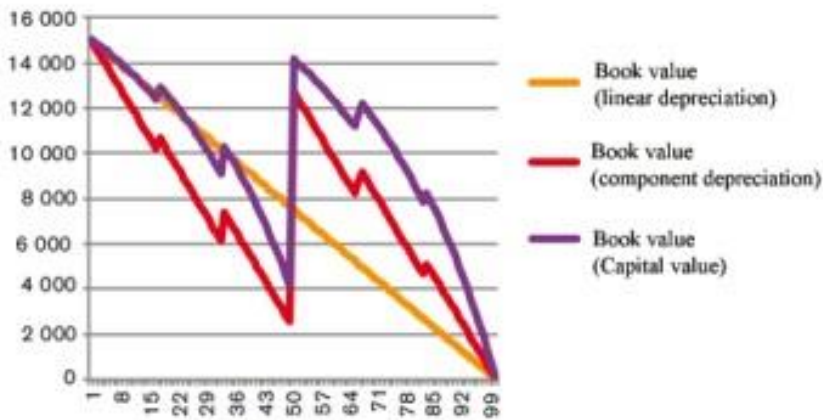


Figure 3.

This figure illustrates the effects of component depreciation compared to linear depreciation are in the balance sheet.



Hellman, Nordlund and Pramhäll, (2011) "Fördjupning: Förbättrad redovisning med komponentansats: Nyttan överstiger kostnaderna" *Balans*. iss: 12.