BABEŞ-BOLYAI UNIVERSITY
FACULTY OF ECONOMICS AND BUSINESS ADMINISTRATION
DEPARTMENT OF AUDIT AND ACCOUNTING

# DOCTORAL THESIS

## SUMMARY

# IMPLICATIONS, ACCOUNTING TREATMENT AND ADVANCED STUDIES OF GOODWILL

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**Cluj-Napoca**
**2013**

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## KEY WORDS

Goodwill, chronology of goodwill, accounting for goodwill, earnings management, global financial crisis, tobit regression, binary logit regression.

## INTRODUCTION AND MOTIVATION OF THE RESEARCH

The "story of goodwill" has been told in the accounting academic literature for more than a century and goodwill continues to be the center theme of one of the most famous accounting debates in history. Because of the continuous change in its structure, of the multiple shifts in development of the accounting treatment and probably most of all because of a fast growing and significant weigh among all other intangible assets, goodwill continues to be a highly discussed topic.

The major changes accounting for goodwill has undergone, which have impacted the financial statements, and the increasing proportion goodwill has gained among all intangibles have given this topic a secure place in the academic literature headlines. The change of accounting treatment from amortization to impairment had the biggest impact on both the financial statements and the academic accounting literature. Managerial professional judgment is required when the impairment test is performed. This opens the way to managerial discretion being used when the amount impaired is established. However, managers have been required to use their professional judgment in financial reporting, but it is the manipulation of earnings when this judgment is used which cause earnings management to appear.

During the tumultuous time of the financial crisis, 2008-2011, which has left its marks on economies worldwide, managers have been faced with the impetuous need to best keep the business going under precarious market conditions. Our thesis examines evidence regarding managers' choice to use the impairment of goodwill as an additional tool to adjust earnings numbers which otherwise do not make the key targeted earnings. We test goodwill impairment write-offs in a cross-sectional distribution analysis for the period 2008-2011, the years of the global financial crisis. We have chosen a representative sample of European companies which compose the main indexes of the top three stock exchange markets. The results we obtain after running both tobit and binary logistic regressions suggest that managers are using their discretion in recognizing goodwill impairments to manage earnings.

Our empirical research is introduced by a comprehensive analysis of the concept of goodwill, as it has been discussed in the academic accounting literature or in accounting standards for over a century. The need for such an extensive analysis arose from the scarcity of such a complex study in the literature, a void which we intended to fill. Early British and American literature contributes to the clarification of the concept of goodwill. Goodwill is “impalpable, ethereal, incorporeal, ephemeral, immaterial, abstract, shadowy and intangible asset, while it has been defined in such vague terms as advantages, benefits, factors, rights, sources and privileges, possessed by a successful business” is how Courtis (1983) summarizes descriptions of goodwill from early literature. Before it was discussed in the accounting literature, goodwill was mainly a topic of commercial case law trials. Dicksee and Tillyard (1906) followed by Leake (1921) dedicate distinct chapters in their books to summarize the impact of trial decisions on the concept of goodwill. Several factors are identified by these goodwill pioneer authors as common to describing goodwill in most cases: “the place and reputation of the premises”, “reputation, personality and skills of the proprietor and/ or his staff”, “the use of an established business name”, “the quality of the goods and services”, “the use of advertising”, “the absence of competition, especially when it arises out of an agreement between the vendor and purchaser of a business”. It is around these factors that most definitions in that time were built on.

As for decades the definition and clarification of the concept of goodwill were prevalent in academic writings, some authors also began to advance theories around the valuation of goodwill, Leake (1921), Nelson (1953) and Lonergan (1995). Each of their views is different than the others, but what all have in common is the constructive perspective in which they regard goodwill, as an aggregate of components, rather than a residual as it would be presented in the accounting standards.

Along with goodwill’s growing impact in the financial statements, accounting standards for goodwill were released in different countries of the world. This interest in accounting for goodwill generated several new streams of literature. From dealing with the recognition of goodwill, to its accounting treatment and the valuation of goodwill, to the harmonization of accounting standards with particular interest in the case of goodwill, and the change in accounting rules and its impact on the business, to the acute discussion of the use of goodwill as an earnings management tool, all these are topics of interest in the body of prior literature which we revise.

The definition of the IASB confirms that goodwill is an asset and some academic literature supports this view, (Johnson and Petrone, 1998), while other authors disagree, (Chambers, 1966, as cited by Bloom, 2008). Academic literature brings evidence that investors accept goodwill as an economic resource, from which future benefits derive from its recognition and impact on equity values, Chen et al. (2004), Churyk and Chewning (2003), Jennings et al. (1996).

Historically there have been three most common accounting treatments of goodwill: immediate write-off from the financial statements, amortization and impairment. Some authors convey the opinion that goodwill should be expensed immediately at acquisition. Brunovs and Kirsch (1991), Nobes (1992), Hughes (1982). Ding et al. (2008) review the opinions on immediate write-offs of goodwill and find three arguments in the literature as to why this method was not a prolonged practice: first, because of the decrease of the reserves that were useful to distribute dividends; second, because of a sudden impact on reserves would not send a good signal to shareholders, (Hughes, 1982); and third, immediate write-off would negatively impact the financial results of the company.

The amortization was long discussed, as it was the accounting practice for goodwill which was used for the longest period of time. Jennings et al. (2001) study the effect of the goodwill amortization on the usefulness of earnings. Their results show that value of earnings, before goodwill was amortized, is more value relevant than after amortization is applied. The conclusion of their study is that goodwill amortization is not useful to investors and only “adds noise” to the valuation of the price of the shares, Jennings et al. (2001). A similar study on the information content of goodwill in the context of amortization is performed by Moehrle et al. (2001). Their results are not consistent to those of Jennings et al. (2001) and the authors conclude that the explanatory potential of goodwill is not significantly different including or excluding amortization. The two studies agree that the goodwill amortization in its self is not relevant to investors, as it is constant over the period of amortization chosen by management. These findings are also supported by Li and Meeks (2006) who study a sample of UK companies and find that amortization is not relevant to investors, but also find that the value relevance of goodwill diminishes over time and by Churyk and Chewning (2003) who study a US sample of listed companies.

Arguments against amortization are extensively presented by Bloom (2008), who quotes Hughes (1982): "In 1909 Henry Rand Hatfield listed an illustrious group of contemporary accounting authorities who supported amortization and then listed an equally illustrious group who advocated permanent retention. In 1946 an Australian writer used the same approach listing several current authorities on both sides of the issue. (Norman S. Young, "Valuation of Goodwill and its Treatment in Accounts," The Australian Accountant, November 1946, pp. 532-533). In the almost forty years separating the two writers, little had changed except the names of those involved in the controversy." In the amortization controversy, two of the strongest arguments Bloom (2008) brings against amortization are: the "double counting" which appears when a company both amortizes goodwill and also incurs expenses to maintain goodwill; the rigid program of amortization which is implies that goodwill loss is unavoidable and timely based.

The impairment of goodwill was the accounting treatment which followed amortization. The academic literature on the impairment of goodwill covers for the most part the value relevance of impairments, the subsequent improvement in accounting quality and the discretionary use impairment by managers. There is little literature on the accounting method of impairment, and mostly US authors have dealt with this: Chambers (2006) tests the relevance of impairments corroborated with the effects of the replacement of goodwill amortization. His findings confirm the projections of the FASB on the improvement of the quality of the financial reports, when impairment is used as opposed to amortization. Chen et al. (2004) describe similar findings by adopting a different methodology of distinguishing between the adoption year and the following impairment years. Later, Lapointe Antunes et al. (2009) examine initial transitional impairment losses, and their research is based on retroactive method. This method requires companies to adjust their earnings in the opening balance for the impairment amount, as stipulated by the IFRS. Lapointe Antunes et al. (2009) use a Canadian sample for their study to investigate the timeliness and value relevance of transitional goodwill impairments and their results are similar to Chen et al. (2004).

The transition from amortization to impairment was a widely discussed topic in the literature. As the demand for internationally comparable standards became increasingly important worldwide, the FASB and IASB decided to join a project to harmonize their accounting standards. Several studies have been undertaken to observe differences between the USGAAP and IFRS. Leuz (2003), Pacter (2002), Choi et al. (2002) findings summarize the differences between the US, UK and IAS GAAPs and conclude that the standards are not very different but that country specifics have an important role in applying the standards. Street et al. (2000) find that even before the joint project, the impact of the accounting differences between the USGAAP and IASs is narrowing and they lobby for a complete adoption of the IASs by the FASB without condition. With regard to goodwill, the difference in the standards is thoroughly discussed in Chapter 2.

The discretionary use of impairment is also a top debated topic, and several research findings support these allegations. In one of the early studies on goodwill impairment and earnings management, Alciatore et al. (1998) results support the view that the GAAPs can flexibly be used to avoid write downs. Another reference paper, is Beatty and Webber (1996) who find that a company’s debt contracting bonuses, turnover, and not least exchange listing incentives affect the decision to accelerate or delay the recognition of an impairment. Francis et al. (1996) investigate whether goodwill impairments can be explained through proxies which capture the management decision to manipulate both earnings and the impairment of the assets. They find that manipulation and impairment are both determinants which play an important role, but that managerial incentives impact goodwill write-offs strongest.

Beatty and Webber (2006) research potential important economic factors which may influence a company’s decision to impair goodwill. They find that factors like debt contracting, the company’s bonus scheme and the CEO tenure are all influential to the impairment decision Provided that they use different samples and settings Masters-Stout (2007), Van de Poel et al. (2008) and AbuGhazaleh et al. (2011) confirm the above mentioned results.

Consistent with the chronological approach used in all the chapters of this thesis, we review prior literature in a similar manner and identify how the literature of goodwill has changed shifts in time, how it has grown, and most importantly which of the subtopics of goodwill created most controversy and why. We continue to use prior literature in our thesis as we develop our research and we often rely on, are inspired of or confirm our ideas with existing literature.

This research project as a whole, contributes to the accounting literature for goodwill in two new ways: first, it provides historical data on the development of the concept of goodwill and its accounting treatment and second, it contributes to the literature of the relation between earnings management and goodwill in that it proves the existence of managerial discretion in establishing the impairment of goodwill.

The thesis is structured as follows: a research methodology section which clearly describes the grounds which the thesis is built on followed by a condensed literature review section which is intended to merely guide the reader through the major shifts in the academic accounting literature of goodwill. Chapter 1 chronologically reviews the definitions of goodwill, the associated theories, the classification of goodwill types and the constituent parts of goodwill. Chapter 2 revises the accounting treatments goodwill was subjected to, again in a chronological manner and covering standards issued by countries which we found to be most active in accounting for goodwill. We continue chapter 2 with a content analysis of the accounting for goodwill as it is required by the International Financial Reporting Standards. Next, we engage in the debate of amortization vs. impairment which is fervidly discussed in the literature. Finally we discuss the case of Romania with regard to the accounting for goodwill and the changes it has met. In the last chapter we conduct the empirical study, which is introduced by an analysis of the earnings management and the context of the global financial crisis, followed by the research design, the results and conclusions. Final conclusions, limitations of the research and future research perspectives are presented in the end of the paper.

## RESEARCH METHODOLOGY

Research in accounting most often involves problem solving, reconsideration of relationships between accounting phenomena and constantly renewing the existing body of knowledge, we have planned our thesis to address the three pillars we discuss below. The problem our thesis investigates the use of goodwill impairment as an earnings management tool during the latest global financial crisis. This topic reconsiders the relationship between three elements which are all hot debated accounting topics: goodwill impairment, earnings management and the global financial crisis and contributes to the existing body of accounting knowledge by developing a new study on goodwill impairment and its use as an earnings management tool during the global financial crisis.

Accounting research is undertaken on four basic levels, as identified by Bennett (1991) and we use all these levels adapting them to the particularities of the thesis: the descriptive approach, classifications, explanations and predictions.

Accounting research most often uses two dominant methods of reasoning: inductive- observation to theory and deductive- theory to observation. Our thesis uses deductive reasoning for the most part: we use the agency theory to develop different hypotheses that verify how managers may have used the impairment of goodwill as an earnings management in the time of the global financial crisis. But we cannot resume to just the deductive reasoning, because it is most of the times interrelated to inductive reasoning.

Our research is predominantly conducted by the post-positivist approach. Post-positivism, which was introduced by Sir Karl Popper and Thomas Kuhn, is a response to positivism, according to which research is done in an objective, unbiased, unaltered by human assumptions way. Post-positivism argues that reality can only be known imperfectly and probabilistically, Robson (2002). Objectivity remains an ideal for post-positivist research, but the usual quantitative methods used by positivism are correlated with the use of qualitative techniques in order to check the validity of the findings, Merriam (2002). While to some extent we either approach different concepts in the thesis in an interpretative way, or use critical thinking when we discuss accounting standards evolution, we consider that the entire paper is best characterized by the post-positivist approach.

The research methods we use in our thesis are mostly qualitative for the first part and mostly quantitative for the empirical study.

The broad area of interest in which we place our thesis is international financial accounting. The specific *area of interest* in which our topic is positioned is at the intersection of three research domains: goodwill, earnings management and global financial crisis.

The *literature reviewed* for this thesis is built on a selected body of accounting academic literature. The selection is done based on the following criteria. The main criterion we use to choose the articles is that the research undergone must be meaningful, novel, interesting and topic appropriate. We selected our sample of articles from international databases and strived to choose papers which are published in ISI rated magazines. We also included in our body of studied literature papers which were published prior to the introduction of the ISI rating, working papers which were on topic and papers which were published in internationally sanctioned journals, even if they were not ISI rated.

The *conceptual framework* of our thesis focuses on the concept of goodwill, as it is the center of the debate. For the most part, we conduct our analysis using archival research. The archival research is based on historical documents, trial transcripts, journal articles and books. The research method we use is mainly content analysis of the development of the concept of goodwill in time. Through the means of content analysis we are able to make inferences on the large amount of literature we analyzed and produce our own conclusions.

In order to progress to the empirical study, we also consider it necessary to go through the developments of the *accounting for goodwill*, in order to obtain a full understanding of the whole accounting process. We approach worldwide standards in a chronological order, and use content analysis to discuss the accounting techniques and specific knowledge.

The *empirical study design* follows that which we would call, based on prior studies, a "classical approach": we start by formulating the research hypotheses, we then choose the sample and collect the data, we process the data accordingly and we present the results.

a. The hypotheses development is driven by theory and prior studies we find in the literature. The theories which our hypotheses are founded on are the Agency Theory and the Positive Accounting Theory, which we elaborate on in the empirical study chapter. The empirical literature which we were guided by is listed in Table 4. The hypotheses we test are:

H1: Goodwill impairments are significantly higher in the period of the global financial crisis, when the company's earnings are unexpectedly low, due to management intervention.

H2: Goodwill impairments are significantly higher in the period of the global financial crisis, when the company's earnings are unexpectedly high, due to management intervention.

H3: Goodwill impairments are different between countries in the period of global financial crisis due to management intervention.

H4: Goodwill impairments are different between industries in the period of global financial crisis, due to management intervention.

H5: Goodwill impairment levels are influenced by the existence of a Big Four or non-Big Four auditor in the period of global financial crisis.

b. We choose our *sample* based on representativeness. The European stock exchange markets' total capitalization is over 55% allocated between the top three markets: London, Paris and Frankfurt, which we comprised in our sample. The *data we collect* for this sample is quantitative, often called "hard information", and include numerical information for all the variables needed to test the hypotheses.

c. Following the data collection we select the *variables* and design the *empirical model*. Our model follows the structure and the types of variables chosen by authors of similar studies. First we define all the variables which are included in the empirical model. We continue with the presentation of the model which we would test in order to verify the hypotheses. The model includes one *dependent variable*, several *independent variables* and some *control variables* as well. The dependent variable is determined by several independent, or explanatory, variables. We include the control variables in our model in order to obtain a more accurate response to the hypotheses in question. By including control variables in our research we aim to more accurate parameter estimation. Although the control variables are not directly explanatory to the hypotheses tested, including them improves the fit of our model. As shown in Figure 4, the explanation of goodwill impairment is associated with big bath charges, income smoothing, country, industry, Big Four auditor, with the effect being moderated by some company control variables: company size, turnover, ROA, EPS, and some macroeconomic factors as well: industry ROA, GDP. The *empirical model* is designed following similar models in the literature, which we adapt and personalize accordingly to our research goal and looks like the following:

$$GWIMP= \alpha_0 + \alpha_1\Delta GWO + \alpha_2 BATH + \alpha_3 SMOOTH + \alpha_4 COUNTRYROL + \alpha_5 GWIND + \alpha_6 BIG4 + \alpha_7\%\Delta GDP + \alpha_8\%\Delta INDROA + \alpha_9\Delta OCF + \alpha_{10} SIZE + \alpha_{11}\Delta TURNOVER + \alpha_{12}\Delta ROA + \alpha_{12}\Delta EPS + \varepsilon$$

d. We approach the *data analysis* process in two stages. First we run the descriptive analysis and second we run the empirical analysis. Descriptive analysis is the first step, which provides an overall image of the variables, and is the starting point for further complex analysis. We use descriptive analysis on all variables to gather information of how they progress in the study. Data was gathered using Amadeus Database, World Bank reports, and hand collected material. We use only simple methods of primary analysis such as: commonly used parameters- mean, median, standard deviation- frequency charts and also graphs. For the descriptive analysis we use SPSS 20.0 and Microsoft Excel software.The data collected, in its self, can only allow a descriptive approach. We can only attribute causation in a meaningful way when we resort to explanatory theory and more complex analysis.

The next step we take is the empirical analysis of the model we designed. First we run a tobit regression, which is appropriate to use when the dependent variable needs to be censored. The change in the value of goodwill is our dependent variable. The distribution of the dependent variable is censored at zero for one main reason.

Companies with a positive goodwill on their balance sheet must apply the test for determining the impairment of goodwill, but if results show an increase in the value of goodwill they are not allowed to record that increase. The advantage to using a tobit regression is that we actually analyze two accounting choices at once: first, the decision to impair goodwill and second, the amount of goodwill impaired.

The second regression we conduct as a robustness check to see if the tobit results hold is a logistic regression. In a logistic regression the dependent variable only takes the value of 1 if the impairment was taken and zero otherwise. The logistic regression results confirm the results from the initial tobit regression. Similar choice of regression and robustness checks were used in the literature by other researchers, see Table 4 for more details.

e. Each *result* of the study is explanatory to the theory we chose to test in our study. While not all results confirm our hypotheses, all results are tested for robustness and explained by theory. The *conclusions* are drawn at the end of each chapter and a summary and final conclusion of the thesis and the entire research are presented last, along with some of the limitations which we encountered in the process and future developments which we expect to accomplish next.

## A SUCCINT PRESENTATION OF THE CHAPTERS OF THE THESIS

**Chapter 1 "What Is Goodwill?"** offers an extensive overview of the concept of goodwill. In order to obtain a clear overview of central concept which we chose to analyze, goodwill, this chapter has been organized in four different sections, each of them offering solid argumentation for another piece of the goodwill puzzle. In section 1.1. we review goodwill as it is explained and defined from an etymological, economic, legal and, most relevant to our field of research, an accounting perspective. We acknowledge and admit that this analysis is not exhaustive, nor do we intend for it to be so. What we aim to provide is a clear understanding of the term goodwill through the evolution of the term, even if at times, due to limitations of our research, a constant time traverse is not possible. Section 1.2. presents a theoretical background of the most cited theories build around the concept of goodwill. In section 1.3. we design a classification of goodwill and prove the necessity for a delimitation of goodwill types, as each of them is subject to a different accounting treatment and has interesting implications in the financial statements of a business. Finally, in section 1.4. we demonstrate the significant weight which needs to be attributed to the component parts of goodwill, as they are determinants for the existence of goodwill as an asset.

**Chapter 2 "Accounting for Goodwill"** is designed to aim four targets: first, to offer an overview of the accounting standards for goodwill in a chronological order and in the context of several countries and regions around the globe; second, to explain the current accounting treatment of goodwill under the IFRS provisions; third, to extend a personal opinion in the most debated subject of accounting for goodwill: amortization vs. impairment; and last, fourth, to discuss the accounting treatment for goodwill in the particular case of Romania.

Accounting standards for goodwill have fluctuated over time. No treatment which we analyzed has proved to be adequate for a longer period of time and in more parts of the world. Up until the convergence program accounting treatments for goodwill were different in different countries, they were under continuous revision to be changed and sometimes provisions were "recycled" to be in forced again. Along with 2005 and the convergence program, the opinion for accounting for goodwill has become more consistent worldwide, thus creating comparability among financial reports from different companies around the world, which was probably the most desired purpose for the standard setters in the debut of their initiative. In Romania, for the accounting for goodwill in particular, the changes have simply followed one international trend or another, as mainly dictated by politics and derived interests. We believe it is reasonable to assert that isolated, the changes in accounting for goodwill have not had a major impact on the market to the day, as the merger and acquisitions activities in Romania, which are the primary generators of goodwill, are not yet extremely influential.

**Chapter 3 "Empirical Study: Goodwill Impairment- A New Earnings Management Tool During The Global Financial Crisis**" addresses the use of goodwill impairment as an earnings management tool during the global financial crisis. Using a sample of 604 company-year observations, obtained from the main indexes of the top three European exchange markets, Frankfurt, London and Paris, for the years 2008-2011 which we defined as the global financial crisis years, our empirical study examines the use of goodwill impairment as an instrument of earnings management. The intention of the standard setters to improve the accounting for goodwill through the impairment method over the amortization has raised many debates among members of academia and professionals. Many empirical studies, some of which we mentioned above, have been conducted to determine whether the change in accounting has managed to bring forward the expected results. Most of the papers published on the relationship between earnings management and goodwill using different samples during the transitional period from one accounting treatment to another. Our paper is among the first to consider this analysis during the tumultuous times of global financial crisis, when managers may be more inclined to use earnings management tools in order to provide more convenient financial results.

After controlling for macro and micro economic factors, we obtain three set of results, from applying two different regressions to our empirical model. The first results only confirm that hypothesis tree is valid, and do not manage to validate the rest of our hypotheses. The results from the second type of regression also validate hypotheses one and two. As for hypothesis four and five we do not obtain though the test we run, significant information in order to confirm them.

Our results reveal that in time of global financial crisis managers use big bath charges when earnings, because earnings are already unexpectedly low. Some results show that income smoothing is also used when earnings are unexpectedly low, but these results are only confirmed in one of the regression tests conducted. Consistent with agency predictions that managers act accordingly to expected benefits, these results confirm managerial discretionary choice to level earnings.

We also find that managers apply impairment differently across the countries included in our sample, depending on the conditions of law and regulation abiding of each country. These results support the Positive Accounting Theory by showing that a country's law and regulation enforcement regime is associated both with the decision and the magnitude of goodwill impaired.

Even though the frequency of impairments differs from one industry to another, results have not confirmed that indeed the industry in which a company is included is relevant to the amount impaired or decision to impair. We found no significant evidence of earnings management usage within the industries used in our sample. Even though according to agency theory we would have predicted that managers operating in different industries face different incentive to manipulate earnings, current results do not support this hypothesis.

Based on the agency perspective that a high quality auditor and high quality auditing may reduce agency problems by monitoring managerial discretionary behavior and limiting earnings management, (Jensen and Meckling, 1976), our fifth hypothesis is not confirmed by relevant results. The auditor type does not seem to be significant to our sample in this period, which means that our fifth hypothesis could not be confirmed.

By the end of this empirical study we manage to answer "yes" to the first research question. We also answer "yes" to the significance of the "rule of law" of different countries affecting managers' decision to impair goodwill. As for the industry type, we do not obtain conclusive results in order to give a positive answer. Last, with concern to the difference between auditor type and its impact on goodwill impairment, the answer is negative.

Our results are consistent with the approach of the international standard setters that the impairment of goodwill is subject to overall economic conditions of a company. Resluts also provide information that the impairment of goodwill is influenced by the macroeconomic conditions as well, and that in times of crisis impairment is used discretionary. The results we have discussed in detail in this empirical study are hard to be generalized to the entire European listed companies. As we could see from the first results revealed by Pardo and Giner (2013), a sample of companies from another country reacts differently at times to the same factors. But even though the sample is not generalizable, because of the representatives of the sample among all European listed companies, these results are important to the standard setters, the stockholders as well as to other stakeholders or financial information users.

## CONCLUSIONS, LIMITATIONS AND PERSPECTIVES OF THE RESEARCH

Studies of goodwill, whether they materialized into books or scientific articles, academic lectures or court rules, have emerged in the literature more than a century ago. The increasing interest in the topic of goodwill led to the creation of a solid body of literature which encompassed studies of many facades of this topic. The definition, the development of theories around the concept, the ever changing accounting treatments, the use of goodwill as an earnings management tool are all topics which accounting researchers have been studying throughout the years. Our thesis aims to bring several novel contributions to the existing body of literature.

The research approach which we would use to define our work for this thesis is described by Chambers (1966) as a "method of construction". The thesis starts with a complex analysis of the evolution of the concept of goodwill. The analysis is constructed in such a way that is provides a different answer to the question posed in the title of the first chapter, "What Is Goodwill?", in each of the compound sections. We first define the term goodwill through all of the etymological, economic, legal, accounting and personal perspectives. We find that the association of goodwill with an *advantage* is prevalent both in the literature and the accounting regulations. We also observe that there are two main methods to define goodwill: the "bottom-up" method, which considers goodwill as a composite of more elements and the "top-down" method, which considers goodwill as a residual. The novelty brought by this extensive analysis of the definitions of goodwill resides in the mere fact that such a complex analysis has not yet been conducted in the literature, to the best of our knowledge. The analysis continues with a revision of the theories on goodwill and highlights how important these theories are and how they have over time influenced the accounting treatment of goodwill. Since many of the goodwill debates are centered on the recognition, or non-recognition, of different types of goodwill, we considered it was relevant that our analysis be continued with a section in which we could discuss the types of goodwill and explain the differences in the accounting treatment corresponding to each type. We designed a personal classification of goodwill, which comprises types of goodwill which are loudly debated and other types which are not so common to the discussions in the literature. The analysis of the concept of goodwill was continued in the last section where we demonstrated that the comprising elements of goodwill are an essential condition for its existence, their dynamic was influential to the changes in the accounting treatment of goodwill and, not least, the diversity of these elements causes continuous change in the structure of goodwill.

Overall, the first chapter aims to provide a thorough understanding of the concept of goodwill, its evolution in time and the sources of the controversies to which accounting for goodwill is subject to.

We understand that history is important and that the knowledge one gains from looking back in time to how things and situations evolved into what they are today is invaluable. We commence the second chapter with a chronological analysis section of the accounting treatments of goodwill. Having already understood from the previous chapter that the accounting treatment of goodwill has been influenced by so many of the goodwill characteristics, makes it more logical to understand the inconsistencies of accounting for goodwill in different countries over time. Our analysis reveals that accounting standards shifted from immediate-write off to amortization and, lately, to impairment. It was following the consensus reached by the two most influential accounting boards worldwide, IASB and FASB, in 2005, that countries worldwide began to adopt similar accounting regulations for a better comparability of the financial results. The latest accounting treatment for goodwill is the impairment. We conduct a thorough content analysis of the IASBs regulations for goodwill in the second section. This analysis is intended to mainly understand the mechanism of the provisions for goodwill, which open the path to managers to use goodwill impairment discretionary.

Whether impairment is a long term solution, we cannot foresee. How impairment differs from the previous treatment- amortization- is the topic of the third section of the second chapter. We engage in the debate of amortization or impairment and we build a solid case based on four main arguments: the discretionary choices which exist when applying impairment, the reflection of goodwill impairment on the financial statements, the “safer-play” which amortization was offering and last, differences between amortization and impairment, and the underlying investment opportunities of both treatments.

The last section of chapter two is a case study of how the Romanian legislation easily shifts with regard to accounting for goodwill. We run a content analysis again, through the main accounting legislation which was passed in Romania from the time when the country regained democracy- after more than four decades of communist regime- until today. Our analysis highlights that Romania has adopted several different accounting regulations in a short period of time. Paradoxically, some were fortunate and ahead of their time, but were replaced with anachronic ones. These changes were driven by political, economic and strategic interests of the country.

Having reached so far with the "construction" of our thesis we considered we had the knowledge and understanding we needed to engage in the last and probably the most difficult, endeavor of this paper, the empirical study. This study is driven mainly by the agency theory which assumes that agency relationships are created between the managers and the shareholders and that these relationships are sealed into agency contracts. To the extent possible, these contracts should equally satisfy both parties. Unfortunately they are almost always linked to the realized earnings. Because of this linkage, managers may be motivated to manipulate reported earnings, if it serves their best interest. One way to manage earnings is through the manipulation of the impairment of goodwill. To address the dilemma whether managers use goodwill impairment as a tool for managing earnings our study examines the financial data from 151 companies listed on the top European stock exchange markets, during the confused and tumultuous period of the global financial crisis. The study was constructed around three research questions: "Does a company's management influence the decision to impair goodwill?", "Does a company's management decision to impair goodwill differ by country or industry?" and "Does the auditor type, Big Four or Non-Big Four influence the decision to impair goodwill?". To answer these three research questions we introduce five hypotheses, which we test through the means of a tobit regression. The results of the tobit regression only confirm H3 and suggest that in a country with higher country rule of law index are less likely to engage in earnings management.

We further introduce some additional tests, in the form of logit regressions to verify if the results from the tobit regression are validated. Indeed H3 is again confirmed, but results from the logit regressions tested also confirm H1 and H2, that managers engage in big bath charges and income smoothing by manipulating the impairment of goodwill.

In the end, we manage to answer positively to our first research question, positively to the first part of the second question and negatively to the second part of the second question and negatively to the third research question.

The findings of our study support the agency theory by providing evidence that given certain conditions and factors of influence, managers engage in earnings management behavior, and that the global financial crisis is a catalyst for this behavior. These results are a new piece of the puzzle of earnings management and goodwill, and they are interesting to the standard setters, the stockholders, the stakeholders and other users of financial information.

The results of this thesis are important first because they enrich the academic accounting literature with a new study which addresses the topic of goodwill. We analyze in a chronological manner how goodwill has evolved to the intangible asset which manages to still arise controversy today. Second, the findings of our study are important because, as indicated in prior literature as well, standard setters need to know how the standards are permissive to manage earnings. Schipper and Vincent (2003) address the need for new accounting standards to prevent further earnings management from happening. But before this can happen, new studies which indicate the use of different elements as earnings management tools or particular setting when earnings management is used are necessary. Our study contributes to the literature of goodwill used as an earnings management tool in that it proves managers use increased discretion in establishing goodwill impairment values in the troubled economic times of the recent crisis.

Limitations are unavoidable to any research project. For our part, we admit that a first limit were language barriers. Most of the literature we studies was written in English. Should we have had the leverage to study articles in another language, more interesting findings might have surfaced in our thesis. We also identified several limitations which are inherent to this study. First, the sample, even though representative is small, and the number of final observations which take impairments is roughly under 30% of the entire sample. Second, the data collection may contain inherent errors, due to manual collection but also the database acknowledged errors. Third, we always have to wonder if the variables in this research indeed test what we intended, or are there several others factors which may have been explanatory but we did not introduce. This potential disadvantage usually exists in archival empirical research studies. We try to undermine this disadvantage by using a representative sample which lessens our third concern.

Further potential research which we identify derives from the extension of the study to the same sample for periods before and after the global financial crisis. This would offer standard setters a complete overview of the development of the earnings management problem in different settings. Such studies are welcomed by Ramanna and Watts (2012) as they consider it may be of importance to both academics and practitioners.

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## Accounting Laws, Standards and Regulations

1. AAS 18 "Accounting for Goodwill"
2. AASB 1013 "Accounting for Goodwill"
3. ARB 24 "Accounting for business intangibles"
4. ARB 43 "Restatement and Revision of Accounting Bulletin Statements"
5. ASC 350 "Intangibles- Goodwill and Other"
6. Fourth Council Directive 78/660/EEC
7. FRS 11 "Impairment of Fixed Assets and Goodwill"
8. FRS 10 "Goodwill and Intangible Assets"

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10. IAS 21 “The Effects of Changes in Foreign Exchange Rates”
11. IAS 22 “Business Combinations”
12. IAS 36 “Impairment of Assets”
13. IAS 38 “Intangible Assets”
14. IFRS 3 “Business Combinations”
15. IFRS 3 Revised “Business Combinations”
16. IFRS 5 “Non-current Assets Held For Sale And Discontinued Operations”
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24. Seventh Council Directive 83/349/EEC
25. SFAS 141 ”Statement of Financial Accounting Standard”
26. SFAS 142 “Goodwill and Other Intangible Assets”
27. SSAP 22 “Accounting for Goodwill”

## Internet Resources

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