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Goodwill impairment test disclosures under uncertainty

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Abstract: The goal of this paper is to examine how disclosures of goodwill impairment tests under IAS 36 are prepared in conditions of high uncertainty. The data come from Polish companies listed at the Warsaw Stock Exchange, where economic and legal developments have been dynamic as compared to the main global equity markets, thus increasing uncertainty. We use interviews and content analysis, and we draw on genre theory to understand how narrative disclosures are written. We find that the disclosures follow clear rules of a genre, which require the financial statement disclosures to be a domain of facts. In cases where significant doubts concerning the reliability of impairment test outcomes exist, preparers place clues that professional readers can notice and follow to determine the reliability of test results themselves. These findings suggest that specific disclosure requirements are needed in countries where the national culture does not favor open discussions of the limitations to the reliability of accounting numbers.

Keywords: disclosure, narrative, content analysis, interview.

JEL codes: M41

1. Introduction

Extensive narrative disclosures required by the International Financial Reporting Standards are still a novelty in Central and Eastern European markets, which traditionally favour secrecy over opennes in financial reporting. Even though more than a decade has passed since the adoption of the IFRS, narrative disclosures remain narrow in focus in comparison to countries such as the United Kingdom.

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This paper focuses on how preparers deal with the particular challenge of communicating uncertain outcomes of goodwill impairment tests in financial statement disclosures required by International Accounting Standard 36 (IAS 36). We draw on genre theory (Rutherford, 2013) in order to the examine the context of disclosures through interviews, then we analyse the content of the disclosures and their interconnections with management reports. This allows us to understand not only how the disclosures are prepared, but also why they are written the way the are. Our main research question is why the preparers of financial statements do not refer to the uncertainty concerning goodwill impairment test results in situations where it is apparent that the users of financial statements have grounds to expect an impairment.

Principle-based financial reporting standards recognize the need to use judgements and estimates when preparing financial statements because they allow preparers the flexibility required to create financial statements that represent the true and fair view of their diverse businesses. The users of financial statements need to be aware of the uncertainty which arises as a result: judgement uncertainty associated with the recognition and classification of transactions and estimation uncertainty associated with measurement. International Accounting Standard 1 (IAS 1) stipulates that sources of uncertainty must be disclosed explicitly if a significant risk of a material adjustment exists. There is no standard on how this information needs to be presented. Research has focused so far on non-compliance (Glaum *et al.*, 2013; Petersen & Plenborg, 2010) and managerial discretion (AbuGhazaleh *et al.*, 2011; Hayn & Hughes, 2006). We take a different approach: we strive to understand the communication between preparers and users concerning estimation uncertainty inherent in goodwill impairment tests.

We contribute a thorough analysis of accounting communication, beginning with a description of the context based on interviews with preparers, auditors and users of financial statements. We find that the respondents view financial statements primarily as a tool used by the management to present their achievements, which motivates us to adopt the approach of Goffman (1959), who refers to such tools as decoration, to the analysis of relationships between the actors involved with financial reporting. Next, we analyse the content of goodwill impairment test disclosures presented in the notes to annual financial statements following the genre-based approach (Rutherford, 2013). On top of the form, style and content of the disclosures, we examine the use of pragmatic strategies by the preparers, especially hedging techniques, which have recently been introduced to the study of professional financial communication (Resche, 2015). Finally, we explore the interconnections between financial statements and the management report, which allows us to understand how the content of the disclosures can be perceived by readers in the context of the entire annual report.

We select an advanced emerging country setting, that of the Warsaw Stock Exchange in Poland, so that we can expect the preparers and the users to be uncertain as to the valuation of goodwill. Poland is a relatively new member of the European Union and has been undergoing a rapid economic transformation for the past 25 years, so the economic setting is deeply uncertain in terms of both opportunities and risks. In addition, the concept of goodwill is relatively unfamiliar, because Polish companies have reached sufficient maturity to engage in mergers and acquisitions only about ten years ago. Poland is in many respects representative of a number of countries in the region, so our findings may be applied to other Central and Eastern European countries.

Goodwill reporting is a complex and controversial issue, the current IFRS 3 standard being a result of a long and difficult evolution (Rutherford, 2007: 204–206). On the one hand, current methods of financial statement consolidation and recognition of goodwill components undoubtedly increase the transparency of reporting by capital groups. On the other hand, the reliability of its measurement and the usefulness of goodwill amounts reported in financial statements remain doubtful (Al Jifri & Citron, 2009; Petersen & Plenborg, 2010). Uncertainty in the measurement of goodwill arises already at the time of initial recognition. At the outset, the amount of goodwill is capped by the total consideration exchanged for the acquired business, and it can be reduced by the revaluation of tangible assets and recognition of specific intangible assets held by the acquired firm. In subsequent periods, the amount of goodwill cannot be amortized, but it is tested annually for impairment in accordance with IAS 36, which entails the comparison of the carrying amount of goodwill with its recoverable amount. Estimations of the recoverable amount are usually based on budgets and assumptions which cannot be voluntarily disclosed, as that could cause commercial harm. Thus, the underlying assumptions of the tests are not transparent to the users.

The International Accounting Standards Board's discussion of the estimates needed for the measurement of the recoverable amount, summarized in the basis for conclusions, makes it clear that estimation uncertainty is particularly high in the case of impairment tests:

> *These estimates involve assumptions about items such as the risk adjustment to cash flows or discount rates used, future changes in salaries and future changes in prices affecting other costs. No matter how diligently an entity estimates the carrying amount of assets and liabilities subject to significant estimation uncertainty at the end of the reporting period, the reporting of point estimates in the statement of financial position cannot provide information about the estimation uncertainties involved in measuring those assets and liabilities and the implications of those uncertainties for the period's profit or loss.* (IAS 1: BC 80)
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> The standard setters further argue that the *disclosure of information about assumptions and other major sources of estimation uncertainty at the end of the reporting period enhances the relevance, reliability and understandability of the information reported in financial statements* (IAS 1: BC 81). The main concern is

that these estimates *require management's most difficult, subjective or complex judgements* (IAS 1: BC 81).

The scope of the disclosures concerning goodwill impairment testing is specified in IAS 36 (§134-135). The disclosures should include the carrying amounts of goodwill allocated to cash generating units, the measurement basis for the determination of the recoverable amount, a description of key assumptions and of the management's approach to determining them, periods over which the projections were made and the discount rates used. If the risk of impairment is particularly high, the standard requires companies to disclose a sensitivity analysis for key assumptions. The basis for conclusions section shows that the IASB had considered broader disclosures but decided against them. One of the reasons is that the amounts reported in the financial statements are based on an estimated range of values, rather than a single point. The preparers select an amount to be reported from that range, such that the amount is a reliable representation of the underlying transactions. The IASB reaffirmed that position in the 2013 revisions to IAS 36: for annual periods beginning in 2014 the sensitivity analysis in high-risk cases can be reduced in scope, with early application allowed if the company applies IFRS 13.

2. The genre-based approach

The complex and multi-faceted nature of financial reporting needs no proof other than a reference to the abundance of accounting studies and the diversity of methodologies applied by researchers. We take a positivist approach, but we focus on narratives, which are not the object of mainstream accounting research. We find that the genre-theoretic approach presented and applied by Rutherford (2013, 2005) offers a lens to approach our research problem. A genre is commonly defined as a category of formal expression, but the use of genre analysis in the study of professional discourse shows that the concept of a genre can help explain why professionals use language the way they do (Bhatia, 1993). Bhatia (2004: 23) summarizes the elements of a genre, which are common among the major theoretical perspectives and can be applied to accounting narratives by analogy:

1. genres can be recognized by members of the professional community as communicative events, which serve specific purposes and occur regularly,
2. genres are subject to conventions which constrain the intentions one can express, the form and style which can be used,
3. the members of a given professional community are able to understand the use of genres better than outsiders,
4. professionals exploit various resources to express their intentions beyond those specified by conventions,
5. genres reflect professional and organisational cultures,
6. each professional genre has integrity of its own.

Rutherford (2005) applied the genre-based approach to the study of annual reports in the UK. He introduced tension into the study design by grouping companies by oppositions, for example the most profitable vs. loss companies. This allowed him to study the stability in the communications, because it is reasonable that differences in the way narratives are used would occur between companies in such diverse economic situations. He then used word counts as the basis for the measurement of stability, which he indeed identified. However, the study also revealed a common occurrence of the Polyanna effect (i.e. the attribution of positive results to the management's actions) and a prevalence of positively charged words. The stability of words used indicates that financial statement narratives are a genre, characterised by specific rules of communication, but Rutherford is careful when making this conclusion: *the notion of genre must be deployed with care in cases where communication is taking place within a complex social setting, such as the use of corporate annual reports to provide information to a variety of stakeholders* (Rutherford, 2005: 353). Thus, he makes a point that in viewing financial reports as a genre one needs to go beyond the text and study the social setting both on the preparer and on the user side. He develops this approach further in his review article (Rutherford, 2013).

We contribute to the genre-based approach by following the suggestions made in the literature concerning the analysis of the preparers and their audience (Beattie, 2014; Rutherford, 2005), and we carry out interviews with preparers, auditors and financial analysts before we proceed to the analysis of the narratives. This allows us to situate the communications in their particular setting and determine the communicative aims, but at the same time it introduces another level of complexity to our study. We manage this challenge by referring to the literature on social interactions (Goffman, 1959), which has been adopted by the impression management literature. Having established the context, we proceed to study the content of goodwill impairment test disclosures, we explore the interconnections between them and the management report.

Rather than focus on compliance, we follow the genre-based approach and we study the format, style and content of disclosures, because our interest is in the way the narratives are created. We pay particular attention to the use of communication strategies associated with hedging and deception, which are likely to occur in a high uncertainty setting. In the financial reporting context, hedges in accounting narratives have recently been suggested as an interesting avenue of research (Beattie, 2014). The notion of hedging strategies in spoken language is attributed to Lakoff (1973), who referred to specific words as hedges, but they are commonly defined as rhetorical devices used for blurring the speaker’s commitment to the truth of the proposition (Prince *et al.*, 1982) or qualifying the speaker's confidence in a proposition (Hyland, 1998). However, hedges can also be viewed as manipulative or deceptive strategies of saying less than one means (Markkanen & Schröder, 1989).

Resche (2015) contributed one of the first papers on hedging in financial communication, in which she studies the use of hedges by central bankers. She argues that hedging needs to be defined broadly and qualitatively when studying complex, professional communication. She lists the classical types of hedges, but shows that these fail to capture many important aspects of professional speech, as do the classical tests of a hedge such as the Crompton test. We follow her suggestions by thoroughly examining selected financial statements and management reports. We do not rely on automated lexical search tools. Given that the style of financial statement narratives is clearly defined, we find that the preparers use only two types of hedging strategies, both of which involve a modification of the subject: subjectivisation and depersonalisation. The former refers to a qualification of a statement by attributing it to a specific point of reference, while the latter refers to a detachment between the preparer and the statement.

Deception strategies, whether or not related to hedging, may be associated with financial statements and management reports in cases where the preparers deliberately attempt to misinform the readers when presenting a positive outcome of an impairment test. Deception is usually associated with lies, but it may take other forms such as deception by omission (Saul, 2012). Deceiving by omission does not involve lying but the purpose of the preparer is still malevolent, because the preparer purposefully keeps relevant information covert, unavailable to the users. As a result, the users make a wrong inference as to what the preparer believes to be the actual state of affairs, and more importantly, what beliefs the preparer means to communicate. The problem of truth in accounting narratives is discussed by Macintosh (2006), who argues that accounting needs to be understood as a process of constructing linguistic meaning rather than a technology. We follow these insights and explore the meanings communicated in accounting narratives in conjunction with other sources of information.

3. The country setting

Unlike the major international markets of London, Frankfurt or Paris which have been evolving over much of the twentieth century, the Polish stock market needed to be created from basics after the fall of communism in 1989. The new national accounting law was initially created with the purpose of increasing tax revenue and serving the needs of creditors, rather than those of investors, which was a response to the concerns associated with the turbulent development of the free market in the initial stage. The future of the Polish accounting regime was uncertain at the time (Jaruga, 1993). It wasn't until 1991 that the Warsaw Stock Exchange began operations with as few as 9 companies listed. In the subsequent years, a dynamic development of the capital market was accompanied by rapid regulatory adjustments (Dobija & Klimczak, 2010). The number of listed companies exceeded 200 in the year 2000. At the end of 2014, there were 471 companies listed on the main market (including 51 foreign companies) and a similar number listed on the alternative market called NewConnect, positioning the Warsaw Stock Exchange as the leading market in the region.

By 2004, Poland had joined the European Union and adopted EU regulations, including the requirement for consolidated financial statements to be prepared in accordance with the International Financial Reporting Standards (Grabinski *et al.*, 2014). Today, Poland is ranked among high income, developed economies, but it continues to exhibit characteristics typical of a transformation country. Companies are relatively small, with only a handful exceeding USD 10 billion in capitalization, 35 exceeding USD 1 billion, and two-thirds of the market below USD 100 million. This results in a low significance of goodwill, as few companies have the resources to engage in mergers and acquisitions. Poland is usually classified as a low-enforcement country in international accounting research (Christensen *et al.*, 2013), which implies the potential positive effects of European Union directives and regulations adopted in Poland may not be fully realized.

The Warsaw Stock Exchange can be described as a tightly regulated market, a characteristic to which its success is often attributed (Stringham *et al.*, 2008). The main act regulating companies whose shares are traded in a regulated market in Poland is the Act of Parliament (Parliament of Poland, 2005), which incorporates relevant EU directives. Reporting requirements are set in the Regulation of the Minister of Finance (Minister of Finance, 2009), which enumerates the required contents of annual, semi-annual and quarterly reports but allows companies to include additional information. The required elements are:

1. A letter from the CEO, commenting on the results and future perspectives,
2. Selected financial data, including comparable data for the past year, in PLN and EUR,
3. The annual financial statements, prepared in accordance with the IFRS or Polish accounting standards (an option for entity statements only),
4. The management report, the contents of which are also enumerated in the regulation,
5. An attestation of the management board as to the reliability of the report,
6. An attestation of the management board concerning the selection of the auditor,
7. The audit report.

4. The preparers and the users

We conducted direct, semi-structured interviews with two preparers, two auditors, six equity analysts, a CFO and a corporate communications team in 2014 and 2015. The respondents are all of professional ranks, most of them aged below 40, which means that a large part of their career development took place after the use of IFRS became a legal requirement. Interviews lasted for up to an hour, they were recorded, transcribed and coded using genre theory and financial reporting concepts.

The respondents highlighted the complexity and diversity of corporate communications. In comparison to the other sources of information, such as current disclosures, quarterly statements, informal communications and the media, financial statements are dominated by mandated disclosures. Preparers avoid providing more information than required, but companies that value investor relations use analyst presentations, meetings and conference calls to communicate additional, useful information:

> *(...) in Warsaw, I had 4 one-hour blocks, meetings. At each meeting there were 4-5 asset managers, a super-intensive day* [R9]

The management board appears to be the main user of financial statements, because the statements are perceived by the respondents as a tool for the communication of the management's performance to the supervisory board and major shareholders. One of the respondents described his approach to preparing financial statements in the following way:

> *I personally think about people... The corporate management board, who "face" and then put their names, sign, take the greatest responsibility for it; they seem to be the most important users.* [R5]

Analysts, investors or banks are considered a less important audience by the preparers, and other respondents recognized that fact. A low regard for the needs of analysts and investors is visible in poorly organized and maintained investor relations websites of many companies. On the other hand, companies which are held by institutional investors and those which are active in international markets pay great attention to investor relations.

The preparation of financial statements is delegated to the accounting function, which may include a specialized financial reporting team in larger companies, or the controlling department which prepares advanced calculations. The auditors, the management board and investor relations or marketing departments negotiate the contents of the financial statements with the accounting function. The management and the accounting function form a team, with the goal of supporting the management's presentation of its achievements, which implies that the accounting function needs to be loyal to the management. However, professional independence demonstrates itself in the existence of limits as to what constitutes an acceptable influence of the management. One of the reasons for the professional independence of the accounting function is the complexity of IFRS standards which are understood only by specialists:

> *I don't sign my name anywhere. My signature is not there. I'm the only person who knows what's in there, who really knows what's in there.* [R1]

The respondents present nuanced views regarding the reliability of financial statements. They are generally supportive, but they criticize the narrow scope of disclosures. Analysts tend to mention examples of companies which attempted to manipulate reported earnings, but they judge these practices as clumsy and short-sighted. They think that companies with a good reporting reputation enjoy a premium in the market. Overall, the following opinion of an auditor seems to accurately summarize the situation:

> *(…) the management board put their best will, their best efforts, so that the report is fair, but at the same time, if that is only possible, they make sure it fits their expectations, so that it can be presented as their own success.* [R4]

Auditors negotiate with the management to improve compliance with IFRS standards, but this role is not seen as important by analysts. In fact, analysts do not mention the inner workings of the financial statements preparation, but rather link the statements directly to the management, as if the financial statements were a decoration used in the management's presentation of their achievements. Depending on the situation, the management rely on this decoration to a greater or lesser extent, which has an impact on the extent of information provided as well as the resources allocated to the reporting process and investor relations. If the management make excessive use of public relations or marketing functions in the investor relations domain, the reliability of information decreases. Analysts need to rely on the information in the media, especially the news about product development or trends in sales, but they are acutely aware that the media present information of low reliability and that they can be manipulated by the management. The scope and detail of disclosures is a cause of tension between analysts and the management, a tension which affects the dynamics between the actors responsible for the preparation of financial statements. The preparers admit that disclosures tend to be limited in scope:

> (…) t*he IAS tells us [to disclose], and if the IAS doesn't tell us, well, then the auditor tells us [to disclose].* [R5]

Companies appear not to comply with IFRS disclosure requirements in full:

> *We just don't want to disclose some of the information required by IAS. Or we disclose it in a very limited way, or in a very aggregated way. Because we just don't feel like disclosing it. Because we think it goes to deep into our, into our business.* [R1]

Analysts are particularly interested in segment disclosures, cost structure, detailed information on future capital expenditures, working capital and sales, all of which are necessary inputs for discounted cash flow modelling. The management view segment disclosure as harmful, because it allows competitors to learn about revenues, margins, and the resources allocated to lines of business. Even the largest companies disclose no more than two or three segments. Geographic segments are disclosed as required but the information on currencies is rarely provided. Similarly, companies tend to aggregate disclosures of financial instruments, including debt, so that the structure of maturities is unclear. The management negotiate such disclosures with auditors, especially if a firm is in a poor financial condition:

> *The key and critical disclosures are those associated with the liquidity of the firm, all kinds of information about problems in acquiring loans, retiring loans, breaking covenants or other elements of loan agreements, other ratios; and that is, of course, a life-and-death discussion for the firm.* [R4]

Forecasts of sales, earnings or budgeted expenditures are not, in general, disclosed in official documents. The management rely on informal settings, meetings with analysts or journalists, to communicate their plans and expectations. Meetings with analysts seem to play a particularly important role, because they are held in person, and thus they offer an opportunity to provide off-the-record information that can always be denied. Analysts need to be careful in interpreting the information they receive, so they tend to put a great emphasis on the consistency of information they acquire from various sources:

> *It's best, if what a company tells institutional investors in such meetings, let's say private meetings, it's good if it's also written in the report.* [R2]

Similarly, companies tend to respond to private inquiries, although they take care to stay within the limits of the insider trading regulations in this regard. The Polish market is small enough in terms of the number of companies and geographic distribution, to make it feasible for analysts to attend such meetings. The meetings facilitate private and off-the-record communication, but both analysts and companies appear to learn that such practices are harmful in the long run. Analysts would welcome a greater use of conference calls, as well as more information provided directly in official statements. In this regard the main global markets offer good practices:

> *I was amazed when I began covering foreign companies that I just, you know, enter their site and I've got the whole [conference] call recorded there the next day or the same afternoon (...)* [R3]

Regarding the format and style of financial statements, the respondents were critical of the length of the documents:

> *Does a man really read two or three hundred pages of information in tiny font? No. Only when he actually needs to, very, very much. There is quite a lot of information in the report which is only understandable to the auditor and the preparer. Not even to the management, but to the preparer.* [R4]

Analysts read the reports extensively when they begin covering a new company or when they need to cover an IPO. Otherwise they are selective, focused on key value drivers. They read the notes or the management report if they find an inconsistency or if they need a key piece of information. While reading, they pay more attention to the amounts and numbers than to the narratives:

> *We are, we have brains that are more analytical, financial, not linguistic.* [R2]

The format of presentation matters to the analysts: the documents should be searchable, not scanned, tables need to be easy to navigate, and key information should be put in a convenient spreadsheet file. However, a great diversity of approaches is found among reporting companies, with some making efforts to increase readability, while others tend to multiply lengthy, copy-paste disclosures, which the users need to sieve later.

The style of financial statements needs to be factual and communicate certainty as to the information presented. This style is acquired by following past practices and mimicking the standard practice of other preparers, but it is also required by auditors. The following statements are commonplace:

> *Respondent: I usually try to write in a neutral way. Neutral, definitely never negative. Even if it is negative, to use such words that they wouldn't sound very bad.*
> *Moderator: OK.*
> *R: But I don't do this because somebody told me to. (...) But I try to avoid words, in general I try to avoid adjectives in the first place.*
> *M: Why?*
> *R: So that it's neutral.* [R1]

The style of the management report is much more liberal:

> *The management report, as the name suggests, is a report of the management's successes. Adjectives are welcome there.* [R4]

The management report is not audited, as the auditors verify only the amounts for consistency with the financial statements and they make sure all the disclosures required by the accounting and commercial regulation are included. The report may be written by the preparers of the financial statements, but most often it is prepared by the management or by investor relations departments. Analysts find the management reports useful if they provide information about the breakdown of sales and margins, as well as future-oriented information: medium-term objectives, projects and investment plans. Some reports contain in-depth market analysis and forecasts, which can improve the reputation of the firm:

> *One of our major competitors does not communicate at all. And another one basically repeats what we say. So, first hand information, what is going on, we provide quick information, that's us.* [R10]

Overall, the respondents treat financial statements and management reports as important documents, which need to provide concrete, certain information. In particular, financial statements are seen as a domain of professionally confirmed facts, so there is no room for uncertainty, whatever the economic situation is. That view is shared among preparers and auditors. On a technical level, uncertainty cannot be present, because uncertain valuations need to be corrected to levels at which certainty exists. On a narrative level, certainty is necessary as a form of presentation:

> *If the management say they are uncertain then who's supposed to be certain in that firm?* [R4]

This approach affects goodwill impairment test disclosures directly. Since the forecasts of future performance, which are needed for the estimation of the recoverable amount, are based on budgets, the management exert a direct influence on the result of impairment tests.

> *The management put their names under the successful acquisition, so now they must stand firm.* [R4]

The preparers negotiate valuations in areas which require their input, such as forecasts beyond the budgets and the determination of the terminal value. Analysts do not put much emphasis on goodwill valuations, because these tend not to affect future performance or dividends. Their concern is with the management's plans and budgets.

> *This a so called black hole. Very few companies provide the assumptions that were taken while estimating these balance sheet items.* [R7]

5. Goodwill impairment test disclosures

In this section, we focus on the notes to the financial statements concerning tests for the impairment of goodwill arising from acquisitions and in the next section we explore management reports to find interconnections between the two elements of the annual report. We study all the documents in their original Polish language versions, but we translated the excerpts presented in this paper for the readers' convenience. Throughout the analysis we use the 2013 and 2014 annual reports of companies listed on the Warsaw Stock Exchange, all of which are required by law to use the IFRS. We select large companies, included in the WIG30 index, so that we can assume they allocate sufficient resources for the reporting processes to be at a highly professional level. at the time of data collection, nine of the non-financial companies included in this index reported goodwill: Asseco Poland, Grupa Azoty, Boryszew, Cyfrowy Polsat, Energa, Eurocash, LPP, Kernel, Tauron, and TVN. This sample is diversified in terms of the size and performance, as Table 1 shows, but the companies are much smaller than the blue chips from major international exchanges. Three companies report goodwill at above 20% of total assets. Market-to-book ratios range from 0.54 to 8.85.

Table 1. Overview of the companies studied

Name	Sector	MCap	Sales	Goodwill/ Assets	MCap/ BV
Asseco Poland SA	Software	1 040	1 502	48.75%	0.54
Boryszew SA	Commodity Chemicals	262	1 219	2.36%	0.76
Cyfrowy Polsat SA	Broadcasting & Entertainment	3 785	1 786	39.54%	1.72
Energa SA	Conventional Electricity	2 300	2 552	0.79%	1.12
Eurocash SA	Food Retailers & Wholesalers	1 208	4 088	22.19%	4.85
Grupa Azoty SA	Specialty Chemicals	1 733	2 385	0.13%	1.11
Kernel Holding SA	Farming & Fishing	592	577	7.24%	2.39
LPP SA	Clothing & Accessories	3 495	1 149	7.16%	8.85
TAURON PE SA	Conventional Electricity	2 085	4 444	0.57%	0.48
TVN SA	Broadcasting & Entertainment	1 374	384	3.77%	5.89

Note: All amounts in EUR million, MCap stands for average market capitalization over 2014, Sales is net revenue from sales in 2014, Goodwill/Assets is the proportion of goodwill to total assets, Mcap/BV stands for the market-to-book ratio.

The format of the descriptions of goodwill testing is predictable, given the requirements of IAS 36. The notes contain elements of accounting policy referring to goodwill, a description of the key assumptions and methods used in the tests and the conclusions. The degree of detail varies greatly, however. Grupa Azoty SA is the only company to report recoverable amounts. Preparers state that they have carried out sensitivity analysis in Tauron, Energa and Asseco Poland, but only the latter presents the discount and growth rate assumptions. Parts of the text referring to standard accounting policies do not change from year to year, while the rest of the narrative can change substantially (e.g. Asseco Poland), or not at all (e.g. Boryszew, where only a handful of amounts change between 2013 and 2014).

The style of the narratives corresponds with the interview results: they are written in a factual style, the preparers avoid adjectives, adverbs and other signals of evaluation. Hedging strategies are present in the form of depersonalisation and subjectivisation. Depersonalisation allows the preparers to detach themselves from the text, reducing their perceived responsibility for the information they communicate, and strengthening the neutral style of the text. Depersonalization is usually achieved by using the word Group as the subject, as in the example of Kernel where we read that *the Group reviews its subsidiaries*, and in the statement of Energa we find that *the Group has carried out impairment testing*. When the results of judgements are communicated, however, preparers resort to the impersonal format, as in the statement of Eurocash, where we find that *as a result of the effected analysis, it is confirmed that an impairment is not required*. Note that in the Polish language the personal pronoun is omitted and a special impersonal form of the verb is used, rather than the passive voice.

Statements referring to the uncertainty in the test assumptions, as required by IAS 36 §134, are attributed to the management. This subjectivisation strategy allows the preparers to express a judgement as the management's personal perspective, rather than as an objective fact. Thus, these statements are clearly separated from the dominant factual style. Despite the fact that the form of this statement concerning management judgements is not dictated by IAS 36, the statements is similar across the sample. The following excerpt from Kernel is a typical example:

> *The management believe that any possible changes in the key assumptions, on the basis of which the recoverable amount was calculated (...), would not cause a situation in which their book value would exceed the recoverable amount.* [Kernel]

The phrase *any possible change* seems surprisingly strong, given that IAS 36 uses the words *a reasonably possible change* in the relevant paragraph. Sometimes the statements attributing judgements to the management are awkward, as in the case of Boryszew:

> *A change of factors is not probable (...). The Management believe that even if justified and probable changes in the key assumptions took place, (...) the book value (...) would not exceed the recoverable amount.* [Boryszew]

This statement may be a result of the negotiations between the preparers and the auditors of Boryszew, which would explain its unusual style, but the reader may nevertheless wonder which changes are of concern. Is it the probable ones which are claimed not to exist, or the improbable ones, which can occur? How is it then that even improbable changes would not cause changes in the results of impairment tests? This seems to be a clue for professional readers that the uncertainty concerning estimates of value in use is particularly high. For that reason we examine Boryszew again in the next section.

One element a regular reader would miss while reading reports, is the variation in the disclosure of recoverable amounts, sensitivity analysis and the occurrence of the management's statement concerning possible changes in assumptions. According to IAS 36 recoverable amounts and sensitivity analysis must be disclosed only if the recoverable amount exceeds the carrying amount by a narrow margin, so that it is possible that a change in assumptions would affect the results of the impairment test. In such a case, the management's statement concerning the assumptions is not needed any more. The narratives do not contain any explanation, so the reader needs to be aware that the mere occurrence of these elements carries a message concerning uncertainty.

Impairments of goodwill are extremely rare among Polish companies, a clear sign that many goodwill impairment tests are conducted with unwarranted optimism. Out of the sample companies only TVN wrote goodwill off in 2012, but this was not a result of impairment testing: TVN sold its wholly owned subsidiary Onet.pl in 2012 for a price below the book value. The financial statements of TVN contain little comment about the impairment, other than a statement of fact and the relevant amounts.

Another interesting case is the impairment of investments in a Russian subsidiary of Asseco Poland SA, ZAO R-Style Softlab. An impairment of PLN 25 million, more than a third of the carrying amount, is reported in the entity statement, where the subsidiary is presented as an investment carried at cost. One paragraph is devoted to this impairment, with a description of the test assumptions and a brief note on the causes (economic situation in Russia and the depreciation of the ruble). A sensitivity analysis table shows that the amount of impairment could range between PLN 15-34 million depending on changes in the cash flow growth rate and the cost of capital. Interestingly, the consolidated financial statement discusses the same subsidiary in the context of goodwill recognition, because the acquisition was a multi-step transaction and the amount of total consideration exchanged was not fully determined until the end of 2014. While there may be technical reasons for not recognising the impairment at that point in time, it is worth noting that as much as PLN 59 million of goodwill is recognised, compared to the carrying amount of the investment in the entity statement of PLN 68 million. No explanation of this discrepancy is provided by the preparers even though the note on the allocation of the purchase price is over one page long.

6. Interconnections with the management report

The management report is a mandatory element of the annual report, but it is governed by lax rules concerning its content and style. It contains information complimentary to the financial statements and it is an element of the communicative context in which financial statements are used. Consequently, the exploration of interconnections between the two documents leads to a better understanding of the preparer's strategies. Moreover, it is only by examining additional documents that we can determine if the preparers of accounting narratives use deception by omission. We analysed the management reports by searching for text relevant to the companies and segments subject to goodwill impairment testing. Out of the companies studied, we focus on the ones associated with the highest significance of goodwill (Asseco Poland, Cyfrowy Polsat, Eurocash), as well as TVN and Boryszew, the two peculiar cases.

Asseco Poland SA is a company in which goodwill constitutes almost 50% of total assets, but at the same time the market-to-book ratio is as low as 0.5. The note on impairment tests is quite detailed in comparison to other companies, so it allows the reader to notice that the market capitalization of three out of five major subsidiaries are below their carrying amounts. Nevertheless, the subsidiaries were tested for impairment using the value in use method and no reason for impairment was found by the preparers. Sensitivity analysis, on the other hand, reveals that changes in assumed discount and growth rates of as little as a third of a percentage point would lead to impairments in two out of three cash generating units. When we examine the relevant elements of the management report, all we can find are stories of success and growth of the company and its subsidiaries as in the following extract:

> *In 2014, ASEE generated better results than in 2013. Total revenue from sales increased by PLN 30.3 million in 2014, that is 6.5%, to PLN 499.3 million.* [Asseco]

The report goes on to discuss new contracts and growth of sales in particular areas of activity. What is missing is a reference to the sensitivity analysis, which shows that the minimum growth rate over the 2015-2019 forecast period for this particular subsidiary needs to be as high as 15% if no impairment is to be recognized. The reported growth is nowhere near that number. Apparently, both the accounting narrative and the management report omit significant information in an attempt to create a positive message. However, the preparers of financial statements are bound by the IFRS and their professional integrity, so they do disclose bits of information that a professional reader can notice and fill in the gaps himself.

Cyfrowy Polsat SA is a complex capital group, resembling Asseco Poland in this respect, but the style and content of the two reports is more aligned here. The company recognizes goodwill equal to about 40% of its total assets, most of it arising as a result of the acquisition of Metelem Holding Company Limited in 2014. The note on impairment testing is brief, but well written. It contains a description of key assumptions, the discount rate beyond the forecast horizon and the growth rate, the values of the two rates used in 2014 and 2013, and a statement of the management concerning the possible changes in assumptions. The note reporting the acquisition and goodwill allocation is more complex, because Metelem is a company with a number of subsidiaries (notably a major telecom operator Polkomtel SA), the main shareholder of Cyfrowy Polsat is also the ultimate owner of two of Metelem's shareholders, and a number of operations concerning the debt structure of Metelem and Cyfrowy Polsat took place at the time of acquisition. The note states that the fair values of assets were not fully determined at the time the statement was published (the acquisition took place half a year earlier and the deadline for goodwill allocation is 12 months under IFRS 3). Consideration exchanged is valued at about PLN 6 billion and goodwill is valued at PLN 8.2 billion because the net assets of Metelem are negative. The management report is written in a factual style, similar to the financial statement narratives. Little can be found about the future plans of Cyfrowy Polsat, which seems to be a consequence of the factual style adopted in the management report. Information relevant to the acquisition is easy to find, as is operational information and the presentation of risk factors concerning the acquisition. However, there is no discussion concerning the amount of consideration exchanged, which would be warranted given that the acquisition was not an arm's length transaction and the amount of goodwill is a high percentage of total assets. Again, a significant issue is missing from the report.

Eurocash SA is the third company to hold the largest amount of goodwill relative to its total assets. The notes to the financial statements are brief and give no indication of uncertainty. However, one may notice that the management statement concerning possible changes to the assumptions is missing, which would normally happen if a sensitivity analysis was presented, but it is not. The largest amount of goodwill is associated with Tradis Group, a major FMCG distributor, which was taken over in 2011 and then merged with Eurocash SA in 2014. The management report presents the integration of Tradis as a challenge, a source of temporary costs and a source of a temporary drop in sales. According to news archives, the acquisition was a lengthy process involving power struggles with the management of Emperia SA, the former owner of Tradis, but these issues are not discussed in the reports.

The reduction in sales must be particularly worrying for the shareholders, since Eurocash operates at low margins and sales have been stagnant for three years. In the 2013 management report, the company attempted to place the negative events firmly in the past, while reserving positive events for the future. It is difficult to determine whether this is an attempt at deception or a reflection of the management's beliefs. The decrease in sales resulting from the loss of a major client (associated with the former owner) of Tradis is removed from the historical growth rate calculations, and the reader’s attention is refocused on continued sales:

> *The main reason for the lack of dynamics in sales was the market situation and internal factors associated with the acquisition and the consolidation process of Tradis. (…) The decrease of sales of Tradis was caused by the withdrawal from sales to the Stokrotka network (…) Taking into account only continued sales, Tradis experienced an increase of 1.6%. (…) The full synergy effects (…) will be possible to achieve within 3 years of acquisition.* [Eurocash 2013]

TVN SA does not hold large amounts of goodwill, but it is a rare example of goodwill impairment, which we discuss in the previous section. In 2012, TVN reported an impairment of goodwill resulting from the acquisition of Grupa Onet.pl. This was a result of the sale of 75% of the subsidiary's shares below their book value. There are many passages devoted to this topic in the 2012 annual report describing the technical details of the transaction, but the passage below is the first one to appear:

> *After the sale of the shares in Grupa Onet.pl to Ringier Axel Springer (…) we lost control over our online business dominated by Onet (...) Both transactions are perceived by the TVN Group as long-term investments, the goal of which is (…) the development of the online market (…) through the use of economies of scale and synergies resulting from the cooperation with our strategic partners.* [TVN 2012]

The sale of Grupa Onet.pl is thus portrayed as a positive event, an investment, despite the fact that TVN sold 75% of its shares and used the proceeds to retire debt. This is creative language use, a local pun, because the term investment refers to the classification of the remaining 25% of shares in Grupa Onet.pl as investments in associates, rather than the common meaning of the term. Thus, the statement is true, but it can be an attempt at deception, since the reader may not be able to recover the latter meaning if he is familiar with the common understanding of the word. It is hardly plausible that the management sincerely believe this transaction to be a source of future benefits, as their use of the term investments would imply. Further, TVN reports a corrected EBITDA in the discussion of financial performance, from which it excluded the impact of the goodwill impairment. The difference is significant, because the reported EBITDA was negative, while the corrected one is positive, making this a classic attempt at impression management.

Boryszew, which we discussed in the previous section, draws attention because of an awkward statement of the management's certainty concerning test assumptions. Boryszew allocated the largest amount of goodwill to its German subsidiaries, especially Theysohn Kunstoff GmbH and Boryszew Kunststofftechnik GmbH. There is a hint in the financial statements that growth of sales in these companies is of concern, because the note states, without any explicit reason, that the acquisition of new contracts is seen as probable. This statement is identical in both 2013 and 2014 financial statements, which suggests that this probability did not materialise. Little discussion of these subsidiaries can be found in the management report, until one notices that they are included in Boryszew Automotive Plastics Group, or BAP, which is in turn included in the Automotive segment, the results of which are discussed in the 2013 management report:

> *Lower sales were associated with a decrease in demand in the European automotive industry and lower sales as a result of contractual discounts and the contract life-cycle. In 2013 old contracts gradually expired and were not (...) replaced (...). In the case of BAP Group companies we expect that [the situation will improve] in mid 2015* [Boryszew].

The 2014 management report states that improvements have been noted, but a full replacement of lost contracts is not expected until 2016. It seems that the accounting narrative contains hints as to the sources of uncertainty, but only a professional reader will be able to appreciate the relevant information.

7. Conclusions

This paper presents the results of a qualitative study of accounting narratives with a particular focus on how uncertainty of the external environment affects the disclosures prapared by Polish companies. We find that uncertainty, inherent as it is in an emerging economy, seems not to affect the disclosures at all. On the contrary, the disclosures conform closely to common, unwritten rules, which require accounting narratives to be technical and neutral. These rules of the genre, as we call them, do not stem from the IFRS. Instead, they have been developed as a local professional practice accepted by the preparers, the auditors and the users. The users may complain about the time and effort required to process the statements, but they are more concerned with the scope and detail of key disclosures (segments, capital expenditure, financing) than about estimate or judgement uncertainty.

The observation that goodwill impairment test results systematically deviate from the economic reality, does not affect the perceived reliability of the statements as a whole, because the actors agree on local rules of the genre. Firstly, the financial statements are perceived as a domain of professionally validated facts, which by definition need to be certain. Even if there is doubt as to the true value of goodwill, this need not be taken into account. Secondly, since financial statements serve as a decoration in the management's presentation of its own performance, the discussion of test result reliability would suggest that the management doubt their own skills. For the same reason no complementary discussion of test assumptions can be found in the management reports.

Accounting narratives uphold a standard of professional integrity, despite the reservations mentioned above. Preparers of accounting narratives use a factual style, and they refrain from the use of explanations or evaluations. When faced with communicating uncertainty, they use hedging strategies of subjectivisation and depersonalisation. They follow the IFRS diligently, but their concern seems to be more with the letter of the standard and the auditor's requests than with the true and fair view. Nevertheless, in cases where significant doubts exist, preparers place clues that professional readers can find and follow to determine how reliable the test results are by themselves. In contrast, narratives in management reports are written in a variety of styles and they may contain deception strategies. Preparers of financial statements refrain from using deception strategies, but it can be argued that they engage in deception by omission in cases where a significant piece information is not included in accounting narratives just because it is not required explicitly by a relevant standard.

The results of this study suggest that preparers in our setting cannot be expected to voluntarily increase the usefulness of goodwill impairment test disclosures beyond the specific requirements of the IFRS. A voluntary discussion of uncertainty in accounting narratives would break the rules of the genre and reflect negatively on the company. If we generalise our findings to other Central and Eastern European countires, we can suggest that an extension of IFRS requirements may be the only method of improving the relevance and reliability of goodwill disclosures in the region. Such requirements would need to be specific enough for estimation uncertainty to become a fact and thus allow the disclosure of uncertainty to comply with the rules of the genre. However, the current approach of the IASB signals the opposite, as the revision to IAS 36 allows companies to reduce the extent of sensitivity analysis disclosed.

This paper shows that the study of accounting narratives along with their communicative context, including the authors and the audience, is an effective method of uncovering the multifaceted nature of financial reporting. The limitations of our method stem from limited spacial coverage and from the focus on the product of financial reporting. Future studies may examine other country settings, which can lead to the discovery of variations in the financial reporting genre. Moreover, our description of the communicative context points to the negotiations between actors in the process of preparing financial statements as an important factor in shaping disclosures. Further research in this area may provide useful insights into the preparation of financial statements.

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