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An Investigation of the Determinants of Discount Rate Manipulation in Swedish and Finnish Listed Companies

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Abstract : In 2004, the International Accounting Standards Board (IASB) issued new accounting standards for impairment testing of goodwill. IFRS 3 Business Combinations and IAS 36 Impairment of Assets prohibited amortization of acquired goodwill and instead required companies to test goodwill for impairment annually or more often if necessary. The goodwill impairment test is based on management's judgement and estimations, making the impairment-only-approach subjective and unreliable. Management can use the discretion opportunistically by managing goodwill impairments. The IASB's remedy to the reliability problem has been to demand transparent financial reports. IAS 36 paragraph 134 requires detailed disclosures regarding the impairment test in order to make potentially unreasonable assumptions and estimations visible. The disclosure requirements should thus (in theory) make it more difficult for management to 'choose' assumptions and estimations that suit an agenda. Whether the requirement to disclose detailed disclosures regarding the impairment test leads to less opportunism is however an empirical question. This work analyses whether one of the required disclosures in IAS 36 paragraph 134, the reported discount rate, differs from an independently estimated risk-adjusted discount rate. Estimates of discount rates that are either lower or higher than the independently estimated discount rate are here defined as opportunism. In the former case - i.e. when the reported discount rate is lower - the objective may be to avoid profit reducing impairment charges. In the latter case - i.e. when the reported discount rate is higher - the objective may be to reduce profits or take 'big baths'. This paper differs in one important respect from previous similar studies, the majority of which are based on purely descriptive statistics; we use multivariate regression analysis to analyze what factors affect deviations between disclosed discount rates and independently estimated discount rates. The sample consists of Swedish and Finnish listed companies. Swedish and Finnish listed companies are analysed since the accounting oversight bodies differ between the two countries. The results show that discount rate deviations in Swedish and Finnish listed companies are significantly related to accounting oversight, size and industry but not financial risk, business risk and goodwill intensity.

Keywords : discount rate, manipulation, goodwill impairment test, disclosures
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