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Disclosures Regarding Impairment Testing of Goodwill

- Does Enforcement Matter?

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Abstract

Title	Disclosures Regarding Impairment Testing of Goodwill – Does Enforcement Matter?
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Five key words	Goodwill, Impairment, IAS 36, Disclosure, Enforcement
Purpose	The purpose of this thesis is to study how the enforcement within the European Union has affected the disclosure practices of companies within the EU regarding impairment testing of goodwill (IAS 36).
Methodology	A quantitative approach was chosen and a document study was conducted. The form of the research is a comparative study. A comparison of 82 companies from countries within the EU and 68 companies from countries outside of EU was conducted where we looked at how many companies from the two different groups that disclosed specific information in their financial statements.
Theoretical perspectives	The theoretical framework consists of theories and former studies regarding factors that could explain differences and similarities in accounting practice. Factors presented in the chapter include isomorphism, earnings management and country specific differences, such as enforcement and culture.
Empirical foundation	The empirics chapter consists of data collected from the document study. Differences and similarities between the EU group and the non-EU group are presented and so is the significance-level of the differences.
Conclusions	This study shows that there are more companies from countries within the EU compared to companies from countries outside of EU that disclose information required by IAS 36. We conclude that the two most important factors to explain the difference are the work of ESMA and the fact that Canada and Russia just recently adopted IFRS which led to lower disclosure ratios.

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Abbreviations

IFRS – International Financial Reporting Standards

IASC – International Accounting Standards Committee

IAS – International Accounting Standard

EU – European Union

IASB – International Accounting Standards Board

GAAP – Generally Accepted Accounting Principles

ESMA – European Securities and Markets Authority

VIU – Value In Use

CGU – Cash Generating Unit

FVLCS / FVLCD – Fair Value Less Cost of Sale / Fair Value Less Cost of Disposal

DCF – Discounted Cash Flows

CESR – Committee of European Securities Regulators

SCE – Sub-Committee of Enforcement

EECS – European Enforcement Coordination Sessions

PAT – Positive Accounting Theory

SFAS – Statement of Financial Accounting Standards

ROA – Return on Assets

ROS – Return on Sales

WACC – Weighted Average Cost of Capital

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1. Introduction

In this chapter, we will start by giving a brief historical background regarding the harmonization of accounting, difficulties that regard accounting harmonization and the accounting treatment of goodwill. We will then discuss the importance of accounting disclosures in order to make information useful to the intended users of financial reports and the important role of enforcement. In section 1.3 the study purpose and research questions are presented while section 1.4 and 1.5 treats delimitations and the outline of the thesis.

1.1 Background

Accounting differences between nations have been discussed by accounting researchers for a long period of time.¹ Different authors have mentioned a lot of different explanations to why these differences exist. Nobes means that it is the providers of finance that is the most important factor that explains accounting differences between countries.² Other factors are, inter alia, enforcement, the link to taxation, differences in legal systems and cultural differences between countries.³ Several authors have also classified countries into groups with similar accounting systems.⁴ The Anglo-Saxon accounting tradition and the Continental accounting tradition are often mentioned as the two major accounting traditions. Countries classified to Anglo-Saxon accounting tradition are, for example, USA, United Kingdom, Ireland and The Netherlands while the Continental accounting tradition is found in e.g. Germany, France and Italy.⁵

When the world economy has been more globalized, the role of accounting harmonization between countries has emerged. When discussing harmonization, it is of importance to define what harmonization really is. Harmonization can be divided into *de jure* harmonization and *de facto* harmonization, where the first means that the accounting regulation and standards are the same and the latter means that the actual accounting practice is the same. It is possible that *de jure* harmonization exists without achieving *de facto* harmonization and vice versa.⁶ For example if standards regarding the value of inventories are different between countries but

¹ See Baker and Barbu (2007).

² Nobes and Parker (2010) p. 51.

³ Nobes and Parker (2010) p. 29-51.

⁴ See Nobes and Parker (2010) p. 60-70.

⁵ Johansson (2010) p. 53.

⁶ Alexander et al. (2007) p. 46.

companies in the different countries values their inventories using the same method, a *de facto* harmonization exists but a *de jure* harmonization does not.

The accounting harmonization process has been going on for a long period of time. In 1904 the First International Congress of Accountants was held and since then, several accounting bodies have tried to enhance comparability of accounting regulation between countries.⁷ Baker and Barbu mention that important steps in the global harmonization of accounting were the forming of the IASC in 1973 and the issuance of the IASC Conceptual Framework in 1989.⁸

Within the European Union harmonization of accounting regulation have been going on for a long period of time in order to achieve free movement of capital within the EU. In 1978 the Fourth Council Directive was issued and treated individual accounts and was a first step towards harmonization within the EU. In 1983 the Seventh Council Directive was issued, which dealt with consolidated accounts. Several studies have been conducted which have shown that the EU Directives have increased harmonization⁹ within the EU but plenty of differences between countries still existed.¹⁰ In 2002 EU issued a new EU-regulation¹¹ which stated that from January 1st 2005, all listed companies within the EU has to prepare their consolidated financial statements using international accounting standards, issued by the IASB, which had been endorsed by the EU. Therefore, since 2005 accounting regulations for the consolidated accounts for listed companies within the EU are *de jure* harmonized.

Even though the accounting regulation within the EU is harmonized, studies have shown that national differences in accounting practice still exist. Nobes and Kvaal made a study using large companies IFRS financial statements from 2008/9 where they compared companies from Germany, France, Spain, UK and Australia and showed that differences within EU companies still exist, because of the fact that IFRS is principle based and the preparers are allowed to make choices and use professional judgment.¹² Nobes study from 2008/9 showed that the classification of countries into a Continental group and an Anglo Saxon group still existed by comparing companies from UK, Spain, Sweden, Germany, France, the Netherlands, Italy and Australia and concluded that UK and Australia conducted an Anglo

⁷ Brunovs and Kirsch (1991).

⁸ Baker and Barbu (2007).

⁹ Archer et al. (1996).

¹⁰ See Baker and Barbu (2007) and Jafaar and McLeay (2007).

¹¹ EU Regulation 1606/2002.

¹² Nobes and Kvaal (2012).

Saxon group while the other six countries formed a Continental group with Germany and France most similar to each other.¹³

One item that has been discussed for a long period of time, which now is harmonized for listed companies consolidated financial statements within the EU, is goodwill and the impairment/amortization of goodwill. The most important change in Sweden after the EU-regulation was issued in 2005 was, according to Hamberg et al. the adoption of IFRS 3 – Business Combinations, which is the standard that concerns goodwill.¹⁴ Hamberg et al. also stated that after the adoption of IFRS 3, goodwill in Swedish companies has increased, partly by the fact that goodwill no longer gets amortized.¹⁵

1.2 Problem

The IASB standards that regard goodwill and impairment of goodwill¹⁶ have been criticized for being very complicated and for demanding plenty of judgments and assumptions.¹⁷ This is because of the fact that when testing goodwill for impairment, a *recoverable amount* must be calculated which demand judgment and assumptions from preparers. When calculating the *recoverable amount*, a Discounted Cash Flow model is often used where discounted future cash flows of a cash generating unit shall be determined and this demands judgments regarding, inter alia, how to determine a cash generating unit, which discount rate to use, how long forecast period to use and which growth rate to use, all these factors should also be disclosed in the financial statements. This treatment of goodwill was a dramatic change from many countries former treatment when goodwill was amortized over a specific amount of years.

Because of the complexity of IAS 36 it is of great importance that companies provide adequate disclosures regarding their judgments and assumptions and IAS 36 has several requirements regarding what information that should be disclosed. As can be seen in the Preface to IFRS¹⁸ as well as the IASB Conceptual Framework¹⁹, the objective of IASB's standards is to provide useful information to the intended users of the financial reports. In

¹³ Nobes (2011).

¹⁴ Hamberg et al. (2011).

¹⁵ Hamberg et al. (2011).

¹⁶ IFRS 3 and IAS 36.

¹⁷ See Guggiloa (2010).

¹⁸ IASB (2010) Preface to IFRS para. 6.

¹⁹ IASB (2010) The Conceptual Framework for Financial Reporting para. OB2.

order for the information to be useful for the intended users, it must be possible to evaluate the judgments and assumptions made by the preparers. Without adequate disclosures from the preparers, users of the financial reports have no chance to evaluate companies, which leads to lower comparability between companies.

As have been mentioned above, the EU has regulated accounting for listed companies, i.e. all listed companies within the EU are obliged to follow the same accounting standards. The EU-regulation was issued in order to get more reliable and transparent financial statements and to increase comparability between companies and therefore eliminate barriers and enhance cross-border trading.²⁰ Despite this, questions could be raised regarding how successful the EU has been in enhancing the comparability between companies from different countries. Soderstrom and Sun have argued that accounting standards is only one factor out of many that affects accounting quality.²¹

A lot of authors have discussed that a well-established enforcement is one of the most important factors in order to improve accounting.²² Schipper wrote that the lack of enforcement of IFRS make the countries look back and account in the same way as they used to do according to their old national GAAP's.²³ According to Guggiloa the enforcement is as important as the adoption of IFRS.²⁴

As mentioned above, researchers have stated that enforcement is a crucial part in order to get accounting standards to be followed and interpreted in the same way by different companies from different countries. Within the EU, enforcement of accounting standards is a national matter which could lead to different interpretations of accounting standards and to the fact that national accounting patterns still exists because of e.g. differences in countries culture, equity markets and accounting traditions. In order to improve the enforcement within the EU, European Securities and Markets Authority is working for getting an increased convergence between enforcers from different countries within the EU.

As mentioned above, the standard that treats the impairment test of goodwill (IAS 36) demands judgments and assumptions and in order for the users of financial statements to evaluate and form an opinion regarding the preparers' judgments and assumptions it is of great importance that the companies disclose relevant information. If a low proportion of

²⁰ EU (2002).

²¹ Soderstrom and Sun (2007).

²² As for example Hope (2003) and Gauffin and Thörnsten (2010).

²³ Schipper (2005).

²⁴ Guggiloa (2010).

companies disclose sufficient information regarding impairment testing of goodwill, it could be questioned how successful the EU has been to achieve its objective to enhance comparability between companies from different countries.

Several countries outside of the EU demand that companies prepare their consolidated financial statements using IFRS. In order to evaluate how companies from countries within the EU follow the disclosure requirements in IAS 36, regarding impairment testing of goodwill, it is interesting to compare companies from countries within the EU to companies from countries outside of the EU. We have therefore made a comparative study where companies are divided into an EU group and a non-EU group. If the result of the EU group is low, it might show weaknesses in EU's work to improve comparability between companies and give guidance on what to do in order to improve their work.

1.3 Purpose and Research Question

As mentioned above, companies' disclosure practices regarding impairment testing of goodwill is of great importance in order for users of financial reports to be able to compare different companies and enforcement is important in order to ensure that the disclosure requirements in IAS 36 are fulfilled. Therefore, the purpose of this thesis is to study how the enforcement within the European Union has affected the disclosure practices of companies within the EU regarding impairment testing of goodwill (IAS 36). This leads to the following research questions:

Has the enforcement within the EU led to more adequate disclosures regarding impairment testing of goodwill?

- Do more companies from countries within the EU disclose information regarding impairment testing of goodwill than companies from countries outside of EU, regarding:
 - Which method used to calculate the recoverable amount?
 - Which discount rates used?
 - Which terminal growth rate used?
 - Which periods covered by management's budgets and forecasts?
 - If pre-tax or post-tax discount rates have been used?

1.4 Delimitations

In our study we have chosen to not make assessments of the companies' ways to disclose the information regarding impairment testing of goodwill. We have chosen to examine disclosures which do not regard our personal judgment. The study performed by ESMA, which will be presented later, have focused on the sensitive analysis and other factors where the author need to, through experience and knowledge, asses the way the companies have chosen to disclose information. We believe that to do this it is necessary have to have a greater experience and more information than just the annual reports. This kind of subjective judgment will also be hard to quantify and compare between companies. Because of this, our study examines factors that can be answered with a yes or no. We have focused on the differences and similarities between the EU countries and non-EU countries. This means that even if we have mentioned the specific countries this is not the main focus in the study. Our choice of subject also means that we have focused on the enforcement and the disclosure of the information required by IAS 36 and not gone into detail regarding how the impairment test is performed. In the study only annual reports from 2012 are used and no other information regarding the companies or the goodwill impairment test has been examined.

1.5 Outline

2. Method

In this chapter, the approach chosen and the way this study was conducted will be presented. The chapter includes how the material and data was collected, how companies were selected and how the data has been processed.

3. Accounting Standards and Enforcement

In chapter three, a review of the accounting standards IFRS 3 and IAS 36, which are important for this thesis, is presented. The chapter also includes a presentation of European Securities and Markets Authority and their work.

4. Framework

Chapter four includes theories and literature that treats different factors which could affect accounting practice. Factors such as isomorphism, earnings management and country specific issues such as enforcement and culture are presented.

5. Empirics

In this chapter, the data collected from the annual reports of the companies' studies as well as the result of the statistical analysis are presented.

6. Analysis and Reflection

In the Analysis and Reflection chapter the findings from the empirical section is discussed and explained by the theories and literature that was presented in the Framework chapter.

7. Summary with Conclusions

In the final chapter, the conclusions are presented and the research questions are answered.

2. Methodology

In this chapter, we will discuss the method chosen to conduct this study. Subjects covered in this chapter include which approach that has been used and why this is the best approach to answer the research question. The chapter also include how the material and data has been collected as well as how the selection of which companies to include in the study have been undertaken. Finally a discussion regarding the studies validity and reliability is presented.

2.1 Approach

In order to fulfill our purpose and study how the disclosure requirements regarding impairment testing of goodwill is followed within the EU, a comparative research design and a quantitative approach was chosen. We have conducted a document study where we have compared how 82 companies from countries within the EU and 68 companies from non-EU countries comply with some factors of the disclosure requirements in IAS 36. The empirical material is collected from annual reports of the companies we have chosen to study. The fact that we have chosen to study a large number of companies makes the study extensive, and therefore a quantitative approach is suiting.²⁵

In order to study how well EU's objective, to enhance comparability between companies from different countries and harmonize accounting, is fulfilled, we have chosen a comparative research design²⁶ which makes it possible to see if there are differences in compliance with IAS 36 between companies from countries within the EU compared to companies from countries outside of EU. A comparative research design is suiting since all companies we have chosen to study, are obliged to prepare their consolidated financial statements using the same standards. If differences could be found, regarding compliance with the disclosure requirements of IAS 36, between companies from countries within the EU and companies from countries outside of EU, the result suggest that there are other factors than the standards that influence the preparation of the consolidated financial statements.

²⁵ Jacobsen (2002) p. 149.

²⁶ Bryman and Bell (2011) p. 61.

2.2 Collection of Material

In order to get information of goodwill and the impairment test of goodwill, we studied the standards IFRS 3 and IAS 36, which were collected from IASB's webpage, as well as academic articles that discuss the difficulties with the treatment of goodwill. To get information about harmonization and differences between countries, a key word search in the Lund University Libraries Database was conducted with the key words: accounting harmonization, accounting differences and country differences within accounting. We focused our search to academic journals. The most useful articles were collected from academic journals such as *Abacus* and *European Accounting Review*.

When writing the literature section we used accounting literature in the form of books as well as articles from academic journals. Key word searches were conducted in the Lund University Libraries Database with the key words: earnings management, enforcement and accounting culture. We also used the references from the articles that we found, when conducting the key word searches, in order to collect more material on the subjects. Articles were found from a wide range of academic journals from different countries.

2.3 Selection of Companies

We have chosen to examine the largest companies, by market capitalization, from the different countries included in the study. The fact that we choose the largest companies was because of our belief that the largest companies are the ones that are most affected by the enforcement since they get most media attention and has most stakeholders. We used Financial Times list of the world's largest companies, FT 500 Global,²⁷ and selected all companies from EU countries, a number of 105 companies. For non-EU countries, we selected companies where IFRS was mandatory and excluded companies from Norway, since they are a part of ESMA. We also excluded companies from Brazil, because it was hard to find annual reports from the companies, and China, because we suspected that it could be hard to find annual report from the Chinese companies. We therefore selected companies from Canada, Australia, Russia and South Africa. In the FT 500 Global, 25 companies from Canada, 12 companies from Australia, 10 companies from Russia and 7 companies from South Africa were represented, a total of 54 companies. Because of the fact that only 54

²⁷ Financial Times (1) (2012).

companies, from these four countries, were represented on the FT 500 Global, we searched for other lists where the largest companies from Canada, Australia, Russia and South Africa were ranked. We then doubled our first selection and got a selection of 50 companies from Canada,²⁸ 24 companies from Australia,²⁹ 20 companies from Russia³⁰ and 14 companies from South Africa.³¹ The lists had good compliance with the FT 500 Global. We therefore got a total of 108 companies from non-EU countries. For the distribution of all companies between countries, see table 2.1 below.

EU Countries	Companies	Non-EU Countries	Companies
U.K.	31	Canada	50
France	21	Australia	24
Germany	18	Russia	20
Sweden	9	South Africa	14
Italy	8	Total	108
Netherlands	6		
Spain	6		
Denmark	2		
Finland	2		
Belgium	1		
Czech Republic	1		
Total	105		

Table 2.1

Out of the 105 EU companies and the 108 non-EU companies, we have removed companies that did not follow IFRS, companies that had not published their annual report for year 2012 and companies that did not report any goodwill. As can be seen by figure 2.1 below, 21 EU-companies and 35 non-EU-companies were removed after this selection.

When conducting an impairment test, IAS 36 states that the recoverable amount is the higher of a Cash Generating Units *Value in Use* and *Fair Value Less Cost of Disposal*.³² This study investigate whether the disclosure requirement is fulfilled when a *Value in Used* method is used or when a *Fair Value Less Cost of Disposal* is calculated with a discounted cash flow model. Companies that calculate the recoverable amount using Fair Value Less Cost of

²⁸ The Globe And Mail (2012).

²⁹ ANZ (2013).

³⁰ Financial Times (2) (2012).

³¹ Financial Times (2) (2012).

³² See section 3.2 for more information regarding the requirement in IAS 36.

Disposal and not using a discounted cash flow model were therefore removed. This was done because of the fact that IAS 36 para. 134 require specific disclosure requirements depending on which method that are used to calculate the recoverable amount. As can be seen by figure 2.1, after our final selection, the study included 82 companies from EU countries and 68 companies from non-EU countries.

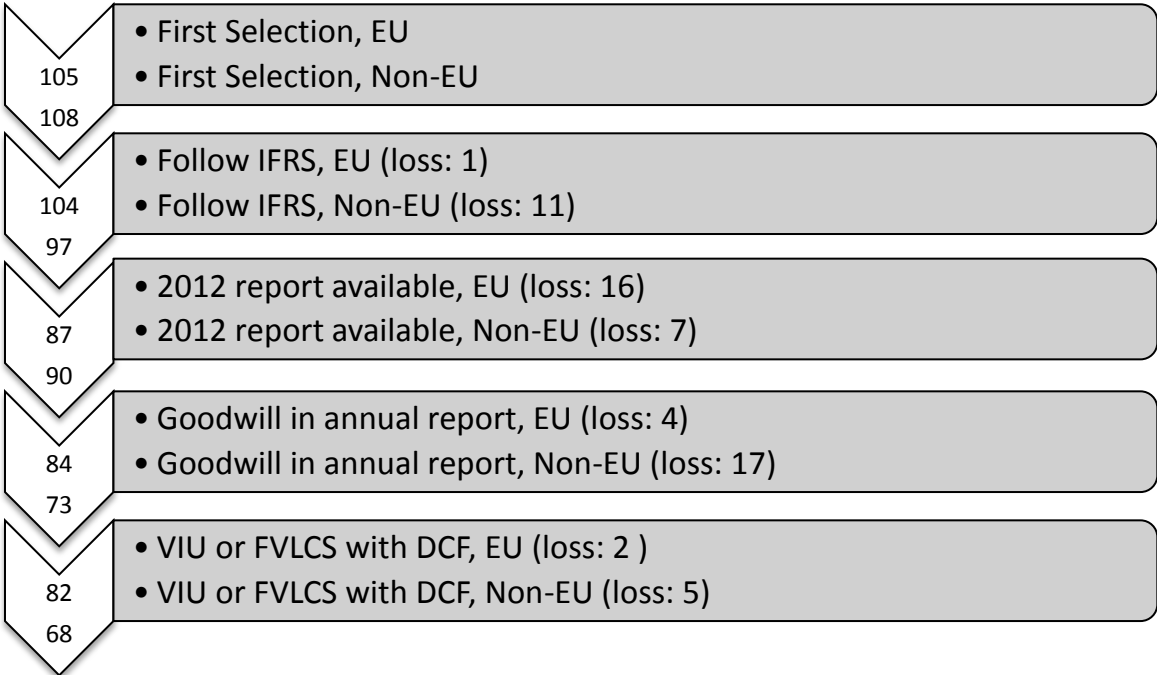


Figure 2.1

2.4 Collection of Data

Since our research question includes studying disclosure practices regarding the impairment testing of goodwill, we have collected data from the annual reports of the 150 companies we have chosen to study for year 2012. The annual reports have been collected from the companies’ webpages. In order to find information regarding companies’ impairment testing of goodwill, we searched for the words goodwill and impairment in the annual reports. Most companies had a note with goodwill or intangible assets where the information was disclosed, while some companies disclosed the information that treats impairment testing in the note regarding accounting policy.

In order to determine which factors to study, we studied paragraph 134 in IAS 36 which demands disclosures regarding several factors. We chose to study factors that were clear and where it was possible to see if the companies either complied with the disclosure requirements or not. IAS 36 states that which method used to calculate the recoverable amount should be disclosed (Value in Use or Fair Value Less Cost of Disposal). When a *Value In Use*-method is used, the company shall disclose, inter alia, the following information regarding all CGU's where the amount of goodwill is significant compared to total goodwill:

- *Which discount rate that has been used.*
- *Which period management has projected cash flows based on budgets and forecasts.*
- *Which terminal growth rate that has been used.*

If a *Fair Value Less Cost of Disposal* is calculated using a discounted cash flow-method, the company shall disclose, inter alia, the following information regarding all CGU's where the amount of goodwill is significant compared to total goodwill:

- *Which discount rate that has been used.*
- *Over which period management has projected the cash flows.*
- *Which terminal growth rate that has been used.*

The factors mentioned above are the ones that we have studied. For each company in the study, we have gone through the annual report and looked for answers on the following questions:

1. Have they used VIU or FVLCD using DCF? (Yes or No + which method)
2. Is a discount rate for each significant CGU disclosed? (Yes or No)
3. Is a terminal growth rate for each significant CGU disclosed? (Yes or No)
4. Is the time period which management has projected cash flows based on budgets and forecasts disclosed for each significant CGU? (Yes or No)
5. Is it disclosed if pre-tax or post-tax discount rates have been used for each significant CGU? (Yes or No)

If the answer on question no. 1 is yes, the company has been included in the study. For questions no. 2 – 5, a yes means that the company complies with the disclosure requirement and a no means that the company does not comply. Due to this way of collecting data, it has been possible to see which factors that have been disclosed, not only if they comply with all the disclosure requirements.

Regarding which CGU's that are significant in comparison to total goodwill, some companies have informed which CGU's that are significant. In cases where the company has not informed about which CGU's that are significant, we have assumed that if the carrying amount of a CGU's goodwill is more than 10 % of total goodwill, it is significant. The fact that we choose 10 % is because of the fact that 10 % is the quantitative limit regarding segment reporting according to IFRS 8 para. 13.

2.5 Statistical Analysis of the Data

We have made a statistic test to see if the differences between the EU group and the non-EU group were significant, to do this we chose a hypothesis test. We developed five questions which we tested, for each question two hypotheses were developed, a null hypothesis (H_0) and an alternative hypothesis (H_1) which we present below. When the sample includes more than 30 observations the sample is, according to Andersson et al., approximately normally distributed.³³

When making a statistic test it is important to decide how accurate the test should be. We have done that by deciding a p-value. The p-value is the probability to get at least the difference we have got between the groups. Common levels is, according to Wahlgren and Körner, 5 % 1 % and 0,1 %.When deciding a p-value it is important to assess the consequences of a wrong decision.³⁴ We classified the result as significant at the 5 % level this means that if the result exceeds 5 % we did not classify the difference as significant and the null hypothesis was not rejected. We also present the actual p-value which makes it possible for the reader to interpret the result.

$$Z = \frac{P_1 - P_2}{\sqrt{P(1 - P) \left[\frac{1}{n_1} + \frac{1}{n_2} \right]}}$$

Figure 2.2

³³ Andersson et al. (1994) p. 57.

³⁴ Körner and Wahlgren (2006) p 194.

We used the equation which is presented above to test if the differences between our groups are significant.³⁵ P_1 represents the proportion of companies which had disclosed the information in the EU group and P_2 represents the proportion of companies which had disclosed the information in the non-EU group. P represents the proportion in the total sample and n_1 and n_2 represents the number of companies in the sample. The Z value will be translated in to a p -value using a normal distribution table.³⁶ Below we will present our hypothesis which we have developed to examine if the differences between the groups are significant.

Hypothesis A

H_0 = There are no significant difference between the EU group and the non-EU group regarding the proportion of companies that disclose which method the companies have used to calculate the recoverable amount of goodwill.

H_1 = There are a significant difference between the EU group and the non-EU group regarding the proportion of companies that disclose which method the companies have used to calculate the recoverable amount of goodwill.

Hypothesis B

H_0 = There are no significant difference between the EU group and the non-EU group regarding the proportion of companies that disclose the discount rate for each CGU.

H_1 = There are a significant difference between the EU group and the non-EU group regarding the proportion of companies that disclose the discount rate for each CGU.

Hypothesis C

H_0 = There are no significant difference between the EU group and the non-EU group regarding the proportion of companies that disclose the expected growth rate for each CGU.

H_1 = There are a significant difference between the EU group and the non-EU group regarding the proportion of companies that disclose expected growth rate for each CGU.

³⁵ Körner and Wahlgren (2006) p. 226.

³⁶ Körner (2000) p.14.

Hypothesis D

H_0 = There are no significant difference between the EU group and the non-EU group regarding the proportion of companies that disclose the period covered by managements budgets and forecasts for each CGU.

H_1 = There are a significant difference between the EU group and the non-EU group regarding the proportion of companies that disclose the period covered by managements budgets and forecasts for each CGU.

Hypothesis E

H_0 = There are no significant difference between the EU group and the non-EU group regarding the proportion of companies that disclose if the discount rates used are pre-tax or post-tax.

H_1 = There are a significant difference between the EU group and the non-EU group regarding the proportion of companies that disclose if the discount rates used are pre-tax or post-tax.

2.6 Reliability and Validity

The concept of reliability refers to how the study has been conducted and the consistency regarding the collection of data.³⁷ Since our study involves how many companies out of two different groups that disclose specific information regarding impairment testing of goodwill, we have been able to formulate questions with a yes or no answer that we have searched for answers to in the companies' consolidated financial statements. Even though we have searched for yes or no answers, situations have arisen where we have been forced to make judgments. In all cases where we have been unsecure regarding if the company has disclosed the information or not, we have looked in the consolidated financial statements together and we have had clear guidelines regarding if the information is disclosed or not. In order to give the reader a possibility to judge the reliability of the study, our way of collecting data is thoroughly explained in the method chapter.

³⁷ Bryman and Bell (2011) p. 41.

The validity of a study regards the fact that the study measures what it is supposed to measure and that the factors measured are relevant.³⁸ In this study, the major focus is to look at how the disclosure requirements are fulfilled and how enforcement could affect the companies' disclosure practices. Since our study measures if the companies disclose some specific information or not, our opinion is that the validity of the study is high. Because of the fact that there are several possible factors that could influence what information companies disclose and how well they follow the disclosure requirements, it is hard to state that enforcement is the deciding factor. Because of this, our framework consists of several factors that could influence companies accounting practices and the importance of these factors is discussed in the analysis and reflection chapter.

³⁸ Jacobsen (2002) p. 21.

3. Accounting standards and Enforcement

This chapter starts with a review of the important accounting standards that treats goodwill and the impairment test of goodwill, namely IFRS 3 and IAS 36 respectively. We then present the European Securities and Markets Authority and their role of enforcement within the EU.

3.1 IFRS 3 - Business Combinations

Goodwill is according to IFRS 3 paragraph 52:

”Goodwill acquired in a business combination represents a payment made by the acquirer in anticipation of future economic benefits from assets that are not capable of being individually identified and separately recognised.”³⁹

IFRS 3 was adopted by the EU and is the standard used since 2005 by the listed companies in the EU. As can be deduced by the quote above IFRS 3 only allow acquired goodwill to be capitalized. This has been debated because some researchers mean that the internally generated goodwill also should be recognized. The reason that only acquired goodwill is recognized is because this can be recognized by a market transaction and because of this can be faithfully valued.⁴⁰

According to IFRS 3 all business combinations shall be accounted for by the purchasing method.⁴¹ This method involves three steps:

- A) identifying an acquire,*
- B) measuring the cost of the business combination, and*
- C) allocating, at the acquisition date, the cost of the business combination to the asset acquired and liabilities and contingent liabilities assumed.⁴²*

The first step is to identify one of the companies as the acquirer. After this the acquirer shall calculate the fair value of the assets and liabilities of the acquiree. The company shall also measure the cost for the business combination, e.g. cost for legal advice caused by the

³⁹ IFRS 3 para. 52.

⁴⁰ Hamberg et al. (2011).

⁴¹ IFRS 3 para. 14.

⁴² IFRS 3 para. 16.

transaction.⁴³ At last shall the company, as long as it is possible, allocate the purchased assets and liabilities.⁴⁴ The earlier standard IAS 22 which was replaced by the IFRS 3 allowed the company to account goodwill as the differences between the purchasing price and the purchased company's booked value of equity. IFRS 3 requires that the company identify specific intangible assets, for example brands and licenses. The identified intangible assets shall be amortized over useful life maximum 20 years.⁴⁵ This was introduced to reduce the amount of goodwill. The amount that cannot be identified as intangible assets will be accounted for as goodwill. Goodwill shall not be amortized as required by the earlier standard it should instead be tested annually, or more often if circumstances indicate in a decrease in value, for impairment in accordance with IAS 36.⁴⁶

The companies shall disclose information about the business acquisition that can be important for the users of financial statements during the period. Paragraph 67 describes a number of criteria's which shall be disclosed to achieve this, for example the acquisition date and disposed operation because of the combination. The companies shall also disclose information regarding changes in goodwill during the period,⁴⁷ like impairment losses during the period in accordance with IAS 36.

3.2 IAS 36 – Impairment of Assets

When goodwill has been recognized after an acquisition, goodwill shall be allocated to the acquirer's cash generating units, or groups of cash generating units.⁴⁸ A cash generating unit is defined in IAS 36 as: *“A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.”*⁴⁹ A cash generating unit must not be larger than an operating segment, which is defined in IFRS 8 para. 5.⁵⁰

An impairment test shall be conducted annually or as soon as there are any indications that goodwill may be impaired.⁵¹ When assessing if there are any indications of impairment, the

⁴³ IFRS 3 para. 24.

⁴⁴ IFRS 3 para. 37.

⁴⁵ Hamberg et al. (2011).

⁴⁶ IFRS 3 para. 55.

⁴⁷ IFRS 3 para. 74.

⁴⁸ IAS 36 para. 80.

⁴⁹ IAS 36 para. 6.

⁵⁰ IAS 36 para. 80.

⁵¹ IAS 36 para. 9 and 10.

company shall consider several external and internal sources of information.⁵² When conducting an impairment test, the cash generating units *carrying amount* shall be tested against the *recoverable amount*. If the carrying amount exceeds the recoverable amount, the cash generating unit is impaired.⁵³ The recoverable amount is the higher of the *fair value less cost of disposal* and the *value in use*.⁵⁴ There is no need for companies to calculate both fair value less cost of disposal and value in use because of the fact that if the recoverable amount is calculated using one of the methods and the recoverable amount exceeds the carrying amount, the goodwill shall not be impaired.⁵⁵ Fair value is defined as: “*Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.*”⁵⁶ Cost of disposal is defined as: “*Costs of disposal are incremental costs directly attributable to the disposal of an asset or cash-generating unit, excluding finance costs and income tax expense.*”⁵⁷ The fair value less cost of disposal could be impossible to calculate and IAS 36 para. 20 states that if fair value less cost of disposal is impossible to calculate, the value in use should be used as the recoverable amount.

When calculating a cash generating units *value in use*, it is the discounted future cash flows that shall be determined. When determining future cash flow, it is the managements that must do estimations and these estimations shall be based on reasonable and supportable assumptions. The cash flow estimations shall be based on the most recent budgets and forecasts which cover a maximum of five years, or a longer period if it can be justified. For periods beyond the budgets and forecasts, a steady or declining growth rate, which must not exceed the long-term average for products, industries or country in which the company operates, shall be used, unless it can be justified to use a higher rate.⁵⁸

The discount rate that shall be used must reflect current markets assessment of the time value of money and the specific risk that the cash generating unit possesses.⁵⁹ A specific discount rate is often not available directly from the market; therefore the company’s Weighted Average Cost of Capital is often used as base for determining the discount rate.⁶⁰

⁵² IAS 36 para. 12.

⁵³ IAS 36 para. 8.

⁵⁴ IAS 36 para. 18.

⁵⁵ IAS 36 para. 19.

⁵⁶ IAS 36 para. 6.

⁵⁷ IAS 36 para. 6.

⁵⁸ IAS 36 para. 33.

⁵⁹ IAS 36 para. 55.

⁶⁰ Ernst & Young (2011).

Regarding what information to disclose in the financial statements, a company shall disclose information for each cash generating unit if the carrying amount of goodwill is significant compared to the company's total carrying amount of goodwill.⁶¹ What information to disclose differs between if the company has used *fair value less cost of disposal* or *value in use* when conducting the impairment test. Companies shall first of all disclose which method used to calculate the recoverable amount (VIU or FVLCS). If value in use has been used the company shall, for each cash generating unit where the carrying amount of goodwill is significant compared to the company's total carrying amount of goodwill, disclose⁶², inter alia:

- Which period management has projected cash flows based on budgets and forecasts
- Which growth rate that has been used
- Which discount rate that has been applied

If fair value less cost of disposal has been used, the company shall disclose, inter alia, which technique that has been used to measure fair value less cost of disposal.⁶³ If fair value less cost of disposal is calculated using a discounted cash flow model, the company must, for each cash generating unit where the carrying amount of goodwill is significant compared to the company's total carrying amount of goodwill, disclose⁶⁴:

- Which period management has projected cash flows
- Which growth rate that has been used
- Which discount rate that has been applied

3.3 European Securities and Markets Authority

In 2002 the EU decided that all listed companies should account according to IFRS to harmonize financial reporting in the EU. To achieve the harmonization a couple of stages were introduced. One of the factors that were important, according to the IAS-regulation no. 16, to maintain the investors trust in the new system was an extensive enforcement.⁶⁵ Responsible for the enforcement became the Committee of European Securities Regulators.

⁶¹ IAS 36 para. 134.

⁶² IAS 36 para. 134 d.

⁶³ IAS 36 para. 134 e.

⁶⁴ IAS 36 para. 134 e.

⁶⁵ CESR/02-118b.

To improve the coordination of the enforcement between the member states, two set of guidelines were developed by CESRs standing committee and the Sub-committee of enforcement.⁶⁶ The first standard gave guidance on the purpose of the enforcement and how it should be brought out in the member states, in principle II in the no.1 standard the enforcement is defined as:

*“- monitoring compliance of the financial information with the applicable reporting framework;
- taking appropriate measures in case of infringements discovered in the course of enforcement.”⁶⁷*

The framework also states that the countries are supposed to announce an independent authority which have the responsibility for the countries enforcement compliance. This could be carried out by another body which is supervised by the responsible bodies and have the competence and recourses to perform the enforcement.⁶⁸ To make sure that the companies are in compliance with the IAS-standards endorsed by the EU the national enforcement body can take action. The penalties should not be the same as the national legislation states. The sanctions should be effective and shall be decided on the national level.⁶⁹ The guidelines also states that the national enforcement bodies shall discuss difficult situations to improve the coordination in the EU. This was criticized by the profession who argued that this could create a conflict in how to interpret the standards.⁷⁰ To avoid this the guidelines states that there shall not be developed applications guidelines by the enforcers⁷¹

The second standard focus on how to improve the coordination between the member states and it seems like it continues where the first standard ends. One of the most important principles is no. 4 which states that European Enforcement Coordination Sessions shall be organized and contains all member states responsible enforcement bodies to discuss dissensions which have been made.⁷² This was introduced to improve the harmonization of enforcement and EECS contains today of 37 bodies from 29 different countries. EECS also have a database where they describe important enforcement decision and some of these are published for the public. During the years several decisions regarding impairment of goodwill

⁶⁶ CESR/03-317c.

⁶⁷ CESR/03-073 p 2.

⁶⁸ CESR/03-073 p 3-4.

⁶⁹ CESR/03-073 p 16-19.

⁷⁰ FEE (2003).

⁷¹ CESR/03-073.

⁷² CESR/03-317c p 4.

have been published, until today thirteen extract from EESCs database have been published on ESMA's webpage.

In 2011 CESR was replaced by European Securities and Markets Authority by the regulation No. 1095/2010. ESMA's main purpose is to continue CESR's work to coordinate the enforcement in the EU. To achieve the goal ESMA monitors the transparency, integrity, efficiency and improving the investor protection in the listed companies. ESMA have also improved the international cooperation to improve the enforcement in all countries which account according to IFRS.⁷³

In January 2013 ESMA issued a report regarding how the companies accounted for impairment of goodwill and other intangible assets. Because of the financial crises and the economic turbulence, ESMA believed that many industries generating lower cash flows compared to calculated and because of that goodwill should be written down.⁷⁴ In the report ESMA found out that the compliance to IAS 36 in the EU is good but need to be improved in some areas. ESMA believes that the most important factors to improve is the sensitive analyze, more transparent reports and better disclosure of the managers key assumptions.⁷⁵

We believe that one of the reasons why ESMA release this kind of report is because this standard has a lot of different stages and this leave space for managers to make assumptions which is not always disclosed in the financial reports. To release a report like this might give some guidelines to the national enforcers but also to the preparer of the financial reports. As the guidelines states, ESMA's work should not be used to interpret the IFRS standards. We believe this is a delicate balance to not make ESMA's reports and the statement to a way for companies to interpret the standards but still achieve better compliance.

3.3.1 ESMA Report Regarding Impairment Testing of Goodwill

After a statement from H. Hoogervorst, chairman of the IASB, where he said that impairment of goodwill often came too late during the financial crisis, ESMA decided to include impairment of intangible assets in its work during 2012. To examine how the disclosure requirements in IAS 36 were followed, ESMA decided to perform an overview of 235

⁷³ ESMA/2011/414.

⁷⁴ ESMA/2013/2.

⁷⁵ ESMA/2013/2.

European companies, from 23 countries, with a significant amount of goodwill.⁷⁶ ESMA selected a couple of factors which they examined, among them was the general information regarding goodwill. Among these factors the use of valuation method, discount rate and terminal growth rate were studied. The overview was performed on public available reports from the companies. The purpose was not to evaluate if the disclosure had been met, but what and how the companies had chosen to disclose.

ESMA found that most of the companies used the value in use method when calculating the impairment test. The report also states that the majority of the companies provided proper information regarding the cash generating units. Considering the discount rate ESMA believes that the companies should be better to use different discount rates on different cash generating units because of the major impact the discount rate have on the value in use calculation. ESMA also believes that the terminal growth rate is too optimistic. According to the study 15 % of the companies had an estimated growth rate over 3 %.⁷⁷

As a result of the review ESMA presented five areas of concern.

- Key assumptions of the management
- Sensitive analysis
- Determination of recoverable amount
- Determination of growth rates
- Disclosure of an average discount rate

ESMA will use these areas and work together with the national authorities to improve the enforcement in the EU. ESMA also states that they will continue to collect and control data from listed companies in this area and report the findings.⁷⁸

⁷⁶ ESMA/2013/2.

⁷⁷ ESMA/2013/2.

⁷⁸ ESMA/2013/2.

4. Framework

In this chapter, different factors which could affect accounting practice are presented. The chapter treats factors such as isomorphism, earnings management and country specific issues. The country specific factors that are treated are, inter alia, enforcement and culture. The chapter ends with a summary of the factors, presented in the chapter, which might influence accounting practice.

4.1 Factors That Might Affect Accounting

IFRS is usually said to be a principle based set of standards, i.e. the standards usually give qualitative guidance rather than quantitative.⁷⁹ This means that the standards are designed to cover as many situations as possible and therefore does not give detailed guidance on how to account in specific situations. These principle based rules, demands that the preparers use their professional judgment when they take accounting decisions and make valuations and estimations.⁸⁰ In order for the preparers to use their professional judgment, the IASB Conceptual Framework, and the Qualitative Characteristics, gives guidance regarding which characteristics the information must possess in order to be useful to the intended users of financial statements. The two fundamental Qualitative Characteristics in the Conceptual Framework is Relevance and Faithfull Representation.⁸¹ Faithfull Representation states that the information must be *complete, neutral and free from error*.⁸² The concept of neutrality means that the information should not be biased or manipulated by the preparers⁸³ and neutrality is something that have been discussed and questioned by several researchers.⁸⁴

As mentioned above, studies between companies, that use IFRS, from different countries have shown that accounting practice differs between countries even though the same set of standards is used and this could be explained by the fact that IFRS is principle based and the preparers uses their professional judgment.⁸⁵ Studies have also been conducted regarding which factors that influences the preparers' judgment and explains why the preparers choose

⁷⁹ Marton et al. (2013) p.7.

⁸⁰ Marton et al. (2013) p.7.

⁸¹ IASB (2010) The Conceptual Framework for Financial Reporting para. QC5.

⁸² IASB (2010) The Conceptual Framework for Financial Reporting para. QC12.

⁸³ IASB (2010) The Conceptual Framework for Financial Reporting para. QC14.

⁸⁴ See Deegan and Unerman (2011) p. 44.

⁸⁵ See for example Nobes (2011) and Nobes and Kvaal (2012).

one accounting method in favor of another. In the part below we will present some of the studies which have been made on which factors that could affect accounting practice. We have chosen to examine a couple of different studies which try to explain accounting choice. To not limit ourselves to only one theory or earlier study we hope to improve our understanding of which factors that affect the accounting decision in companies by discussing some different studies and theories. These studies discuss both the organizations and the individuals in the organizations and what factors that could affect their choices.

4.1.1 Isomorphism

One of the most important studies in explaining why organizations tend to be constructed alike and because of this take similar decision is DiMaggio and Powell's⁸⁶ study. They discuss the fact that the organizations have become more homogenous is driven by external factors such as the state and the profession which, they mean, have become more influential the last decades. The authors argue that the organizations in the long run always will become similar and creates a context in which the individuals are limited to handle. The study divides this phenomenon into three different mechanisms, coercive isomorphism, mimetic isomorphism and normative isomorphism.⁸⁷ An example of coercive isomorphism is when organizations change their institutional practices because of pressure from powerful stakeholders such as the state or credit holders.⁸⁸ The mimetic isomorphism explains the fact that organizations tend to adopt successful organizations methods. One example of this is, according to DiMaggio and Powell, the way Japan copied the best western systems in banking and military during the nineteenth century. The normative isomorphism states that people are characterized by their education, culture and economic background and because of that act similar. In our case this might explain some of the assessments made by the companies' top management. The executives might have studied in similar schools and environments. Carpenter and Feroz used, inter alia, these mechanisms to try to explain the state of New York's decision to adopt U.S. GAAP for the external accounting. In this study the authors states that in New York the accountants and auditors needed an education to be able to perform their work. Many of the practitioners also were active in professional organizations. The authors believe that this made the practitioners united in the process to adopting the GAAP and are an example of how the normative isomorphism can affect an organizations

⁸⁶ Dimaggio and Powell (1983).

⁸⁷ Dimaggio and Powell (1983).

⁸⁸ Deegan and Unerman (2011) p. 363.

decision.⁸⁹ A more recent study made by Lundqvist et al. shows that also individual accounting decisions in companies are affected by the pressure from national rules as well from the existing practice in the country.⁹⁰

Douglas describes in her book “How institutions think” that people in an organization sometimes get limited in their decisions to what is accepted in the organization. She writes:

“It is well said that individuals suffer from the bounding of their rationality, and it is true that by making organizations they extend the limits of their capacity for handling information.”⁹¹

It is according to Douglas only the individuals that can think and feel, but the individuals in an organization might sometimes make the decisions in “auto pilot”.⁹² We interpret this as, the individuals, despite what they believe take the easy choice and let the norm of the group make the decision.

Summarizing this part, the reasons that organizations act and are constructed in the same way are according to the isomorphism dependent of both pressure from the environment that the companies act in and from factors inside the companies. As explained in the studies above the pressure make the organizations more homogeneous. This might mean that the companies will perform the accounting more alike over time. In a globalized world this would also reduce differences between companies from different countries and continents.

4.1.2 Earnings Management

One factor that could affect preparers’ judgments and valuations is Earnings Management. Healy and Wahlen define Earnings Management as:

“Earnings Management occurs when managers use judgment in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of the

⁸⁹ Carpenter and Feroz (1992).

⁹⁰ Lundqvist et al. (2008).

⁹¹ Douglas (1986) p.55.

⁹² Douglas (1986) p.15.

company or to influence contractual outcomes that depend on reported accounting numbers."⁹³

Healy and Wahlen stated that there are several different ways which managers can use judgment in accounting, as for example within valuation of assets and assets impairment. They also discuss that their definition states that the use of judgment is to *mislead* stakeholders; this can be achieved because of the fact that preparers have more information than outside stakeholders.⁹⁴

The reasons why earnings management is used in companies can be many. One theory that is commonly used to explain why earnings are managed is Positive Accounting Theory, developed by Watts and Zimmerman in the 1970's.⁹⁵ In PAT, one important assumption is that all humans are driven by their own self-interest. Therefore the theory predicts that if managers bonuses are connected to the accounting figures, for example to earnings, managers will use their accounting discretion and arrange the accounting figures in order to get as high bonuses as possible. A theory like this which assumes that all humans are driven by self-interest can explain why earnings are managed in several different directions.

Burgstahler et al.⁹⁶ studied earnings management in Europe by examining several public and private companies from 13 different European Countries. The study was conducted before IFRS became mandatory within the EU. Burgstahler et al. concluded that, for public firms, Earnings Management is more significant in countries with weaker legal system and enforcement. The result of the study also showed that companies in countries with highly developed equity markets engage less in earnings management. It also showed that managers in private companies used more earnings management than managers in public companies.⁹⁷

Leuz et al.⁹⁸ made a study on how important investor protection is for earnings management and compared companies from 31 different countries. Leuz et al. defined earnings management in the same way as Healy and Wahlen and argued that incentives to manipulate reported earnings through earnings management arise if there is a conflict between the interest of a firm's insiders and outsiders. Leuz et al. thereafter stated that legal systems protects the outsiders by giving them rights to, for example, replace managers and by enforcing that

⁹³ Healy and Wahlen (1999).

⁹⁴ Healy and Wahlen (1999).

⁹⁵ Deegan and Unerman (2011) p. 268.

⁹⁶ Burgstahler et al. (2006).

⁹⁷ Burgstahler et al. (2006).

⁹⁸ Leuz et al. (2003).

insiders' do not exceed their private control benefits. The authors therefore predicted that earnings management was more widespread in countries with a low level of investor protection than in countries with stronger investor protection. The result from the empirical material shows that countries with higher investor protection (stronger enforcement and more legal rights for minorities) have less earnings management.

Jordan and Clark⁹⁹ studied if Big Bath Earnings Management could be found within US companies after the implementation of SFAS No. 142 *Accounting for Goodwill and Other Intangible Assets*. The standard demands, as IAS 36, that no amortization should be done, instead the assets should at least annually be tested for impairment and this test demands many assumptions and judgments. Big Bath Earnings Management means that a company that is having a year of low earnings is using their discretion to make write downs which reduce the earnings even more in order to show better earnings figures coming periods. This is done because of the believe that the market does not punish a company much harder if the company is far away from the earnings prediction or just below it. In the initial year of adoption (2002) of SFAS No. 142 impairment losses did not affect operating income, while after 2002 it did, therefore Jordan and Clark predicted that Big Bath Earnings Management could be seen in US companies in 2002. Jordan and Clark therefore studied the fortune 100 companies for years 2001 and 2002 by comparing the return on assets, return on sales and goodwill to total assets between companies that did impairments and the companies that did not. The results showed that the companies that did impairments had significantly lower ratios in 2002 compared to 2001 and compared to the companies that did not impair their goodwill. Jordan and Clark therefore concluded that the results are evidencing that companies practiced Big Bath Earnings Management in the year when SFAS No. 142 was adopted.

To summarize former studies and literature regarding earnings management, as have been mentioned above, earnings management could be used to explain why managers make certain choices regarding judgment, valuations and estimations. Several authors, Such as Watts¹⁰⁰ and Massoud and Rayborn¹⁰¹ (Both articles dealt with the implementation of the US standard SFAS No. 142 which has big similarities to IAS 36), have argued that the change of the treatment of goodwill, to impairment testing rather than amortization, could lead to more earnings management. This has also been shown by Jordan and Clark who concluded that Big Bath Earnings Management was used by companies when SFAS No. 142 was implemented in

⁹⁹ Jordan and Clark (2004).

¹⁰⁰ Watts (2003).

¹⁰¹ Massoud and Raiborn (2003).

the USA. Other studies, such as Leuz et al. and Burgstahler et al., have shown that the amount of earnings management that is performed varies between different countries. The studies showed that more earnings management is performed by companies in countries with less developed equity markets and in countries where the investor protection was lower, i.e. countries with stronger legal enforcement and stronger rights for minority shareholders suffered less from earnings management.

4.1.3 Country differences

As have been mentioned above, all listed companies within the EU are using the same accounting standard when preparing their consolidated financial statement. Despite that, studies, by for example Nobes¹⁰² and Nobes and Kvaal¹⁰³, have shown that there are differences in accounting practice between companies in different countries. These differences have been explained by the fact that IFRS is principle based and demands professional judgments to be made by the preparers. The reason for why the IFRS standards get interpreted differently can be explained by several factors.

One factor that could influence how principle based accounting standards gets interpreted and used in practice is how the accounting standards are enforced. Schipper¹⁰⁴ mentioned that it is problematic to get a convergent accounting practice between countries when the enforcement in EU is at a national level. Schipper also mentions that even though Committee of European Securities Regulators¹⁰⁵ exists, it is not as effective as having one enforcement body and it will be hard to create one enforcement body within the EU since countries have different legal systems and different cultures.¹⁰⁶

Hope¹⁰⁷ has made a study on enforcement where he compared the enforcement in 22 different countries. Hope formulated an index based on his studies on audit spending, insider trading laws, judicial efficiency, rule of law and shareholder protection. Based on his findings, Hope concluded that United States and United Kingdom were the countries with strongest enforcement indexes while Spain and Italy were the countries with lowest enforcement

¹⁰² Nobes (2011).

¹⁰³ Nobes and Kvaal (2012).

¹⁰⁴ Schipper (2005).

¹⁰⁵ Nowadays called European Securities and Markets Authority.

¹⁰⁶ Schipper (2005).

¹⁰⁷ Hope (2003).

indexes. Sweden and was ranked fifth, Canada was ranked third while South Africa was ranked third last.

Another factor that differs between countries and could affect accounting choices and the judgment is the link between tax and accounting. Even though consolidated financial statements are not used for tax purposes there are, according to Nobes and Parker, some ways that the tax could influence even the consolidated financial statements.¹⁰⁸ Nobes and Parker mention that impairment of assets are tax deductible in Germany which could lead to more impairments of assets in the individual accounts, compared to for example U.K. where the asset impairment are not tax deductible, and these impairment might get along to the consolidated accounts since IAS 36 leaves room for judgment.¹⁰⁹

It is not only different rules that can affect differences in accounting, also culture have been proved to affect the accounting and the judgment in companies. Hofstede made in the 1980's a major study where he examined and discussed the differences in culture between countries and how that affected the management's way of acting. He defines the culture in the following way:

“... culture is the collective programming of the mind which distinguishes the members from one group or society from another.”¹¹⁰

The author divides culture in four value dimension to be able to define the differences between countries. These are, individualism versus collectivism, level of power distance, how people in the society feel about uncertainty and masculinity versus femininity.

Inspired by Hofstede's article, Gray made a study to examine how these cultural differences affected the accounting in different countries. The author used Hofstede's groups of countries e.g. the Anglo group which, inter alia, included Australia, the U.S. and The U.K.. and the Nordic group which included all Nordic countries.¹¹¹ Gray then translated Hofstede's value dimensions into how these were going to affect the accounting. Based on this he divided the groups into a model explaining how the culture characteristics the accounting. These studies have been tested by many different researchers and we will now discuss some of them to emphasize the importance of cultural differences in accounting judgments.

¹⁰⁸ See also Nobes in ACCA (2011).

¹⁰⁹ Nobes and Parker (2011) p. 157.

¹¹⁰ Hofstede (1984).

¹¹¹ Gray (1988).

Built on Hofstede's and Gray's studies Tsakumis, tested if he could find differences between the Greek and U.S. accounting decisions caused by the culture differences. According to Gray and Hofstede the U.S. and Greece culture is very different in conservativeness and secrecy. The U.S. is defined as a country with high level of conservatism and secrecy and Greece as having a much lower level. The purpose with the study was to test Gray's framework by examine differences between American and Greek accountants in disclosing and recognition decisions.¹¹² The result showed that there were no difference between the American and the Greek accountants decisions regarding recognition of assets and liabilities. But there were differences between what they chose to disclose. Tsakumis analyze this as a flaw in Gray's framework but still believes that cultural differences affect the accounting decisions and because of this can hinder the comparability between countries.

Even more recent studies show that the culture is an important factor explaining the judgment in accounting. Chand et al. concludes that:

“The results of this study show that national culture has a significant effect on the judgments of accounting students when interpreting and applying selected IFRS containing uncertainty expressions, despite the location of their tertiary education.”¹¹³

This study performed on Australian and Chinese accounting students show that culture has a strong affect in accounting decisions even if the students have the same education. Summarizing these studies we believe that differences in culture have a strong effect on accountants and their judgment. Despite that some tests have shown that Gray's and Hofstede's research is not flawless we believe that the culture could have an impact to how people make different decisions despite the same standards. The result of Chand's study also indicates that despite educated at the same university the culture still affect the judgment.

4.1.4 Guidance

As we mentioned in the beginning of this chapter IFRS is principle based standards compared to U.S. GAAP which is rule based. Because of this the guidance of how to implement and to use the standards sometime is not completely clear, instead it leave some questions to the practitioners to interpret. Because of this Schipper questioned the mandatory implementation

¹¹² Tsakumis (2007).

¹¹³ Chand et al. (2011).

of IFRS in the EU 2005 and how successful this would become. She meant that implementing a single set of standards to all listed companies would create problems because of the differences in size, ownership structure, political jurisdiction and quality of financial reporting.¹¹⁴ She also believed that there were not enough guidelines of how to implement the standards. Schipper thought that in the uncertainty that would appear because of the change the accountants and auditors might try to find the answer in other ways e.g. the national GAAP. Because of this she assumed that because of the lack of guidance, this adoption would take more time and be more expensive than necessary. She also predicted that this would create a slower international convergence in the accounting.¹¹⁵

4.1.5 Summary

Summarizing these studies and theories we have tried to examine a couple of different factors that, according to earlier studies, can affect judgment in accounting decision. As we wrote above, IFRS is principle based and because of this the practitioners' judgment affects how the companies account. These studies show that the reasons for the decisions can depend on both internal and external factors. By external factors we mean factors outside the companies. Accounting also gets affected by internal factors such as the people who perform the accounting and the culture in the companies. Trying to divide the earlier studies in to external and internal is hard because many of these affect in both ways. We will, despite this, discuss them based on these two ways. The guidelines, enforcement and the different national rules e.g. the tax-rules are factors which affect the companies from the outside. They are all decided outside the companies and the companies have to adapt to these regulations.

All of these studies, except the isomorphism, discuss things that will explain why there are differences between the companies. The isomorphism theory is instead trying to explain why organizations are acting in a homogenous way. This theory can, as mentioned earlier, be divided in to three lines were the coercive and the mimetic can be classified as affect the accounting decisions from the outside and the normative can be said to affect in both external and internal ways. Also the culture can be said to affect the company both from the outside and the inside. The national cultures can be seen as an external factor and the companies' corporate culture and the individuals' way to act in the organization can be seen as an internal

¹¹⁴ Schipper (2005).

¹¹⁵ Schipper (2005).

factor. Earnings management literature focuses on the individual and how and why they account as they do and because of this we believe that this is an internal factor.

Of course there can be other factors that affect the accounting choices in companies but we believe these factors, mentioned above, are the major ones. We are also aware of that these factors affect each other in different ways. For example, studies have shown that accounting in countries with high level of enforcement is less affected by earnings management.¹¹⁶

¹¹⁶ See Leuz et al. (2003) and Burgstahler et al. (2006).

5. Empirics

In this chapter the collected data will be presented. The collected data comes from 82 companies from countries within the EU and 68 companies from countries outside of EU. The data collected treats what information, regarding their annual impairment test of goodwill, companies have chosen to disclose in their annual reports for 2012.

5.1 Overview

As have been mentioned in the method, we have conducted a comparative study where we have gone through annual reports from companies within the EU and from countries outside of EU. We have studied if the companies disclosed information, required by IAS 36, regarding impairment testing of goodwill.¹¹⁷ Our first selection included 105 companies from EU countries and 108 companies from non-EU countries. After removing companies that had not published their 2012 annual report, did not have any goodwill, did not prepare their consolidated financial statements using IFRS, or did not use a discounted cash flow model to calculate the recoverable amount for their cash generating units, a final selection of 82 companies from EU countries and 68 companies from non-EU countries were included in the study. The companies represent 11 countries within the EU and four countries outside of EU. The distribution of companies between countries can be seen in table 5.1 below.

EU Countries	Companies	Non-EU Countries	Companies
U.K.	25 (31)	Canada	32 (50)
France	10 (21)	Australia	16 (24)
Germany	18 (18)	Russia	9 (20)
Sweden	9 (9)	South Africa	11 (14)
Italy	7 (8)	Total	68 (108)
Netherlands	4 (6)		
Spain	4 (6)		
Finland	2 (2)		
Denmark	1 (2)		
Belgium	1 (1)		
Czech Republic	1 (1)		
Total	82 (105)		

Table 5.1

¹¹⁷ See section 2.4 for more information regarding how the data was collected.

In table 5.2 the amount of goodwill compared to total assets in companies from EU countries compared to non-EU countries is shown. As can be seen by table 5.2, the median goodwill to total assets is higher in companies from the EU and so is the proportion of companies who has a goodwill post that is more than 20 % of total assets.

Goodwill / Total Assets	EU	Non-EU
Range	0,02 – 51,16 %	0,07 – 49,91 %
Companies Goodwill > 20 % of total assets	26	7
Proportion Goodwill > 20 % of total assets	31,71 %	10,29 %
Median Goodwill / Total Assets	10,00 %	3,20 %

Table 5.2

Regarding which method to use when calculating the recoverable amount for cash generating units, IAS 36 states that the recoverable amount is the higher of Value In Use and Fair Value Less Cost of Disposal. Figure 5.1, below, shows the proportions regarding which method that has been used by companies from all countries in the study. As can be seen by the figures, FVLCS is more frequently used in the non-EU countries compared to the EU countries where VIU is the predominant used method. It should also be noted that there are more companies from non-EU countries than from EU countries that did not disclose which method that was used to determine the recoverable amount. To see if the difference, regarding disclosure of method used to calculate the recoverable amount, was significant, we tested **hypothesis A** and got a p-value of 0 % which means that H_0 is rejected and there is a significant difference.

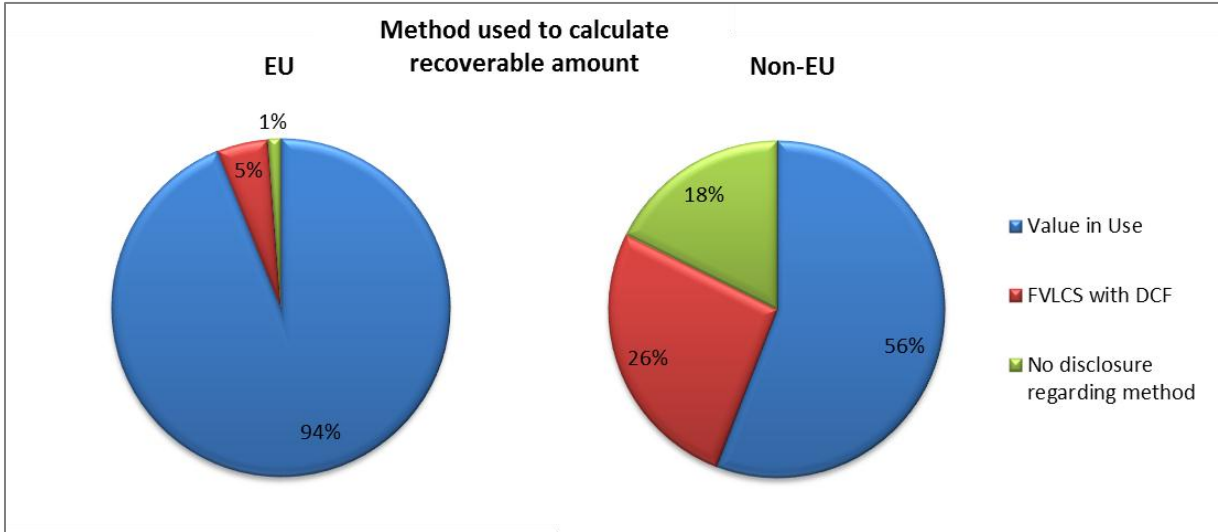


Figure 5.1

Figure 5.2 shows which method that has been used by companies from countries within the EU. As can be seen, VIU is the most commonly used method in all countries. In Germany, there were three out of 18 companies that used FVLCS, in the U.K. one company out of 25 used FVLCS, in the other countries all companies in this study used VIU. One out of 82 companies did not disclose which method that was used to determine the recoverable amount, and it was the French company LVMH¹¹⁸. It should also be noted that two companies used FVLCS but did not calculate the FVLCS using a discounted cash flow model and therefore was not included in the study and is not shown in figure 5.2, these two companies were from the Netherlands.

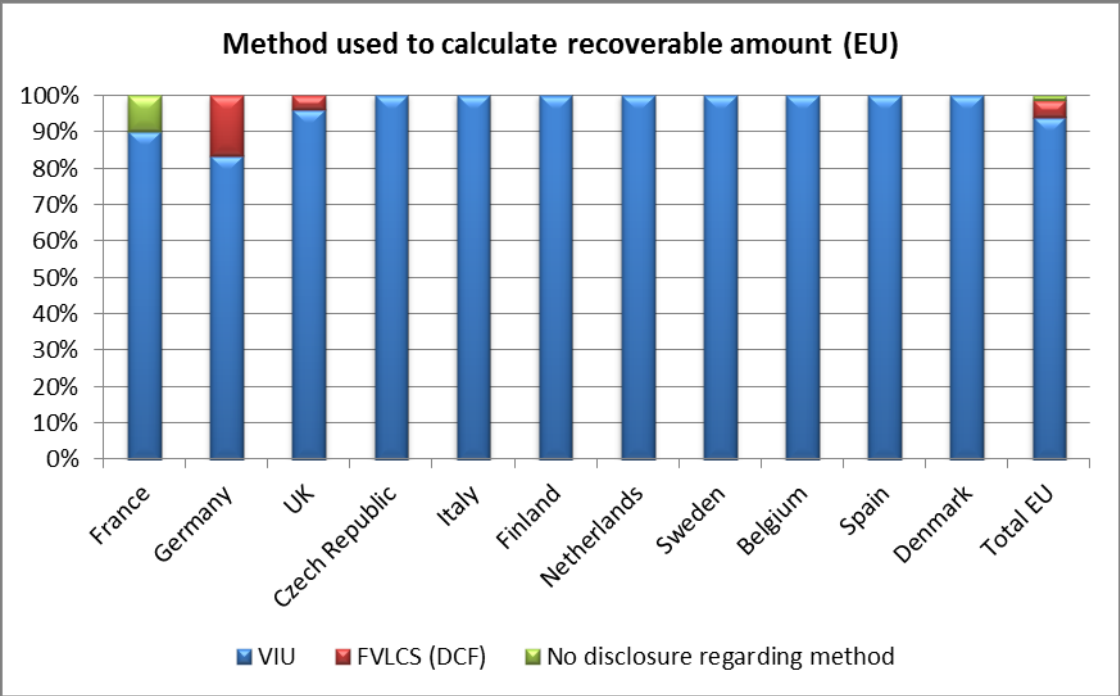


Figure 5.2

Figure 5.3 tells the proportion regarding which method that has been used to calculate the recoverable amount in companies from non-EU countries. As can be seen, VIU is the most used method by companies from Australia, Russia, South Africa and overall. In the Canadian companies that were included in the study, it was more common to calculate the recoverable amount using FVLCS. 12 out of 68 companies did not disclose which method they used to calculate the recoverable amount, distributed as follows, six companies from Canada, two companies from Australia, three companies from Russia and one company from South Africa.

¹¹⁸ Louis Vuitton Moët Hennesy.

It should also be noted that five companies did use FVLCS but did not use a discounted cash flow model and therefore was not included in the study. Out of these five companies, two were Canadian companies and three were Australian companies.

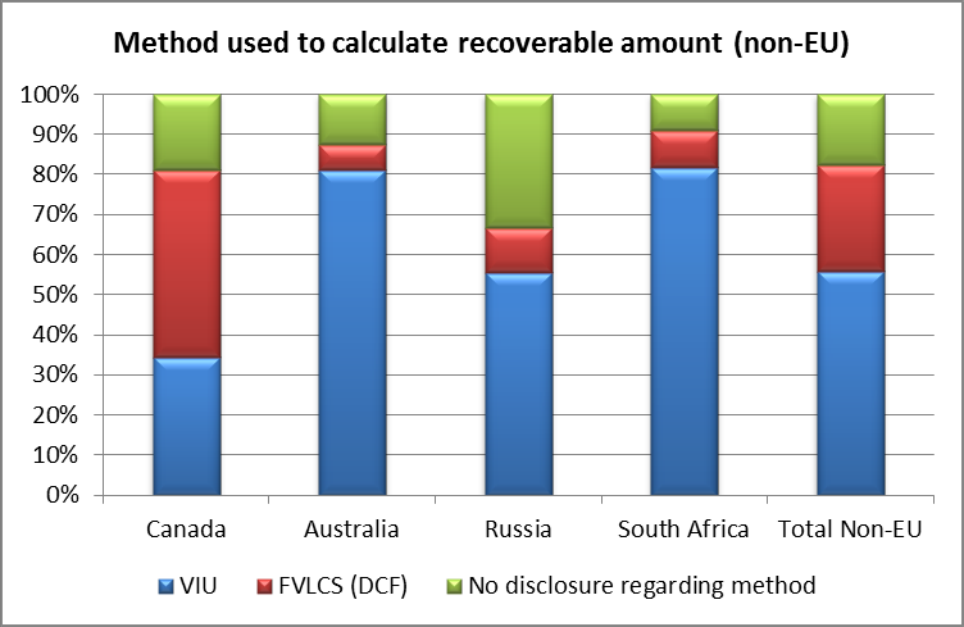


Figure 5.3

5.2 Discount Rates

As mentioned above, IAS 36 requires companies to disclose which discount rate that has been used for each Cash Generating Unit where the amount of goodwill is significant compared to the company’s total goodwill.¹¹⁹ This is required regardless if the company uses VIU or FVLCS with a discounted cash flow model. As can be seen by figure 5.4, there were more companies from EU countries than from countries outside of EU who disclosed which discount rate that was used for each cash generating unit. 72 % (59 out of 82) of the companies from countries within the EU disclosed the discount rate used for each cash generating unit compared to 55,9 % (38 out of 68) of the companies from countries outside of EU. To see if the difference was significant, we tested **hypothesis B** and got a p-value of 4 % which means that H₀ is rejected and there is a significant difference.

¹¹⁹ As have been mentioned in the method-chapter, IAS 36 do not say which cash generating units that are significant compared to total amount of goodwill, therefore, in cases where the companies have not stated which cash generating units they find significant, we have assumed that if a cash generating units carrying amount is more than 10 % of the carrying amount of total goodwill, the cash generating unit is significant.

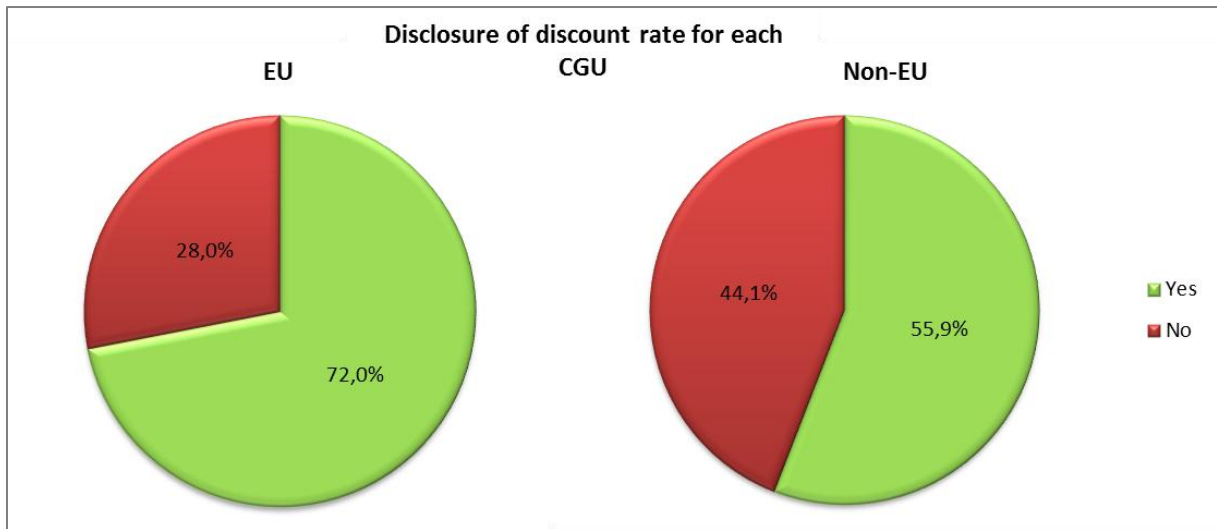


Figure 5.4

Figure 5.5 shows the proportion of companies from each country in the study that have disclosed which discount rate used for each cash generating unit with a carrying amount of goodwill that is significant compared to the company’s total carrying amount of goodwill. The group called “other EU” includes companies from Netherlands, Spain, Finland, Denmark, Czech Republic and Belgium. France and Germany from the EU group and Canada and Russia from the non-EU group were the countries which had lowest disclosure ratios.

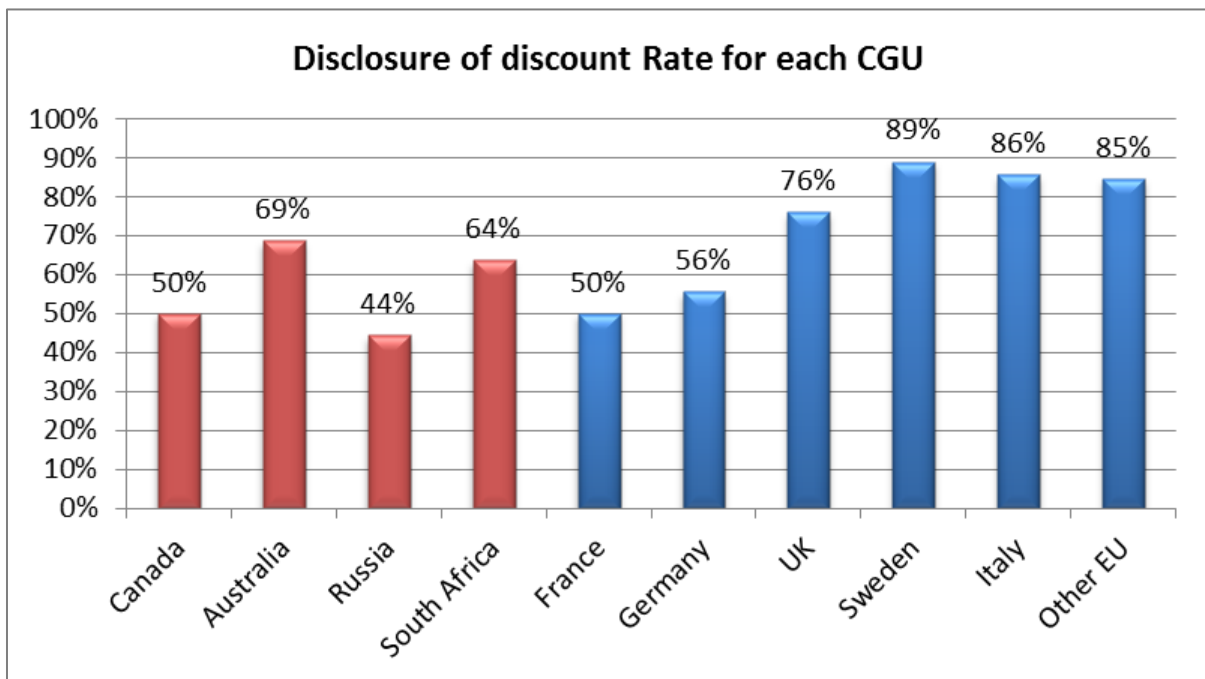


Figure 5.5

5.3 Terminal Growth Rate

The growth rate was one of the things ESMA discussed in their report. They believed that the companies were too optimistic because many companies decided to calculate with a growth rate over three percent.¹²⁰ We have found that companies often have major differences between the CGU depending on which country and industry it is operating in. This can be seen in, for example, SABMillers annual report where the company estimate a growth rate between 1,8 % in Europe to 19,2 % in the Asia Pacific.¹²¹ IAS 36 does not regulate the amount of the growth rate but states, as we mentioned above, that the companies shall disclose what terminal growth rate they have used for every CGU. Figure 5.6 shows how the companies in the study meet this requirement. The results shows that 65,9 % (54 out of 82) of the companies in the EU group disclose this and 42,6 % (29 out of 68) of the companies in the non-EU group disclose the growth rate for every CGU. To see if the difference was significant, we tested **hypothesis C** and got a p-value of 0,4 % which means that H_0 is rejected and there is a significant difference.

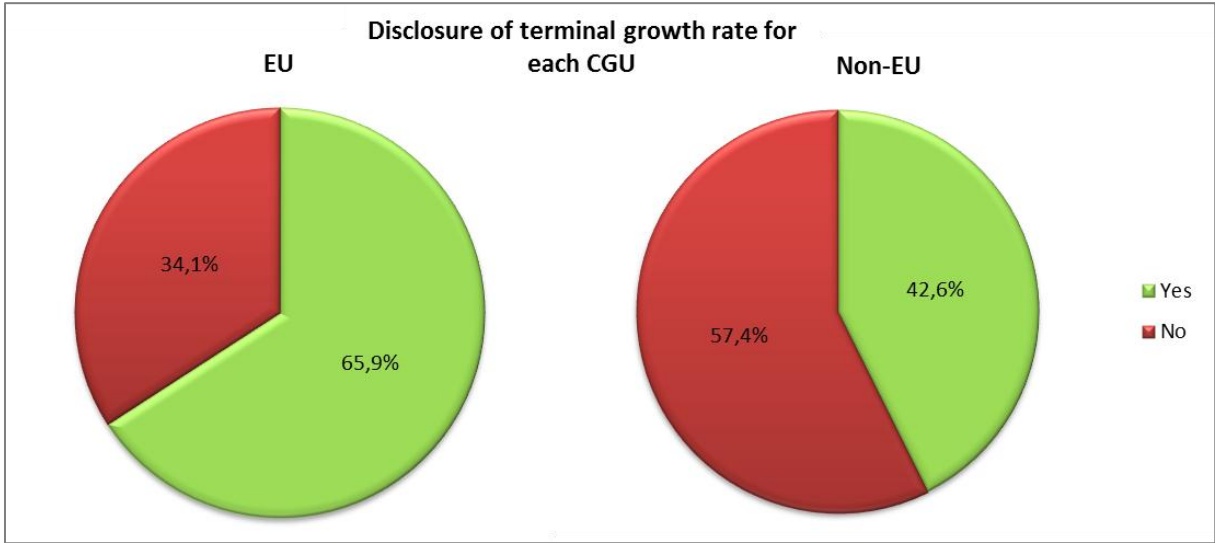


Figure 5.6

Figure 5.7 shows the proportion of companies from each country in the study that disclosed which terminal growth rate used for each CGU where the carrying amount of goodwill was significant compared to the company’s total carrying amount of goodwill. As can be seen by

¹²⁰ ESMA/2013/2.

¹²¹ SABMiller annual report 2012 p. 112.

the figure, all countries in the EU group have a higher proportion of companies that disclosed which terminal growth rate used for each CGU than the non-EU group, except for France.

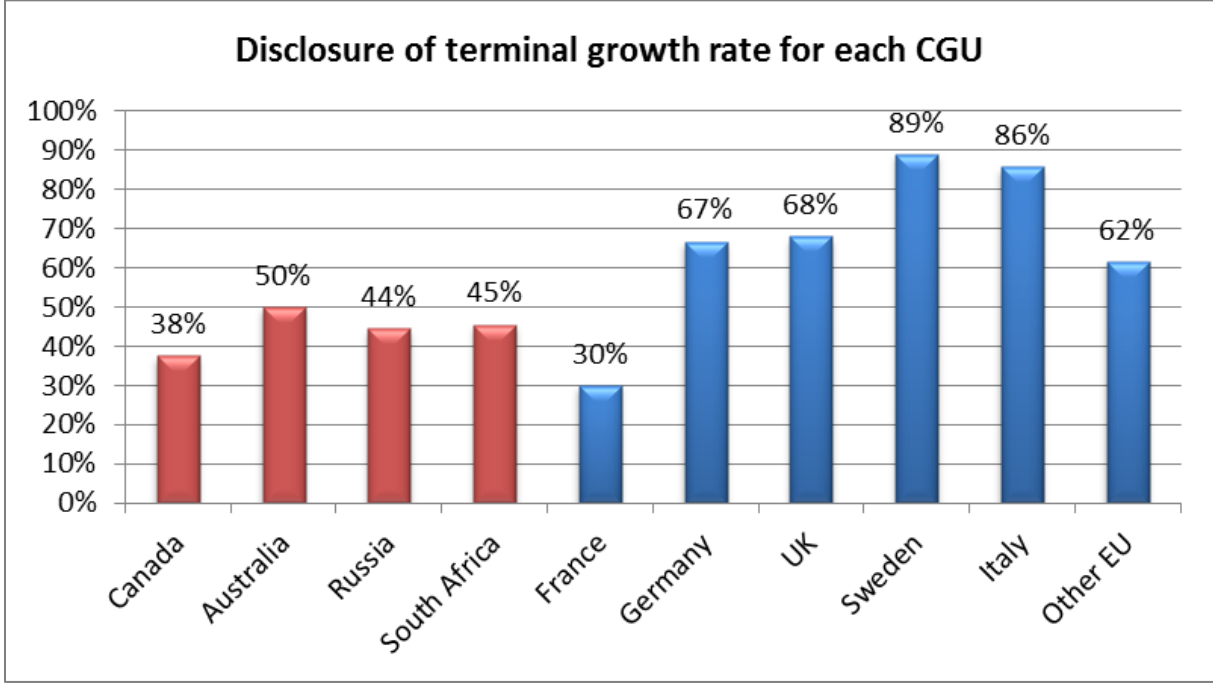


Figure 5.7

5.4 Periods Covered by budgets and forecasts

In our study we have also examined how many of the companies disclosing the period of time the discounted cash flows are estimated on. Figure 5.8 shows that 48,5 % (33 out of 68) of the non-EU group disclose this information and 78 % (64 out of 82) in the European group. To see if the difference was significant, we tested **hypothesis D** and got a p-value of 0 % which means that H_0 is rejected and there is a significant difference.

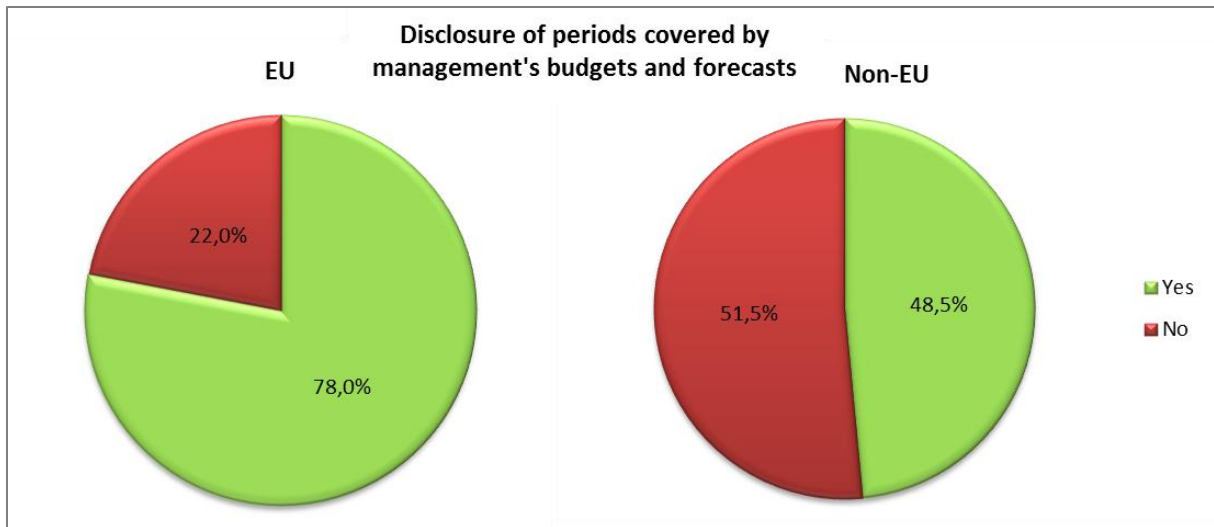
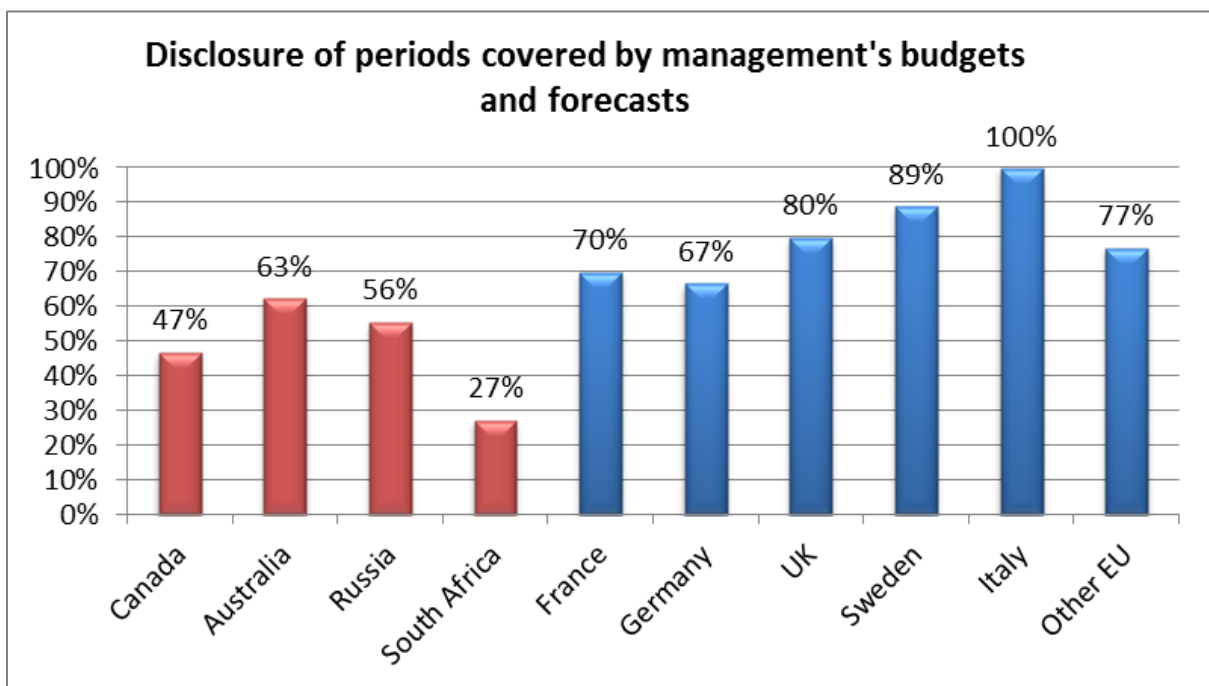


Figure 5.8

Figure 5.9 shows the proportion of companies from each country that disclosed which periods, in their discounted cash flow model, that was covered by management's budgets and forecasts. As can be seen by the figure, all countries in the EU group had higher proportion of companies that disclosed which period covered by management's budgets and forecasts compared to the non-EU group.



Figur 5.9

5.5 Pre- or Post-tax discount rates

The rules in IAS 36 also require the companies to perform the calculation with a pre-tax discount rate.¹²² During the collection of data, we saw that several companies used post-tax discount rates. In order for users to be able to form an opinion regarding the discount rates used, it is of importance that the preparers disclose if the discount rates used is pre-tax or post-tax. For the users, it is of less importance if the discount rates are calculated using pre-tax or post-tax discount rates, since it is possible for the users to recalculate the discount rates from post-tax to pre-tax and vice versa. According to our study most of the companies have chosen to disclose if they use a pre-tax or post-tax discount rate. As figure 5.11 displays, 81,7 % (67 out of 82) of the companies in the EU group disclosed if a pre-tax or post-tax discount rate was used compared to 64,7 % (44 out of 68) in the non-EU group. Less than 10 % of the companies also choose to disclose the discount rate both before and after tax. To see if the difference was significant, we tested **hypothesis E** and got a p-value of 1,8 % which means that H₀ is rejected and there is a significant difference.

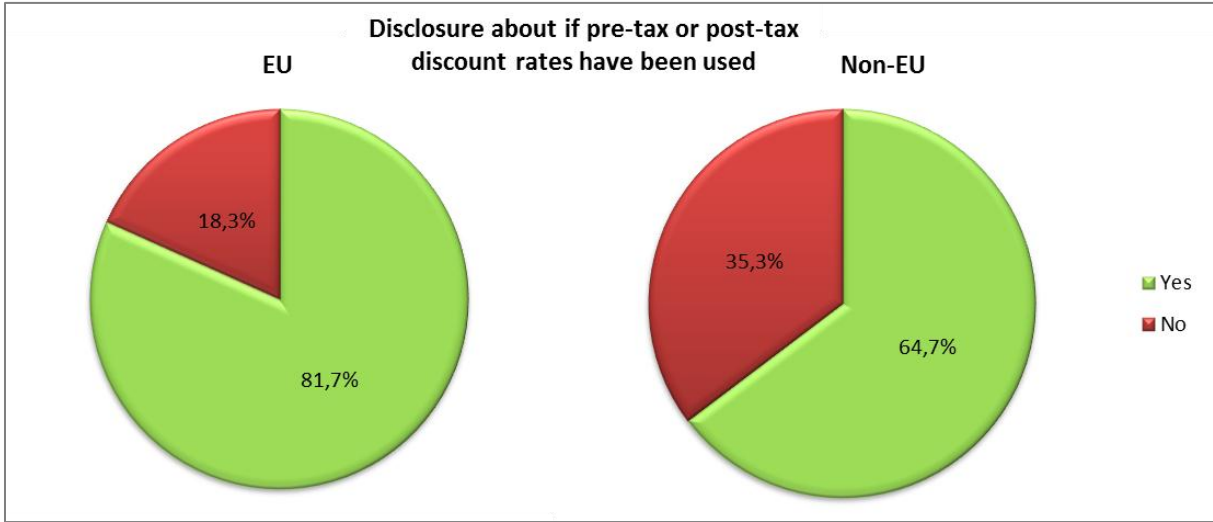


Figure 5.10

Figure 5.12 shows the proportion of companies in all countries regarding the disclosure of if pre-tax or post-tax discount rates have been used. As can be seen by the figure, Australia and South Africa has a high proportion of companies that disclosed the information and are quite in line with the EU group. France was the country from the EU group that had the lowest proportion of companies that disclosed if pre-tax or post-tax discount rates were used.

¹²² IAS 36 para. 55.

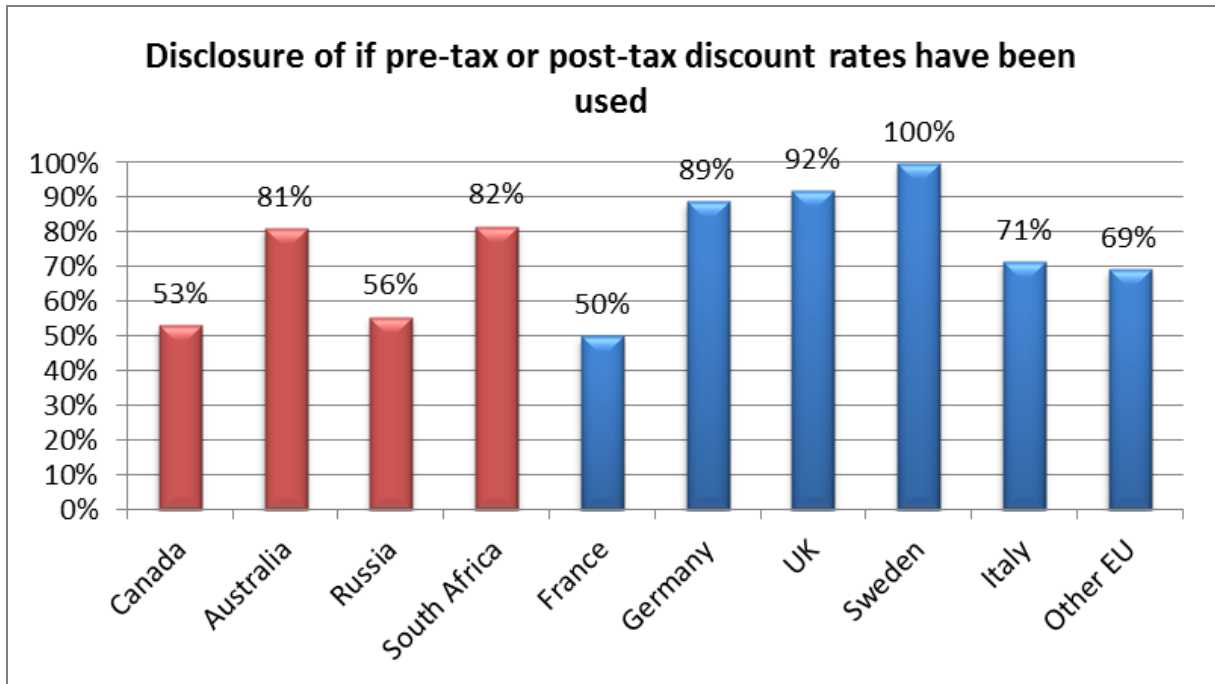


Figure 5.11

6. Analysis and Reflection

In this chapter, we will analyze and reflect over the results from the conducted document study. The result of the empirical study will be discussed by using the external and internal factors, mentioned in chapter four, that could influence accounting practice in order to try to explain differences and similarities and in that way answer the research question.

6.1 Findings

As have been shown in the empirics chapter above, the results of the study shows that there are differences regarding how many companies from countries within the EU that discloses information required by IAS 36 compared to companies from countries outside of EU. Significant differences were found regarding how many companies from the two different groups that disclosed which method used to calculate the recoverable amount, which discount rates used, which terminal growth rates used, which periods that was covered by managements budgets and forecast, and if pre-tax or post-tax discount rates were used.

Disclosure of:	EU	Non-EU	p-value
Method used to calculate recoverable amount	98,8 %	82,4 %	0,000
Discount rate	72,0 %	55,9 %	0,040
Terminal growth rate	65,9 %	42,6 %	0,004
Periods covered by budgets and forecasts	78,0 %	48,5 %	0,000
If pre-tax or post-tax discount rates was used	81,7 %	64,7 %	0,018

Table 6.1

All companies in this study follow IFRS and are therefore obliged to follow the same accounting standards and have the same disclosure requirements. Despite this, there are significant differences regarding the disclosure ratio regarding all five parameters studied. These results indicate, what several other studies have already shown, that there are other factors than the actual accounting standards that affect accounting practice.

IFRS is a principle based set of standards and the conceptual framework is of great importance when financial statements are prepared. The objective of IFRS is to provide useful information to the intended users of financial reports and for the information to be useful, the fundamental qualitative characteristics, relevance and faithful representation, must be fulfilled. Since the result of this study shows that the disclosure ratios in the EU group are higher compared to the non-EU group, it could be discussed if the companies from countries within the EU provides more relevant and faithfully represented information. As have been mentioned throughout this thesis, in order to harmonize accounting between countries and enhance comparability between companies, it is of great importance that financial reports are transparent, i.e. it is important that companies disclose relevant information. Disclosures are particularly important when companies have used a large amount of judgments and assumptions when preparing the accounts. Without relevant disclosures, users of the financial reports have no chance to form an opinion regarding companies' judgments and assumptions and it will be impossible for users to compare different companies. The fact that the EU group had higher disclosure ratios indicates that the information is more relevant and faithfully represented, which also leads to higher comparability between companies.

There are also other reasons than to enhance comparability that makes disclosures important. Healy and Wahlen discussed how earnings management could affect management's judgments and assumptions.¹²³ Healy and Wahlen stated that earnings management includes misleading some stakeholders and this could be done because of information asymmetry. As have been mentioned before, the factors discussed in chapter four do not only affect accounting practices and disclosures, the factors could also affect each other. Several studies have shown that earnings management is a larger problem in countries where the enforcement is weak, i.e. the degree of enforcement affects the level of earnings management.¹²⁴ It could be discussed if level of earnings management is affected directly by the enforcement, or indirectly by the fact that enforcement agencies makes companies disclose more information and in that way the information asymmetry gets lowered and therefore reduces the companies' possibilities to manage earnings. By disclosing information, the information asymmetry might decrease which makes the possibility for earnings management smaller. The fact that the EU group had higher disclosure ratios than the non-EU group might lead to less information asymmetry and therefore fewer possibilities for earnings management.

¹²³ Healy and Wahlen (1999).

¹²⁴ See for example Burgstahler et al. (2006) and Leuz et al. (2003).

As have been mentioned several times throughout this thesis, many researchers have stated that accounting enforcement is a crucial factor for how accounting standards are followed and interpreted. The differences found between the EU group and the non-EU group could therefore be interpreted as enforcement within the EU has led to the fact that more companies from countries within the EU disclose information regarding their impairment test of goodwill. As mentioned in chapter four, different researchers have pointed out several external and internal factors, other than enforcement, that affect companies accounting practices in different ways and explain differences and similarities. Therefore, it might also be other factors than enforcement that could explain the results of this study, such as isomorphism and country differences. These factors and their possible implication on companies' disclosure practices will be discussed below.

6.2 Isomorphism

The result which we presented in the chapter above shows that the EU group do more disclosures, regarding impairment testing of goodwill, compared to the non-EU group. As mentioned earlier the isomorphic theory is generally used to explain why organizations act similar. This could, according to the theory, depend on different reasons such as external forces, the organizations willingness to mimic successful competitors and organizations way trying to adapt to the norms of the society. Even though many of the multinational companies, which we have based this study on, are active all around the world, many studies shows that the companies still are affected of their country of origin.¹²⁵ The company's main decisions might often be decided in the headquarters and it is likely to believe that the companies try to mimic successful companies which operate on the same markets. This might explain why companies in the EU group have higher disclosure ratios compared to the non-EU group in disclosing information regarding impairment testing of goodwill. In the EU there are different countries but the geographic location and the years of cooperation between the countries might have made the group more similar than the countries in the non-EU group.

The coercive isomorphism states that organizations are affected by important and powerful stakeholders. DiMaggio and Powel wrote that powerful stakeholders often are the state or credit holders. ESMA might be seen as such a stakeholder who tries to get all national enforcers to monitor the companies in a uniform way. IASB do not have an international

¹²⁵ See Nobes (2011) and Nobes and Kvaal (2012).

enforcement body to monitor how the IFRS standards are being followed. This means that the countries using IFRS often are monitored by a national enforcement body. According to a lot of researchers the enforcement is very important to get companies to perform the accounting in a uniform way. If ESMA is seen as a powerful stakeholder its work, trying to make the national enforcers to cooperate and make equal rulings, might explain that there is a difference between the EU group and the non-EU group in our study.

DiMaggio and Powel are also discussing a time factor and that all organizations in the long run are going to be uniform and create a framework which employees will use as a norm. Also Douglas writes that the organizations norms are limiting the practitioners' space to act. This might give that when the companies mimic each other the differences will reduce. In the EU group all companies have been obliged to follow IFRS since January 1st 2005. In Canada and Russia¹²⁶ IFRS became mandatory in 2011¹²⁷ while Australia and South Africa have used IFRS longer. As could be seen by the empirical study in chapter five, Canada and Russia had lower disclosure ratios regarding; method used to calculate recoverable amount, discount rate, terminal growth rate and if pre-tax or post-tax discount rates were used. It should be noted that a comparison between countries in our study could be discussed since the selection of companies from each country is quite low and the significance of the difference have not been tested. The findings anyhow indicates that there are differences, regarding some of the parameters studies, between Australia and South Africa compared to Canada and Russia and these differences might be explained by the fact that IFRS have been mandatory for a shorter period of time in Canada and Russia compared to Australia and South Africa. This might explain some of the differences between the groups as well as within the groups and if DiMaggio and Powel's theory regarding time are correct the country differences will be reduced over time.

6.3 Country differences

If isomorphism is trying to explain why organizations are becoming more alike, several other factors could explain differences between organizations and countries. These factors influence companies accounting practice and therefore could affect what information companies choose

¹²⁶ In Russia, it is only Public Interest Entities that are obliged to prepare their financial reports using IFRS.

¹²⁷ Deloitte (1) (2013) and Deloitte (2) (2013).

to disclose. Hope¹²⁸ has discussed how differences in enforcement affect accounting practice while Hofstede¹²⁹ as well as Gray¹³⁰ has discussed the role of differences in culture. There could also be other country specific reasons to why differences between companies from different countries exist.

The two groups in our study included countries with differences in both cultures and enforcement. According to Hope's study of enforcement, U.K. was ranked second while Italy and Spain were lowest ranked of all companies in his study. Canada was ranked third from the top while South Africa was ranked third from the bottom. As can be seen by Hope's enforcement index, both our EU group and non-EU group include companies from countries where the enforcement was ranked high and where it was ranked low. Hope as well as several other authors¹³¹ has argued for the fact that enforcement is of great importance in order to get companies to comply with accounting standards. Under the assumption that enforcement and which accounting standards used are the only factors that influence companies disclosure practices, the results of Hope's study indicates that the disclosure ratio in both the EU group and the non-EU group should be similar to each other. Despite that, our study shows a significant difference regarding the disclosure ratios in the EU group compared to the non-EU group. Since Hope's study was conducted, the enforcement within the European Union has developed and ESMA has been created in order to enhance enforcement in the EU countries and in that way increase comparability between companies from different countries. The results of our study shows that the disclosure ratio is higher in the EU group compared to the non-EU group which indicates that the work of ESMA could have affected companies' disclosure practices in a positive direction.

Another factor that could explain differences in accounting practice is culture. Gray tried to explain differences in accounting by the use of different cultures. Many studies have been made and Gray's theory has been criticized to have some flaws but according to numerous studies culture differences have been proved to affect the accounting.¹³²

In Gray's study, Hofstede's classification of countries is used, the countries in the EU are divided into different groups based on cultural differences. According to the study the EU countries are represented in several of the different groups, for example Spain and France in

¹²⁸ Hope (2003).

¹²⁹ Hofstede (1984).

¹³⁰ Gray (1988).

¹³¹ See for example Schipper (2005).

¹³² See for example, Tsakumis (2007) and Chand et al. (2011).

the “more developed Latin” Germany in the “Germanic group” and U.K. in the “Anglo group”.¹³³ This can be interpreted as that there are no such thing as a common EU culture. According to the division Canada, South Africa and Australia are all part of the Anglo group making the non-EU group more homogeneous than the EU group. Despite this the EU group in our study has a significantly higher level of disclosure compared with the non-EU group. This result could be explained by the fact that the Anglo group has a high amount of flexibility compared to the “Germanic group” and the “more developed Latin”. According to Gray this means that the values in the Anglo countries can affect the companies to interpret the accounting standards more flexible to fit the individual company or situation.¹³⁴ This might also explain why more different ways of disclosure and valuation methods are used in the non-EU group where 56 % of the companies used VIU compared to the EU group where 94 % of the companies were using the VIU model. One aspect which we find can argue against this is that the U.K., which also is classified as an Anglo country, has a high amount of disclosure and all U.K. companies except one used the VIU model. This can be compared with the France companies which have a much lower compliance in our study. Hofstede’s and Gray’s studies about culture were published during the 1980s and because of the globalization and the increasing cooperation between countries these result might be questioned. But, as presented in chapter four, also more recent studies suggest that the culture still affect the accounting.¹³⁵

The more flexible way of interpreting the accounting standards might also result in that Anglo countries need higher accounting enforcement. According to Hope, his enforcement index differs a lot between the countries in Hofstede’s Anglo group. The U.K. which according to our study has a high compliance is also one of the countries, in Hopes study, which have one of the highest enforcement-index. This can be compared with Canada which also is ranked as one of the top countries in Hope’s study and according to our study have a lower disclosure ratio compared with the other countries in the sample. As mentioned above, this might indicate that Hope’s study is out of date and this might be explained by ESMA’s work to improve the enforcement in the EU.

According to Shipper the implementation of IFRS is a critical moment and she believes that more implementation guidelines need to be developed to improve the new users’ compliance. The author believes that the lack of guidelines will lead to that the companies will seek

¹³³ Gray (1988).

¹³⁴ See Gray (1988).

¹³⁵ See for example, Tsakumis (2007) and Chand et al. (2011).

guidance in the national GAAP which will create differences between countries. To improve the implementation process Shipper writes that more detailed guidelines together with more powerful enforcement is needed. ESMA, and CESR before that, have been questioned and Shipper argues that one enforcement body to rule all companies would be better. Despite this critic, our study shows that the disclosures among the examined companies in the EU are more compliant with the disclosure requirements in IAS 36 compared to the non-EU group.

All factors that have been discussed above, which might explain the different amount of disclosure between the groups also exists inside both the groups. As have been presented, the EU group contains of different jurisdiction with different cultures and legal systems and despite this our result shows that the EU group has higher disclosure ratios, regarding impairment test of goodwill, compared to the non-EU group. One of the major differences between the groups is that the EU has ESMA and EECS where national enforcers can cooperate and discuss enforcement problems to better perform a united enforcement in the EU. One other difference between the groups is the recent adoption of IFRS by Russia and Canada. According to Schipper, the lack of guidance for the implementation can result in that the adoption of IFRS takes time and according to DiMaggio and Powell the time will reduce these differences.

7. Summary with Conclusions

In this chapter, a summary of the thesis as well as the conclusions drawn from the analysis and reflection will be presented. Finally, suggestions for further studies within this area of research will be presented.

7.1 Summary

In this thesis we have examined if and how the enforcement has affected the accounting disclosures, regarding impairment testing of goodwill, in the EU. According to the IASB conceptual framework, the information in the financial reports shall fulfill the qualitative characteristics which mean that the information should be faithfully represented and relevant. As have been mentioned throughout this thesis, in order for the financial reports to be useful to the intended users, relevant information must be disclosed. IFRS is a principle based set of standards, which leads to the fact that preparers use judgment and assumption in a lot of different situations. One situation where several judgments and assumptions must be made is regarding impairment testing of goodwill. In order for users of the financial reports to be able to evaluate these judgments and assumptions and to be able to compare different companies, it is of importance that the disclosure requirements are followed and that relevant information is disclosed in companies' financial reports.

Several researchers have pointed out that enforcement is important in order to enhance comparability between companies. Within the EU, accounting regulation for listed companies is regulated on EU-level while the enforcement is taking place on a national level. To monitor that the accounting standards were followed, after the adoption of IFRS in 2005, EU created CESR who was supposed to work to support the member states national enforcement authorities. In 2011 ESMA replaced CESR and continued to regulate and coordinate the enforcement in the EU. IASB do not have any international enforcement authority which make the countries national enforcement authorities the organizations which shall perform the enforcement of the accounting standards.

This study has tried to answer if ESMA's work and the enforcement within the EU have led to more adequate disclosures regarding impairment testing of goodwill. To do this we chose to examine companies from different countries who prepared their consolidated financial statements using IFRS and compare them to see if we could find differences. We chose the

largest companies from the EU and compared them with the largest companies from Canada, South Africa, Australia and Russia. The result of the empirical study showed that the disclosure ratios were significantly higher in the EU group compared to the non-EU group regarding all factors studied.

7.2 Conclusions

The main research question in this thesis was:

- Has the enforcement within the EU led to more adequate disclosures regarding impairment testing of goodwill?

The result of the empirical study shows that the EU group had significantly higher disclosure ratios compared to the non-EU group regarding all factors studied. As several researchers have stated, enforcement is important in order to get companies to follow accounting standards and interpret them in an equal way. But as have been mentioned throughout this thesis, several other factors, which we cannot exclude, could also explain the results. We believe that the two main reasons for the differences found between the EU group and the non-EU group could be explained by ESMA's work and the fact that IFRS have been mandatory within the EU for a longer time than in Canada and Russia.

The different explanatory factors, presented in chapter four, have been discussed in the analysis and reflection chapter. As can be seen, many of the factors could explain both differences and similarities between the EU group and the non-EU group as well as differences and similarities within the two groups. Both groups consist of companies from different jurisdictions with different culture and legal systems. Because of the fact that U.K., which had high disclosure ratios regarding all parameters studied, was classified in the Anglo group in Gray's study as were three out of four countries in the non-EU group, we do not believe that the cultural aspect provide a high degree of explanation.

Researchers have also stated that the lack of guidance when implementing IFRS could lead to differences between countries. The lack of guidance from IASB affects all countries and therefore might not explain why one group has higher disclosure ratios than another.

The enforcement, which also has been stated to affect the accounting, is according to us, a more important factor to explain the results of our study. This suggests that ESMA's work to

improve enforcement within the different countries in the EU has provided result. Several researchers have stated that enforcement is a crucial element in order to improve companies' accounting practice. Since one difference between the two groups studied is the collaboration between enforcement agencies from the different EU countries it is, in our opinion, likely that it is ESMA's work that has the decisive role in explaining the result of our empirical study.

One other factor that cannot be ignored is the recent adoption of IFRS in Russia and Canada. DiMaggio and Powell discussed the time factor and stated that all companies will be similar to each other over time. The implementation of new accounting standards can take time and it is possible that the result in our study have been affected by the fact that Russia and Canada just recently adopted IFRS. As can be seen, it seem like Australia and South Africa have higher disclosure ratios than Canada and Russia which indicates that this factor has an impact.

As can be seen, culture and the lack of guidance are, according to our discussion above, less important as factors to explain the difference between the EU group and the non-EU group. The different explanatory factors left are enforcement and recent adoption of IFRS. We do not suggest that the culture and the other factors do not affect the accounting but after analyzing the results in our study we believe that ESMA's work have made a difference and have contributed to the fact that the EU group has higher disclosure ratios compared to the non-EU group. We therefore draw the conclusion that ESMA's work and recent adoption of IFRS, in Canada and Russia, is the factors most likely to explain the fact that the EU group had significantly higher disclosure ratios compared to the non-EU group regarding disclosures of impairment testing of goodwill.

7.3 Suggestions For Further Studies

During our thesis several thoughts have raised of possible future studies which can be made. A similar study but with a deeper focus on more qualitative disclosure can be made to examine if the judgment behind the disclosures of impairment test differs between countries or companies. Another idea, because of our result, is a study of disclosures over time. This can be made a couple of years in the future with the same groups as in our test to see if the time has reduced the differences we have found, like DiMaggio and Powel suggests. A similar study could also be made on companies within the EU from the adoption of IFRS in 2005 and until now to be able to see if the disclosure has been improved.

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Appendix 1 – Companies studied

Company	Country	Company	Country
Westpac Banking	Australia	Brookfield Asset Management	Canada
National Australia Bank	Australia	Potash Corporation of Saskatchewan	Canada
Telstra	Australia	Cenovus Energy	Canada
Wesfarmers	Australia	Great West Lifeco	Canada
Woolworths	Australia	Power Financial	Canada
CSL	Australia	IGM Financial	Canada
QBE Insurance Group	Australia	Royal Bank of Canada	Canada
Suncorp Group	Australia	Toronto-Dominion Banks	Canada
Origin Energy	Australia	BCE	Canada
Brambles	Australia	CIBC	Canada
Insurance Australia Group	Australia	Husky Energy	Canada
Ancor	Australia	Manulife Financial	Canada
Stockland	Australia	Rogers Communications	Canada
Newcrest Mining	Australia	Telus	Canada
Macquarie Group	Australia	Rostelecom	Russia
Transurban	Australia	Severstal	Russia
Harvest Operations	Canada	Sberbank of Russia	Russia
National Bank of Canada	Canada	Inter RAO UES	Russia
Shoppers Drug Mart	Canada	Gazprom Neft	Russia
Suncor Energy	Canada	Rushydro	Russia
Barrick Gold	Canada	Rosneft Oil Company	Russia
Bank of Montreal	Canada	VTB Bank	Russia
Thomson Reuters	Canada	Uralkali	Russia
Teck Resources	Canada	Gold Fields	South Africa
Sun Life Financial	Canada	MTN Group	South Africa
Agrium	Canada	Sasol	South Africa
Power Corporation of Canada	Canada	Naspers	South Africa
Crescent Point Energy	Canada	Standard Bank	South Africa
Talisman Energy	Canada	Impala Platinum Holdings	South Africa
Loblaw Companies	Canada	Firststrand	South Africa
Nexen	Canada	Absa Group	South Africa
Fairfax Financial Holdings	Canada	Anglogold Ashanti	South Africa
Kinross Gold	Canada	Nedbank Group	South Africa
Goldcorp	Canada	Shoprite Holdings	South Africa

Company	Country	Company	Country
Anheuser-Busch Inbev	Belgium	ArcelorMittal	Netherlands
CEZ	Czech Republic	Philips Electronics	Netherlands
A P Moller - Maersk	Danmark	Reed Elsevier	Netherlands
Fortum	Finland	Telefonica	Spain
Nokia	Finland	Banco Santander	Spain
Total	France	BBVA	Spain
Sanofi-Aventis	France	Iberdrola	Spain
L'Oreal	France	Hennes & Mauritz	Sweden
Schneider Electric	France	Nordea Bank	Sweden
Vinci	France	Ericsson	Sweden
Pernod-Ricard	France	Volvo	Sweden
Vivendi	France	TeliaSonera	Sweden
Societe Generale	France	Atlas Copco	Sweden
Unibail-Rodamco	France	Sandvik	Sweden
LVMH	France	Swedbank	Sweden
SAP	Germany	Svenska Handelsbanken	Sweden
Basf	Germany	BP	U.K.
Volkswagen	Germany	Vodafone Group	U.K.
Daimler	Germany	Royal Dutch Shell	U.K.
Bayer	Germany	HSBC	U.K.
BMW	Germany	GlaxoSmithKline	U.K.
Allianz	Germany	British American Tobacco	U.K.
Deutsche Telekom	Germany	BG Group	U.K.
Deutsche bank	Germany	SABMiller	U.K.
RWE	Germany	Standard Chartered	U.K.
Munich Re	Germany	Barcalys	U.K.
Deutsche Post	Germany	Glencore International	U.K.
Fresenius Medical Care	Germany	Tesco	U.K.
Continental	Germany	Reckitt Benckiser	U.K.
Man	Germany	Imperial Tobacco	U.K.
Siemens	Germany	Lloyds Banking Group	U.K.
E. On	Germany	National Grid	U.K.
Henkel	Germany	Prudential	U.K.
Eni	Italy	BT group	U.K.
ENEL	Italy	Royal Bank of Scotland	U.K.
Unicredit	Italy	Centrica	U.K.
Generali	Italy	Rolls-Royce Holdings	U.K.
Saipem	Italy	Compass Group	U.K.
Tenaris	Italy	British Sky Broadcasting	U.K.
Telecom Italia	Italy	Xstrata	U.K.
Heineken	Netherlands	Unilever	U.K.