ELSEVIER

Available online at www.sciencedirect.com

SciVerse ScienceDirect

Procedia Economics and Finance 2 (2012) 16 – 25

Procedia
Economics and Finance

www.elsevier.com/locate/procedia

2nd Annual International Conference on Accounting and Finance (AF 2012)

Fair Value, earnings management and asset impairment: The impact of a change in the regulatory environment

Richard Andrews*

Hull University Business School, Hull University, Scarborough, YO11 3AZ, United Kingdom

Abstract

This paper investigates the practice of asset impairment in large listed UK corporations before and after the change in the regulatory environment to International Financial Reporting Standards. The results find that overall implementation of an asset impairment charge results in a greater amount of income smoothing as opposed to big bath accounting, but that post the change in the regulatory environment, the extent of big bath accounting increases.

© 2012 The Authors. Published by Elsevier Ltd. Selection and/or peer-review under responsibility of Global Science and Technology Forum Open access under CC BY-NC-ND license.

Keywords- impairment; fair value; earnings management

1. Introduction

Asset impairment is a relatively new term in the corporate reporting arena. However, the concept of asset impairment relates closely to that of an asset write-down. Asset write-downs historically have been a feature of corporate reporting for many years (Lee (1975) due to the principle of conservatism, although largely discretionary in nature in the UK until the introduction of Financial Reporting Standard 11 Impairment of Assets and Goodwill (FRS 11) in 1998. This paper evaluates the extent of asset impairment amongst large UK listed corporations both pre and post the change to International Financial Reporting Standards in 2005.

* Corresponding author. Tel.: +44-1723-357270; fax: +44-1723-357119.
E-mail address: r.c.andrews@hull.ac.uk

2212-5671 © 2012 The Authors. Published by Elsevier Ltd. Selection and/or peer-review under responsibility of Global Science and Technology Forum
Open access under CC BY-NC-ND license. doi:10.1016/S2212-5671(12)00060-3

Section II of the paper commences with a review of selected prior literature, Section III explains the research questions and methodology, Section IV provides an analysis of the results and Section V provides some concluding comments.

2. Prior literature

2.1. Earnings Management

Asset impairment loss recognition is contemporaneously linked to both the issue of earnings management (Elliott and Shaw (1988), Walsh, Craig and Clarke (1991), Elliott and Hanna (1996), Jordan and Clarke (2004), Sevin and Schroeder (2005) and Andrews (2006)) and the principle of conservatism (Ball and Shivakumar (2003), Watts (2003), LaFond and Watts (2008)). The question of whether asset impairment constitutes a form of income smoothing in terms of managing the earnings of an entity or whether asset impairment presents the management with the opportunity to take a big bath† (Trueman and Titman (1988), Walsh et al (1991), Bartov (1993), Basu (1997), Burgstahler and Dichev (1997), Healy and Wahlen (1999), Shaw (2003), Jordan and Clark (2004), Sevin and Schroeder (2005)) is an important question in terms of this thesis and has been debated amongst academics and regulators‡.

2.2. Asymmetrical Timeliness of Earnings

The implementation of an asset impairment loss impacts upon the asymmetrical timeliness of earnings and this important characteristic (Basu (1997), Ball and Shivakumar (2003)) is determined by the fact that in the current financial reporting regime, timeliness of earnings tends to be skewed towards loss recognition§ rather than recognition of gains. This results in a bias in the symmetry of the reported financial information towards greater reporting of unrealised losses and not so much reporting of unrealised gains (Basu 1997). The asymmetrical aspect of earnings is long established within the principle of conservatism (Watts (2003), LaFond and Watts (2008)).

The amount of discretionary choice available to management in a decision to charge an impairment loss is also an important point in terms of whether management uses this discretion in order to manipulate the published financial results. This aspect has been investigated by researchers such as Beatty, Ramesh and Weber (2002), Elliott and Hanna (1996), Francis, Hanna and Vincent (1996), Rees, Gill and Gore (1996), Fields, Lys and Vincent (2001) and Riedl (2004).

Additionally discretionary choice forms an important part of the seminal work by Watts and Zimmerman (1978) in the area of Positive Accounting Theory and management choice in discretionary accounting policy. Central to the issue of discretionary choice is the measurement and valuation method applied by management in the determination of an asset impairment loss.

---

† Big bath accounting is the practice of using a large write-off to 'clear the decks'. Healy and Wahlen (1999) provide a comprehensive literature review relating to big baths.

‡ Arthur Levitt (then chairman of the SEC in the US) expressed his concern at the rising incidence of big bath accounting used to manipulate financial reports in a speech delivered to New York University on 28th September 1998.

§ For example, regulation in both the US under SFAS 142 and Internationally under IFRS3 and IAS 36 only permit downward valuation adjustments in the form of asset impairment charges and no upward revaluations of intangible assets. However, under IAS 16 Property, Plant and Equipment, periodic upwards revaluations of tangible fixed assets such as land and buildings are allowed.

Download English Version:

https://daneshyari.com/en/article/983076

Download Persian Version:

https://daneshyari.com/article/983076

Daneshyari.com