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**GOODWILL IN EARNINGS MANAGEMENT
OF THE CAPITAL GROUP**

Doctoral thesis abstract

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1. Justification for the choice of topic

The free movement of property components, capital and human resources as part of the globalization process contributes to cooperation between enterprises. As a result, there is a concentration of capital and the creation of complex economic structures of international scope, such as capital groups. This led to an intensive development of accounting and the harmonization of its principles, in particular in the area of capital group accounting.

At the same time, accounting began to be perceived as an international business language, because through financial statements, it provides the necessary information for stakeholders to assess the economic efficiency of entities. Thus, the data included in financial statements determine economic decisions made by users of these statements (Remlein, 2013, p. 9). Hence, management boards of entities sometimes take actions aimed at managing the reported values, in particular the financial result, by influencing the amount of revenues and costs and their distribution over time, in order to present the desired picture of the entity's achievements. This phenomenon is defined in the English-language literature on the subject as earnings management.

In the Polish literature on the subject, this phenomenon is referred to, among others, as earnings management, the balance sheet result management, active earnings management. On the other hand, in this doctoral dissertation, it is taken after P. Wójtowicz (2010, p. 83) as earnings management, because this phenomenon is not about actions taken to implement the management function in relation to the enterprise, but about choices made in a conscious and planned manner in within the framework of financial reporting by persons responsible for a given area in the entity.

Moreover, the reorientation of accounting objectives in terms of decision-making utility, numerous scandals related to aggressive accounting, frauds of management boards, as well as the active participation of some auditors in serious fraud have made earnings management one of the important areas of research in modern accounting (Piosik, 2016, p. 9; Smejda, 2012, p. 173; Śnieżek i Wiatr, 2014, pp. 351-352).

One of the instruments of earnings management is goodwill and its impairment write-off. This is evidenced, *inter alia*, by the published research results by Ch.E. Jordan, S.J. Clark and C.E. Vanna in 2007, N.M. AbuGhazaleh, O.M. Al-Hares and C. Roberts in 2011 and M. Bisogno in 2015.

In the literature on the subject, goodwill is defined as a set of various, individual for each entity, hardly measurable intangible factors that reflect the above-average ability of

the entity to generate profits (Cieciura, 2009b, p. 105; Kolesnik, 2009, p. 106). As a consequence, goodwill is considered a very controversial, subjective component of the entity's assets and is interpreted in various ways (Bąk, 2020, p. 75). The condition for its creation is the purchase transaction, understood as various types of merger processes of entities (Cieciura, 2012, p. 6; Kamela-Sowińska, 1996, p. 9). As a result, it is more and more often one of the important items disclosed in the consolidated financial statements (Strojek-Filus, 2013, p. 11).

The analysis of Polish legal regulations in the field of accounting and the International Accounting Standards (IAS)/International Financial Reporting Standards (IFRS) regulations regarding the accounting treatment of business combinations shows that there are a number of discrepancies between them. Significant issues differentiating the solutions contained in both regulations relate to the determination and settlement of goodwill, in particular negative goodwill. Both the Polish Accounting Act (Act of September 29, 1994) and the IAS/IFRS regulations define the method of determining goodwill, but they differ in the components of calculation formulas and in terms of accounting for multi-stage combinations. In the case of negative goodwill, Accounting Act does not define its concept, but provides an algorithm for its calculation. On the other hand, in IAS/IFRS, the concept of negative goodwill does not appear, despite the fact that a description of its formation is provided (Bąk, 2016, p. 26). At the same time, the concept of profit on a bargain purchase is used to define negative goodwill. The Accounting Act treats goodwill as an asset with a limited economic useful life and, as a consequence, is gradually depreciated. Moreover, in accordance with Polish accounting regulations, goodwill may also be additionally accounted for through write-offs due to partial or complete loss of the ability to generate economic benefits in the event of occurrence of premises indicating with high probability that it will not bring the expected economic benefits in the future. On the other hand, in international regulations, goodwill is perceived as an asset with an unlimited useful life and is obligatorily tested for impairment every year, or more frequently if there are indications of impairment.

It should be noted that in the case of IAS/IFRS, contrary to the Accounting Act, goodwill can be settled only in those financial years in which the entity determines, based on the test, that there has been a decrease in the value of this asset. In other words, capital groups by making or withdrawing from goodwill write-offs may significantly affect the level and type of financial result, especially when they are aimed

at managing the desired earnings of the group. Hence, the growing interest of users of financial statements in the value of the company and the determinants of its settlement is noticeable. This is evidenced, inter alia, by the studies conducted by G. D'Alauro, which were published in 2013, A. Šapkauskienė, S. Leitonienė and E. Vainiūšienė in 2016, or M. Glaum, W.R. Landsman and S. Wyrwa in 2018.

At the same time, in the Polish literature on the subject, there are few comprehensive studies dealing with the issues of earnings management (Artienwicz, Bartoszewicz, Cygańska and Wójtowicz, 2020; Grabiński, 2016; Piosik, 2013, 2016; Wójtowicz, 2010) and the valuation and settlement of the goodwill (Cieciura, 2012; Ignatowski, 1995; Kamela-Sowińska, 1996; M. Gierusz, 2020; Strojek-Filus, 2013).

2. Research area, problem, subject, object, objectives, main hypothesis, literature and methods

Based on the above considerations, within the research area of accounting and financial reporting, the research problem of this doctoral dissertation was formulated, which requires the determination of the possibility of capital groups using goodwill and its impairment write-offs to earnings management in the light of Polish and international legal regulations in the field of valuation and settlement of goodwill.

The research subject of the doctoral dissertation is goodwill, both positive and negative, shown in the financial statements of the capital group.

The research object is a capital group understood as an entity without legal personality, constituting a grouping of individual economic units related by capital, personally or contractually, having a separate legal personality, conducting business activities and accounting records. With regard to empirical research, the research object are capital groups listed on the main market of the Warsaw Stock Exchange, which have their headquarters in Poland, do not conduct financial and insurance activities and demonstrate goodwill throughout the research period.

The time range of the research covers the years from 2011 to 2020.

The main objective of the dissertation is to assess the effects of applying solutions for the valuation and settlement of goodwill in earnings management of the capital group.

The implementation of the main objective of the dissertation requires clarification and achievement of specific objectives, which include:

1. identification of the process of earnings management in reporting entities,

2. recognition of the capital group as the entity of accounting and comparison of the regulations related to it contained in Polish legal regulations in the field of accounting and international standards,
3. identification of the goodwill shown in the financial statement of the capital group and comparison of the principles of its valuation and presentation both in the context of the theoretical concepts of consolidated financial reporting and in accordance with the solutions contained in Polish legal regulations and international accounting regulations,
4. determining the essence of settlement of the goodwill presented in the financial statement of the capital group and comparing the procedures in this regard contained in Polish legal regulations and international accounting standards,
5. examination of the use of goodwill and its impairment write-offs as instruments for earnings management in capital groups listed on the Warsaw Stock Exchange.

The results of the research undertaken are potentially important for users of financial statements of capital groups, auditors and accounting regulators. Hence, the following main research hypothesis was adopted for this dissertation: The variety of solutions permitted by Polish and international legal regulations in the field of valuation and settlement of goodwill shown in the consolidated financial statement affects the earnings management of the capital group. At the same time, the following two auxiliary hypotheses for the doctoral dissertation were formulated:

1. Goodwill and its impairment write-off are significant components of the financial statement of the capital group.
2. The capital group manages the amount of earnings through goodwill and its impairment write-off.

The doctoral dissertation is theoretical and empirical. The dissertation uses Polish and English-language literature, published in the form of joint papers, articles in journals and scientific monographs, on economics and finance, in particular accounting and financial reporting. Polish and foreign legal regulations in the field of accounting were also applied. The empirical research used information available in the Notoria Serwis Online database and on the Internet, including, inter alia, financial statements of capital groups listed on the Warsaw Stock Exchange, presented on their websites and financial portal.

Various research methods were used to achieve the intended objective of the doctoral dissertation and to verify the main hypothesis. In the theoretical part of the dissertation,

the method of critical analysis of literature, the method of comparative analysis and the method of inductive reasoning were used. In turn, the research in the empirical part was divided into two stages. In the first stage of the research, the method of examining documents, the method of comparative analysis, the method of inductive reasoning and statistical methods of one-dimensional nature were used. On the other hand, in the second stage of the research, the method of individual cases, the method of comparative analysis, the method of inductive reasoning and two-dimensional statistical methods (correlation and regression) were used.

3. Thesis structure

The doctoral dissertation consists of four chapters preceded by an introduction and summarized at the end. At the end of this dissertation, there is a bibliography, list of tables, figures and an appendix.

The first chapter is devoted to the presentation of the phenomenon of earnings management within the research area related to accounting and financial reporting and to the characterization of the research object, i.e. the capital group. The essence and objectives of earnings management were discussed, as well as the factors determining its occurrence in reporting entities. The classification of earnings management and its instruments is presented. The previous research on earnings management was reviewed, indicating the research topics and problems undertaken, the country of origin of the research sample, and scientists who played an important role in understanding and analyzing this phenomenon and the methodological approaches used to measure it. The essence of the capital group was also discussed and its concept defined. The national and international accounting regulations concerning this organization were also compared. The chapter ends with the presentation of the objectives and instruments of earnings management in the capital group. The conducted considerations allowed for the implementation of specific objectives number one and two.

The second chapter presents the research subject, i.e. goodwill shown in the consolidated financial statements. The essence, classification and determinants of goodwill are discussed. In addition, for the purposes of further research, the acquired goodwill shown in the financial statement of the capital group was defined. The theoretical concepts of consolidated financial reporting were presented and their influence on the valuation and presentation of goodwill in the consolidated financial statements was shown. The principles of valuation and presentation of goodwill in the

consolidated financial statements were also reviewed, both in accordance with Polish legal regulations and IAS/IFRS. The last part of the chapter compares the principles of valuation of goodwill disclosed in the consolidated financial statement in accordance with Polish legal regulations and international accounting standards. The considerations made allowed for the implementation of the specific objective number three.

The third chapter focuses on the presentation of the procedure for settlement of goodwill shown in the consolidated financial statement. The essence, conceptions used in accounting and determinants of settlement of goodwill are discussed. The adopted solutions for the settlement of goodwill presented in the consolidated financial statement, both according to the Polish accounting regulations and the IAS/IFRS regulations, were presented. The chapter ends with a comparison of the principles of settlement of goodwill shown in the consolidated financial statement in accordance with Polish legal regulations and international accounting standards. The conducted considerations allowed for the implementation of the specific objective number four.

Chapter four is devoted to the implementation of the specific objective number five, consisting in the empirical examination of the use of goodwill and its impairment losses as instruments for earnings management in capital groups listed on the main market of the Warsaw Stock Exchange in 2011-2020. The research sample consisted of 55 capital groups that have their headquarters in Poland, do not conduct financial and insurance activities and show goodwill throughout the research period. The first part of the chapter presents the methodology and scope of the conducted research, and characterizes the research sample. The solutions adopted in the field of valuation, settlement and presentation of goodwill in research entities were also presented. Moreover, goodwill, profit on bargain purchase and impairment loss on goodwill were compared with selected reporting items in dynamic terms. In addition, the profit on a bargain purchase and the write-down of goodwill in dynamic terms were considered in combination with the dichotomous features. On the other hand, the second part of the chapter analyzes the interdependencies between goodwill and its impairment write-offs and selected variables that are used to analyze and assess the financial situation of entities. Regression models were also developed to explain the shaping of goodwill, its write-offs and the net financial result of the surveyed capital groups based on selected variables. Based on the results obtained from the conducted empirical research, the auxiliary hypotheses of the doctoral dissertation were verified.

The conclusion is a summary of the considerations carried out in this dissertation. An attempt was made to present in a synthetic manner the conclusions obtained as a result of the conducted research in the theoretical and empirical parts of the dissertation. The obtained conclusions were related to the main objective of the dissertation and the formulated main hypothesis. The author's conclusions on the cognitive value of the dissertation and recommendations for further research were also presented.

4. The results of thesis

The theoretical considerations and empirical research carried out as part of this dissertation made it possible to achieve the presented main objective and specific objectives.

At the same time, the considerations presented in the dissertation contributed to the confirmation of the legitimacy of the formulation of the main objective of the research consisting in the assessment of the effects of the application of solutions for the valuation and settlement of goodwill in earnings management of the capital group. The conducted literature studies and empirical research allow to conclude that capital groups influence the level of the reported financial result through goodwill and its write-offs in order to create the desired image of the entity in the consolidated financial statement in order to influence the economic decisions of the stakeholders. The main reason for this is too much flexibility and discretion in legal provisions on the valuation and settlement of goodwill.

The result of the conducted literature and empirical analyzes are numerous conclusions regarding the use of goodwill and its impairment write-offs as instruments of earnings management of the capital group.

Based on the literature review, the essence of earnings management in reporting entities was identified, its objectives, determinants and instruments were defined. It was indicated that earnings management should be understood as actions taken by members of the management board in order to influence the value of data presented in the financial statements, in particular the financial result, by using appropriate methods, estimates and taking real actions to mislead certain stakeholders as to the achievements financial of the entity or for obtain private gain. Moreover, it has been shown that this phenomenon is conditioned by the asymmetry of information and areas subject to discretion in financial reporting. Hence, earnings management should not be equated

with illegal activities, as it is carried out within the framework of the principles adopted in the accounting policy.

The analysis of the research conducted so far shows that research based on samples from North America dominates. Analyzes carried out on the basis of listed companies from Western Europe are also common. On the other hand, in Poland, earnings management has so far been the subject of few empirical studies.

As a result of the literature review, an original definition of a capital group was developed, showing its characteristics that make it a special accounting entity. According to the author, a capital group is an entity without legal personality, constituting a grouping of individual economic units, having a separate legal personality, conducting business activities and accounting records, which are characterized by various types of internal links between the entities belonging to the group of a capital, personal or contractual nature. These relationships allow to distinguish one unit that exercises control over the others, referred to as subordinated units.

On the other hand, the analysis of the regulations relating to the capital group contained in the Polish legal regulations in the field of accounting and international standards shows that most of the solutions adopted for the capital group in the Accounting Act are consistent with the provisions of international regulations. However, the discrepancies concern the names, the scope of disclosures of individual elements of the consolidated financial statements, some principles of full consolidation and the valuation of shares using the equity method. As a consequence, these differences lead to a limited comparability of data presented in the consolidated financial statements prepared in accordance with Polish and international accounting regulations.

Based on studies of the literature and Polish and international accounting regulations, an original definition of acquired goodwill shown in the financial statement of the capital group was developed, defining it as the goodwill arising from acquisition, corresponding to at the acquisition date of that part of the price paid for another entity, its organized part or shares in it, resulting in the creation of a relationship of dependence, interdependence or association between these entities, which has not been compensated in total, the fair value of the net assets thus obtained. The following characteristics of goodwill were established:

- appears as a positive or negative value,

- it consists of a set of various, intangible components that have the ability to generate profits greater than the average in the industry,
- it does not appear in the accounting books and balance sheet of the entities included in the capital group,
- is an important element of the assets of the capital group, which contributes to the emergence of a competitive advantage and affects current and potential investors.

In addition, the analysis of the solutions adopted in Polish and international accounting regulations regarding the valuation as at the acquisition date, settlement and presentation of goodwill shown in the consolidated financial statement shows that there are significant differences between them. As a consequence, these discrepancies may result in obtaining different assessments of the financial situation and profitability of capital groups made by external stakeholders.

The results obtained from the conducted empirical research indicate that in the capital groups included in the research sample in 2011-2020, goodwill constituted a significant component of total assets and fixed assets, which proves that in the research sample there was a tendency to systematically increase goodwill in the consolidated financial statement in as a result of making new acquisitions and not showing impairment or showing at an insignificant level. The obtained results of statistical analyzes allow to conclude that goodwill is a significant component of the financial statement of the capital group.

In the years 2011-2020, the vast majority of the analyzed capital groups did not show a profit on a bargain purchase. Moreover, the conducted research shows that in the research sample, the profit on a bargain purchase did not significantly affect the reported financial results, and thus the financial situation presented in the consolidated financial statements. Therefore, the obtained results of statistical analyzes allow to conclude that the goodwill of a negative nature is not a significant component of the financial statement of the capital group.

In the analyzed period, in most of the observations, no impairment write-offs were found for impairment by goodwill, which proves that in the years 2011-2020 in most of the examined entities, based on the tests performed no impairment of goodwill. At the same time, the vast majority of capital groups determine the recoverable value of a cash-generating unit (or a group of units) to which goodwill has been assigned only on the basis of value in use, which in the literature on the subject is considered a discretionary value, burdened with subjectivity and difficult to verify by external

stakeholders. Therefore, even though the percentage of capital groups disclosing the information required by IAS 36 regarding the impairment test for goodwill increased in the analyzed period, the degree of detail disclosed by the audited entities still differs significantly. It was observed that in practically most of the observations there is a different value of the discount rate used in cash flow forecasts and no impairment of goodwill is stated, which, according to the author of the dissertation, means that the examined entities use discretion in assessing impairment through goodwill to affect the relevant items in the consolidated financial statements.

In addition, it was found that the goodwill write-offs made in 2011-2020 do not significantly affect the reported financial results or the financial situation of the analyzed capital groups due to the small number of observations with recognized write-offs in the research sample. Hence, the results of statistical analyzes obtained for all observations in the research sample allow us to conclude that the impairment loss due to goodwill does not constitute a significant component of the financial statement of the capital group.

It was noticed that in the case of observations with the disclosed write-downs updating goodwill, there is a statistically significant and positive correlation between the average value of write-offs updating goodwill and the average value of revenues from sales, the average value of total assets, the average value of equity and the average value of net cash flows from operations operating, which proves that goodwill write-offs are recognized by entities in which the financial situation improves. Moreover, it was found that in the observations with the disclosed write-offs updating goodwill, write-offs updating goodwill have a significant impact on the reported financial result and the financial situation of the given capital groups. Hence, the results of statistical analyzes obtained for the observation with the disclosed write-offs updating goodwill allow to conclude that goodwill impairment write-off is a significant component of the financial statement of the capital group. However, it should be borne in mind that in the research sample there are only 10.55% of observations with a write-off updating goodwill.

The results obtained from the conducted empirical research allow the conclusion that the capital group manage the amount of earnings through the goodwill and its impairment write-offs.

In addition, the obtained results of literature and empirical research confirm the main research hypothesis put forward by the author of the dissertation, stating that the variety

of solutions permitted by Polish and international legal regulations in the field of valuation and settlement of goodwill shown in the consolidated financial statement affects the earnings management of the capital group. Too much flexibility and discretion in legal solutions regarding the valuation, settlement and presentation of goodwill mean that management board members can use them intentionally to earnings management in order to create the desired picture of the financial situation of the capital group in the consolidated financial statement and thus affect stakeholders and motivate them to specific actions. At the same time, the application of two different legal regulations in the field of valuation and settlement of goodwill makes it difficult to compare the consolidated financial statements of capital groups prepared in accordance with both regulations, and may even lead to irrational economic decisions.