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SCHOOL OF BUSINESS, ECONOMICS AND LAW

Master Degree Project in Accounting

Communication within an Agency Relationship

A study on Bostadsbolaget and the 'Deferred Revenues'

Oscar Berndtsson and Oscar Gustafsson

Supervisor: Svetlana Sabelfeld and Marcus Brogeby
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University of Gothenburg – School of Business, Economics and Law

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Oscar Berndtsson

Oscar Gustafsson

Abstract

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Authors: Oscar Berndtsson and Oscar Gustafsson

Supervisors: Marcus Brogeby and Svetlana Sabelfeld

Titel: Communication within an agency relationship – A study on Bostadsbolaget and the ‘deferred revenues’

Background and problem: The purpose of financial reporting is to supply information to users of the financial statements. The information can include complex accounting items such as ‘deferred revenues’, which need to be communicated from a subsidiary (agent) to an owner (principal). In order to reduce the complexity of accounting items, the information must be communicated, so that both agent and principal gain a deeper understanding of the accounting items and the economic events from which they arise.

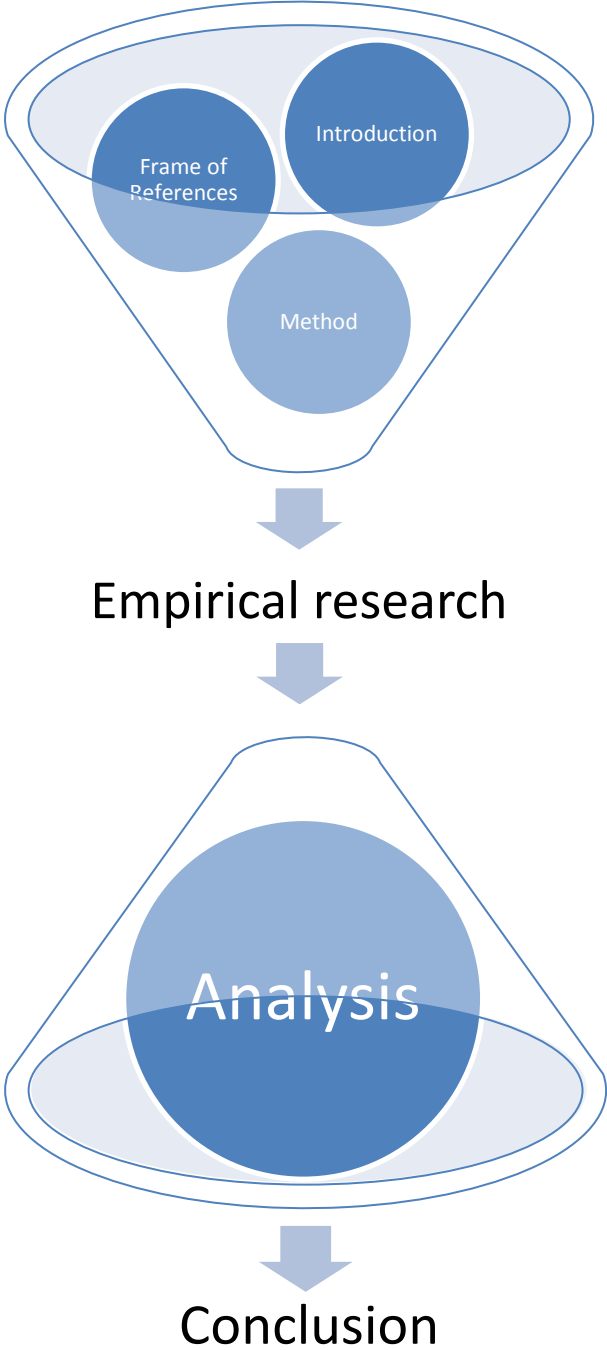
Purpose: The purpose of the study is to investigate the role of communication within an agency relationship between a municipality and a municipally owned real estate entity. The research will show how communication is reducing the complexity of accounting items in such a relationship.

Method: This study examines the communication within an agency relationship through a case study on a municipally owned real estate entity, investigating the accounting item ‘deferred revenues’. The empirical data is gathered through archival research and semi-structured interviews.

Analysis and conclusion: The analysis shows how the three communication channels (information groups, common intranet and internal reporting system), reducing the complexity of ‘deferred revenues’, are linked to the matrix of communication. Furthermore, it shows the communication channels’ relation to the assumptions of information asymmetry and information as a commodity within agency theory. This study proves that communicating information reduces the complexity of accounting items within an agency relationship.

Keywords: *communication, agency theory, matrix of communication, municipally owned real estate, deferred revenues, Bostadsbolaget, Förvaltning AB Framtiden*

Disposition



Abbreviations

AKB	– Public Friendly Real Estate Limited Company
BFN	– Accounting Board
FASB	– Financial Accounting Standards Board
GAAP	– Generally Accepted Accounting Principles
GDP	– Gross Domestic Product
IASB	– International Accounting Standards Board
IFAC	– International Federation of Accountants
IFRS	– International Financial Reporting Standards
IFAC PSC	– IFAC Public Sector Committee

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1. Introduction

This chapter will present the reason for conducting a research. Further, the research question will be stated alongside with the purpose of the study. The chapter will be concluded with a brief description of the limitations and benefits.

1.1. Background

The purpose of financial reporting is to supply information to users of the financial statements (Beaver & Demski, 1974). The individual user faces a period over time of investments where his investing capabilities are constraint by his wealth. Beaver & Demski (1974) clarify how the users more than often use a conventional approach to the decision-process, observing natural performance value measures of a firm.

Revenue is one the most prevalent and value-applicable items in a firm's financial statements. Srivastava (2013) explains how the recognition of revenue requires a determination of how much revenue to recognize or defer to a certain period of time. Within the term of revenue, two principles are stated which must be in accordance with the revenue recognition's "realizable" and "earned" criteria. These principles are *timing of delivery* and *selling price*. The general approach highlights the fact that when these two criteria are met, revenue can be recognized regardless of situation. Furthermore, the approach as a single unexplored object excludes information about accruals (Srivastava, 2013).

However, Dechow et al. (1996) and Palmrose et al. (2004) describe the field of revenue recognition as open for accounting frauds and complex earnings restatements, which notifies how the revenue is a highly misreported item in the financial statements of the firm. Furthermore, the item has historically been controversial as a process of earnings management, therefore misinforming for the investors and other users of the financial statements (Srivastava, 2013). However, not only is it an area of earnings management, but also an area of misunderstandings, where the reporting entity may suffer problems in grasping the complex accounting method. Additionally, users might even have greater problems in analyzing the revenue correctly (Srivastava, 2013). Therefore, in the area of revenue recognition, there is a need for a well-functioning communication between agent and principal (Srivastava, 2013; Eisenhardt, 1989).

One of the major accounting theories is the agency theory, which focuses on the agency relationship. In this relationship, the subsidiary is viewed as the agent while the owner is viewed as the principal (Eisenhardt, 1989). The theory is based on the complexity of communication between the agent and principal, which mainly involves communication of accounting items (Eisenhardt, 1989), found in the financial reports. Eisenhardt (1989) states one of the main underlying assumptions as 'information asymmetry' within the agency theory. This asymmetry is believed to exist between the agent and the principal, thus, causing a misalignment in the communication flow of financial information. Eisenhardt (1989) emphasizes the importance of reducing this asymmetry.

Prakash & Sinha (2013) portray how business arrangements firms, to a large extent, enter into compound contracts with customers where performance obligations¹ are being derived and satisfied over a specific period of time. In these arrangements, firms in general may pre-collect cash from customers, given that all the demands from the contracts are fulfilled. This accounting approach is giving rise to a ‘deferred revenues’ liability. These types of business arrangements rely on the communication between the agent and principal (Prakash & Sinha, 2013; Eisenhardt, 1989).

1.2. Problem

The subject of ‘deferred revenues’ is a controversial and complex area within financial accounting and often leads to problems for the entity and its shareholders. Prakash & Sinha (2013) discuss how a consequent mismatch of revenue can arise when an entity accounts for ‘deferred revenues’ but not associated expenses, thus, having an impact on the profit margin for current and subsequent fiscal years. When accounting for ‘deferred revenues’, the item is, due to the accrual basis of accounting², reported as a liability (*‘deferred revenues’ liability*), since ‘deferred revenues’ is a debt that is bound to be reversed the subsequent fiscal year. Prakash & Sinha (2013)’s study shows how changes in ‘deferred revenues’ liability have a considerable impact on the profit margin for current and future periods. The study elaborates this by explaining how a high ‘deferred revenues’ liability causes the profit margins to be lower for the current fiscal year, and increase for the subsequent year, when the ‘deferred revenues’ liability is reversed. Consequently, current profit margins become a poor indicator for future profit margins.

‘Deferred revenues’ (*prepaid rents*) is common among municipally owned real estate entities, which tend to be less researched in comparison to privately owned entities. Since 1st of January 2011, a new legislation was enforced (AKBL 2010:879) claiming how a public friendly entity is bound to operate in accordance with the existing commercial purposes. By this, the restriction of avoiding profit was eliminated. The purpose of the new legislation was to align Swedish law with the current EU standards (Prop 2009/10:185).

The municipality exercises its influence over the Public Friendly Real Estate Limited Company (AKB) by using the Article of Association³ and owner directives (Langlet & Örnberg, 2012). Furthermore, Langlet & Örnberg (2012) elaborate how the two documents should be used by the municipality in order to estimate a proper yield. Therefore, there is an increased need for the municipality, as a principal, to be able to analyze the presented

¹ Even though the term performance obligation is used in many accounting standards, there is no single, precise definition of the term. However, the two main international standard setters; International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) propose the following definition: “An entity’s performance obligation is a promise in a contract with a customer to transfer an asset (such as a good or service) to that customer”. (IFRS, 2008)

² The accrual basis is one of the most influential underlying assumptions in both national and international accounting. The purpose of this assumption is to recognize transactions when they occur. (Alexander et al., 2011). In the case of deferred revenue, the revenue should be recognized in the period when it occurs, which is the subsequent fiscal year.

³ The documents outlining the core rules applied for a limited company, thus, showing how the company should be operated (Bolagsverket, 2012).

financial information, including ‘deferred revenues’. This can be compared with what Prakash & Sinha (2013) wrote about the analysts’ need for understanding the financial information and ‘deferred revenues’, in order to forecast future profits.

By examining annual reports produced by three different municipally owned real estate entities in Sweden, during a four-year spectrum, it shows the magnitude of prepaid rents in proportion to total deferred revenues. The result of the examination (see *Appendix 1*) showed how the prepaid rents amounts to the total ‘deferred revenues’, regardless of year or entity (KBAB, 2012; KBAB, 2010; MKB, 2012; MKB, 2010; Poseidon, 2012; Poseidon, 2012). The results from Appendix 1 should only be viewed as a confirmation for the magnitude of prepaid rents in proportion to total ‘deferred revenues’ in Swedish municipally owned real estate entities.

The complexity of ‘deferred revenue’ is partly a result of the complexity in an agency relationship. All the shares of a municipally owned real estate entity are held by the municipality, therefore, as the only investors, the municipalities are large users of the financial statements presented by the entities. As such, the municipalities’ role in analyzing the financial information can be viewed as the role of an analyst. According to Prakash & Sinha (2013), a lack of knowledge of how the ‘deferred revenues’ affects financial statements might cause problems by misinterpreting the fundamentals of how to account for ‘deferred revenues’. Therefore, it is evident that communication will reduce the complexity in agency relationships, which in turn can reduce the complexity of accounting items, such as ‘deferred revenues’.

1.2.1. Purpose

The purpose of the study is to investigate the role of communication within an agency relationship between a municipality and a municipally owned real estate entity. The research will show how communication is reducing the complexity of accounting items in such a relationship. The purpose will be obtained by conducting a case study on ‘deferred revenues’ in a single municipally owned real estate entity and the shareholder of the entity.

1.2.2. Research question

How do a municipally owned real estate entity and its shareholders communicate information to reduce the complexity of accounting items within an agency relationship?

1.3. Limitation

The research is limited to a single municipally owned real estate entity. Furthermore, the research is focused and limited to the accounting item ‘deferred revenues’ and Sweden, Gothenburg; Swedish accounting standards, Swedish respondents and Swedish financial statements.

1.4. Benefits

Agency relationships are interesting due to their extensive influence on financial reporting. This study uses agency theory and a matrix of communication to show how communicating information can reduce complexity of accounting items, such as ‘deferred revenues’. Previous research within ‘deferred revenues’ is often conducted in the private sector, whereas this

study is conducted in a municipally owned entity. The analysis, along with the conclusion, will show how entities within the real estate business can use information to create higher level of understandability for accounting items.

Furthermore, the study focuses on the information flow and communication within the real estate business, unlike previous research which mainly focus on financial values (Diaz, 1993; Breuer & Nadler, 2012; Torfason, 2010). Although, the research was conducted in a specific industry, the conclusion of how information is communicated can be applied to other industries, in order to reduce complexity of accounting items within similar agency relationships.

2. Frame of references

This chapter will present theoretical perspectives and previous research relevant to this study. The chapter will start off by presenting the agency theory and communication theory, which will be used to analyze the collected data. Thereafter, accounting terms associated with the item 'deferred revenues' is presented. This study focuses on municipally owned real estate entities. Therefore, this chapter will also present the areas of real estate research and municipally research.

2.1. Agency theory

To contribute to the scientific research, it is important have a theoretical view on the analysis and conclusion. Since this research covers the interaction between the entity and owner, a theory explaining that specific relationship is vital. Therefore, the agency theory will be presented and further on criticized.

Agency theory, over the 20th century, has developed into the foremost standard in the financial economic literature (Jensen & Meckling, 1976; Ross, 1973). The studies of Jensen & Meckling (1976) as well as Ross (1973) explain how the agency theory and dilemma has focused on the relationship between managers and shareholders. However, Eisenhardt (1985) and Kosnik (1987), who primarily researched in the area of management, started to elaborate on the fact that agency theory has an impact on the disciplines of organizational behaviour, managerial theory and the strategic administration.

Furthermore, Eisenhardt (1989) divides the Agency theory into two different streams, which need to be explained in order to understand the propositions within agency theory: *Positivist Agency Theory* and *Principal-Agent Research*.

2.1.1. Positivist Agency Theory

The main feature with the positivist agency theory, compared to the principal-agent research, is that it almost exclusively focuses on the specific principal-agent relationship within large cooperation, where the principal is represented by the owners and the agent by management (Eisenhardt 1989). Fama & Jensen (1983) have done influential research when regarding the board of directors as a communication channel. The authors found that the board of directors is a useful tool for owners when controlling management opportunism through increased access to information. Researchers within this field have also discussed the usage of golden parachutes and corporate raiding as means to control top executives (Jensen 1984; Jensen & Ruback 1983).

According to Eisenhardt (1989), the positivist stream's focus on the principal-agent relationship within large cooperation has derived into an attempt to solve the problem through government mechanisms. Eisenhardt (1989) elaborates two proposition explaining government mechanisms. The first proposition is regarding how an outcome-based contract between the principal and agent is probable to result in the agent acting in accordance with the interest of the principal. The second proposition states how a higher degree of information about an agent's behaviour is probable to result in the agent acting in accordance with the

interest of the principal. The propositions are showing how both outcome-based contract and information can improve the interaction between the agent and principal.

2.1.2. Principal-Agent Theory

Harris & Raviv (1979) explain how this theory, in contrast to the positivist agency theory, is more general when assessing principal-agent relationships. The theory is not only about owners–top executives’ relationships, but also focuses on additional relationships (e.g. employer–employee, buyer–supplier, lawyer–client). Furthermore, Eisenhardt (1989) elaborates how the more general approach of the principal-agent theory allows researchers to test more implications within principal–agent relationships. However, Eisenhardt (1989) emphasizes that the two streams are not to be viewed as opposites, but rather as a compliment to each other. While the positivist stream focuses on identifying contract alternatives, the principal-agent stream strives to indicate which contract should be the most efficient, depending on the circumstances. That includes factors such as *outcome uncertainty*, *risk aversion*, *information*, and *the length of the relationship*. Different contract alternatives are either based on outcome or behaviour, and depending on the specific situation, the principal-agent theory gives guidance in identifying the most optimal contract (Eisenhardt, 1989).

Eisenhardt (1989) emphasizes that even though there are different relationships, there is a starting point that the principal should use when constructing the most optimal contract. Firstly, the principal should consider whether he is buying the agent’s behaviour or not (which often is true when perfect information exists). If so, the focus should be on a behaviour-based contract. However, if the information asymmetry (*see 2.1.3.1. Information asymmetry*) is greater (the principal cannot control the behaviour of the agent), the principal should start by focusing on an outcome-based contract. According to Eisenhardt (1989), formal literature have detected and discussed two aspects of this agency problem: *moral hazard* and *adverse selection*. Moral hazard is determined as when the agent simply does not put in the required effort, thus, eluding from his responsibilities. Adverse selection has its roots in a misalignment between the agent and principal in terms of the agent’s abilities. The agent could either have lied about his abilities, or the principal could simply have misunderstood the agent upon hiring him. Either way, both moral hazard and adverse selection creates a problematic situation where the principal should focus on an outcome-based contract, or possibly investing in more communication channels to reduce the information asymmetry.

2.1.3. Assumptions

Eisenhardt (1989) explains and emphasizes several important assumptions and terms, influencing the agency theory: *Self-interest*, *goal conflict*, *bounded rationality*, *information asymmetry*, *information as a commodity*, *risk aversion* and *preeminence of efficiency*. However, for this study, the most important assumptions are the information asymmetry and information as a commodity.

2.1.3.1. Information asymmetry

Eisenhardt (1989) explains how agency theory is built upon the assumption of information asymmetry between principal and agent. However, one of the propositions within agency theory is also an understanding of how the information asymmetry is affected by time. If the

principal and agent are involved in a long-term relationship, the information asymmetry is assumed to be lower, compared to the asymmetry in a short-term relationship.

2.1.3.2. Information as a commodity

Eisenhardt (1989) further elaborates that when expressing the term 'information', it is viewed upon as a commodity and can therefore be purchased. Information is a variable that affect the relationship between principal and agent. One of the main propositions is that when the principal has access to a higher level of information about the agent and his behaviour, the agent will act, to a higher extent, in accordance with the principal's interests. In order to gain a higher level of information, the principal can invest in improved communication channels, thus, making information a commodity.

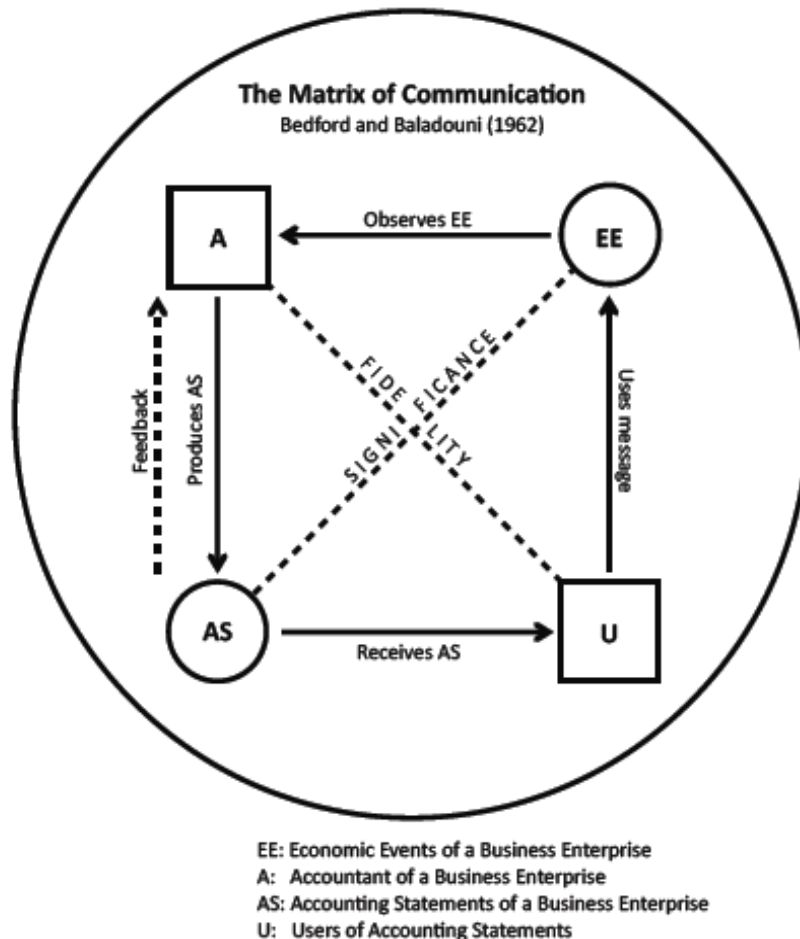
2.1.4. Criticism towards the Agency Theory

Agency theory has received criticism by different authors throughout the years. For instance, Perrow (1986) explains how detractors have labeled agency theory as dehumanizing, trivial and occasionally even 'dangerous'. Furthermore, the criticism is divided into the two different streams, where the more renowned positivist stream has received the majority of the criticism (Perrow, 1986; Hirsch et al., 1987). Jensen (1983) stated that the positivist agency theory's main contribution can be viewed as a complex elaboration of the organizational theories. The criticism is supported by Hirsch et al. (1987), Perrow (1986) and Jensen (1983) claiming it to be minimalistic and not accounting for external factors. The principal-agent theory is, in comparison to the positivist agency theory, more mathematical based and abstract in its assumptions, making it less accessible to the detractors, who mainly consist of organizational scholars (Eisenhardt, 1989).

2.2. Accounting as communication

Along with the agency theory, this study also focuses how accounting can be seen as communication. Bedford & Baladouni (1962) propose that if accounting is viewed as a communication process, it may provide a more transparent picture of the accounting's function in an economic environment.

2.2.1. Communication theory and the matrix of communication



Communication theory was commonly used in various science areas, and in the beginning of the 60's, Bedford & Baladouni (1962) applied it in the field of accounting. The application of communication within the field of accounting resulted in a conceptual framework of the communication process. Bedford & Baladouni (1962) separated four components, shown in the matrix of communication, used in the communication of accounting. Simplified, the producer (A) sends informational messages (AS) to the user (U) that initially has been coded and transformed from economic events (EE). This causes the user to make a decision, which will influence the future economic events of the company (Bedford & Baladouni, 1962). Furthermore, the model describes the relationship between A and U, as well as EE and AS, by using two dimensions: *fidelity* and *significance*. Fidelity, in this case, refers to the consistency of the user's perception regarding the accounting documents sent by the company, while significance emphasizes the degree of relevance of different accounting documents in relation to the EE (Bedford & Baladouni, 1962).

In this research, EE represents revenues, A represents the agent, AS represents accounting information and U represents the principal. The process starts when the agent receives ‘deferred revenues’, which is recognized in the financial statements through accounting. The financial statements, along with other documentations regarding the revenue recognition, are then communicated to the principal. The revenue has a *significant* effect on the financial information, presented in the financial statements. The principal consistently requires *fidelity* in the correspondence with the agent, in order to understand and assess the financial information.

In order to fully comprehend how Bedford & Baladouni (1962)’s matrix of communication is associated with financial information, it is important to understand that financial information is created through accounting. This causes a need to grasp the role of accounting, both from a historical as well as a contemporary perspective.

2.3. Accounting

The purpose of accounting was at first to keep track of personal transactions, thus, accounting was a memory tool for remembering different debts between peers (Artsberg, 2005). Hoskin & Macve (1986) elaborate the development of accounting by considering two main historical events. The first was the invention of the *double-entry bookkeeping*, developed during the 13th and 14th century. The second took place in the 19th century, highlighting the accounting’s progress into a more social context. Furthermore, Hoskin & Macve (1986) explain how the social development resulted in a wide-spread adoption of the double-entry bookkeeping, thus creating a professional network of accountants.

However, Marton (2013) states that in order to understand how contemporary accounting is used in today’s society, four different terms are emphasized:

- *Economy* – Management of limited resources
- *Money* – A measurement of resources
- *Result* – The final outcome, i.e. the net resources gain less resources used
- *Capital* – Money deposited into the organization, enabling control of resources

Marton (2013) further explains the vitality of information, in order to evaluate and manage the use of resources. This kind of information is derived from accounting. Therefore, accounting is a tool to convey information to the stakeholder, which is pragmatic since accounting focusing on evaluating and forecasting results (Artsberg, 2005).

2.3.1. Stakeholders

The users of accounting are often labeled stakeholders; groups or individuals interacting with the organization or interdependencies, whom are affected by the goals, actions and decisions made by the organization (Gray, 1989; Carroll, 2008). According to Evan & Freeman in Beauchamp & Bowie (1988)’s book, stakeholders can be:

“*suppliers, customers, employees, stockholders, and the local community, as well as management in its role as agent for these groups*” (p. 97).

Wheeler & Sillanpää (1998) develop the term of stakeholder's value in its alignment with the value of accounting, by claiming that the association between the values requires two active commitments. The first one is to share perspectives and attitudes, by having a natural, effective communication. The other one highlights the motivation for allowing these cross-stakeholders' values to develop.

2.3.1.1. Shareholders

Shareholders are stakeholder (Freeman et al., 2004) and, according to Marton (2013), shareholders are primarily interested in future profit yields. However, in order to forecast profit yield, shareholders need access to the current financial information, provided by accounting, thus, creating a need for useful, financial information. Furthermore, Marton (2013) explains how this relationship between shareholders and entities are general. Therefore, shareholders to non-listed companies, such as municipally owned real estate entities, have the same requirement for useful, financial information.

2.3.2. Revenue recognition

One of the most influential fields within accounting is revenue, which BFN (2012) defines as an increase in equity, caused by payments, a decrease in liabilities or an increase in assets. Furthermore, an increase in equity caused by a deposit derived from the owners is not recognized as revenue. Revenue should be recognized if (BFN, 2012):

“a) it is probable that the economic benefits associated with the item will received by the entity in the future, and b) the item's initial value or current value can measured reliably” (p. 20).

Additionally, BFN (2012) emphasizes that revenue recognition is caused by the recognized value of assets and liabilities. This approach to recognize revenue is commonly known as the assets/liability approach (Ohlson et al., 2011; Nobes, 2006).

2.3.2.1. True and fair view

Nobes (2006) describes how the revenue recognition is under the impact of the 'true and fair view' concept, used in the financial statements. Furthermore, Flint (1982) highlights the 'true and fair view' as a safety net. The 'true and fair view' concept is crucial when striving to obtain accountability and relevance in the financial reporting, especially within a changing environment (Parker & Nobes, 1994). According to Kirk (2006), the concept is one of two opposing professional standards for financial information quality, where one challenging concept does not necessarily excludes another.

While the 'true and fair view' concept is linked with judgement and used in the International Financial Reporting Standards (IFRS) setting, the 'present fairly in accordance with generally accepted accounting principles' is a standard used in the U.S. Generally Accepted Accounting Principles (GAAP) and Financial Accounting Standards Board (FASB), mainly since it is accredited as a rules-based approach⁴ (Marton et al., 2013). Within the European Union, the

⁴ Schipper (2003) along with Nelson (2003) argue, since the U.S. standards are based on the conceptual framework, that they are principle-based, but, in order to obtain guidance and permit exceptions, rules have been given.

“true and fair view” requirements in a legal setting predominates other financial reporting requirements (Parker & Nobes, 1991; Kirk, 2006). However, the concept is currently moving towards a more technical understanding where acquiescence with a set of rules is demanded (Kirk, 2006). Countries that account for revenues in an agreement with the “true and fair view” concept tend to coordinate and interpret it in accordance with country-specific variables (Parker & Nobes, 1991; Higson & Blake, 1993).

Furthermore, Nobes (2006) explains how the recognition of revenue should be guided by the principles, utilized in the financial statement; *prudence, realization and accruals*. The major determinants of accrual accounting information, including its belongings, are the principles which administer the recognition of revenue and expenses (Dutta & Zhang, 2002).

2.3.3. Accruals

The accounting assumption of accruals differentiates revenues from inflows of cash and expenses from outflows of cash, thus, recognizing the dissimilarity of income and cash flows as liabilities or assets (Dutta & Zhang, 2002). IFAC PSC (2013) defines the accrual accounting as follows:

“A basis of accounting under which transactions and other events are recognized when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions and events are recorded in the accounting records and recognized in the financial statements of the periods to which they relate. The elements recognized under accrual accounting are assets, liabilities, net assets/equity, revenue and expenses” (p. 1587).

Guthrie (1998) clarifies the difference between cash and accrual accounting in the public sector. Cash accounting focus on the records of cash receipts, payments and balances when the cash exchange occur. Furthermore, Guthrie (1998) explains how the cash accounting derives into a setting where managers traditionally have had the competence to control and display receipts and payments against the actual appropriations. When these cash basis approaches are used in the annual reports, cash-based information has made it possible for management to account for the appropriate monies in accordance with the parliament’s demands. Regarding the accrual accounting, the approach focuses on when the moment of earnings or expenses occurs, rather than the receiving or payments of cash. Therefore, according to Guthrie (1998), the major difference between the two approaches is the timing of the recording of transactions.

Dechow & Skinner (2000) elaborate the concept of accrual accounting by explaining that the objective of the accrual basis is to aid investors in evaluating entities’ economic performance through revenue recognition and matching. In opposite to cash accounting, accrual focuses on the reported earnings which are proven to be more useful for investors’ decision-making (Dechow, 1994). However, models regarding accrual accounting have also received criticism for relying extensively on estimates, thus, making the conclusions questionable and possibly biased (Bernard & Skinner, 1996).

Additionally, accrual accounting will impact revenue recognition through two items (Caylor, 2010): *accounts receivable* and *deferred revenues*. Caylor (2010) further explains how that

difference between the two accounting items is the nature of the transactions. Accounts receivables show cash belonging to the current fiscal year, which have not yet been received, while the ‘deferred revenues’ show cash received in the current fiscal year, belonging to the subsequent fiscal year.

2.4. Deferred revenues

It is fundamental to comprehend how the ‘deferred revenues’ is a result of the operating transactions, received from suppliers, customers and employees, and not a liability caused by financial funding (Nissim & Penman, 2003; Prakash & Sinha, 2013). Furthermore, Nissim & Penman (2003) separate the financing liabilities as contractual obligations for repayments of loaned funds and the operating liabilities as contractual obligations, including accrual liabilities (e.g. deferred revenues), based on the operating process within a firm. These accrual liabilities are normally complex estimates. However, Ohlson et al. (2011) state the new impression of academicians and practitioners regarding how the ‘deferred revenues’ item is no longer viewed exclusively as representing operating liabilities. Instead, a discussion has arisen, focusing on the increase of analysts’ interpretation concerning the ‘deferred revenues’ item being an indication of understated revenues.

Nissim & Penman (2003) elaborate the complexity of ‘deferred revenues’ by emphasizing an additional difference compared to other liabilities: Normally, a liability is booked to the amount which will be required in order to settle the liability, but since ‘deferred revenues’ liabilities are outcomes of cash which has been received in exchange for a future service or product, the booked value is likely to be higher than the actual cost to settle. Prepaid rent is deferred revenue and a major reoccurring item within the real estate business (KBAB, 2012; KBAB, 2010; MKB, 2012; MKB, 2010; Poseidon, 2012; Poseidon, 2010).

2.5. The real estate business

This study contemplates the real estate business as an entity which administer and rents properties to the population. Real estate is real (Geltner & Miller, 2007). Real is derived from realty, which translates into land and everything permanently attached (Brueggeman & Fisher, 2007). Further, Brueggeman & Fisher (2007) elaborate how estate refers to everything possessed by an individual. However, the term real estate is still viewed as complex, and depending on the individual’s perception, the interpretation can differ (Brueggeman & Fisher, 2007; Geltner & Miller, 2007). For instance, an architect can perceive the term real estate from an aesthetic and practical perspective, while an engineer will focus on the physical structure of the object (Geltner & Miller, 2007). All answers are correct, and to perform studies within the area of real estate business, a very comprehensive approach is required. Diaz (1993) unifies two approaches within real estate research, *Multidisciplinary Approach*⁵ and *Financial Management Approach*⁶, in order to focus on both economic activities and resource allocation. By doing so, Diaz (1993) explains the complexity of real estate research, where not only a single discipline can be considered. In this study, the Multidisciplinary Approach is most suitable.

⁵ The main purpose of the multidisciplinary approach is to avoid consideration of only a single discipline and rather focus on multiple disciplines within real estate research (Graaskamp, 1976).

⁶ A focus on financial management and maximizing shareholder value (Dasso & Woodward, 1980).

Breuer & Nadler (2012) emphasize the current importance of real estate and real estate finance, since the global economy is still negatively affected by the financial crisis during the late 21th century. The real estate business is particularly interesting due to its high contribution in terms of employment rate and its significant impact on the national Gross Domestic Product (GDP)⁷ (Breuer & Nadler, 2012). Furthermore, the interest in the real estate as a field of research is likely to increase in the future because of its high monetary value, both for real estate companies as well as financing companies (e.g. banks, insurance companies).

2.6. A municipally perspective

The scope of the research is Swedish real estate entities and these are commonly owned by the municipalities⁸ (Langlet & Örnberg, 2012). Therefore, it is vital to explain the municipalities and the real estate business from a Swedish perspective.

Since the 1st of January 2011, Swedish municipally owned real estate entities are supposed to conduct their business commercially, including a return rate in accordance to the market (AKBL 2010:879). However, Boverket (2014) point out that the major role for the real estate entities is still associated with the purpose of being public friendly. Furthermore, profits derived from the business of rental properties owned by the municipally owned real estate entities, can be transferred to the municipality or other real estate entities within the municipality only if these profits provide to enhance the integration and social commitments, or providing new homes to the public (Boverket, 2014). Earlier research by Lapsley (1988) enforces the importance of conducting research in the public sector, due to its high degree of complexity and somewhat lack of earlier research.

⁷ "GDP is the market value of goods and services produced within a selected geographic area (usually a country) in a selected interval in time (often a year)" (Leamer, 2009. p. 19).

⁸ A study provided by The Swedish National Board of Housing, Building and Planning shows that 786 000 apartments, 46 % of total number of tenancies, were owned by municipally owned real estate entities (Boverket, 2014).

3. Method

This chapter will present the research process for obtaining the purpose and answering the research question. This includes the selection of method, selection of research approach (archival research and interviews), selection of industry and entities (selection of respondents) and, finally, data analysis. Furthermore, this chapter will discuss the credibility of the study.

3.1. Initial run-up

The interest for research concerned the area of revenue recognition within the public sector. The reason for the interest is because revenue recognition is continuously relevant for entities, regardless of industry. Furthermore, the general opinion appears to be that the public sector somewhat lacked research in comparison to the private sector. In order to acquire a viable area of research within the field of communication within an agency relationship, the first step was to study scientific articles covering the subject in hand. While studying the articles, current research was found about the linkage between communication and the complexity of 'deferred revenues'. However, the research focused mainly on the private sector, which caused an even more enhanced interest of studying the 'deferred revenues' within the public sector. With the research area decided, a selection of specific articles with a stronger association to the subject was studied. This enabled us to obtain the required background information for structuring a pertinent research question. Thereafter, a thorough investigation regarding frame of references, including the germane terms and definitions, was conducted. However, in order to obtain a scientific value for the analysis, agency theory and communication theory were selected as the most suitable theories to use when examining the problem.

3.2. Research process

Initially, the research process was designed in accordance with the purpose of the research and the desired result. Therefore, the research process was divided into four sections, presented in chronological order: *Selection of method*, *Selection of research approach*, *Selection of industry and entities* and *Data analysis*.

3.2.1. Selection of method

Changes in the social structure and the diversification of cultural tradition continuously confront researchers with new contexts and perspectives (Flick, 2014). Therefore, in order to answer the research question, the study requires an enhanced qualitative methodology to include the rapid changes of a social structure (Flick, 2014). Flick (2014) elaborates on how cultural differences in a local environment could cause distortions within the social nature, such as the differences between a private and public entity. This study involves such a social nature and would therefore benefit from a qualitative methodology.

According to Diaz (1993), the real estate business is as a complex area for research, since it involves both resource allocation and economics. The complexity of the field was supported by Brueggeman & Fisher (2007) and Geltner & Miller (2007), whom emphasized the individual perception of the researcher. Therefore, Diaz (1993) elaborated by stating that researchers conducting studies within this field should use both the *Multidisciplinary*

Approach and Financial Management Approach. This research was done in accordance with Diaz (1993)'s argument, since information from more than financial accounting was crucial.

3.2.2. Selection of research approach

The study demanded a consideration of three different conditions, stated by Yin (2009), which are vital when choosing a research approach (method). *Form of research question* is a categorization regarding the type of research question(s). The categorization is general and focuses on “who”, “what”, “where”, “how” and “why” questions. In the field of case studies, the research question should cover “how” and/or “why”, which corresponds to this study. *Requires control of behavioural event* focuses on the level of required control. Some research methods, such as experiments, require a high degree of control of behavioural events in order to be applicable. However, a case study should not require any control of behavioural events, thus, be viewed as an approach observing the natural environment. Consistent with Yin (2009)'s statements, this study requires no control, thus, enabling the usage of a case study. *Focuses on contemporary events* is used when the associated behaviours are unable to be manipulated. The condition focuses on investigating current events, which in this research is the complex situation between the municipally owned real estate entity and the owners, within the field of ‘deferred revenues’.

One of the major strengths of a case study is its ability to manage a variety of interviews, observations and documents as a single method (Yin, 2009). This study focused on one entity and its owner (another entity), therefore, enlightening the question of whether it is a single- or multiple-case studies (Agranoff & Radin, 1991; Dion, 1998; Lijphart, 1975). However, this study is performed on a specific situation, rather than on a specific entity, thus, making it a single-case study.

According to Yin (2009), criticisms towards the case study as a research method do exist. Samples of these are the lack of rigor, little basis for generalization and the time required, which is far more extensive compared to other methods. Furthermore, Bruns (1989) elaborates on an uncovered area of Yin (2009)'s study. A problem is formed when a researcher's findings differ fundamentally from what the researcher expected. Additionally, there is little advice stated in how to redesign a continuous study, when the result discovered is inconsistent with the prospects which shaped the research question and purpose (Bruns, 1989).

In order to achieve the purpose of the research and to provide benefits for the entity focused in the investigation, Welch (2000) states how qualitative interviews are, combined with the archival research, useful complements, specifically in case studies, therefore, the most suitable approach. How the two approaches complement each other will be presented in 3.2.2.1. *Archival research* and 3.2.2.2. *Interviews*.

3.2.2.1. Archival research

Archival research consists of archival records, which can be defined as documents of continuing value that have been made or received by the organization, associated with the conduct of affair (Welch, 2000). Welch (2000) elaborates how researchers within the area of business commonly use archival documentation including chairmen's statements, public

speeches, annual general meeting minutes, policy papers, correspondents files, staff records and financial statements. This study's archival documentation consists of financial statements and correspondents files.

Welch (2000) emphasizes how archival data is particularly suited to explain developments and changes in different environments. The documents in this research mainly focused on explaining the change in ownership structure, thus, making archival research a necessary part in the gathering of empirical data.

In order to explain how archival data can be a suitable complement to interviews, Denzin (1989) outlines three main arguments where archival data compensates for the shortcoming of interviews. First, archival data is more detailed. Huber & Power (1985) state how this kind of data usually provides the researcher with accurate and instant records of the studied interactions, whereas interviews rely on human memory. Second, archival data is argued to be neutral and, unlike interview, is not a subject of social interactions, such as sensitive respondents and ego protection (Denzin, 1989). Third, archival data is less dependent on interviewing factors, such as interruption, time and other general distractions (Denzin, 1989).

3.2.2.2. *Interviews*

Yin (2009) explains the connection between interviews and a case study; why interviews essentially is important for this type of research. According to Yin (2009), interviews possess two major undisputable strengths, *Targeted* and *Insightful*. While combining these two, the interview will provide the case study with a focus on the targeted topic and perceive casual extrapolations and clarifications. Furthermore, an interview within a case study as a research approach will transform the consistent line of examination into an unsolidified stream of questions, where answers derived from the interviews may answer other areas of inquiry as well (Yin, 2009).

However, interviews as a single source of evidence in a case study might harm the research. Yin (2009) elaborates on how interviews can cause unfairness if the questions asked are poorly articulated. Additionally, inaccuracies may occur due to deprived recalls. Lastly, Yin (2009) highlights how important it is not to provide the respondent with questions and articulations in accordance with what the respondent anticipates (wants to hear).

Collis & Hussey (2009) distinguish three kinds of interviews: *Structured*, *semi-structured* and *unstructured*, where semi-structured and unstructured are associated with qualitative studies. The collection of the data within this research is obtained by semi-structured interviews. In order to reach the purpose of the research, in accordance with Yin (2009)'s view in interview for case studies, Collis & Hussey (2009) explain how semi-structured interviews offer the interviewer the ability to use probes. Probes are characterized by presenting the possibility of gaining a deeper understanding in term of clarity, relevance, depth and significance (Collis & Hussey, 2009), required in this study.

Trost (2010) emphasizes the importance of a well-functioning cooperation when there is more than one interviewer. Therefore, such a collaboration described by Trost (2010) can neutralize some of the weaknesses stated by Yin (2009). Furthermore, Trost (2010) and Collis & Hussey

(2009) elaborate how two interviewers, provided that the well-function cooperation is consistent, can gain benefits. The essence of the benefits is derived from the possibility of two interviewers comprehending more information, thus grasping a deeper understanding (Trost, 2010).

During the interviews, a recording device was used in order to collect the data for the analysis. Using a recording device is beneficial, since it enables the interviewer to concentrate on the dialogue and ask relevant follow-up questions. Additionally, the approach of recording made the process of taking notes, which can be perceived as a source of irritation, redundant. However, Trost (2010) isolates how visible recording devices can be observed as an annoyance by the respondents.

Furthermore, before beginning the interviews, short presentations regarding certain background information were performed. The information included communication theory and basic knowledge about the bookkeeping of 'deferred revenues' as well as description of the historical size of prepaid rents over the last four years. The purpose of the presentation was not explanatory, but rather an introduction in order to avoid misinterpretations.

3.2.3. Selection of industry and entities

Firstly, the real estate industry contains typical agency relationships. Furthermore, the purpose of the study is to reveal how the entities within a municipally owned real estate entity reduce the complexity of accounting items through communicating information. Since the study aims to explain this by using 'deferred revenues', an industry containing a substantial amount of 'deferred revenues' is necessary. The real estate industry is such an industry. Secondly, a selection of which entities to include was conducted. Bostadsbolaget is the oldest real estate entity in Gothenburg, and as such, Bostadsbolaget has experienced both recessions and booms. Therefore, the entity has a working knowledge of managing both significant and less significant amounts of prepaid rents, thus, making Bostadsbolaget most suitable for this case study. The selection of Bostadsbolaget and its owner Förvaltning AB Framtiden allowed the research to focus on the actual case of study, henceforth, excluding irrelevant information about the owner's owner or other influential external actors. With the two entities established, it was necessary to select respondents, within respectively entity, possessing the required knowledge to answer the interview questions. Since the complexity of 'deferred revenues' is exposed in the accounting and information flow, the respondents had to be chosen accordingly. The accounting of prepaid rents is mainly managed by Bostadsbolaget, thus, making the Head of Accounting most suitable. The communication of information is covered by both entities. However, since Förvaltning AB Framtiden is the owner, the entity is more dependent on a well-functioning information flow. Therefore, the Chief Financial Officer was the logical choice in terms of managing financial information.

3.2.3.1. Selection of respondents

The 1st of January 2014, the *City Management Office* in Gothenburg changed the ownership structure regarding municipally owned real estate entities (Kommunfullmäktige, 2013). Therefore, contact was established with:

Carl Bartler *Coordinator – City of Gothenburg*

The correspondence provided internal documents, explicitly explaining the new ownership structure in the City of Gothenburg. Furthermore, the documents elaborated the conditions regarding yield.

In order to fulfill the purpose of the study, two additional interviews were required. The interviews concluded both *Förvaltning AB Framtiden* (principal) and *Bostadsbolaget* (agent). The focus of the interviews was to examine the communication of information between the principal and agent, as well as the complexity of ‘deferred revenues’ (‘prepaid rents’). The open questions, serving as a base for the interviews, are found in Appendix 2 (*Förvaltning AB Framtiden*), respectively Appendix 3 (*Bostadsbolaget*).

The first interview was held 14th of April at *Förvaltning AB Framtiden*’s head office (Ågatan 40) with:

Carina Grönberg *Chief Financial Officer – Förvaltning AB Framtiden*

The interview lasted 35 minutes, with emphasize on the communication between them and *Bostadsbolaget* and factors influencing the required yield.

The second interview was held 15th of April at *Bostadsbolaget*’s head office (Engelbrektsgratan 69) with:

Lena Quick *Head of Accounting – Göteborgs Stads Bostadsaktiebolag
(Bostadsbolaget)*

The interview lasted 35 minutes, with emphasize on the accounting as well as the information flow and cooperation within the group structure (i.e. group owner – subsidiaries).

3.2.4. Data analysis

The empirical data was analyzed by using Bedford & Baladouni (1962)’s matrix of communication (see 2.2.1. *Communication theory and the matrix of communication*). The interviews and archival research enabled the study to apprehend four angles in the matrix of communication. During the analysis, the four angles are linked to each other, with a focus on communication between subsidiary and owner. Specifically, the matrix emphasizes fidelity (the consistency of the user’s perception regarding the accounting documents sent by the company) and significance (emphasizing the degree of relevance of different accounting documents in relation to the ‘deferred revenues’).

Additionally, this study analyzed the empirical data using the agency theory and the assumptions of information asymmetry (see 2.1.3.1. *Information asymmetry*) and information as a commodity (see 2.1.3.2. *Information as a commodity*). The information asymmetry

emphasizes the importance of communication, whereas information as a commodity suggests how the asymmetry can be reduced by investing in communication channels.

3.3. Credibility of the study

The specific terms of validity and reliability are not presented, since the research is qualitative (Trost, 2010). Golafshani (2003) explains that there is a continuous discussion about the terms and their usefulness within qualitative studies. However, there is no coherent set of tests for case studies within the area of validity and reliability (Riege, 2003). Regardless of the outcome and the used terms, the credibility⁹ of the research will be presented. According to Golafshani (2003), the credibility within a qualitative research relies on the researcher's effort and ability.

The study will gain credibility since it uses the two methods; 3.2.2.1. *Archival research* and 3.2.2.2. *Interviews*. The two selected methods complement each other, thus providing the research a higher degree of credibility. The research is transparent in terms of providing the reader with the interview questions. The transparency will allow the readers to draw their own conclusion, therefore, increasing the credibility. In order to further increase the credibility and to avoid misinterpretations, all the interviews were transcribed the same day as the interviews were conducted. Furthermore, while transcribing the material, a notion was made regarding the time of potential quotations.

⁹ Credibility is a terminology that encompasses both validity and reliability and is commonly used within the field of qualitative research (Golafshani, 2003).

4. Empirical research

This chapter will present information about Bostadsbolaget and the empirical findings of this study. Furthermore, it will not be divided in accordance with the specific interviews, but rather a merged presentation of the collected data.

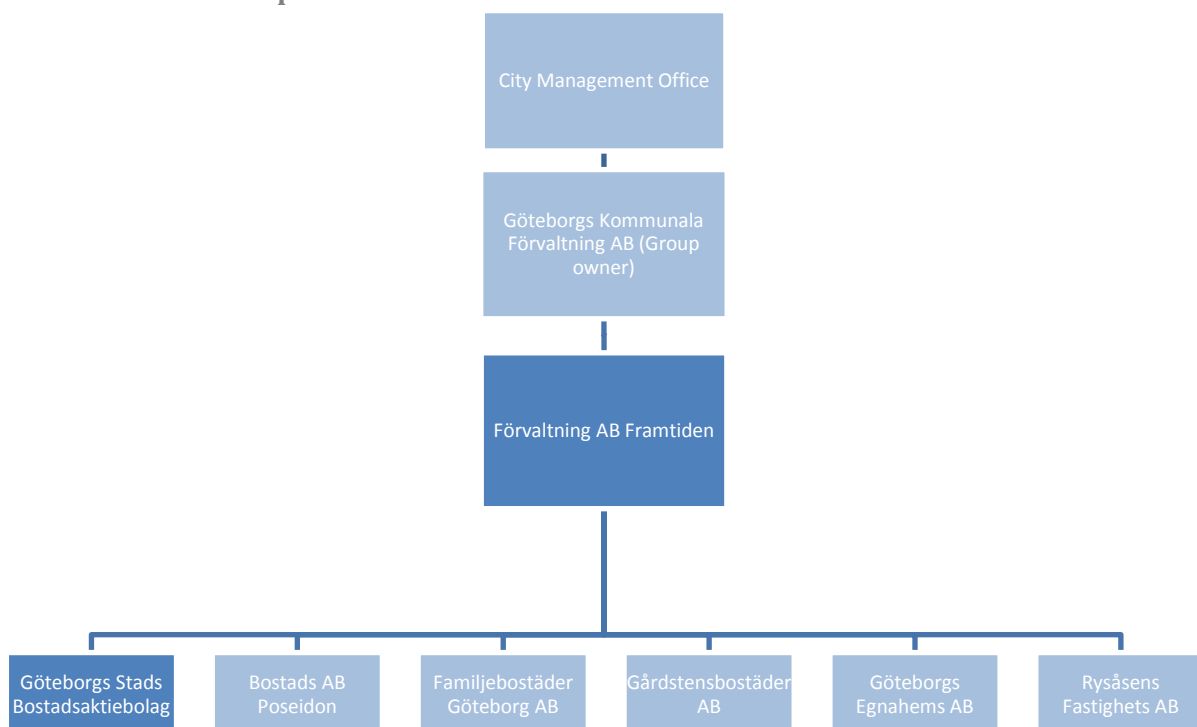
4.1. The case of Bostadsbolaget

Bostadsbolaget is a municipally owned real estate entity founded in 1945 (Bostadsbolaget, 2014a). Bostadsbolaget is one of the biggest real estate entities in Sweden and sublets parking lots, commercial premises and apartments (Bostadsbolaget, 2014a). Currently, Bostadsbolaget owns approximately 23,000 apartments, 15,000 parking lots and 450 commercial premises across Gothenburg.

4.1.1. Vision

Bostadsbolaget's vision is to provide their services through an appealing property portfolio while maintaining a competitive rent level. Furthermore, the entity strives to be the leading real estate entity within the City of Gothenburg, both in terms of property portfolio as well as leading the development of future living standards. This vision is being obtained through professional management and a high degree of customer satisfaction. Bostadsbolaget has outlined three core values, reflecting the business: *caring*, *joy* and *challenging*. (Bostadsbolaget, 2014b).

4.1.2. Ownership structure



The 1st of January, 2014, the ownership structure shifted for every municipally owned entity within Gothenburg, including Bostadsbolaget. With the aid received from Carl Bartler, it was possible to grasp the new ownership structure. A simplification of the ownership, relevant for

this study is that the City Management Office owns Göteborgs Kommunala Förvaltnings AB (Group owner), which further owns Förvaltning AB Framtiden; owning all the municipally owned real estate entities in Gothenburg (including Bostadsbolaget).

4.1.3. Deferred revenues

To answer the research question about how communicating information can reduce complexity of accounting items within an agency relationship, the study was conducted on the accounting item “deferred revenues”. Historically, ‘deferred revenues’ in Bostadsbolaget has been about 7% over the last years:

YEAR	Total revenue (KSEK)	Deferred revenue (KSEK)	DR/TR
2013	1583444	116671	7,37%
2012	1519030	107950	7,11%
2011	1463955	110456	7,55%
2010	1413122	109210	7,73%
2009	1387791	98683	7,11%
2008	1330110	91132	6,85%
2007	1295562	46434	3,58%
2006	1274259	86238	6,77%

The matrix shows how ‘deferred revenues’ is an item significant enough to have an impact on the financial statement, therefore a suitable accounting item for the study. Furthermore, ‘deferred revenues’ has been relatively constant, fluctuating between 6,77-7,73%, except for an extreme value in 2007 (3,58%). An accounting item with such an impact on the financial statement often contains complexity. The following empirical data will show how the complexity of accounting items, such as ‘deferred revenues’, is reduced by a well-functioning communication within this agency relationship.

4.2. The communication between Bostadsbolaget and Förvaltning AB Framtiden

Internal documents provided by Carl Bartler explain how Förvaltning AB Framtiden has received the responsibility of managing the administrative work within the group. The administrative work consists of marketing, common development projects, Information Technology (IT) projects and purchase, with a purpose of making the group more efficient. Further objectives include responsibilities such as calculating a suitable yield, mapping the demand of the increased energy efficiency and ensuring that the subsidiaries cooperates in order to meet the public demands in terms of living standard. These objectives should be achieved through a joint effort by all the subsidiaries and the principal. Furthermore, the internal documents state how the purpose of the yield is to generate a positive cash flow, sufficient to cover continuous maintenance and reinvestments. The main reason for restructuring the ownership was to provide Förvaltning AB Framtiden with a better insight and a higher degree of control over its subsidiaries.

Bostadsbolaget and Förvaltning AB Framtiden emphasized the importance of a well-functioning information flow as a part of their cooperation. The entities use three

communication channels for reducing the complexity within the agency relationship: *Information groups, a common intranet and internal reporting system.*

4.2.1. Information groups

One of the main initiatives, created by Förvaltning AB Framtiden, has been to compile the several discussion groups within different fields. The groups consist of one person from each entity (*see 4.1.2. Ownership structure*). For instance, within the field of accounting, there is one group consisting of the Heads of Accounting. However, since the entities vary significantly in size and turnover, every entity might not be represented in all groups.

“In terms of communication, a major project that we initiated was the different information groups, in order to promote cooperation and information-sharing between owner and subsidiaries, but also among the subsidiaries” – Carina Grönberg (14-04-2014)

Bostadsbolaget and Förvaltning AB Framtiden claim that the information groups create a better understanding for the underlying economic events. Förvaltning AB Framtiden emphasizes that all kinds of information cannot be communicated through accounting and the monthly reports. A major objective with the information groups is to discuss the underlying economic events. For instance, changes in ‘deferred revenues’ are shown in the accounting, but might be difficult to understand without additional information. Therefore, the communication within the information groups is a necessity in reducing the complexity of ‘deferred revenues’ within the agency relationship. Since Förvaltning AB Framtiden is the owner of several real estate entities, these different information groups are vital in order to ensure continuity within the group. Additionally, it also provides the principal with information regarding the real estate business from a broader perspective. Furthermore, the principal sees more positive attributes regarding the yield:

“Obviously, a more extensive cooperation gives us the ability to see similarities and differences among the entities, which in turn provides us with useful information when we decide the yield” – Carina Grönberg (14-04-2014)

Lastly, the information groups have increased cooperation among all the entities within the group, which has proven to be useful. However, Bostadsbolaget points out that the increased cooperation probably is an effect from the current market as well; when times were worse, the competition among the entities was significantly higher compared to today.

“For us, the cooperation with the other entities has proven to be useful. Especially the cooperation between the entities with a similar size and turnover, since the smaller entities might face other situations to which we cannot relate” – Lena Quick (15-04-2014)

4.2.2. Common intranet

In order to establish usefulness derived from the gatherings, all decisions are transcribed and published on the intranet. The information can thus be obtained by any entity within the group. According to Bostadsbolaget, this way of handling the decisions is a vital way for the whole consolidated work form to strive towards a better communication and better understanding of the complexity existing in entities’ relationship. Furthermore, it serves as a

tool for inspiration and learning. Additionally, the intranet is a fast way to obtain information, since it severs communication lines. For instance, if Bostadsbolaget wants to access internal documents regarding Förvaltning AB Framtiden's current yield demand, the documents can be derived immediately from the intranet. Bostadsbolaget emphasizes the importance of obtaining information directly from the intranet, compared to establishing contact with the other entities to gain every bit of information.

Since the intranet makes the information constantly accessible, the entities can continually obtain information about accounting items, standards and policies used within the group. The entities agreed on the necessity of a common intranet to maintain a well-functioning communication, thus reducing the complexity of accounting items, such as 'deferred revenues'.

4.2.3. Internal reporting system

Bostadsbolaget reports to Förvaltning AB Framtiden on a monthly basis, with more extensive reports every sixth month. By using such a frequent reporting system, both Bostadsbolaget and Förvaltning AB Framtiden believe that Förvaltning AB Framtiden will gain a deeper understanding for Bostadsbolaget's business. However, Förvaltning AB Framtiden elaborated on how the frequent reports support them with assurance, since a result of the system is that there usually are no surprises in the final annual report. Compared to the common intranet and information groups, the internal reporting system is considered formal and consists mainly of numerical information.

Therefore, since it shows accounting items, it creates a useful substitute to the other communication tools. For instance, when discussing 'deferred revenues' within the information groups, accessible through the intranet, internal reporting systems will show how Bostadsbolaget interpreted the result of the information groups. Förvaltning AB Framtiden is given the possibility to either establish further information or settle with the current accounting. Since a high degree of complexity in accounting items, such as 'deferred revenues', lies within the communication between the owner and subsidiary, the frequent reports allows Förvaltning AB Framtiden to be continuously updated about the accounting item.

4.2.4. Open communication

Additionally to the three communication channels, an underlying company culture, supporting an open communication within the group, was emphasized. Bostadsbolaget explains that although the monthly reports are positively viewed upon, there is another part of the information flow that is perceived as the key to a well-functioning communication:

“We strive towards having an open approach against our subsidiaries as possible. We believe that this will result in a mutual trust and sense of comfort within the group” – Carina Grönberg (14-04-2014)

Furthermore, Bostadsbolaget emphasized the importance of the possibility to contact any employee within Förvaltning AB Framtiden, depending on the subject. A major benefit with an open communication is that information regarding unexpected events, heavily influencing the financial statement, can be transferred instantly.

“In case of fire, which would lead to a fluctuation in ‘deferred revenues’, we account for that cost immediately and report it to our owner” – Lena Quick (15-04-2014)

Therefore, Bostadsbolaget highlights how Förvaltning AB Framtiden must grasp the physical content of what an unexpected event, such as fire, can cause in accordance with Bostadsbolaget’s cost structure; how to correctly account for fire and fluctuation within ‘deferred revenues’. However, even with the open communication, Förvaltning AB Framtiden emphasizes the importance of a higher degree of involvement in certain cases. For instance, deviation might occur when Bostadsbolaget’s profit exceeds or fail to meet the yield. In such a situation, it is vital that both parties can reach an agreement of how to best solve the situation. If the yield is exceeded; how should the extra funds be used? If the yield is not met; why and what are the consequences?

“For instance, if Bostadsbolaget were to have an unexpectedly positive result, maybe because of warm weather throughout the year, it is important for us, as owners, to have influence over where that extra money should be spent. Even though we might not have any suggestions that Bostadsbolaget has not thought about, we still want to be a part of the discussion and have the final say” – Carina Grönberg (14-04-2014)

To summarize, the archival research and interviews showed that three communication channels, alongside with the company culture, were used to reduce the complexity of ‘deferred revenues’. The next chapter will analyze the empirical data using the matrix of communication and perspectives received from the agency theory.

5. Analysis

This chapter will present an analysis of the empirical data from the relevant theoretical perspectives, in order to answer this study's research question. The analysis will be conducted by using an agency theory perspective and the matrix of communication. The structure of this chapter will start by focusing on the research question and then embrace a broader perspective.

The purpose of this research was to investigate how communicating information reduces the complexity of accounting items within an agency relationship. The empirical data showed that information reduces complexity of accounting items within an agency relationship. The analysis will explain how information is communicated and used to reduce complexity.

5.1. The matrix of communication

Bedford & Baladouni (1962)'s matrix is a useful tool for analyzing communication within an agency relationship. It helps the study to allocate the different means of communication and their relation to the entities studied; Förvaltning AB Framtiden and Bostadsbolaget. As shown in 2.2.1. *Communication theory and the matrix of communication*, the matrix will be used to analyze communication between Bostadsbolaget and Förvaltning AB Framtiden, with a focus on revenues and accounting information. Initially, Bostadsbolaget receives revenues in terms of rent. At the end of the fiscal year, a part of the rent is accrued, thus becoming 'deferred revenues'. Bostadsbolaget account for the 'deferred revenues' in the financial statements, which are collected and processed by Förvaltning AB Framtiden. Lastly, Förvaltning AB Framtiden as the owner has a strong interest to understand the market and how revenues occur.

Bedford & Baladouni (1962) explained how the financial statements as a single mean of communication are not sufficient for the owner/user (Förvaltning AB Framtiden) to contemplate the economic events ('deferred revenues'). This argument becomes more evident when the economic event is a complex accounting item, such as Prakash & Sinha (2013) stated 'deferred revenues' to be. Therefore, Bedford & Baladouni (1962) proclaim the importance of information that is significant in relation to the economic event, with a high level of fidelity.

5.1.1. Achieving fidelity

A high level of fidelity (*see 2.2.1. Communication theory*) is mainly achieved through the three communication channels and the company culture presented in the empirical data; information groups, common intranet, internal reporting system and open communication. The objective for Bostadsbolaget is to produce and communicate accounting information that will help Förvaltning AB Framtiden to fully understand the economic event of 'deferred revenues'. The information groups provide an opportunity for Förvaltning AB Framtiden to both get an insight and influence the production of financial information, produced by Bostadsbolaget. The common intranet supports the information groups by withholding the results received from the information groups, therefore continually making information available. A frequent internal reporting system is vital in order to avoid misunderstandings when the final financial statements are produced, thus creating a higher level of fidelity by

assuring that the financial statements are correct and understandable. The company culture supports an open communication which positively affects the entire matrix of communication in terms of consistency. Since both entities are comfortable to establish contact at any given time, a common understanding for the economic event and the accounting information is created.

5.1.2. Ensuring significance

Before ensuring that information is significant (*see 2.2.1. Communication theory*), the entities must cooperatively decide what type of information that should be regarded as best reflecting the economic events. When Bostadsbolaget observes ‘deferred revenues’ and produces financial information, it is important to decide what information that is significant and, henceforth, will be communicated. The information groups provide Förvaltning AB Framtiden the possibility of influencing the decision, which is essential since the financial information is directed towards Förvaltning AB Framtiden. However, other communication channels are used to ensure that the produced information reflects the economic events in accordance with the decision made by Bostadsbolaget and influenced by Förvaltning AB Framtiden (accessible through the common intranet and frequently presented by the internal reporting system).

5.2. Information from an agency perspective

This part of the analysis will use an agency theory perspective when analyzing the empirical data regarding communicating information between Bostadsbolaget and Förvaltning AB Framtiden when reducing complexity in ‘deferred revenues’. Since this study was conducted on the relationship between management in a large cooperation (Bostadsbolaget) and its owner (Förvaltning AB Framtiden), the analysis will foremost be influenced by the positivist agency theory stream.

5.2.1. Information asymmetry and how it is reduced

The empirical data showed that both entities highly value a relationship based on a well-functioning information flow. The respondents confirmed that there existed an underlying information asymmetry within the relationship. Information asymmetry is one of the main assumptions that have influenced the agency theory, which objective is to explain how the information asymmetry can be reduced (Eisenhardt, 1989). The empirical data showed that the communication between Bostadsbolaget and Förvaltning AB Framtiden was perceived to be well-functioning. According to agency theory and its assumption of information asymmetry, a usual reason for a low asymmetry between Bostadsbolaget and Förvaltning AB Framtiden is a long-term relationship. When conducting this research, it seems that the long-term relationship between the entities has been a preeminent factor in reducing the information asymmetry. The long-term relationship has improved the information flow, but specifically enabled the open communication. First, the study showed that the information groups were created during the relationship. The information groups are perceived to be a useful and rewarding solution for reducing potential complexities for both Bostadsbolaget and Förvaltning AB Framtiden. Such a solution did not initially exist, but was created as the relationship evolved; the entities gained a mutual understanding of the business. Second, the open communication was an initial initiative by Förvaltning AB Framtiden in the beginning of

the relationship. Along the way, this initiative has evolved into a company culture, which both entities can rely on. Therefore, the open communication serves as a foundation for the relationship, supporting the communication of information. These observations are in line with previous agency research (Eisenhardt, 1989), showing how information asymmetry is reduced during a long-term relationship.

5.2.2. Information as a commodity

Another underlying assumption within agency theory is that information is viewed upon as a commodity. Therefore, it is interesting to examine whether the communication channels showed in the empirical data have been purchased. Agency theory explains that purchasing information is not restricted to payment in terms of monetary resources, but could also be purchased by other resources. This study showed that, in accordance with the commodity assumption of the agency theory, both Bostadsbolaget and Förvaltning AB Framtiden have invested in communication channels through different resources. The investments, stated in the empirical data, are the information groups (including all costs associated with the groups), the intranet and the reporting system (including monthly, interim and year-end reports).

The information groups, intranet and reporting system are all initiated by Förvaltning AB Framtiden with the purpose of gaining a higher degree of information about Bostadsbolaget's behaviour. According to the positivistic stream within agency theory, it is appropriate for a principal to focus more on behavioural solutions when the information level is higher (Eisenhardt, 1989). The behavioural approach is supporting this study, since the relationship focus more on gaining a higher level of information, rather than constructing outcome-based solutions. This argument is supported by the principal-agent stream, where a higher focus on behavioural solutions is preferred, when there is a high level of information shared across the relationship. The principal-agent stream supports the importance of how these groups serve as a furtherance factor to other relationship than between principal-agent, in this case, across subsidiaries. Since accounting items can possess a high degree of complexity, investing in information-based solutions has proven to be a way for Bostadsbolaget and Förvaltning AB Framtiden to reduce such complexities. This becomes evident within the field of 'deferred revenues', where the communication between subsidiary (Bostadsbolaget) and owner (Förvaltning AB Framtiden) is a source of complexity (Prakash & Sinha 2013).

Additionally, the open communication structure provides Förvaltning AB Framtiden with a higher level of insight in Bostadsbolaget's business. Meanwhile, Bostadsbolaget gains the opportunity to contact Förvaltning AB Framtiden whenever a question arises. The alternative would have been to have certain contact persons at each company, whom subsequently would forward the question to the person with the demanded knowledge. The current communication allows both entities to save a substantial amount of time. Furthermore, Beaver & Demski (1974) claim how the entity faces a period over time of investments, where the entity's capabilities are constraint by its wealth. Based on the assumption of information as a commodity, the lack of resources could result in entities not having the ability to invest in communication channels reducing complexity within an agency relationship. However, Bostadsbolaget and Förvaltning AB Framtiden have developed a common company culture, supporting open communication, which requires few resources to maintain. Therefore, in this

case, the open communication would reduce the complexity of accounting items in the agency relationship, even though resources to maintain other communication channels are scarce.

5.2.3. Reducing moral hazard and adverse selection

The two aspects, moral hazard and adverse selection (*see 2.1.2. Principal-Agent Theory*), have been reduced by the long-term relationship and the three communication channels. The long-term relationship reduces the risk of adverse selection, since Bostadsbolaget and Förvaltning AB Framtiden have gained a higher degree of knowledge about each other during the years of corporation. Furthermore, the communication channels reduce the adverse selection as well as the moral hazard, by enabling the high level of information exchange.

5.3. Applying the analysis on revenue recognition

In a broader sense, this research has been conducted within the field of revenue recognition. According to Dechow et al. (1996), Palmrose et al. (2004) and Srivastava (2013), revenue recognition is an area with a possibility for accounting frauds, earnings management and misinformation towards owners. This study indicates that a long-term relationship between Bostadsbolaget and Förvaltning AB Framtiden reduces the potential misinformation flowing between the same entities. Therefore, a long-term relationship and a high level of significant information communicated with a high level of fidelity are likely to reduce the information asymmetry within revenue recognition. Furthermore, in this case, it would be difficult for Bostadsbolaget to use earnings management. The reason for this is mainly because Förvaltning AB Framtiden's high level of insight, which has been acquired by investing in communication channels (information groups, intranet and internal reporting system). Both respondents also agreed that since they are municipally owned, the pressure on financial performance should be lower. Less pressure on financial performance reduces the incentives for manipulating the revenues. This study shows the importance of communication channels and communication to maintain unbiased and qualitative financial reporting towards the users (Förvaltning AB Framtiden).

6. Concluding remarks

This chapter will present the conclusion, final reflections of the study and suggestions for further research.

This study has aimed to show how communicating information is used to reduce the complexity of accounting items within an agency relationship. There are three communication channels used by Bostadsbolaget and Förvaltning AB Framtiden to reduce the complexity within the specific case of ‘deferred revenues’. These are *information groups*, *common intranet* and *internal reporting system*. The channels combined have created a well-functioning information flow, establishing what significant information is. Furthermore, there is a lean company culture within this agency relationship, which supports an open communication. This open communication has created a sense of comfort for exchanging information at any time.

This study investigated how communicating information reduced the complexity of ‘deferred revenues’ within an agency relationship. However, by analyzing the empirical data using the matrix of communication, the analysis showed that the communication channels used to reduce complexity of ‘deferred revenues’ also is applicable in reducing complexity for other accounting items within a similar agency relationship. Lastly, this case study showed that communicating information is vital for reducing complexity within agency relationships.

6.1. Final reflections and suggestions for further research

After conducting the study, we realized that the two theories do not explain the entire situation, since communication in practice is not as linear as it is assumed to be in agency theory and the matrix of communication. For instance, the dimension of trust between the subsidiary and owner is not captured in the theory. Therefore, it would be meaningful to consider adding a more interpretative perspective to the topic in future research.

Further suggestions for future research are to investigate the role of communication in another industry and testing other accounting items. Furthermore, since the empirical data suggested that there might be differences, it would be interesting to compare two company settings, where one operates in the private sector while the other operates in the public sector. Finally, it would be interesting to see if the role of communication differs from an international perspective, since different traditions and cultures have an influence on accounting.

7. References

This chapter will present the articles, books, electronic documents and regulations used in the research.

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Appendix 1

Year	Prepaid rents			Deferred revenues			Company (%)		
	MKB	KBAB	Poseidon	MKB	KBAB	Poseidon	MKB	KBAB	Poseidon
2012	80 800 000	31 427 000	129 512 000	80 800 000	31 427 000	129 512 000	100%	100%	100%
2011	135 500 000	33 755 000	124 293 000	135 500 000	33 755 000	124 293 000	100%	100%	100%
2010	126 500 000	28 081 000	125 170 000	126 500 000	28 081 000	125 170 000	100%	100%	100%
2009	121 800 000	27 331 000	122 419 000	121 800 000	27 331 000	122 419 000	100%	100%	100%

Appendix 2

Questions for the interview with Förvaltning AB Framtiden:

- Do you, as the owner, focus specifically on 'deferred revenues' (prepaid rents) when evaluating Bostadsbolaget AB?

- On which factors are your required yield based on?

- How do you perceive the information flow between yourself and Bostadsbolaget AB, especially in terms of yield demanded?

- How do actively work with sustaining a well-functioning information flow as well as possible improvements?

- Do you perceive that a sufficient amount of information is shared between yourself and Bostadsbolaget AB?

- Have you perceive misinterpretations in the information flow?

Appendix 3

Questions for the interview with Bostadsbolaget AB:

- Do you perceive a complexity when accounting for 'deferred revenues' (prepaid rents)?

- How do you perceive the information flow between yourself and Förvaltning AB Framtiden, especially in terms of yield demanded?

- How do actively work with sustaining a well-functioning information flow as well as possible improvements?

- Do you perceive that a sufficient amount of information is shared between yourself and Förvaltning AB Framtiden?

- Have you perceive misinterpretations in the information flow?