

assignment to help them with adoption of or convergence with IFRS. The SEC simply sets guidelines and expects companies that wish to list in the United States to abide by these guidelines and laws.

IFRS are being set by collaboration with many of the major countries in the world, so they are the product of a great deal of negotiation, compromise, and broad-based input. They're appealing to the Europeans, because they have a lot of influence in the development of the standards, and the IFRS are free of regulation by the U.S. SEC. In addition, as noted earlier, they have the backing of the EU. Initially, it appeared that by 2009 non-European companies (including U.S. companies) would have to list on European exchanges using IFRS. And if they also wanted to list in the United States, they would have to list according to U.S. GAAP unless they were fully compliant with IFRS. However, at least the new IFRS is modeled after the capital-markets orientation of the United Kingdom and the United States. At some point, it's possible that the United States will simply adopt IFRS, but that is not likely in the near future. The major vote in favor of U.S. GAAP is that half of the world's stock market capitalization is located in the United States, and companies that want access to U.S. capital must play by U.S. rules. People in the United States have always felt that their standards were the best in the world and that it would be unfair for U.S. companies competing for cash in the U.S. market to allow foreign companies to list using IFRS, which is perceived as more flexible and less comprehensive than U.S. GAAP. Foreign companies that want to list outside their national markets typically look to the United States first and thus have to adopt U.S. reporting requirements, although that is shifting rapidly to IFRS. As European stock markets continue to increase in importance, more European companies are choosing to list in Europe instead of the United States. In 2009, about 40 percent of the Global 500 companies listed according to U.S. GAAP, about the same percentage used IFRS, and 20 percent listed in their home markets using home-country GAAP.

An additional complication to combining or converging IFRS and U.S. GAAP is the Sarbanes-Oxley Act of 2002. This act requires companies to establish solid internal controls over financial reporting, limits the types of services that may be performed by primary auditors in addition to the financial-statement audit, and requires the managers of publicly traded companies to assess internal controls and make a statement on this assessment, which must be examined and opined on by external auditors.

All of these requirements add additional costs to those already related to complying with U.S. GAAP. Although perhaps good for companies in the long term, as companies must establish effective controls over financial reporting, the initial costs of complying with the Sarbanes-Oxley Act of 2002 may be too great for some firms to consider listing on U.S. exchanges. In addition, the United States has strict laws on the granting of stock options to managers, and the U.S. market has a heightened sensitivity to wrongdoing because of recent accounting scandals, including Enron and WorldCom.

However, the convergence project between the FASB and IASB may solve some of these problems in the long run. To its credit, the IASB has expanded coverage of key topics and has narrowed the alternatives available to companies. The IASB has sold itself as based on *principles* rather than *rules*, although it is more accurate to say that IFRS are simpler and less comprehensive. Anytime you have a standard, you have to have a rule. It's just that U.S. GAAP is very rule-based and complicated and covers far more topics and industries. However, the FASB and IASB are narrowing the differences in existing standards and developing new standards together. Now they jointly write new standards so that even the wording is the same. In addition, public accounting firms and publicly traded companies have five years of experience in adopting the requirements of Sarbanes-Oxley. Maybe the future of accounting standards will be like a merger of Coca-Cola and Pepsi, but accounting is more complicated than soft drinks. ■

## Ericsson: The Challenges of Listing on Global Capital Markets and the Move to Adopt International Financial Reporting Standards

In 2002, the European Union mandated that its member countries adopt International Financial Reporting Standards (IFRS) as the basis for preparing and issuing consolidated financial statements beginning in 2005.<sup>38</sup> Ericsson, the Swedish MNE that supplies products and services to the world's largest mobile- and fixed-network operators, is a public



limited-liability company that must follow the Swedish Companies Act and the listing requirements of the Swedish Stock Exchange. In addition, it must comply with the listing requirements of the London Stock Exchange and NASDAQ in the United States, because it lists securities on both stock exchanges. Given that Sweden is a member of the EU, Ericsson was required to adopt IFRS as of 2005, which is a change from its past practices. However, there are currently two sets of IFRS: (1) EU-approved IFRS and (2) IFRS as issued by the International Accounting Standards Board (IASB).

Should Ericsson adopt the full IFRS or just the more limited EU-approved IFRS? What are the implications of its decision to list on NASDAQ, and what are some of the other issues Ericsson has to face as a result of its decision to raise capital outside of its home market of Sweden?

### A Little More about Ericsson

L. M. Ericsson was founded in Sweden in 1876 and is best known to the casual consumer through a Sony Ericsson joint venture that sells cellular handsets worldwide. However, it fits in the broader network of the communications equipment industry. Although Ericsson is known as one of Sweden's premier MNEs, it generates 29 percent of its sales in Western Europe; 28 percent in Central and Eastern Europe, the Middle East, and Africa; and 45 percent in Asia Pacific—but only 9 percent each in Latin America and North America.

It issues stock in three major stock markets: Stockholm, London, and NASDAQ. Thus it raises capital from investors internationally and generates most of its sales outside its native Sweden. In fact, only 3.6 percent of its sales are generated in Sweden, even though 58.4 percent of its assets and 29.9 percent of its employees are located there. Ericsson's major competitors are Nokia, Motorola, Cisco Systems, and Alcatel-Lucent, and it is considered to be the fourth largest company in the industry.

### Before the Changeover to IFRS

Prior to the move to IFRS in 2005, Ericsson reported its financial results in compliance with Swedish GAAP—a bit of a mixture between Anglo-American accounting, which is driven by the capital markets, and Germanic accounting, which is driven by bank financing and taxation. Swedish reporting tends to be a little more transparent than German accounting but less transparent than Anglo-American accounting.

### Issues of Transparency

One of the reasons why Swedish accounting has been less transparent is its orientation to creditors, government, and tax authorities. However, companies like Ericsson have had to become more transparent because of their desire to raise capital on foreign stock exchanges. In addition, because the Swedish Stock Exchange has become a focal point for listings by Nordic companies, the influential Swedish accounting profession has pushed for consolidated accounts to represent the needs of shareholders, whereas the parent-company accounts have reflected Swedish legal requirements. Swedish accounting tends to be very conservative due to the importance of taxes to fund extensive social welfare programs and the tendency of the Swedish government to use tax policies to influence investment in areas deemed important to the government and its social objectives.

### Sweden and the EU

Since Sweden entered the EU, Swedish accounting has evolved to incorporate EU accounting directives and philosophies. The Swedish government established an Accounting Standards Board (BFN) in 1976 to recommend accounting principles that fit within the framework of the Company Law. The Swedish Financial Accounting Council (RR) was established in 1991 to take over the role of the accounting profession in making recommendations on accounting practices, especially with respect to how to prepare an annual report according to the Annual Accounts Act.

The Swedish Stock Exchange has supported the efforts of the Accounting Council and the BFN, even though the recommendations of both bodies are voluntary and subject to the Company Law. However, the decision by the EU to require firms to use IFRS for consolidated financial statements takes precedence over everything for consolidated financial statements.

### The Gap between U.S. GAAP and Swedish GAAP

In its 2004 annual report, Ericsson still disclosed information according to the Swedish Company Law, although it knew by then that it would have to adopt IFRS the following year. Because so many IFRS were still being finalized in 2004, it did not “early adopt” the new standards. In its Note on Accounting Policies, Ericsson stated that it prepared its consolidated and parent-company financial statements “in accordance with accounting principles generally accepted in Sweden.” However, it also mentioned that “these accounting principles differ in certain respects from generally accepted accounting principles in the United States (US GAAP)” and it gave a description of those differences in a later footnote in the report.

Even though it was trading shares on the London Stock Exchange, it did not make any reference to differences between Swedish GAAP and U.K. GAAP. This is because the London Stock Exchange does not require a reconciliation like the U.S. exchanges do.

**Applying the Conservatism Index** In its Note to the Financial Statements detailing the differences between Swedish GAAP and U.S. GAAP, Ericsson mentions that the major differences are the treatment of capitalization of development expenses, provisions for restructuring, pension costs, hedge accounting, and goodwill. The overall difference in income is fairly significant. Using *Gray's conservatism index*, we can calculate the degree to which Ericsson's net income in 2004 was more or less conservative compared to U.S. income. We gain this information from Ericsson's Form 20-F, which provides a reconciliation from foreign GAAP to U.S. GAAP required by the SEC for U.S.-listed companies (see Table 18.6).

Given that Sweden is more driven by conservatism and tax issues, one would expect Swedish GAAP income to be more conservative than U.S. GAAP income. Gray's index of conservatism for 2004 is computed as follows:

$$\text{Index} = 1 - \frac{\text{U.S. GAAP earnings} - \text{Swedish GAAP earnings}}{\text{U.S. GAAP earnings}}$$

or

$$\text{Index} = 1 - \frac{(14,386 - 19,024)}{14,386} = 1.3224$$

The result implies that Swedish GAAP income was less conservative than U.S. GAAP income. For example, under U.S. GAAP, the cost of developing new products must be expensed in the period in which it occurs, which lowers net income. In Sweden, development costs can be capitalized, which means they don't show up as expenses for the period, thus resulting in higher income. That was one of the largest adjustments for 2004, so Swedish net income had to be reduced by the amount of development costs amortized to get U.S. GAAP net income.

In addition to these differences, Ericsson mentioned in its report that in 2004 it had adopted a new U.S. accounting standard issued by the FASB (FIN 46R—Consolidation of Variable Interest Entities) and that it planned to adopt two other U.S. standards and pronouncements in 2005 (SFAS 123R—Share Based Payments, and SFAS 151—Inventory Costs). This is interesting, because Ericsson already knew it was going to adopt IFRS the next year. Why, then, did it continue to adopt U.S. standards?

### Impact of IFRS on Ericsson's Results

In the Note on Accounting Policies in its 2004 annual report, Ericsson disclosed that from 2005 it would prepare its financial statements according to IFRS. It also mentioned that the IFRS that

TABLE 18.6 Ericsson's Form 20-F: Net Income Reconciliation, 2004

Adjustment of Net Income	2004	2003	2002
Net income as reported per Swedish GAAP	19,024	-10,844	-19,013
<b>U.S. GAAP adjustments before taxes:</b>			
Pensions	-245	-840	412
Pension premium refund	—	—	47
Capital discount on convertible debentures	—	179	124
Goodwill amortization	475	1,636	1,064
Sale-leaseback	352	682	113
Hedging	-2,915	1,603	2,884
Capitalization of development costs for products to be sold	-2,606	-4,798	-4,018
for internal use	-131	-355	-922
Restructuring costs	-1,354	1,225	-1,240
Unrealized gains and losses on available-for-sale securities	-82	370	-370
Other	37	12	35
Tax effect of U.S. GAAP adjustments	1,831	533	966
<b>Net income in accordance with U.S. GAAP</b>	<b>14,386</b>	<b>-10,597</b>	<b>-19,918</b>
<b>Earnings per share in accordance with U.S. GAAP</b>			
Earnings per share per U.S. GAAP, basic	0.91	-0.68	-1.58
Earnings per share per U.S. GAAP, diluted	0.91	-0.68*	-1.58
Average number of shares, basic, per U.S. GAAP (million)	15,829	15,823	12,573
Average number of shares, diluted, per U.S. GAAP (million)	15,855	15,831	12,684

\*Potential ordinary shares are not considered when their conversion to ordinary shares would increase earnings per share.  
 Source: Telefonaktiebolaget LM Ericsson, *Ericsson Annual Report on Form 20-F 2004*, www.ericsson.com (accessed May 31, 2007)

were likely to have the greatest impact on income and shareholder equity were standards regarding capitalization of development costs, business combinations, share-based payments, and financial instruments.

### Conversion Costs

Ericsson estimated that the conversion to IFRS in 2005 would result in a difference of about 1.5 billion Swedish kronor for 2004 net income and a difference of 5.7 billion kronor for equity as of January 1, 2005. Net income under Swedish GAAP would have been 17,539 million kronor under IFRS, compared with 19,024 million kronor under Swedish GAAP. In addition, the recognition of cash on the balance sheet appears to be quite different under IFRS than it is under Swedish GAAP, with cash under IFRS being SEK46.1 billion less than cash under Swedish GAAP. From Ericsson's Form 20-F report, one can also see that cash at the end of 2004 was the same under U.S. GAAP and IFRS.

Costs of implementing IFRS are difficult to gauge. Many countries implemented national regulations that attempted alignment with IFRS (e.g., Sweden). Thus costs of implementation may have been spread out over several years because companies knew that full IFRS implementation was drawing near. Ericsson's management notes the following in the 2004 annual report:

*Because Swedish GAAP, in recent years, has been adapted to IFRS to a high degree and as the rules for first time adopters allows certain exemptions from full retrospective restatements, the transition from Swedish GAAP to IFRS is expected to have a relatively limited effect on our financial statements. Furthermore, we believe the conversion to IFRS will align our reporting more closely with US GAAP.*

## After the Changeover to IFRS

As Ericsson studied the transition to IFRS, it had to decide if it wanted to adopt full IFRS or the EU-mandated IFRS, which was more limited in scope. Ericsson stated the following in its 2006 annual report:

*The consolidated financial reports as at and for the year ended December 31, 2006, have been prepared in accordance with International Financial Reporting Standards as endorsed by the EU, RR 30:05 Additional rules for Group Accounting and related interpretations by the Swedish Financial Accounting Standards Council (Redovisingsrådet) and the Swedish Annual Accounts Act. For the Company there is no difference between IFRS and IFRS endorsed by the EU, nor is RR 30:05 or the Swedish Annual Accounts Act in conflict with IFRS.*

Note P1 to the Parent Company Financial Statements of Ericsson indicates that the parent company generally follows Swedish GAAP, with the following stipulation:

*The Parent Company, Telefonaktiebolaget LM Ericsson, adopted RR32 'Reporting in separate financial statements' from January 1, 2005. The adoption of RR32 has not had any effect on reported profit or loss for 2004 and 2005. The amended RR32:05 (from 2006) requires the Parent Company to use the same accounting principles as for the Group, i.e. IFRS to the extent allowed by RR32:05.*

The Swedish MNE Electrolux, which lists on the Swedish Stock Exchange and trades in the United States through an American Depositary Receipt, states the following in its 2006 annual report:

*The consolidated financial statements are prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. Some additional information is disclosed based on the standard RR 30:05 from the Swedish Financial Accounting Standards Council. As required by IAS 1, Electrolux companies apply uniform accounting rules, irrespective of national legislation, as defined in the Electrolux Accounting Manual, which is fully compliant with IFRS. . . . The Parent Company's financial statements are prepared in accordance with the Swedish Annual Accounts Act and the standard RR 32:05 from the Swedish Financial Accounting Standards Council.*

A careful reading of these statements indicates two things:

- The consolidated financial statements of some European companies are prepared on a different basis than parent-company financial statements.
- More than one set of IFRS can be used by European companies for their consolidated financial statements: IFRS as adopted by the EU and IFRS as recommended by the IASB.

This dual standard in the EU is disturbing to the IASB.

## Future Reconciliation to U.S. GAAP

As we noted in the chapter, companies will not have to file 20-F reports with the SEC in the future if the companies are in compliance with IFRS. Which set of IFRS will the SEC allow registrants to use—the EU version or the version endorsed and issued by the IASB? The EU is not allowing companies to list on European exchanges while preparing financial statements solely in conformance with U.S. GAAP after December 31, 2008. Thus, if firms want to disclose results in U.S. GAAP and list on European exchanges, they will have to report financial results in both U.S. GAAP and IFRS. The cost of using two reporting systems can be large for firms but may not be any larger than the cost currently incurred by firms that reconcile from IFRS to U.S. GAAP and from U.S. GAAP to IFRS today.

Ericsson's shares trade as "pink sheets" (securities traded over the counter (OTC) rather than on an exchange) and on NASDAQ. Because it lists in the United States, Ericsson has to

prepare Form 20-F reports with the SEC. Interestingly, however, in its 2006 annual report, no reconciliation to U.S. GAAP is presented, whereas reconciliations were presented in the 2004 annual report. This change in presentation shows that the transition to IFRS is real and that companies in Europe, as well as shareholders, may consider IFRS to be at least as valid as U.S. GAAP.

Even though the reconciliation was not included in the 2006 annual report, Ericsson filed Form 20-F separately with the SEC for 2006. Table 18.7 illustrates that the difference between IFRS net income and U.S. GAAP net income was much less than that between Swedish GAAP net income and U.S. GAAP net income in 2004.

#### Fast Forward to 2009

Because Ericsson now registers with the SEC using IFRS, it doesn't have to provide a reconciliation report to U.S. GAAP. In the statement on accounting policy, Ericsson discloses the following:

*The consolidated financial statements for the year ended December 31, 2008, have been prepared in accordance with International Financial Reporting Standards (IFRS) as endorsed by the EU and RFR 1.1 "Additional rules for Group Accounting", related interpretations issued by the Swedish Financial Reporting Board (Rådet för Finansiell Rapportering), and the Swedish Annual Accounts Act. There is no effect on Ericsson's financial reporting 2008 due to differences between IFRS as issued by the IAS B and IFRS as endorsed by the EU, nor is RFR 1.1 or the Swedish Annual Accounts Act in conflict with IFRS.*

TABLE 18.7 Ericsson's Form 20-F: Net Income Reconciliation, 2006

Adjustment of Net Income	2006	2005	2004
Net income attributable to stockholders of the parent company per IFRSs	26,251	24,315	17,534
<b>U.S. GAAP adjustments before taxes:</b>			
Pensions	-439	-64	-245
Sale-leaseback	93	191	352
Hedging	0	408	-2,915
Capitalization of development costs	-37	-78	-76
Restructuring costs	-4	120	-1,354
Unrealized gains and losses on available-for-sale securities	0	0	-82
Reversals of impairment losses	-31	-380	0
Other	93	56	82
Tax effect of U.S. GAAP adjustments	154	-73	1,085
<b>Net income in accordance with U.S. GAAP</b>	<b>26,080</b>	<b>24,495</b>	<b>14,386</b>
<b>Earnings per share in accordance with U.S. GAAP</b>			
Earnings per share per U.S. GAAP, basic	1.64	1.55	0.91
Earnings per share per U.S. GAAP, diluted	1.64	1.54	0.91
Average number of shares, basic, per U.S. GAAP (million)	15,871	15,843	15,829
Average number of shares, diluted, per U.S. GAAP (million)	15,943	15,907	15,855
Net income for the period from continuing operations according to U.S. GAAP	23,260	24,312	14,228
Net income for the period from discontinued operations according to U.S. GAAP	2,820	183	158
<b>Total income for the period according to U.S. GAAP</b>	<b>26,080</b>	<b>24,495</b>	<b>14,386</b>
Earnings per share from continuing operations, basic	1.47	1.53	0.90
Earnings per share from discontinued operations, basic	0.17	0.02	0.01
<b>Total earnings per share, basic</b>	<b>1.64</b>	<b>1.55</b>	<b>0.91</b>

Source: Telefonaktiebolaget LM Ericsson, *Ericsson Annual Report on Form 20-F 2006*, www.ericsson.com (accessed July 31, 2007).

As before, Ericsson states that there are no differences between IFRS as issued by the IASB and IFRS as endorsed by the EU. This is an important issue for both the IASB and the SEC. The company also refers to the Swedish Annual Accounts Act, so it is in compliance with Swedish law, and it also mentions a new Swedish Financial Reporting Board, something that was missing in its 2006 annual report. But Ericsson demonstrates that a company can be in compliance with local law, IFRS, EU-sanctioned IFRS, and SEC requirements to raise capital without having to use U.S. GAAP in either its primary financial statements or a reconciliation statement. ■

## QUESTIONS

1. What are the major sources of influence on Ericsson's accounting standards and practices?
2. What has been the impact on Ericsson's reporting of its listing on the London Stock Exchange? On NASDAQ?
3. What type of IFRS did Ericsson decide to disclose in its financial statements in 2006?
4. How would the adoption of IFRS affect Ericsson's index of conservatism in 2004? How does that compare with the index for conservatism according to U.S. GAAP? What was the index in 2006 for IFRS GAAP income reported by Ericsson and U.S. GAAP income disclosed to the SEC? What does that tell you about the convergence process?
5. Should Ericsson adopt full IFRS or IFRS as adopted by the EU? What difference does it make?

## SUMMARY

- The MNE must learn to cope with differing inflation rates, exchange-rate changes, currency controls, expropriation risks, customs duties, tax rates and methods of determining taxable income, levels of sophistication of local accounting personnel, and local as well as home-country reporting requirements.
- A company's accounting or controllership function is responsible for collecting and analyzing data for internal and external users.
- Culture can have a strong influence on the accounting dimensions of measurement and disclosure. The cultural values of secrecy and transparency refer to the degree of disclosure of information. The cultural values of optimism and conservatism refer to the valuation of assets and the recognition of income. Conservatism results in the undervaluation of both assets and income.
- Financial statements differ in terms of language, currency, type of statements (income statement, balance sheet, etc.), financial-statement format, extent of footnote disclosures, and the underlying GAAP on which the financial statements are based.
- Important users of financial statements that must be considered in determining accounting standards are investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies, and the public.
- Some of the most important sources of influence on the development of accounting standards and practices are culture, capital markets, regional and global standards-setting groups, management, and accountants.
- The International Accounting Standards Board (IASB)—an independent, privately funded accounting-standards setter—is charged with developing a single set of high-quality, understandable, and enforceable global accounting standards. Standards developed by the IASB require transparent and comparable information in general-purpose financial statements.
- In cooperation with national accounting-standards setters around the world, especially the Financial Accounting Standards Board (FASB) in the United States, the IASB hopes to achieve convergence in accounting standards.
- The possible elimination of the Form 20-F requirement for foreign companies listing in the United States and different methods of adopting IFRS are major issues that could affect the global convergence of accounting standards.
- When transactions denominated in a foreign currency are translated into dollars, all accounts are recorded initially at the exchange rate in effect at the time of the transaction. At each subsequent balance-sheet date, recorded dollar balances representing amounts owed by or to the company that are denominated in a foreign currency are adjusted to reflect the current rate.
- Companies enter foreign-exchange gains and losses arising from foreign-currency transactions on the income statement during the period in which they occur. Companies enter