DISCUSSION

Of the paper by Hellman, Najjar & Tylaite

Morten Seitz
Postdoc, Department of Accounting

Summary

The setting

- Unique setting to observe small private firms' reporting demands
- Firms can choose standards that are external-reporting oriented (K3) or simplified (K2)
- Tradeoff between tax minimization (K2) and 'informative' reporting (K3)

The findings

- 14% choose K3, despite the costs
  - Accounting determinants

    \+ IGIA

    \- Tax burden
  - Capital-market determinants

    0 Trade credit and debt

    \+ M&A activity
- The findings are based on archival *and* survey evidence

Stated contributions

- Demonstrate firms' demand for reporting IGIA (not allowed under IFRS for SMEs)
- This demand stems from stakeholders other than lenders

A firm can choose K3
The choice is costly, but could

- Provide better information to users
  IF benefits exceed costs

- "We … highlight potential issues with the adoption of IFRS for SMEs"
- "external reporting preferences"
- "External-user oriented"
- "higher-quality reporting under K3"

- Offer discretion in financial reporting
- This discretion could be used opportunistically
  IF benefits exceed costs

Do firms choose K3 opportunistically?

Is the capitalization of IGIA better for users?

Results from the paper, first clue

Results from the paper, second clue

Loss avoidance (or 'benchmark beating')

+

IGIA

+

K3 adoption

-

Profitability
(ROA, Loss)

Results from the paper, third clue

+

Future M&A

Insights from the literature

- IGIA capitalization ↑ before firm failure
- Earnings management ↑ before SEOs or IPOs

Takeaway:

Demand for complex financial reporting from *preparers*

≠

Better financial reporting for *users*

What factors influenced the K3 choice?

Is K3 an indicator of 'external reporting preferences'?

Survey evidence

Responses to "What factors influenced the K3 choice?"

'Informative' reporting incentives

- Capitalizing IGIA 13%
- Components approach (PPE) 9%

Other (nonreporting) incentives

- Don't remember 39%
- Long-term planning incentives 37%

"the company is expected to grow which means K3 will become mandatory for the company"

Archival evidence

A desire to stay at the status quo?

Only possible with K3 (not K2):

- Capitalization of IGIA Corr=0.16
- Expenses by-function Corr=0.50

Takeaway:

Compliance and 'stay at status quo' seem to explain the K3 adoption.
The incentives to make the reporting 'informative' seem less relevant.

VERY few thoughts on tax

- Tax expenses remain unchanged when capitalizing – but timing differs!

- The tax burden measures could capture profitability: Profitable firms don’t need to capitalize IGIA to increase earnings

- The tax results seem sensitive to alternative designs
  - Tables OA2, OA4
  - No results with conforming tax avoidance measures

- Swedish auditors do not mention taxes as a motivation to adopt K3

CBS

Takeaways

It is interesting that

- Some firms are willing to adopt costly and more complex reporting
- This demand stems from stakeholders other than lenders

Limitations

- Does *voluntary* K3 adoption improve informativeness of financial reporting for <u>users</u>?
- Is the observed K3 choice an indication of
  - 'External reporting-oriented' incentives?
  - Other incentives (e.g., compliance or status quo)?