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SCHOOL OF BUSINESS, ECONOMICS AND LAW

The Relevance in Annual Reports

Studying the use of annual reports in the credit and investment decision.

Bachelor Thesis in Business Administration / Accounting

Spring 2010

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Abstract

Background: The adoption of the mandatory use of IFRS as accounting principles for all listed companies in the European Union in 2005 have triggered a debate about the usefulness of the financial statements prepared in accordance with these regulations. Voices have been raised, both in favor of these regulations and against them.

Purpose: The purpose of this bachelor's thesis is to describe the use of the annual report in the analytical processes of investors and lenders. Furthermore, an evaluation is made whether annual reports made in accordance with IFRS meet the IASB framework quantitative characteristic of relevance for investors and lenders.

Method: The empirical findings in this thesis were obtained through qualitative interviews. Interviews were conducted with representatives for both lenders and investors.

Conclusion: For lenders, the annual report lacks the timeliness needed to be of relevance in the decision making process. The annual report, however, is valuable for the credit analyst in that it provides reliable audited information with which they can confirm the information previously obtained. The investment analyst has the same problem with the timeliness issue as the creditor. Furthermore, the investment analysts feel that the annual report provides information lacking in quality due to the fair value valuation method. The conclusion can be drawn that from the investor's perspective, the annual report lacks relevance in the decision making process.

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1. Introduction

In this chapter the background to this thesis is presented. Following the background is the problem discussion highlighting the complexity in the issue regarding IFRS as accounting standards. The problem discussion results in the research question and the purpose of this thesis. This chapter is concluded with an explanation of certain concepts and a presentation of the continued disposition of the thesis.

1.1. Problem background

As of today, the accounting principles are not as globalized as the world in which they are to be used. There is no set of uniform collection of standards used by the whole world. Instead, since the beginning of accounting different opinions concerning the focus of the accounting have emerged between countries. In the United States and Great Britain the purpose of accounting information has primarily been to provide investors and owners with financial information about the company, the Anglo-American focus of accounting. In the rest of Europe, the focus have been to provide lenders and state with the necessary information to analyze the credit risk respectively in taxation purpose, the continental-Europe focus of accounting (Smith, 2006).

For Sweden, this has changed in the last years. In March 2002 the European Parliament decided to adopt International Financial Reporting Standards, IFRS, as the new accounting principles to be followed by all publicly listed companies in the European Union. This decision therefore affects the large Swedish companies listen on financial markets. The decision by the European Parliament states that, starting in 2005, European publicly noted companies are to present their financial statements in accordance with IFRS (Axelman et al., 2003).

The independent organ International Accounting Standards Board, IASB, is the publisher of new accounting standards. IASB is a reconstruction of the accounting regulating organ International Accounting Standards Committee, IASC. To follow IFRS also includes following the standards issued by IASC (Marton et al., 2008).

In the *Framework for the Preparation and Presentation of Financial Statements (2001)* IASB establish the investors and owners of the company as the stakeholders for whom the usefulness of the accounting information is emphasized. For most of Europe, this means the abandonment of the traditional continental European focus of accounting.

For the companies of Sweden, the adaptation to IFRS still means that the accounting regulations are principle based. However, it has brought an increase in both the number of regulations to follow and the level of detail these regulations require.

1.2. Problem discussion

The opinions differ whether IASB has succeeded in making the accounting information relevant for stakeholders to the company, primarily the investors. Both in media and in the annual reports themselves critical voices have been raised concerning IFRS regulations. Nordstjernan AB's, an investment company from Sweden, CEO Tomas Billing raises the issue in the CEO statement in their annual report of 2008 by calling IFRS very bad and continues:

“There are two general areas that we believe cause many harmful effects: regulatory detail orientation and the increasing element of fair value. [...] Another consequence of IFRS is that more and more assets are to be valued at market value. This is also true for many assets without a liquid market. In addition, increases and decreases in market value are to be recorded as profit or loss in the income statement.” –Tomas Billing
(Nordstjernan annual report 2008, p.2-3)

Furthermore, Ratos, a Swedish private equity company, expresses similar views in their annual report for the year 2009. They have also previously expressed their views on different IFRS regulations in their annual reports. Ratos argues that, even though they agree with the principles behind the IFRS regulations, relevance and reliability, IFRS does not live up to these principles themselves. Furthermore, Ratos disagree with IFRS focusing on the balance sheet instead of the, according to them, more important statement of income. They also express concerns that IFRS is heading in the direction of the rigid and inflexible system used in the United States. This, they say, means that IFRS more and more uses ruled based solutions instead of principle based. Instead, Ratos seek a regulation organ driven by the need for new standards, and that is not what IASB is today. These views have also been expressed in a published article in the trade publication Balans.

“In some cases we think that the choices made or the place of emphasis can be questioned. This can be exemplified with the choice of a balance sheet approach instead of a statement of income approach and the emphasis on entity theory instead of owners’ theory regarding the consolidated financial statements that IASB has chosen.” –Carina Strid, Ing-Marie Pileber-Bosson
(Balans, 2010:4, p.55)

IASB’s focus on the balance sheet instead of the statement of income is also stated as one of the bigger concerns Ratos have about IFRS in their annual report 2009. “When the whole world base most of their financial decisions (acquisitions, stock recommendations, credit decisions, etc.) on the statement of income and statement of cash flows analyses, which is to place the church in the centre of the village, IFRS suddenly places the outhouse, that is to say the residual post, there instead.” (Ratos, 2009, p.21).

It is possible to conclude that some producers of the financial reports are less than pleased with the development of the IFRS regulations. Other opinions have, however, been raised. Jan Marton, Ph.D. in accounting at School of Business Economics and Law at Gothenburg University and accounting expert at KPMG presented his views on IFRS as a reply to Ratos’s article. In his reply, Marton explains the accounting principles and guidelines to be the only possible solution for the international setting in which these regulations are to be adopted.

“Carina Strid and Ing-Marie Pilebjer-Bosson dislike the balance sheet approach instead of the statement of income approach and the emphasis on entity theory regarding the consolidated financial statements. The problem is that assets and liabilities can be defined, but revenues and costs can only be defined as changes in assets and liabilities, and this is why the basis lies in the balance sheet.” –Jan Marton
(Balans, 2010:5, p.50)

Given the different opinions on the use and usefulness of IFRS as accounting standards provided by the producers of financial reports and by a theoretical expert, the authors of this bachelor's thesis find it to be of interest to investigate how the financial reports are perceived by the actual users of these. Ratos states that IFRS has made it more difficult, sometimes impossible to correctly interpret information about companies (Ratos annual report, 2009). Is this opinion reflected by investment analysts and credit analysts in the financial industry?

1.3. Research question

Based on the problem discussion above the research questions of this bachelor's thesis are:

Does the information in the annual report meet the requirement of relevance in the IFRS framework in the investment and credit decision?

1.4. Purpose

The purpose of this bachelor's thesis is to describe the use of the annual report in the analytical processes of investors and lenders. Furthermore, an evaluation will be made whether annual reports made in accordance with IFRS meet the IASB framework quantitative characteristic of relevance for investors and lenders.

1.5. Delimitations

The authors seek to evaluate how IFRS is perceived by the intended users. In this thesis IFRS regulations are therefore regarded together as a single unit or set of rules in order to get the overview perspective sought. Delimitations have been made concerning the investigated stakeholders where the focus of this thesis lies in the stakeholders described in IASB's theoretical framework p.9a & 9c, investors and lenders. Naturally, this means that the focus has been on the analytical process of companies who prepare their financial statements in accordance with IFRS.

Further delimitations have been made concerning investors in that the authors have focused on professional investors who have a long term perspective (more than two years) on the investments. The reasoning behind this decision is that investors with short term perspective focus more on technical analysis instead of deeper analysis and greater knowledge on the companies.

Finally, we have limited the evaluation to include in particular one of the four most important qualitative characteristics brought forth in the conceptual framework point 24: relevance. Relevance is specified in point 26 as being of relevance for the users in the decision making process. Therefore, the authors claim that this characteristic is the most important to consider when answering the research question.

1.6. Abbreviations and definitions

Abbreviations

IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards
Framework	IASB's Framework for Preparation and Presentation of Financial Statements
AP 2	Second Swedish National Pension Fund
AP 6	Sixth Swedish National Pension Fund

Definitions according to the ninth point in the framework:

Investors “The providers of risk capital and their advisers are concerned with the risk inherent in, and return provided by, their investments. They need information to help them determine whether they should buy, hold or sell. Shareholders are also interested in information which enables them to assess the ability of the entity to pay dividends.”

Lenders “Lenders are interested in information that enables them to determine whether their loans, and the interest attaching to them, will be paid when due.”

1.7. Disposition

In the next chapter of this bachelor’s thesis, chapter two, the theoretical framework is presented. The theoretical framework contains the essential background knowledge of the accounting principles and the regulations governing them. Furthermore, theories concerning the effect of certain choices in the accounting standards are presented. In chapter three, the methodological choices made in this bachelor’s thesis are presented. In addition, the respondents interviewed are presented. A discussion about the quality of the thesis is also made. Chapter four presents the empirical findings of the thesis. The empirical findings consist of the views raised in the interviews conducted with investment analysts and credit analysts. In chapter five an analysis is made of the empirical findings with basis in the research question and the theoretical framework. The results are concluded in chapter six and the research question is answered. Furthermore, the authors suggestion on further research is stated.

2. Theoretical framework

In this chapter the theoretical framework regarding IASB and their framework is presented. In addition, views on how the IFRS regulations affect the users of the financial information are presented. The chapter concludes with highlighting a specific property of IFRS, the use of fair values in the financial reports.

2.1. IASB and the Framework for the Preparation and Presentation of Financial Statements

2.1.1. Background

International Accounting Standards Committee, IASC

During the 20th century's increased globalization with increased foreign investment the request for a more harmonized accounting system grew stronger. This was a problem especially for the stock market and its investors for whom it became problematic with all the local GAAP developing in different directions. To solve this, accounting organizations in several countries founded the International Accounting Standards Committee in London, June 1973. The non for-profit organization consisting of only accountants, were to produce International Accounting Standards, IAS, that would harmonize the companies’ financial reports and to ease the international stock trading. During the 1990s the use of IASC’s standards increased but at the same time concerns were raised.

The main reason for concern was regarding the organizations structure and to ensure independence from interest groups. Without solving these problems few developed countries were prepared to implement the use of IAS for all its companies (Marton et al., 2008).

International Accounting Standards Board, IASB

In 2001, the IASC underwent a major reorganization because of the critic against its organization and changed its name to International Accounting Standards Board. This made it possible for more countries to implement the new International Financial Reporting Standards (IFRS). In 2002 the European Union decided to implement IFRS for all of its listed companies starting in 2005. This means the use of the new IFRS, includes old IAS and interpretations, after they have been adopted by the EU in the form of regulations (Marton et al., 2008).

2.1.2. Framework for Preparation and Presentation of Financial Statements

The IASB intends to develop principle-based and not rules-based accounting standards. The underlying Framework for the Preparation and Presentation of Financial statements contains the fundamentals for every accounting standard in terms of accounting, valuation and reporting. A principles-based standard setting gives relatively little guidance or examples on how these principles should be used in a specific situation. Instead, the accounting firms under the principles of accounting have to make professional judgments and interpretations (Marton et al., 2008).

The Framework for preparation and Presentation of Financial Statements was first established by the IASC and published in July 1989. After the reorganization into IASB it was once again established in April 2001 (Marton et al., 2008). Problems with financial reports have been that the definition of economic events differs from country to country. Therefore, the Framework is a cornerstone that defines concepts and basic principles for preparation and presentation of financial reports on a general level. The Framework is not a standard and therefore not superior to any IAS or IFRS (Framework pt.1-2).

There have also been concerns about the uniformity of the accounting among different countries. Ball (2006) thinks that it is inevitable that there will be substantial difference in how countries implement the IFRS and therefore the information in financial report may not be as uniform as intended.

A uniform standard

There are several reasons for using uniform accounting standards for companies around the world. The first reason is the benefit for countries that choose to adopt a uniform existing standard is a kind of scale economics; the marginal cost for use in an additional country is very low, in contradiction to inventing a new standard. Another advantage for a uniform standard is that it will reduce the risk that producer changes auditor for someone that will accept doubtful accounting since all auditor's need to play by the same rules. Third, the more companies that use a uniform accounting standard is that the comparability between companies increase and therefore lowering the costs for users of the financial reports (Ball, 2006).

2.1.3. Qualitative characteristics

Qualitative characteristics are the characteristics that make the information in the financial reports useful for the users. According to the IASBs Framework for the Preparation and Presentation of Financial Statements there are four primary qualitative characteristics. These are understandability, relevance, reliability and comparability (Framework pt. 24).

Relevance

For the information in the financial statements to be of any value it needs to be relevant for the user. The Framework defines relevance as if the information has an effect on the user's decision and facilitates the assessment of past, current and future events, or by confirming or correcting previous assessments. Information about financial position and past performance is used for future forecast of financial position and result used by the users to determine dividend, share price development, salary and the company's ability to fulfill their commitments (Framework pt. 26-28).

Another aspect of relevance is *timeliness*; the information needs to be up to date. If the Financial Reports contains highly reliable information, but therefore also old information, it might not be relevant for the reader (Framework pt. 43).

Understandability

A necessary and quality for the information in financial reports is to be relevant is that it is understandable for the user. This of course requires the user to have necessary knowledge in business, economic and accounting to be able to interpret the information given. Information that are relevant for the user can however not be left out because it might be hard to understand for some user (Framework pt. 25).

Comparability

For the information to be relevant to an investor and to be able to make informed decision in investments it is important to be able to compare one company with others. This makes it important that companies use the same accounting principles to make the market more transparent, even though there are some differences between industries. If the comparability is maintained it should also be able to follow a company's financial development over a longer time period. The requirement for comparability in a company over time is not cause enough to refrain from adapting newer accounting standards that meet the demands on relevance and reliability. If the accounting principles changes it is necessary to include comparison data (Framework pt. 39-42).

Balancing between qualitative characteristics

The qualitative characteristics in the framework need to be balanced between each others. It is important for the producer of financial reports to weight the different characteristics in the right way for the specific situation, without affecting the objectivity in the statements (Framework pt.45). For example is there a conflict between the relevance of information and its reliability. It is easier to achieve high reliability in information the longer time passes, for example to determine the rate of depreciation for the company's assets. However, when the information reaches total reliability it most likely misses the relevance (Smith, 2006). Following are the main characteristics that are in conflict with relevance.

Balancing benefits and costs

The benefits for composing the financial reports should be larger than the cost to provide it. The cost does not always fall on the one who benefits from it. This means that for some costs there are clear benefits for the paying company, for example can the financial reports contribute to lower the company's risk and therefore also give a lower credit cost or a higher market value. In other cases the benefiter of the financial reports might be employees, customers, government or other users. When setting up new accounting standards or preparing financial reports it is important to be aware of and take in to consideration that the benefits should exceed the costs. This means the benefits for all users and not only for the company or its owners (Framework pt. 44).

Reliability

For the information to be useful it needs to be reliable. The information is reliable if it does not contain any significant errors or if it is not biased. The user must be able to rely on the information to be correct. Information could be relevant but so uncertain that the financial statement risk to be misleading if it is used in the financial reports, in some cases it might be better to enlighten the user of certain circumstances (Framework pt.31-32).

Materiality

The information's relevance is affected by its character and materiality. In some cases the information's character is vital for its relevance. Information about a new business can affect the company's risk and opportunities even though the result may not be material. Information is material if the omission or misstatement affects the user's decision based on the information given in the financial reports. The degree of materiality depends on the size of the error given in the financial report or under the circumstances for the omission (Framework p. 29-30).

2.2. Agency theory in accounting

Agency theories are adoptable in a situation where a task is too complicated or too costly to perform on your own. In such situation the person who wish to have the task performed, called the principal, have to hire another person with these specialized skills or knowledge, called the agent, and have this person performing the task (Sappington, 1991). Jensen & Meckling (1976) defines an agency relationship as:

"...a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent." (Jensen & Meckling, 1976, p.308)

If both the agent and the principal are trying to maximize their profit/benefit the agent is likely to not behave in a way which is of the most benefit for the principal (Jensen & Meckling, 1976). Due to the principal's lack of knowledge in the task-specific area there are difficulties in monitoring the agent's activities (Sappington, 1991). Problem may arise in the situation where the principal faces difficulties in measuring the performance of the agent. One significant problem is when the agent's and the principal's agenda differ. In this case, the principal thus have a need for information about the doings of the agent performing the task (Eisenhardt, 1989).

Agency theory can be applied on numerous relationships. Sappington (1991) exemplifies with the following: the relationship in a company, where a boss has the role of principal and a worker lower in the hierarchy is considered the agent; a regulator for an industry can act as principal for the regulated firms, who are considered the agents; a military leader and the troops under his command, a dean of a college and the faculty and, finally, the example where a landlord is the principal of a tenant farmer (Sappington, 1991).

The current ownership model of modern corporations is complex and diffuse. In these modern corporations the stockowner and manager relationship can be viewed as that in an agency relationship. It is therefore not surprising that the potential problems in agency relationships are transferrable to the separation of ownership and control in modern corporations (Jensen & Meckling, 1976). Thomasson et al. (2006) state that the purpose of financial accounting is to provide the stakeholder, such as the owner or the creditor, with information about the financial state of the corporation.

2.3. The use of information

2.3.1. IFRS requirements on information disclosure

The need for financial reporting and disclosures is due to the information asymmetry between outside investors and managers in a company. Furthermore, agency conflicts are considered a factor behind the demand for financial reporting. Thus, the financial reports and the disclosed information contained within are important means for the management to communicate their achievements to the outside investors of the company. The disclosing of information is considered to be crucial for a capital market to function efficiently (Healy & Palepu, 2001).

The debate about stricter regulation concerning mandatory information disclosure is due to three main reasons. Firstly, voices are often raised for a higher degree of regulation after severe financial crises. Secondly, in order to achieve a convergence in the accounting rules many countries' accounting standards bodies have begun to use the IFRS framework. Thirdly, increasing internationalization of capital markets has made the need for regulation an issue for the whole world (Leuz & Wysocki, 2008).

After a decision by the European Commission all listed companies in the European Union were forced to follow IFRS as their accounting method starting in 2005. IFRS requires an increased amount of financial information disclosed in the financial reports. The exact amount of additional information required for each adopting country differs depending on the previous accounting standards in these countries (Li, 2010).

The common assumption that IAS/IFRS standards provide the outside investors with information of higher quality than the previous local reporting standards not sharing the Anglo-Saxon perspective is based on the greater quantity of mandatory disclosure and the supposedly higher information content due to accounting regulations developed with the aim of providing relevant information to outside investors. This opinion is especially reflected in the annual reports from countries with the continental European perspective due to the criticism that these countries' regulations are too heavily influenced by tax accounting rules (Daske & Gebhardt, 2006).

It is important for managers and investors active in Europe to, after the implementation of IFRS in the European Union, understand the effects of this implementation on the accounting information due to the many focus shifts away from the continental accounting practices (Hung & Subramanyam, 2007).

The European Parliament adopted IFRS with the intention to increase the comparability, consistency and transparency of the financial statements and thus making the information to be of benefit for the users (Cormier, et.al., 2009). The goal of IASC and IASB, have been to develop a set of accounting standards of high quality. This goal is to be achieved in an international environment. Thus the standards published by the IASC and IASB have been principle based rather than rule-based. Furthermore, the regulators have the desire that the financial reports will better reflect the companies' economic position and their performance (Barth, et.al., 2008). The switch to IFRS was motivated by the desire to have higher quality accounting standards within the European Union. The study is limited to three countries; Austria, Germany and Switzerland but the results states that in all three countries the information quality is considered to have increased significantly since applying the internationally recognized accounting standards. One important finding to consider is the fact that the positive effects are not limited to companies that voluntarily switch to IFRS but also for those for whom the switch was mandatory (Daske & Gebhardt, 2006). These results are shared by Bart, Landsman & Lang (2008) who comes to the conclusion that firms applying IAS present accounting information of higher quality and that the information quality has increased since the adoption of the IAS standards.

2.3.2. Information disclosure's effect on the financial markets

Information asymmetry can become a problem when investors with a limited amount of information have to worry about trading with counterparts who have deeper knowledge about a company due to a greater amount of information. This results in the investor with the limited amount of information being willing to buy for a lower price and sell to a higher to compensate the risk of trading with a more informed counterpart. Furthermore, this also affects the amount of securities the investor is willing to trade. These two behaviors dampen the liquidity of the market, that is to say the possibility to buy or sell quickly with little effect to the price. By disclosing information, a company can mitigate these problems and even out the amount of information between the different investors (Leuz & Wysocki, 2008). The efficient allocation of resources may be obstructed by information problems. The disclosing of information and the regulators of these disclosures between management of the company and the investors are important in preventing these problems (Healy & Palepu). The findings of Leuz & Verrecchia (2000) suggests that voluntary adoption of IFRS standards reduces the firms cost of capital. These findings are supported by those presented by Diamond & Verrecchia (1991) which states that voluntary disclosed information reduces the information asymmetry between investors. A result of this is that the investors of the companies disclosing information can reduce the information risk and therefore the liquidity of the company's stock increases.

However, the European Union made it mandatory from 2005 to follow IFRS when producing financial reports. This has forced all companies to adopt these new accounting standards in a "one size fits all" fashion. Before this was the case, disclosing more information than was mandatory was a management decision made when the benefits outweigh the cost (Li, 2010).

The results presented by Daske & Gebhardt (2006) show how the disclosure quality has changed since the adoption of IFRS. In the three continental European countries studied the quality of the disclosed information has increased significantly. One important factor is that these results hold true for companies for which it was mandatory to switch to these standards as well as the companies which had adopted IFRS voluntarily. Thus, their reports constitute strong evidence that the quality of the financial reports has increased significantly with the adoption of IFRS. Furthermore, higher information quality will lead to higher liquidity in the financial markets and lower cost of capital for the companies subject to these new accounting standards (Daske & Gebhardt, 2006).

The credibility of the disclosures provided by the management of a company is considered to be enhanced by the governing and control of regulators, standard setters and auditors. Furthermore, stock prices react to earnings announcements and this is an indication that investors find the accounting information to be credible (Healy & Palepu, 2001).

2.3.3. The relevance of book values

The relevance of the annual report in the investors' decision making process must be considered in the accounting theory. If the already existing regulations provide accounting information which can be utilized by investors consideration must be taken as to whether changing the regulation provides information which is of more value to the investor as the cost to change regulations is great (Martin, 1971).

A reason for stock prices fail to accurately reflect the accounting information is the occurrence of so called non-information-based trading. Such trading, which is not based in the information from financial reports, creates differences in the stock prices and the book value of earnings and equity (Dontoh, et.al., 2004).

Paananen & Lin (2009) presents a study with the purpose of examine and compare the quality of accounting information under the IAS regulation and with that under IFRS regulation. IASB upon taking over the responsibility to develop standards has aimed to achieve high quality in the standards to promote a greater harmonization worldwide of the accounting standards. The findings presented state that the information from the financial reports, in this case the earnings and book value of equity, have become less relevant after the adoption of IFRS. Furthermore, the quality and relevance of the accounting information have decreased over time and this because of the change of accounting standards to IFRS. Paananen & Lin (2009, p.33) state in their study that:

“Contrary to the intention with the European adoption of IFRS, this might make it harder for investors to base their decisions on the accounting information.”

These new or revised standards published by IASB reflect their ambition to implement fair value measurements of assets and liabilities in the balance sheet (Hung & Subramantam, 2007). Regulations aiming to provide fair value measurements mean that the adoption of IFRS by the European Union will have great effect on the companies within the Union as well as on the investors in these companies. It is important that they understand the implications of the IFRS standards on the accounting information provided in the financial reports. One of the factors which is deemed to have had a major impact on the relevance on the book value of equity and earnings is the fact that IFRS requires impairment tests for certain assets as well as goodwill which means that an impairment loss is recorded as an expense in the income statement (Paananen & Lin, 2009).

Paananen & Lin (2009) presents results concerning the book value of assets and equity and earnings since the implementation of IAS in Germany. Firstly, the values of assets and equity have increased since the adoption. Furthermore, these values tend to be subject to more variations than with the old German GAAP standards. This variability can also be seen in the income post. These results, the authors claim, are due to the fair-value approach to valuation that IASB has adopted for their standards. The results of the study are also consistent with the view of IASB to consider balance sheet valuation to be of great importance. This view of IASB places more emphasis on the book values in the balance sheet than it does on the statement of income. However, in the case of Germany, the increased emphasis on book values has not proven to make the relevance of the information more significant.

2.4. Fair value implications

2.4.1. Explaining fair value

The use of fair value in the financial reports has its roots in the objective of IASB to present useful information to investors. The use of historical costs as basis for valuation was influenced by many different stakeholders of the company. The fair value, however, has its root in the desire to exclusively have its basis in the usefulness for investors in their decision making process (Hitz, 2007).

Fair value is used in the estimation of the values of an asset or a liability. Furthermore, fair value estimates is the basis when performing impairment tests of for example goodwill (Cairns, 2006).

Fair value can be perceived as being the market price in a market with ideal conditions. This includes that the parties are knowledgeable parties who are rational in their behavior and have an identical set of information. This market is perceived as being purely hypothetical (Hitz, 2007). Whittington (2008) states that the fair value view requires the assumption that markets at which the items are traded are to be close to perfect and that in these markets the financial information will therefore meet the need of investors and creditors in that they report these market values as fair values in the accounting information.

IASB does not present an overall definition of what they mean with fair value. However, the definitions in the standards presenting fair value accounting models states the meaning of fair value in the same way (Hitz, 2007, p.326):

“Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction.”

According to Cairns (2006) this definition has been subject to very small changes during the last 25 years, replacing “buyer” and “seller” in IAS 16 to “parties”, and in IFRS 2 stating it as:

“The amount for which an asset could be exchanged, a liability settled or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm’s length transaction”

This definition of fair value allows for IASB to use it for many different posts in the financial reports. Fair value can be estimated by the use of different methods. To use the market value to calculate the value of an asset, a liability to be settled or equity to be granted is to use the price at which this variable can be exchanged in an active market by knowledgeable and willing parties in an arm's length transaction. IASB ranks market value as the primary source for obtaining fair value for assets, liabilities and equity instruments. Other ways of calculating the fair value in a way supported by the IASB are to use market information in the use of widely used and accepted valuation models. This method is used when it is impossible to ascertain market values (Cairns, 2006). A more descriptive view of the establishment of the fair value is presented by Hitz (2007). He states that the estimation of the fair value can be made in three ways. The preferred method is indeed the market based measure. This is due to the view that market data are both more informative and more reliable than the data that can be provided from internal calculations by corporations and that this is why IASB considers the market value to be the best estimate of fair value. The second approach to estimate the fair value is to use market values of similar items. When neither of the previous methods can be used the fair value is to be calculated using internal estimates, this is called marking to model and is the least preferred method of estimating fair value.

2.4.2. Effects of fair value on reporting quality and relevance

In their constitution IASB presents certain objectives towards which they work. These objectives are presented in the International Accounting Standards Committee Foundation Constitution point 2:

- To develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions;
- To promote the use and rigorous application of those standards;
- To bring about convergence of national accounting standards and International Accounting Standards and International Financial Reporting Standards to high quality solutions.

As IFRS standards contain a significant influence of fair value accounting the question arises whether they gone too far in their attempts to bring fair values into the financial reports. Certain problems may arise when using fair value in the financial reports. For the system to work, it is important that markets at which the items are traded have high liquidity. If the market lacks liquidity the fair value accounting may fail to present relevant information and cause uncertainty about the values. Furthermore, it might prove impossible to obtain a fair value using a mark to market method during times of financial crisis. Another source of concern is that when market prices of assets, liabilities and equity instruments are not available the companies must use a mark to model approach to estimate the fair value. This means that it is not the actual arm's length market price that is presented in the financial reports but the company's own estimate of this value. These values are therefore subject to the risk of faulting models or incorrect values within these models (Ball, 2006).

Providing more information is not always of benefit for the investors. More information can bring with it more uncertainty, especially can information containing fair value as estimated by a mark to model method prove to have a volatile effect on the accounting information due to errors in the data used in the model.

Thus, the current emphasis on fair value by the IFRS can potentially prove to make investors worse off than without this information, which contradicts the purpose with IFRS (Ball, 2006). This opinion is reflected in Hitz (2007) who presents the views raised in the debate concerning fair value. These question the use of the fair valued information and especially emphasize the mark to model estimates which rely on the company's management and their expectations and forecasts.

The decision usefulness of the fair value varies depending on which method is used to estimate the fair value. If the value is estimated by the market value on liquid markets the usefulness is high. However, the use of the marking to model method can be questioned. Fair value based on a mark to model approach does not provide information about the markets expectations about the values of the items valued, this is a concern for the relevance of the information presented in this way (Hitz, 2007). Further arguments against usefulness of fair values in the accounting information also comments on the market pricing. The financial markets are not the perfect markets required by the IASB. Due to this, the usefulness of fair value and its relevance to the investors is limited as the theory presented by the standard setters is not coherent with the reality in which the standards are to be implemented (Whittington, 2008).

3. Method

In this section of the paper the authors present their research approach and research method. A discussion is made about the methodological choices made by the authors in the study of the differences in the use of disclosures by creditors and investors. Furthermore, the selection of respondents, presentation of the respondents and data collection method is presented. Finally, the chapter concludes by discussing the quality of the study by examining the reliability and validity of the paper.

3.1. Research approach

This paper applies a deductive research approach. Patel & Davidsson (2003) describes a deductive research approach as one where the purpose of the research is to draw conclusions about specific situations with the basis in theory. The authors of this paper argues that the deductive approach well fits the purpose of this study in that the theoretical framework is as the foundation in the analysis of the real world situation studied in the thesis.

Furthermore, it is the perceived relevance, by investors and lenders, of the annual report and the financial reports within as a unit which is of interest for this thesis. The studied users of the financial reports are not producers of accounting information, nor are they regulators. Because of this, it is the overall thematic of the effects of following IFRS which has been addressed in this thesis. Therefore the standards themselves have not been subjected to greater scrutiny at a detailed level in the theoretical framework section nor have the focus of the interviews laid on a walkthrough of the accounting standards.

With the relatively new accounting principles the adaptation of IFRS brought, the authors find it to be of interest to compare investors' views on the use of accounting statements with the views expressed by lenders.

The ground for considering this to be of interest is that IASB, in their framework, expresses that their standards lean towards the Anglo-American perspective of accounting in that the information in the financial statement should be of benefit for investors and owners rather than creditors and state.

3.2. Research method

According to Holme & Solvang (1997) there are two types of research methods, the quantitative and the qualitative. The quantitative is useful when there are a lot of objects to be examined and when you want to convert information into numbers which enables the researcher to perform statistic calculations and generalizations. A qualitative approach, however, examines a small number of research objects but in return try to gain greater understanding by digging deeper within each object and by being closer to the reality the study examines. Patton (1990) describes the qualitative approach as one where a great amount of information is obtained concerning a small amount of research objects. This is something that gives the researcher a greater knowledge about the specific situation examined but the disadvantage is that it becomes more difficult to draw general conclusions.

Which method to be used depends on which method in the specific settings best fits to investigate the research question. This choice is described as a strategic decision where the researcher must consider the research problem as well as what resources he has at his disposal (Holme & Solvang, 1997).

The empiric data in this study was collected with a qualitative research method. The authors find this to be the best choice in this specific study because the research problem is complex to its nature. The accounting principles to be followed are many, detailed and in some cases difficult to understand. In addition, valuation is often made with subjective choices and preferences. The authors therefore deem it necessary to come close to the source of information to be able to fully grasp the processes and choices made when valuation and analyzing companies. Furthermore, closeness is needed to sort out the possibilities and problems the new accounting principles brought the user. In addition, it is the authors' opinion that the choice to focus the study to investors and creditors enables a deeper understanding for the important factors for these stakeholders.

3.3. Respondents

3.3.1. Selecting respondents

In order to get the best possible appreciation of the use of the annual reports in the decision making process for investors as well as lenders and whether the disclosed information cover these stakeholders information needs, it is of the outmost importance for the quality of the thesis that the respondents are working with these respective issues and that they have experience from using these types of document. However, it is not a requirement that they use the documents in their analytical processes.

Interviews have been made with representatives for lenders and for investment analysts. The respondents representing lenders have work as credit analysts and in credit decision management. A total of five respondents working with credit analysis have been interviewed, three from Nordea Shipping and Oil Services and two from Swedbank's credit department in Gothenburg.

Furthermore, investment analysts from three different organizations have been interviewed, one from the Second Swedish National Pension Fund, one from the Sixth Swedish National Pension Fund and one from Stena Finans. These three organizations share the purpose of managing capital by investing profitably with long term perspectives. It is therefore reasonable to assume that these organizations conduct a more thorough business analysis when searching for profitable investment objects than investors with a short term perspective.

It is the opinion of the authors that the decision making processes are a complex processes subjected to subjective assessments by the analysts performing these analyses. Therefore, it has been of utmost importance that the respondents interviewed have the relevant knowledge and experience in order to obtain the deeper understanding concerning the information need in these situations. Furthermore, it was desirable to interview investment analysts with a long term perspective in their investments as it seems that they seek more information about the companies they invest in rather than benefit from shortsighted irregularities in the financial markets.

The requirements placed on the selected respondents therefore where that they actively should work with the analysis of corporations, either as creditors or investors. There where, however, no requirement that the analysts should use the financial reports to a certain degree in their analysis process due to the purpose of the study.

3.3.2. Presenting the respondents

Creditors

At Nordea, **Bengt Zacharoff**, **Eva Brolin Schönning** and **Inger Hjelm** were interviewed. Bengt Zacharoff holds the position of Head of Shipping Sweden and Eva Brolin Schönning and Inger Hjelm works at the same department as Senior Credit Analyst and Credit Analyst.

At swedbank, Ulf Croona and Göran Hagman were interviewed. Ulf Croona holds the position of Senior Vice President and Göran Hagman works as Credit Manager.

Investors

Claes-Göran Lyrhem is Equity Manager at the Second Swedish National Pension Fund in Gothenburg. Before Lyrhem began working there he worked as an accountant for some years. Lyrhem works in the part of the pension fund that has an active management of the capital, the other parts being passive management and the outsourced part that handles investments abroad.

The Second Swedish National Pension Fund is a buffer fund in the Swedish pension system. This means that money is withdrawn from the fund those months when employment taxes are not sufficient to cover the government's expenditures on pensions. Because of this, the pension fund makes long-term demographic estimates and prognostications to ensure that funds exist to pay Swedish pensions in the future. Today the Second Swedish National Pension Fund has 60 percent of its managed capital invested in stocks in about 60 different corporations. There are six people who are working with follow these corporations on a daily basis.

Håkan Bohlin is Investment Manager at the Sixth Swedish National Pension Fund (AP6). He has a bachelor degree from School of Business Economics and Law at Gothenburg University. He also has a Ph.D. in accounting. After achieving a bachelors degree Bohlin continued working as a consultant part time and as a teacher part time, at first with basic courses and later more advanced.

While writing his dissertation he worked part time at Volvo and part time at the school. His dissertation was focused towards the communication between the company and the different types of investors, professional and small savers. He wrote his dissertation in collaboration with Volvo. In 1990 he started working with investment at SEB. At SEB his work experience ranges from investment to credit analysis and risk management to working with reconstructions within the company. Bohlin has worked at AP6 for thirteen years. His work at AP6 involves finding investment objects, the development of these and the selling of these.

The Sixth Swedish National Pension Fund is one of the National Pension Funds. The purpose of the sixth differs from the others. AP6 is to invest in small companies based in Sweden, participate more actively in the management of the company and then sell their share in the company. Thus, it acts as stimuli for small Swedish companies in need of capital and knowhow.

Roy Berg has been the Chief Financial Analyst at Stena Finans the last thirteen years. Berg has a bachelor degree in business administration and a master degree in economics. After his studies, Berg started his career as an accountant and continued working as accountant for eight years before he changed path and started working as an analyst. Berg worked as an analyst in different banks, including Swedbank and Norske Bank, for eight years before starting his work at Stena.

Six people at Stena Finans work with everything ranging from makro analysis to business analysis. The capital management in Stena is divided threefold, one short term portfolio, one medium term portfolio and one long term equity portfolio. The investments in the long term equity portfolio have future perspective of three to four years.

3.4. Collection of data

3.4.1. Personal interviews

The empirical data in this paper consists of primary data. This primary data comes from qualitative interviews with the respondents presented above. To perform personal interviews fits well in with the qualitative research method. This allows for the interviewer to interpret the respondent's answers. Furthermore, the interviewer has the flexibility to ask the respondent for more in depth answers or clarifications if provided with unclear answers. The interviewer is also present to, when needed, clarify the meaning of certain questions in order to minimize the risk that the respondent misinterprets the question.

The personal interviews were conducted with an interview guide approach (Patton, 1990, p.288). The questions were formulated in an open-ended fashion which enables the respondent to answer the questions with his or her own words. By the use of an interview guide the interviewer is able to keep the conversation somewhat focused on the most important issues that he wants raised and thus ensuring that nothing is left out. This while keeping the conversation open and flexible and allowing the respondent to express his or her opinions from their perspective and experience (Patton, 1990).

Holme & Solvang (1997) points out that it is important for an interviewer not to try to steer the respondent too much in a qualitative interview. It is, however, of importance to have prepared an interview guide in advance in order to assure that the interesting topics are discussed. At the same time, as an interviewer you have to be flexible and explore the conversation paths leading to deeper understanding of the questions asked (Holme & Solvang, 1997).

The interview guide was sent to the respondents well before each interview occasion so that the respondents would have enough time to prepare. Another purpose of sending out the interview guides is that the authors minimize the risk that they have contacted a respondent who lacks knowledge about the area of the study. If that is the case, the respondent would have the chance to express this to the authors before the interview. The downside to sending out the interview guide is that the respondent gets the chance to prepare too much and maybe formulate the answers differently than if asked without knowing the questions beforehand. In this case, the authors do not consider this to be a risk because it is the respondents' views that are of interest for this paper. Holme & Solvang (1997) describes this type of interview as a respondent interview where the person being interviewed him- or herself is involved in the object studied.

“The purpose of interviewing is to find out what is in and on someone else’s mind. The purpose of open ended interviewing is not to put things in someone’s mind [...] but to access the perspective of the person being interviewed.” (Patton, 1990, p.278)

With this, Patton (1990) illustrates the importance of not influencing the respondent's answers in a qualitative interview. The quality of the information gathered from an interview can therefore be considered dependent on the skill of the interviewer (Patton, 1990). By using open-ended questions it is the authors' opinion that the risk of influencing the respondents and “putting things in their heads” has been minimized.

3.4.2. Conducting the interviews

During the interview sessions both authors have been present and both took notes. Taking notes during the interview is a good way to ensure that you as interviewer understand the answers given and the reasoning behind these. If uncertain about an answer, one can always ask the respondent to clarify immediately. Because both authors were taking notes during the interviews a comparison was made immediately after the interviews to minimize the risk of misunderstandings. The notes from the interviews were also transcribed immediately after the interviews took place in order to make sure that the details were not forgotten.

The interviews were conducted at each respondent's place of work without recording equipment. The length of the interviews varied between one and two hours and the interviews were conducted at a time and place chosen by the respondents. This is important as it enables the respondents to feel comfortable and that they do not feel forced to complete the interviews in a limited amount of time. No interview felt stressed or lacked enough time to ask all questions, on the other hand, there was always time for reasoning about questions and going more in depth. Furthermore, for a number of reasons the interviews were conducted in Swedish. Firstly, the quality of the interviews is increased when the respondents are able to answer and reason in their native language. Furthermore, another purpose was to minimize the risk for misunderstandings. In addition, in a qualitative interview it is important for the respondents to feel comfortable in the interview situation.

3.5. The quality of the thesis

3.5.1. Reliability

High reliability is a fact when independent inquiries of the same variable provide similar results (Holme & Solvang, 1997). That is to say, the reliability points to the trustworthiness of the study (Strömquist, 2003). In order to achieve high reliability the measurements and examinations must be free from subjective influence from the researcher.

The study's empirical data was obtained from qualitative interviews. This may affect the reliability of the study. Despite the use of an interview guide the qualitative interview is, of its' nature, such that the time, setting and specific situation can affect the answers to the questions asked. Furthermore, different answers from the respondent allow for different follow-up questions and these can be difficult to anticipate for the interviewer. Patton (1990) suggests that the quality of the obtained information from a qualitative interview depends on the skill of the interviewer. Also, there may be incentives for the respondent to withhold information from the interviewer.

Interviews were made with several respondents from each researched category. All interviews were made in person enabling the authors not only to obtain the spoken information but also the chance to observe body language and tone of voice. Furthermore, the reliability should be strengthened by this type of interview because it allows for more in depth answers and that misunderstandings can be sorted out, even to the recreation of the interview may be difficult.

IASB's framework does not differentiate investors into long-term and short-term categories. In this thesis the focus has been with the long-term investors for reasons previously explained. This, however, calls for caution when choosing respondents, interpreting their answers and relates these answers to the framework's definition of relevance.

3.5.2. Validity

The validity of a study measures if the study answers what it was supposed to answer (Strömquist, 2003). This means that the data necessary for answering the research question has indeed been collected (Holme & Solvang, 1997).

To enhance the validity of the paper the authors chose to conduct the interviews with an interview guide (Patton, 1990, p.288). The interview guide was compiled in advance with respect to the research question and the theory presented in the theoretical framework. This ensured that the important topics for answering the research question were covered during the interviews. In addition, the interview guide was revised and some wording was changed if there had been misunderstandings during the interview in order to minimize the risk for this happening again.

Furthermore, the purpose of the paper was presented when contacting possible respondents to ensure that people with the right knowledge and experience was interviewed.

3.5.3. The quality of references

Articles featured in the theoretical framework are exclusively of scientific standard. It has been the aim of the authors that these articles in addition are peer reviewed but it has not always been possible to assure that they are. In addition to scientific articles the theoretical framework has also included the use of legal documents, IFRS standards, other documents published by IASB, previous research reports and literature.

The search for scientific articles has been made through databases accessible through the university libraries of Gothenburg. Databases used include Business Source Premiere, Science Direct, Social Science Research Network and FAR Komplet. Keywords used most frequently include "IFRS information relevance", "IFRS information quality", "Agency theory", "IASB relevance", "IFRS" and "IFRS Accounting standards" and "IFRS fair value" among others. In order to broaden the search, the keywords Swedish translations were also used. As for the literature used as secondary data, these books were acquired from the university libraries and from the tutor of this thesis.

4. Empirical findings

In this chapter the empirical findings are presented. The empirical findings consist of the views and opinions expressed by the respondents in the performed interviews. In order to achieve a better overview, the findings are presented separately for each respondent in turn. Analysis of the opinions and parallels between the respondents views will be presented in chapter five; Analysis. This chapter is divided in two parts. The first part consists of the views expressed by the interviewed creditors and the second part of the investors.

4.1. Creditors

4.1.1. Nordea

At Nordea the following respondents were interviewed;

Bengt Zacharoff, Head of Shipping Sweden

Eva Brolin Schönning, Senior Credit Analyst

Inger Hjelm, Credit Analyst

The decision making process

At Nordea, the annual reports play a large role in the information flow between companies and the bank as creditor. Schönning says that the annual reports are "... the analyst's primary source of information." The internal rating within the bank in accordance with Basel II is based on the information found in the annual reports. However, the respondents point out that one have to consider that the information presented in the annual reports are historic figures.

Besides the annual report, the quarterly reports and the year-end reports are frequently used as source for information. These have the benefit of not being published with the kind of delay the annual report is. Furthermore, the interim reports are more focused on guiding towards the future.

Creditors, they point out, are however not dependent on the financial reports published by the companies for acquiring information about clients. The respondents feel that they as creditors are in a position which allows them to demand potential clients to disclose more information before granting credit. Because of this, they always have the necessary information available which allows them to perform their analysis.

The analysts at Nordea consider the statement of cash flows to be the most important source of information in the annual reports. This is something the bank demands from potential clients, regardless if they follow IFRS or not, before granting credits. Besides the statement of cash flow, other parts of the annual report of value to the creditors at Nordea are the forecasts made by the companies as well as the EBITDA post in the statement of income. Generally, Nordea claim that the statement of income is of greater importance for their needs than the balance sheet. Zacharoff describes it as follows: "The focus is to make enough money to maintain your mortgages, this is not achieved in the balance sheet but in the statement of income."

When raising the question about which parts of the annual reports need the most clarification in terms of the disclosing of additional information in notes they specifically point to the statement of cash flows, the operating profit and EBITDA. These are posts where the information content differs between companies. Furthermore, for creditors detailed information is important about net interest income and the about depreciation. Depreciation is an area in the financial reports where they express that the annual reports does not contain the desired information. Satisfying information concerning the speed of depreciation for different assets is not provided. This is something that influences the comparability between companies and because of this the analyst on occasion has to adjust the depreciation post in order to compare companies and perform accurate analyses.

Information disclosure

Disclosing information is seen as positive by the respondents. Not only from the creditor perspective but, stepping away from their professional roles, it is their opinions that companies find it easier to negotiate credits from suppliers if the company has a transparency towards its surroundings. Furthermore, the more information a company discloses the easier it has to negotiate credits from the banks. This is incentive for companies which are not forced by law to follow IFRS accounting principles to do so, at least to some extent. To be open towards the bank and be friendly with your bank is very important, especially when the financial climate is tough. At the end, it is the assessment of the respondents that overall, the benefits from the financial reports outweigh the costs, or as Zacharoff put it: "*Companies does not exist in isolation. They exist in a world where they have to interact with different stakeholders.*"

The greatest change the respondents at Nordea have noticed with producing financial reports in accordance with IFRS is the valuation to fair value. After learning their lesson with the bank crisis in the 1980's the banks learned that lesson, says Zacharoff. Thus, the banks have market values before IFRS made it mandatory. In fact, Nordea even conduct their own valuation of assets with the help of external assessors even if one already is provided by the analyzed company.

The quality of annual reports

The credit analysts at Nordea welcome the possibility of having an internationally standardized set of accounting regulations in the world. They explain that due to the international nature of the shipping industry this would simplify the analysis of, and comparability between different companies in this industry.

The relevance of the annual reports is considered to be high. There is the issue with the time gap between the end of the business year and the publishing of the annual report. In the eyes of the creditors however, this does not reduce the usefulness of the annual reports.

Considering the amount of information contained within these reports, they on the contrary feel that if too much pressure is put on the companies to prepare the annual reports faster the quality of the information may suffer instead.

4.1.2. Swedbank

At Swedbank the following respondents were interviewed;

Ulf Croona, Senior Vice President, Head of Large Corporate Business

Göran Hagman, Credit Manager

The decision making process

At Swedbank the annual reports are of great importance to the creditors. Even though the information in the reports is not really up to date it is still important to receive a document that has been audited and approved by an accountant. It is also used to confirm old information that they received earlier from the customer or model forecasts. The notes in the report's are of most use to the analysts because it contains a lot of information that is needed in the bank's business and risk models.

Information that is not only monetary to its nature is also of interest for the creditors at Swedbank. CSR is a area that they have started to take an interest in but also the company's moral behavior, not only for the banks reputation but also because it could have a great impact on their customer's future development and ability to repay their loans.

For the bank, the most important report in the annual reports is the cash flow. How the company values its assets and liabilities, and the impact it has on the net income is not that important because it does not affect the cash flow. Croona says that the company's ability to repay its loan is the only thing that counts.

Information disclosure

Goodwill is a very important post in the annual reports, which also makes it harder to interpret, "*Goodwill is a risk in itself*" according to Croona. This because a large post of goodwill is often hard to assess its value if it is unclear what it contains of.

Another post of information disclosed in the annual reports is the company's assets, which of course is of great interest for the creditors. They also use the notes to isolate the operating result from the unrealized result. Hagman says this is important so get a more fair view of a company. He exemplifies with the real estate sector, which uses fair value on assets, where he thinks it is more relevant to see if the company makes money in the operation instead of the short time profit or loss due to the markets high volatile in real estate investment. This said, they do not do any assessment of the value of their customers' assets, but they do off course, make sure the value seems reasonable, knowing it have been approved by an accountant.

Future plans for the company helps the creditors to assess the future risk for lending money to a certain company. Because of this, they attach great importance to the CEO's statement, even though they often get this kind of information in advance during credits negotiation.

They would like to see more information about the corporate social responsibility, even though a lot of the larger company's do this there are a lot of company's out there that does not.

Other information they would like to see more about is extraordinary events that requires more information; an example is the recent ash cloud from Iceland which strongly affects the business for airlines. Information about how this affects the company's profit is of great importance for a creditor but is seldom founded in the annual reports due to timeliness. However in these kinds of situations the creditor demands up to date information from the company.

The quality of annual reports

The respondents think that the quality of annual reports is high among Swedish companies, and though with little knowledge about foreign companies, they think it is hard, because of different culture, to get a standardized accounting standard to function around the world. Current and previous financial crises has made the financial information from the companies more useful, even though they press that they still get more information than the market as a whole.

How much it cost to prepare annual reports are they not aware of, but they say that it is necessary for them as creditors to receive them, approved by an accountant, in order to make a good analyze of the companies situation, and to be able to approve new loans. They have also noticed that the companies put more and more effort in to the annual reports, but this is most likely to attract investors and not for the creditors.

The creditors at Swedbank find the annual reports to be understandable for them and that it contains material information, and if not, they think that someone else might have use of this information. One problem with the annual reports is that they are published too late to be of any relevance, that is part of why the creditors request information in advance. For them as creditors it is important that the information is reliable, and they think that it mostly is. However they do suspect that there are hidden reserves among some of the assets, for example real estate, where they never see a building being sold for less than its value in the books, but often to a higher price. They also think that it is their responsibility to look in to the historic figures of the company to see if current value of the assets seem probable. However they say that it is hard to get full protection if the counterpart has a criminal intent. Another problem with the annual reports is its comparability. There are few companies today that are the same as five to ten years ago and that have not partly changed in either what business or geography they operate in. Therefore comparability is low, both over time and between companies, according to Hagman.

4.2. Investors

4.2.1. The Second Swedish National Pension Fund

At the Second Swedish National Pension Fund the following respondent was interviewed;

Claes-Göran Lyrhem, Equity Manager

The decision making process

Lyrhem states that the usefulness of the annual report is limited by the historic nature of the data within. The financial information is considered to be too old even at the date of the publishing. In explaining this he says that the financial information in the annual report consists of the aggregated data from the previous year. That is, the numbers presented is made up of financial information from the first quarter of the previous year, and this information is, at the date of the annual report being published, often more than a year old.

Therefore, old data affects the financial information presented when the annual report is published. Instead of using the information in the annual reports, AP2 extracts the financial information needed in the analysis process from other types of information sources. Lyrhem specifically emphasize the interim reports as the financial documents with which the analysts work continuously. The use of these is motivated by the fact that they are timelier in their publishing. It is the information obtained from the interim reports which are fed into the valuation models. The annual report, he says, instead is used as a library with which the analysts can dig deeper in the information about the companies and earn a deeper knowledge of the companies.

The most interesting part of the annual report to the analysts at AP2 is the CEO statement. This is used to get an insight into the confidence of the company. Furthermore, the financial information divided in the different divisions and market segments are of interest. According to Lyrhem, the statement of cash flows is the most important financial report in the annual report.

Due to a daily follow-up of the investment objects AP2 is able to gather more information about the investment objects than many other investors. Furthermore, the analytical process as it is performed by AP2 takes more information into account than the information obtained from the financial reports. Examples of additional information which is of interest is: the analysis of the markets where investment objects are active; the analysis of the customers of the investment object and the forecasts made of the economic future of the objects. Lyrhem specifically point to the analysis of the customer as a source for information about the future performance of the company. In fact, when comparing the different types of information used in the analytical process it is the information about the customer situation which is valued highest, information about the market second and the information from the annual report third.

Information disclosure

Lyrhem thinks that the cost to produce the information in the annual report affects different types of companies in different ways. He emphasizes that especially smaller companies suffer from the costs of producing this information. The explanation to this is that the smaller companies lack the infrastructure and enterprise resource planning systems that larger companies have implemented. From these ERP systems the larger companies have the possibility to access this required information more easily than the smaller companies.

The people responsible for governing the IFRS accounting standards, the IASB, are according to Lyrhem people who invent new rules and regulations with no other purpose than to justify their own existence.

Despite the increased requirements of information disclosure in the annual reports Lyrhem has not experienced that the liquidity of the market has changed since the introduction of IFRS. Instead, he says, the liquidity of the market changes in regular cycles. What has happened since the introduction of IFRS is that the investors have become more secure in trusting the goodwill post. He says that the way goodwill is regulated with IFRS better reflects its fair value. The importance of an accurate goodwill post lies in the ability to compare different companies. In order to compare companies you have to know the difference in how the companies grow, either organically or by acquisitions. By examining the goodwill post and the additional information disclosed in the annual report the analysts can obtain that information.

The quality of the annual report

The analysts at AP2 have received some education on the new IFRS standards. This education takes the form of half day long seminars once a year. During these an accountant presents important aspects of a new standard and its effect on the financial reports. Thus, the analysts have enough knowledge of the impact of IFRS on the financial information they use in their analyses.

One aspect of the IFRS accounting standards which reduces the quality and relevance of the financial reports is the emphasis on fair values. Lyrhem sees the use of fair values as more of a burden than of benefit for the analysts. He raises the concern that IASB can not possibly have thought through the implications of these regulations thoroughly and points to the difficulties of demanding market values of assets when the market has ceased to function properly, as it has done during this latest financial crisis. The relevance of the annual reports constructed in accordance with IFRS thus fail when the overall economic climate is uncertain. By leaning too heavily on the use of fair values the system fails in the extreme situations when the market does not work properly.

Even though IFRS has its flaws, Lyrhem points to some of the positive effects of these accounting standards on the accounting information. Firstly, by having these types of accounting standards, U.S. GAAP and IFRS, investors can place a greater deal of trust in the financial information presented in the annual reports. Thus these regulations diminish the information risk for the investors. In addition, Lyrhem has a positive attitude towards the idea of common accounting principles throughout the world. This due to the increased comparability between companies from different parts of the world.

4.2.2. The Sixth Swedish National Pension Fund

At the Sixth Swedish National Pension Fund the following respondent was interviewed;

Håkan Bohlin, Investment Manager

The decision making process

The annual reports rarely provide any kind of unique, surprising revelations according to Bohlin. It must instead be used as a means of getting more detailed knowledge about the company you study. He clarifies by pointing to the accounting information being split into different market segments or geographical areas. More specifically, exemplified by the sales post, Bohlin is not satisfied with the information in the statement of income but wants to know how this figure is divided between different geographical locations, types of industries and types of products. Furthermore, there is a lot of information in the notes in the annual reports which is not presented in the interim reports.

The greatest disadvantage of the annual report is that the financial information within is too old. The investors at AP6 already follow these companies very closely and thus gather information which is more up-to-date from other sources. In fact, most of the financial information used in the analytical process comes from the interim reports and other published material from the companies. Furthermore, analysts at AP6 does not only use the financial reports as sources of information but they also follow the industry as a whole closely, analyze the subcontractors to the companies and analyze the customers of the companies to complete their analysis before making an investment decision. This additional information, in addition to the annual reports, enables the analyst to be more accurate in their financial forecasts. This is especially important when there have been large fluctuations throughout the year. Bohlin emphasize the fact that the annual report lack the necessary forecasting relevance by stating: *“January and December, they are like two different planets”*.

Important posts in the annual reports according to Bohlin are first and foremost the operating profit. This post is also explained in more detail in the notes and Bohlin is interested in knowing how this figure is divided between the different market segments, the different geographic markets and the different types of products.

Information disclosure

Bohlin says that IFRS has succeeded with a lot of things and agrees that more information is always better, provided that the information is manageable and not lacking in quality. More information disclosure reduces the risk for the investor. Before, the hedging post was an x-factor in the accounting information. By providing more detailed information in the notes about hedging IFRS has managed to correct that problem. Furthermore, IFRS accurately measures the fluctuations in the value of the financial instruments.

The disclosing of information is done by the company to attract capital from the investors. The company wants the price of the stocks to mirror the true value of the company. Therefore, there are incentives for the company to paint the picture of the company's financial situation a little better than what it actually is.

Bohlin is convinced that a lot of the information required by IFRS is expensive to produce. These costs can not always be motivated as some of the requirements do not add to the information needed by the investors. He provides an example with the real estate companies. The valuation requirements are expensive for these companies. Another example is the impairment tests. If these tests are conducted properly the companies need to put a lot of work into them and that costs a lot of money. One simple way of explaining the cost of accounting information is that more detailed regulations and more required information leads to the accounting process becoming more complicated and takes more time to perform. This in turn leads to the accounting process becoming more expensive. Bohlin believes that many companies feel that this money is wasted on something that is not of enough benefit for them.

The quality of the annual report

Bohlin feels that it is very positive that IASB tries to create a set of shared accounting principles for the different countries. However, IASB hides a lot of really bad changes behind the IFRS. These changes have nothing to do with converging IFRS with U.S. GAAP. Bohlin points to the focus being shifted away from the statement of income to the balance sheet as an example of these negative changes. Furthermore, he says that they take their changes too far instead of taking one step and stopping there to wait and see how this change affects the accounting information. The problem, he says, is that the people working at IASB do this for a living, they are getting paid to invent new principles.

Bohlin feels that for IASB it is too important that the accounting principles make sense in theory. He clarifies by saying that they strive for the same accuracy as in the natural sciences. This, he claims, is not accomplishable in the social sciences. According to IFRS, it is more important that the accounting principles make sense in theory than that they result in a true and fair view of the company and to be useful as a base for the analyses made by investors. As an example, Bohlin speaks about the impairment tests required for certain assets by IFRS. He claims that it is possible for companies to invent the numbers they want to present. This is done by counting backward by beginning with the number you want, and then adapting the prerequisites so that this number is the result.

He says: "Tell me what value you want and I will tell you the prerequisites needed to calculate this, it is very easy". As an example he mentions the real estate industry, by adjusting the required rate of return in the valuation model of the real estates by just a fraction of a percent one can create great effects on the result.

Bohlin also speaks about the accounting principles in the US, the U.S. GAAP. He says that in the US the focus lies on following the rules in all situations. In their culture they need detailed guidelines for everything they do in order not to be subject to blame if something turns out to be wrong. This, he claims, is a step away from the personal responsibility. These extremely detailed regulations enable the companies to adjust the economic situations so they can apply the set of regulations that fits their needs. Instead of asking themselves what the true economic meaning of the transaction is they try to change the details of the transactions to fit with the right accounting regulation. When providing this opportunity, investors can not be sure that the accounting information provides a true and fair view of the company. Bohlin claims that this is the direction in which IFRS too is heading and he does not like the potential implications of this on the Swedish accounting information.

Furthermore, he expresses concerns that with the IFRS regulation everything shall go through the statement of income. This increases the amount of posts in the statement of income making it confusing and difficult for the less knowledgeable reader to understand. This is a direct effect of the focus being shifted from the statement of income to the balance sheet. The solution Bohlin suggests is that the disclosing of additional information should be done in the notes. There, the analysts can find and interpret them while the statement of income remains accessible and readable to the small savers. The focus shift away from the statement of income is thus negative to the understanding of the annual report. This leads to the investors getting information which lacks the quality needed to create analyses and forecasts of high enough quality. The decrease in the understandability of the annual report is also negative for the relevance of the financial report for the investors. Bohlin feels that IASB have shot themselves in the foot by making the annual reports less relevant for the investors.

4.2.3. Stena Finans

At Stena Finans the following respondent was interviewed;

Roy Berg, Chief Financial Analyst

The decision making process

When speaking to Berg he states that the annual reports are of great importance in performing his analyses. He can not, however, go as far as calling the annual report the primary source for information. This is because they as investors keep a close eye on the companies in which they have invested and thus gathers information about them on a regular basis from other sources. In the long term perspective Berg states that the deeper knowledge of a company is obtained by studying the annual reports. For Berg the interim reports are used as a way of following up on the direction of the investment and making sure it follows the forecasts. Berg emphasizes the longer term perspective as being very important in the analysis of companies. He claims that regular analysts are too short-sighted and are reluctant to invest the time to dig deeper in their analyses. The long term trends concerning the functionality of the company and the line of business to focus on are of great importance in the long run.

The most interesting parts of the annual report, for Berg as an analyst, is the CEO statement, the five year summary and the administration report. Furthermore, it is important to know how the information given in the top line is divided in different market segments, types of industries and geographic areas. Furthermore, Berg points to the EBITDA measurement as useful for roughly estimating the cash flows. When asked directly about the relative importance of the statement of income and the balance sheet Berg states that the statement of income is somewhat more important in the analysis. He would weigh them 60 percent to 40 percent with the statement of income being the most important. However, he emphasize that it is impossible to ignore the balance sheet in the analysis of a company.

The focus of Berg's work is to find profitable investment opportunities. These assessments are not exclusively based on business analyses. Instead, by analyzing different makro factors the analysts at Stena Finans are able to find interesting markets and interesting types of industries in which to invest. Berg exemplifies with saying that the analysts at Stena Finans participate in meetings with large selections of companies from Russia. The purpose of this is partly to come in contact with interesting companies but also to get a overall feeling of the entire market in which these companies act. It is not until after the interesting markets and types of industries in these markets have been identified that the analysts start their analyses of the companies acting in these markets. Berg says that the idea of what to invest in exist before they find the specific object of their investment.

Information disclosure

In Berg's experience, Swedish companies are in the forefront concerning the disclosing of information and the transparency of the company. This is also true for all Nordic companies which are similar in their openness and can be considered to be easily accessible according to Berg. This is not true for all of Europe. Even though it is mandatory for listed companies in the European Union to follow IFRS standards the amount of disclosed information and the degree of transparency differs greatly.

All the information in the annual report is of interest for the different stakeholders of the company. Even if Berg does not use all of the information, or finds all of the information to be relevant, he is certain that someone else does. He does, however, say that he has not noticed any changes in the liquidity of the market since IFRS became mandatory. On the contrary, disclosing too much information, in his opinion, is not always of benefit for the company.

When asked about the cost of producing information which is mandatory in the annual reports Berg claims to be aware of the current discussion regarding this. His opinion is that if a company does not have the resources to provide this information and can manage the extra cost this brings it does not belong at the stock exchange. The investor, he says, appreciates to receive the annual report and he considers the annual report to be a way for the company to attract capital.

The quality of the annual report

The analysts at Stena Finans have not had any education about the accounting standards in IFRS. This does not mean that they have not found that some of the effects of the standards on the financial reports have been useful in their analyses. Berg mentions the test for impairment as a good way to show if fluctuations in the key performance indicator return on capital depend on changes in the general economic situation or if these fluctuations are because of non profitable acquisitions.

The usefulness of the impairment test is, however, limited to what Berg calls “real companies” and industries. The real estate industry is an example of an industry where he expresses concerns about these types of tests. The analysts, he says, have already made the assessment of the fair values of the assets in these companies which are reflected in the stock price of these companies. The effect IFRS regulations have on these companies is that they create volatile fluctuations in the debt/equity ratio. This enhances the business risk for these types of companies with no apparent upside, and causes companies of good financial health to appear to be volatile investments.

Furthermore, the valuation to market value, Berg says, is not applicable in all situations. Berg once again point to the real estate industry where this type of regulation causes unnecessary risk for insolvency problems.

Berg expresses a clear opinion on the tendency for IFRS to move towards the level of detailed regulations that the US accounting standards, the U.S. GAAP, consist of. He forcefully claims that U.S. GAAP accounting principles are completely crazy in their level of details. He explains this by saying that the information is too detail oriented and that the information therefore is not accessible.

When asking Berg about how he experiences the qualitative characteristics presented in the framework Berg expresses the opinion that the understanding of the annual reports is high. Furthermore, the quality of the annual reports has increased during the last ten years. This, he says, is because companies disclose more information than mandatory in order to attract capital. As a result of the increased information disclosure, the comparability of companies has increased. Berg states that even if he is not an expert on the details in the IFRS standards, the use of accounting standards such as U.S. GAAP and IFRS enables analysts to place more trust in the financial information presented by the companies. Thus, the accounting standards provide a greater security for the investors. Berg claims that Stena Finans avoids investing in companies not following either U.S. GAAP or IFRS.

5. Analysis

In this chapter the empirical findings are analyzed with reference to the theoretical framework and the research question. Firstly, the relevance of the annual report is analyzed from the perspective of the lenders. Secondly, the relevance of the annual report is analyzed from the perspective of the investors. Finally, a short discussion is made about the differences and similarities between the uses of the annual report in the decision making processes for investors and lenders.

5.1. Lenders

The use of the annual report

The use of annual reports is one of the keys to answering the research question, if the information in the annual reports is relevant in the credit decision. According to the analysts at both Nordea and Swedbank the annual report is considered to be an important tool for the analysts. Schönning goes so far as to say that the annual reports is “...the analyst’s primary source of information”. One of the reasons for this is the annual reports high grade of reliability because it has been audited and approved by an accountant. It is also important because it confirms previously disclosed information, as the one in the quarterly reports.

However, there is a consensus among the analysts that the information in the annual report is considered to be too old to be used for forecasts in deciding future abilities to repay new or outstanding loans. At Swedbank they say that it is mostly for the notes they are interested in the annual reports. For the information to be relevant, according to the Framework for Preparation and Presentation of Financial Statements, it needs to be able to influence the economic decision of the user. The respondents said that the information was reliable but it came too late, which means that the information had a low timeliness. This is a characteristic that according to both Smith and the framework often stands in conflict with the other qualitative characteristic reliability. This means, according to the respondents, that the information in the annual reports lacks the characteristics of timeliness in favor of a higher grade of reliability. It also means that the decision relevance of the annual report for the credit analysts is lacking.

Instead of using the annuals report for credit decisions the analysts at the both banks use another financial statement, namely the quarterly report , which is the most up to date public information published by the companies. All of the respondents agree on this and says that the interim reports are also much more future-oriented sources than the annual reports. However, in addition to the quarterly report, the creditors also receive classified information from the company's before it is released to the public. Being given classified information is possible thanks to the Swedish bank laws. This means that the quarterly report, or the information disclosed under the bank law, has larger influence over the creditors' decision than the annual reports have, due to the greater degree of timeliness. For the information to be relevant according to the framework it should be up to date so that the information could have an effect on the user's economic decision. This also means that the increased requirements of information disclosure in the annual reports have little effect on the usefulness of the annual report in the credit decision.

Issues with IFRS

The creditors, both at Swedbank and Nordea, are not satisfied with IFRS focus on the Balance sheet in the financial statements. When they do an assessments of a customer's future ability to repay a loan the balance sheet is not the most important statement, instead they think that the income statement has much more relevance. They believe that the income statement is a better report to show progress in the company. Zacharoff says that: *"The focus is to make enough money to maintain your mortgages; this is not achieved in the balance sheet but in the statement of income."* The report that is of most importance in the credit decision, according to Croona, is the cash flow statement, which shows the company's ability to repay its loans, and that is the only thing that counts.

The analysts at Swedbank, who is creditors for a much wider clientele and industries than Nordea Shipping & Oil Services, says that they think that the comparability both between companies and over time are low. This is because of an ever changing world in which companies change all the time. According to the framework, comparability is one of the characteristics that should increase the relevance for user of financial statements. According to lenders operating in different industries it seems that the comparability is low, while it is better for those operating in only one industry.

When preparing financial statements it is important that the cost for presenting the information does not overweigh the benefits. This is somewhat of a restriction for how much the information's relevance, or the sum of the qualitative characteristics, is allowed to cost to produce.

The creditors view on the cost for financial reports prepared and presented in accordance with IFRS is that they do not know the costs, but the information given today is necessary if they are to provide any loans. And because the companies who are not required by law to do this still prepare their statements according to IFRS it seems that they deem it to be worth the cost. The claim by the creditors that they require an annual report in order to grant loans even though they have said that their use of the annual report is limited seems to be a contradiction. The solution to this contradiction seems to be that the fact that the company have prepared an annual report and that it is prepared in accordance with a rigorous set of accounting principles provides extra security for the creditor that the company is of sound economic health. Furthermore, the information in the annual report is audited by an independent auditor and the creditors can therefore use the annual report to double check the other information they have obtained from other sources.

An issue with IFRS raised by the respondents is the use of fair values in the financial reports. None of the analysts express that they really trust the fair values in the financial statements presented by the companies. In fact, the creditors in some cases do their own assessments of the values of the assets in the financial reports to deem if the values in the financial statements are reasonable. In the cases that the creditors have a credit security in one of the company's assets they always do their own thorough assessment of the value of the asset. The intention with fair value, according to IFRS, in the balance sheet was to make the values more relevant to the users and thus making it more useful for the user. It has proven difficult to assess whether the credit analysts find it to be more or less problematic with the use of fair value compared with book values.

5.2. Investors

The analysis of the investment analysts use of the annual reports emphasizes on three occurrences pointed to by the respondents during the interviews. The theoretical framework is used to compare the opinions expressed with the purpose of IASB and with the theories expressing their views of the effects of the use of IFRS as accounting standards.

Timely versus reliable

The empirical findings suggest that the lack of timeliness in the publishing of the annual report is an issue for the investors' finding it useful in their analytical process. Lyrhem points to the fact that the data in the annual reports are old even at the day of the publishing. Bohlin shares this view and says that it is very rare that once can find new, previously unknown, information when reading the published annual report. The problem with lack of timeliness can not be solved even if the companies publish the annual reports very early in the new year. The fact that the financial information in the annual reports are the aggregated sums of the previous year's information and therefore contains financial information from the first quarter of the fiscal year, and thus the information is one year old when the annual report is published, is a problem for the investors. They feel that this information is useless in the analytical process. It is therefore not possible to use only the data in the annual report as basis in their analyses. Bohlin emphasize that much can happen during the course of one year and that the numbers in January and December are not comparable. These views expressed by the respondents questions whether the requirement expressed by IASB of the annual report being relevant in the decision making process for investors. Furthermore, the nature of the financial information in the annual report makes it questionable if it is relevant for the investors, at least to the professional investors on which the focus of this thesis lies.

In addition, the opinions expressed by the respondents claiming that the aggregated financial information is useless in the valuation models used in the analytical process to create forecasts of high quality also weaken IASB's purpose of providing information with forecast relevance. It is important to emphasize that this implication of the annual report exists regardless of what accounting principles the annual report is prepared in accordance to.

Instead of using the financial information presented in the annual report, the professional investors consider the interim reports to be of greater importance because the financial information presented in these are up to date. It is the financial information obtained from the interim reports which is being used in the valuation models. Berg however, disagrees with the other respondents about the uselessness of the annual report in the valuation models and claims that they use this financial information. They do, however, use the interim reports to follow the development of the investments and make sure they follow the forecasts.

All respondents work very close to the investment objects and follow them continually in order to make their investment decisions. This enables them to gather a great deal of information besides the published annual reports and interim reports. This enables the professional investors to be more informed about the companies than the small investor and private person. The respondents all emphasize that it is not only financial information obtained from annual reports and interim reports which is taken into account when performing business analyses. Macro factors, such as the state of the market, the company's customers and subcontractors are emphasized as important factors in order to develop high quality forecasts about the future development of the company. The fact that the interviewed investment analysts work with the investment objects continuously and thus can gather the information needed in their investment decision processes and that they tend to include much more information than the pure financial data received in the financial statements suggests that the annual report as a foundation for investment decision making is exaggerated. The information presented within is in most cases already known by the professional investors. These are additional factors which questions the relevance of the annual report in the decision making process. Therefore, regulations which increase the amount of mandatory information disclosures bears the risk of creating additional work and costs for the companies producing the annual reports without increasing the usefulness of the annual reports for the investors.

The lack of timeliness of the annual report and the fact that the investors gather the financial information needed in their analyses elsewhere raises the question whether IASB's choice to focus on the shareholders as the primary benefiter of the annual report is a relevant choice.

Instead of using the annual report continually in the valuation models the analysts agree that the strength of the annual report lies in the amount of extra information within allowing them to study the company at a deeper level and thus getting to know them more thoroughly. The respondents specifically points to the parts of the annual report where the financial information is split into the different market segments, divisions and types of products. Another point of interest in the annual reports is the CEO statement. Lyrhem is of the opinion that reading the CEO statement gives the analyst an insight into the confidence of the company. Furthermore, there is a shared view that the statement of cash flows is very important in the analytical process.

In addition, the investors express that even though they do not necessarily use the annual report continuously the fact that it exists and they know that the preparation and presentation of it is strictly regulated enables them to trust the financial information presented by the companies more. The annual report is used as a library in which they can go back and check the numbers and obtain more detailed information concerning these when needed. The investors can therefore be said to experience the annual report as a means of reducing the information risk. This use of the annual report fits with the purpose of the information in the annual report being reliable. A tradeoff can therefore be seen between the relevance of the information and the reliability of it, and as stated in the theory, these two characteristics are hard to achieve together. Furthermore, these findings support the theory of the use of the annual report as a means for the management of the firm to communicate information between the managers of the companies and the investors, and thus filling the information gap between the owners and the managers.

The liquidity of the market

Theory and previous research suggest that increased quality of the annual reports due to greater requirements of information disclosure increases the liquidity of the market. This effect is achieved by limiting information risk for investors and decreasing the risk that you as investor trade with a more informed counterpart.

The respondents claim that they have not noticed an increase in the liquidity of the market since the mandatory adoption of IFRS in 2005. They have, however, claimed to see an increase in the quality of the financial information since the adoption of IFRS as well as seeing the IFRS standards as a security for the information being reliable. The findings presented in the theoretical framework point to the fact that the liquidity of financial markets in other European countries during this period have increased. This indicates that despite our respondents' limited use of the annual report, other investors have found the increased amount of information in the annual report to be relevant and useful in making investment decisions. The fact that the respondents in this thesis have not experienced this suggests that the usefulness of the annual report have increased for other types of investors. It is likely that the enhanced quality and increased information disclosure requirements have been of use to the smaller investors and private persons, it is however beyond the scope of this thesis to further investigate this theory.

The use of fair value

The degree to which the analysts have prepared themselves to the implementation of IFRS varies between our respondents. They have however all recognized areas where the IFRS standards have affected their work. IFRS seem to have succeeded in improving some aspects of the financial information. The respondents point to the goodwill post and increased information disclosure concerning acquisitions, the hedging of financial instruments, and in some cases the test for impairment. With these regulations the IASB has managed to provide additional information in the annual reports which is of benefit for the investors.

Voices of concern about the IFRS regulations have however been raised by the respondents during the interviews. It is in particular the emphasis on fair value accounting which is perceived as the reason behind many of the problems with IFRS. The empirical findings present views that the use of fair value is not of benefit to neither the investment analysts nor the companies themselves.

It is specifically in the problematic situation when the financial markets are not working properly that it is possible to see the flaws in the use of fair values. Furthermore, opinions are expressed that the use of fair value is not applicable in all situations and for all types of companies. The use of market values as the primary estimate of the fair value creates unnecessary financial risks for the companies, especially for companies in the real-estate industry. Fears about the impact on the financial information due to fair values in times of financial crisis are also expressed in theory. Thus, the empirical findings suggest that the use of the financial information valued to fair value might not be useful in times of financial crisis, or create unnecessary uncertainty about the fair values presented due to illiquid financial markets.

When it is not possible to use the market value as an estimate of the fair value IASB prescribes the use of valuation models based on other products market values or the use of market value on the interest in the valuation model. Other parameters in the valuation models are based on assessments made by the companies' managers. This type of fair value estimate is called mark to model. Mark to model is one of the biggest flaws with IFRS pointed out by the respondents. By giving the managers of the companies the responsibility to value the assets and liabilities and evaluate the value of other posts subjected to impairment tests, using the same methods, the managers get the opportunity to create the figures they see fit by selecting appropriate values on the prerequisites in the valuation models. These assessments made by the managers include selecting the required rate of return used in the models, which can have huge impacts on the result in the statement of income. In these situations, it is impossible for the accountants to question the choices made by the managers of which values to use in the valuation models. Being subjected to the assessments of the managers, and thus the possibility for the managers to affect the figures presented, the usefulness of the accounting information valued to fair value when using a mark to model method decreases. Therefore, the information subjected to these flaws is in these situations not considered to be relevant for the investors, and as explained in the interviews, the investors tend to make their own valuations of the assets in the analytical process. Not only does these subjective assessments in the valuation models affect the quality of the financial information in the annual reports but using fair values also create unnecessary and sometimes large volatility in the performance of the companies making it more difficult for the investors to understand how the companies are actually performing. This volatility is created by the accounting system rather than the actual performance of the companies. The use of fair values in the annual reports can because of this in some situations make the investors' decision process more difficult due to this approach to the financial information which is the opposite result of the purpose of IFRS.

As is the case with the mark to model method of estimating the fair value of assets and liabilities the test for impairment is raised as an aspect of IFRS which has flaws. Impairment tests are also subjected to the influence of the management of the companies. The ambition in both these cases is, from the regulators point of view, to provide the investor with relevant information values in the financial reports. In reality, however, this is perceived by most of the interviewed investors as being counter productive and in fact providing them with information lacking the quality needed to create their analyses.

Furthermore, the emphasis on presenting fair values in the financial statements has shifted the focus from the statement of income to the balance sheet. The changes in the values in the balance sheet due to changes in market values all go through the statement of income and thus making this more difficult to read. The investors claim that the statement of income is more important than the balance sheet in the decision making process and a change of focus from the statement of income to the balance sheet therefore decreases the relevance of the statement of income as source for information about how the company actually performs. By emphasizing the valuation of assets and liability the net income post in the statement of income loses relevance for the investors as it is too influenced by variations in the values presented in the passive balance sheet. The statement of income can therefore be said to no longer provide the correct information about whether the company's area of operation is profitable.

5.3. Comparing lenders and investors

One of the major differences between the lenders and the investors and their need for the financial information presented in the annual report is that the lenders are able to obtain much more information about the companies due to the Swedish bank laws. The investors interviewed in this thesis claim that they collect more information than the average investor due to their close scrutiny of the investment companies on a daily basis. This being the case, the amount of information that can be provided to the investors is limited to what the company can disclose without suffering competitive disadvantages. The lenders, however, do not have these restrictions. Due to this, the increased requirements of information disclosure should, in theory, be of more interest for the investment analysts than for the credit analysts. In reality, however, the investors can still gather more information from other sources and in a timelier manner than by using the annual reports.

Both investors and lenders share the view that the international accounting standards, both IFRS and U.S. GAAP, provide a security in that the information is more reliable due to the strict regulations. For especially the investors, however, this reliability comes at the price of a decrease in the relevance of the information in the annual reports.

One key difference between the investors and the lenders is the use of the interim reports. The investors use these reports more actively and use the financial information in these reports in their investment analysis processes. The lenders, however, have this information in advance to the publishing of the reports and therefore use the interim reports more as a means to double check the numbers already provided to them.

Both the lenders and the investors find the shift of focus away from the statement of income in favor of the balance sheet as negative. Both for the investors and the creditors it is the company's ability to earn money which is essential in their credit and investment decisions, and this information is not found in the balance sheet. Therefore, it makes both types of analysts' work more difficult in that they have to sort out the essential information from the statement of income which now contains more posts related to the balance sheet.

6. Conclusion

This chapter concludes the thesis by answering the research question, both from the lender perspective and the investor perspective as well as presenting the authors' own reflections about the reasons behind the results. The chapter, and the thesis, is concluded with providing a suggestion for further research.

The purpose of this thesis is to describe the use of the annual report in the analytical process for investors and lenders as well as evaluate whether the annual report is relevant in the decision making process for lenders and investors. This is achieved in answering our research question: *Does the information in the annual report meet the requirement of relevance in the IFRS framework in the investment and credit decision?*

The findings of this thesis suggest that the lenders' use of the annual report as source of information in the analytical process is limited. Supporting this is the fact that the lenders have the possibility to demand the disclosing of more financial information than what the company has already provided due to the Swedish bank laws. Because of this the use of the annual report and the relevance of the financial information within are limited in the credit decision. Because the lenders find timely information to be essential in their credit decisions and the annual reports does not provide this information the lenders instead choose to demand this information directly from the company.

It is the authors' opinion that because of this possibility the lenders have less need for timely information in the annual report compared to other stakeholders of the company. Thus the usefulness of the annual report for the lenders should lie in the fact that the information in the annual report is audited and therefore, from the perspective of the lenders, the importance of the annual report lies in providing them with reliable information.

The lender has a special relationship with the company to which they have given credit. A key difference between the lender and the investor is that the lender does not trade with their mortgages in the same way as an investor trade with their invested equity. This suggests that the lender is concerned with the company's continued existence in order to collect the interest on the mortgages. Therefore, the authors believe that the lender has a long term interest in the financial development of the company and is concerned with the continued existence of the company. It is also important to stress that the consensus among the lenders is that the company's ability to pay interest on the mortgages is what matters the most, at least in the short term perspective and that this ability is shown first and foremost in the cash flow statement, and to some degree in the income statement. These are reasons why lenders find the annual report to be important even though they do not use it in their credit decision process.

The investment analysts have the same issues with the lack of timeliness of the annual reports as the lenders. But because the investors do not have the same possibility as the lenders to obtain additional information the investors must include other types of information in their investment analyses. All the respondents point to having other primary sources of information beside the annual report. These include information about macro factors about the markets and information about customers and subcontractors to the companies analyzed. In order for the annual report to be relevant for the investor it must achieve much higher demands on timeliness than possible with the annual reports being prepared as they are today.

Furthermore, although the investment analysts agree that the use of fair value may be relevant in some cases the authors have come to understand, both supported by empirical findings as well as previous research, that there are situations where fair value valuation causes problems for investors. These problems primarily occur when valuing assets or liabilities and the market values for some reason can not be used. The valuation process then becomes subjected to the influence of the company's management. The findings supports the theory that this has a negative influence on the relevance of the information in the financial reports in the decision making process for the investor.

One conclusion to be drawn is that the lenders and investors have similar needs with the accounting information being reliable. The authors believe that this reliability is not exclusively dependent on the use of IFRS as accounting regulations but that the large, recognized international standards are equal in this instance. This includes both IFRS and U.S. GAAP. The information in reports prepared in accordance with IFRS or U.S. GAAP is considered by the lenders and investors to be very reliable. This means that even though they do not collect the information directly from the reports, that companies presenting reports in accordance with these sets of accounting principles ensures that the companies can be trusted.

To conclude, the authors can state that neither lenders nor investors find the information provided in the annual reports to be of relevance, as defined in the IASB framework, in the decision process due to the reasons stated above. The strength of the annual report prepared in accordance with IFRS instead lies in other areas, such as reliability. In fact, even though the annual report does not meet the requirement of relevance the reports are crucial in that an investment or credit decision would not be made should the company not be able to provide an audited annual report prepared in accordance with IFRS or U.S. GAAP.

6.2. Future research

This thesis focuses on the lenders and investors as stakeholders of the company. Further delimitations were made to include only the professional investors in the study. The indications mentioned in the theoretical framework that the financial markets in other countries indeed have become more liquid suggests that investors indeed have found the new regulations useful. Therefore, the authors would find it interesting to investigate how the small investor and private person use the annual reports in their investment decisions.

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Appendix 1: Interview guide – translated from Swedish

The annual report

- How big a role does the annual report play as an information intermediary between the company and the market?
- How big a role does the annual report and interim reports play in the investment/credit decision?
- The annual report is more detailed when it comes to additional information compared to other types of information from the company, how does this affect the usefulness of financial statements compared with the other sources of information?
- Has the use of financial statements as a tool for business analysis changed since the introduction of IFRS in 2005?
- What role has increased details and increased disclosure requirements had in this?
- Which posts in the annual report have the greatest need for plenty of additional explanatory information in the annual report? How does this vary between different types of industries?
- In your experience, is their relevant information missing in the annual reports?
- Have you noticed an increase in the liquidity of the market since the implementation of IFRS?

IASB/IFRS regulations

- The transition to IFRS has meant more detailed regulations concerning what information to be included in the financial statements, IFRS regulations thus approach the American standard U.S. GAAP. There is also a major convergence project between U.S. GAAP and IFRS with the goal to achieve a uniform, international accounting standard. Is this trend something that is helpful in analyzing the company?
- Is there a general pattern among Swedish companies if they are more or less willing to disclose additional information not mandatory by IFRS?
- Despite the introduction of IFRS as the common accounting standard in the European Union, studies show that the quality of annual reports still varies between countries. Have you noticed if the annual reports published by Swedish companies differ from those published by other countries, and in that case, how?

Business leaders have expressed views that the cost of producing annual reports has increased and that the process has been made unnecessarily complicated. From a creditor / investor perspective, do you think you may benefit from the use of financial statements justify these costs?