Introduction

The IFRS revolution: some early evidence
- Improved reporting quality
- Lower cost of equity and higher liquidity for “serious” adopters
- Increased institutional investment
- Greater cross-country comparability

Lessons from accounting research
- Variation in reporting practices persists; some pre-IFRS differences survive
- Uneven IFRS compliance
- When compliance is weak, benefits are not expected to follow
- Important role of institutional regimes and firm-specific attributes in shaping incentives for compliance
Introduction

Relevance of asset write-downs: why now?
► Financial and economic instabilities
► Events surrounding the crisis may have triggered write-downs
► Importance of assumptions and estimates underlying impairments
► IFRS preparers in Europe are likely to continue to face impaired assets

Persistent economic uncertainty: A recipe for impairment
► Assets: probable future economic benefits (e.g., future cash flows)
► Downward revisions to forecasts of future cash flows and growth
► Upward revisions to projected discount rates (risk)
► Reduced likelihood that carrying amounts will be recovered
► Revised assumptions and estimates following the crisis

Measuring asset impairment – IAS 36

The balance sheet value of an asset is the lower of:

- Carrying amount: Depreciated historical cost (or other allowed alternatives)
- Recoverable amount, which is the higher of:
  - Fair value less cost to sell
  - Value in use
**Overview of the research**

**What we do in this study**

- An empirical evaluation of “asymmetric timeliness”
  - Timeliness of IFRS impairments across Europe (2006-2011)
  - Speed at which economic losses are captured by impairments
  - Cross-country variation in the timeliness of asset write-downs
  - A sample of impairment-intensive (impairments as a % of total assets) firms

- A survey of impairment reporting practices
  - Compliance with IFRS impairment reporting requirements in recent published annual accounts (2010-2011)
  - Role of country-level institutional and regulatory regimes and firm-specific factors
  - Unexplored role of effort and managerial judgement in shaping compliance
Overview of the research
Institutional and regulatory diversity
► Presence of “institutional bundles” around the world
  ► Cluster 1 countries: Outsider economies with strong outside protection and rule enforcement regimes
  ► Cluster 2 countries: Insider economies with (relatively) stronger rule enforcement regimes
  ► Cluster 3 countries: Insider economies with weaker regulatory scrutiny and rule enforcement regimes

Role of institutional differences
► Variations in timely loss recognition across institutional country-clusters
► Differences in IFRS compliance for impairments of non-current non-financial assets (PP&E, intangible assets and goodwill)
Institutional clusters in Europe

<table>
<thead>
<tr>
<th>Cluster 1</th>
<th>Cluster 2</th>
<th>Cluster 3</th>
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<tbody>
<tr>
<td>Large, developed stock markets</td>
<td>Less developed stock markets</td>
<td>Less developed stock markets</td>
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<td>Less developed stock markets</td>
<td>Concentrated ownership</td>
<td>Concentrated ownership</td>
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<tr>
<td>Concentrated ownership</td>
<td>Weak investor protection</td>
<td>Weak investor protection</td>
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<tr>
<td>Strong enforcement</td>
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<td>Weak enforcement</td>
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<thead>
<tr>
<th>Country</th>
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<tr>
<td>Ireland</td>
<td>Austria</td>
<td>Czech Republic*</td>
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<td>United Kingdom</td>
<td>Belgium</td>
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<td>Greece</td>
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<td>Switzerland</td>
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* Countries not covered in earlier classifications

See: (Leuz et al., 2003; Leuz, 2010)

Timeliness of impairments

- Asymmetric timeliness: manifestation of conditional conservatism
- Evidence from 4,474 listed companies (2006-2011) support the role of institutions in shaping timely loss recognition across all three asset classes

<table>
<thead>
<tr>
<th>AT across country/clusters (2006-2011)</th>
<th>Firms</th>
<th>Earnings Impairment</th>
<th>PP&amp;E Impairment</th>
<th>Intangible asset impairment</th>
<th>Goodwill impairment</th>
</tr>
</thead>
<tbody>
<tr>
<td>All countries</td>
<td>4,474</td>
<td>31.7%</td>
<td>5.7%</td>
<td>7.4%</td>
<td>17.8%</td>
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<tr>
<td>Cluster 1</td>
<td>1,203</td>
<td>35.1%</td>
<td>9.4%</td>
<td>9.2%</td>
<td>20.7%</td>
</tr>
<tr>
<td>Cluster 2</td>
<td>2,321</td>
<td>32.9%</td>
<td>4.4%</td>
<td>5.3%</td>
<td>12.9%</td>
</tr>
<tr>
<td>Cluster 3</td>
<td>950</td>
<td>18.6%</td>
<td>1.2%</td>
<td>0.0%</td>
<td>5.9%</td>
</tr>
</tbody>
</table>
Survey of impairment reporting practices

IFRS compliance behaviour

How we document compliance levels

- Survey based on IFRS impairment disclosures (99 items across asset groups)
- Unweighted and partial indices, overall and for each asset class
- Sample of 324 impairment-intensive companies in 2010-2011

Some highlights from our findings

- Major variations and limited cases of full compliance across the asset classes
- Median compliance ranges from 77.2% (intangible assets) to 85.6% (PP&E)
- Positive association between impairment intensity and compliance

Observations from selected disclosure areas

Accounting policies and judgements

- High levels of compliance across Europe
- Boilerplate disclosures, possibility of mere “box-ticking”

Estimation uncertainty and changes to past assumptions

- Uncertainty: root of subjectivity in impairment measurements
- Heightened relevance in times of economic uncertainty
- Limited disclosure on changes to or the continued relevance of assumptions

Sensitivity of carrying amounts

- Limited disclosure (country-level median: 56.8%) may have implications for the relevance of goodwill information
- Disclosures are important in shaping users’ views on reliability
Survey of impairment reporting practices

Observations from selected disclosure areas

Triggering events
► Justification for asset write-offs is critical
► Lack of adequate transparency adds to uncertainty (e.g., only 71% in PP&E)

Basis for recoverable amount (VIU or FVLCD)
► VIU is the prevalent measurement method
► Many cases where the basis is not specified (e.g., 38% in intangible assets)
► Selected bases impact balance sheet positions

Highly aggregated disclosures for segment results
► Impairments are often aggregated with segment depreciation and amortisation
► Potential for reduced relevance of segment information

CGU description and allocation of goodwill to CGUs
► Higher disclosure scores (e.g., description: 74%; GW per CGU: 85%)
► Uneven disclosures on justification for allocation decisions

Cash flow projections, growth and discount rates
► Variation in disclosures on assumptions about projections and selected rates
  ► Projection periods: single versus multiple forecast period
  ► Growth rates: single versus multiple growth rates
  ► Discount rate: WACC used evenly across CGUs with different risk profiles
Drivers of impairment reporting practices

Institutions and firm-level attributes
  Compliance differences across country-clusters
  ▶ Higher compliance scores in cluster 1 countries
  ▶ No major difference in compliance between cluster 2 and cluster 3 countries

Institutions and firm-specific features
  ▶ Range of firm-level attributes considered
  ▶ Results for our sample suggest that disclosure quality is higher when:
    ▶ firms have Big 4 auditors;
    ▶ are larger (size measured based on total assets)
    ▶ have higher leverage (measured based on scaled total debt)
    ▶ are more impairment-intensive
    ▶ are operating in the oil and gas industry

Role of effort and judgement

A general effort-based classification of IFRS disclosures
  High-effort versus low-effort disclosures
  ▶ Discretion and judgement varies across disclosures
  ▶ Some require high effort (e.g., annual sensitivity analyses) while other do not
    (e.g., accounting policy on depreciation)
  ▶ Potential for variation in compliance across the two partitions

Results
  ▶ Significant differences in the two sets of disclosures across all asset classes
  ▶ Cost and effort associated with disclosures adversely influence the quality of
    information provided by preparers
  ▶ High compliance with low-effort requirements is masking low compliance with
    high-effort requirements
Role of effort and judgement

Asset class

- Goodwill
  - Low-effort: 74.82%
  - High-effort: 88.80%
- Intangible assets
  - Low-effort: 52.64%
  - High-effort: 69.24%
- PP&E
  - Low-effort: 69.80%
  - High-effort: 86.11%

Summary and conclusion

Uneven application of IFRS for impairment reporting across Europe
- Variations in timeliness and compliance levels across countries and industries

Role of regulatory and oversight regimes in IFRS application
- Harmonised standards may not translate into harmonised reporting practices

IFRS entail major judgements, estimates and assumptions
- Managerial discretion in making judgements
- Validity of assumptions underlying measurements
- Compliance effort is uneven across requirements; do the benefits of disclosure justify preparers’ costs (efforts)?

High-quality disclosure can reduce uncertainty about measurements
- Relevant for valuation purposes and to users’ economic decisions
Selected references


Selected references, continued