Asian Social Science; Vol. 11, No. 21; 2015
ISSN 1911-2017 E-ISSN 1911-2025
Published by Canadian Center of Science and Education

Delayed Goodwill Impairment Charges: An Examination of the Declined Market Capitalization

Jamaliah Abdul Majid[1] & Nor Asma Lode[1]

[1] School of Accountancy, Universiti Utara Malaysia, Malaysia

Correspondence: Jamaliah Abdul Majid, School of Accountancy, Universiti Utara Malaysia, 06010, Sintok, Kedah, Malaysia. E-mail: jamaliah@uum.edu.my

Received: April 26, 2015 Accepted: May 24, 2015 Online Published: July 6, 2015

doi:10.5539/ass.v11n21p258 URL: http://dx.doi.org/10.5539/ass.v11n21p258

"…… Often, share prices reflect the impairment before the company records it on the balance sheet. In other words, the impairment test comes too late."

Hans Hoogervorst, Chairman of the IASB[1]

Abstract

This study has two main objectives. First, it examines the extent to which the declined in the market capitalization below the book values of the net assets represents an appropriate proxy for an indication that goodwill may be impaired by listed companies in Malaysia, as an example of listed companies in an emerging market. Using the findings from the first research objective, this study explores cases of late reporting of goodwill impairment losses. Results show that as a stand-alone, the declined in the market capitalization is not an ideal proxy for an indication that goodwill may be impaired, as it does not fully reflect the condition of the cash-generating-units containing goodwill, disclosed in the Notes to the financial statement. However, when the declined in the market capitalization is examined in relation to financial performance of companies and their segment results, it becomes a useful starting point in identifying cases of late reporting of goodwill impairment losses. The study provides important implications for policy makers and relevant authorities, in that, to enhance the quality of financial reporting, the relevant authorities need to closely monitor the disclosure of goodwill impairment by listed companies in the emerging market of Malaysia.

Keywords: market capitalization, goodwill impairment, managerial discretion

1. Introduction

The implementation of goodwill impairment-only approach by the US Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) has led to a renewed focus on a subsequent accounting for goodwill. Standard setters and regulatory bodies raise concern on the lack of rigorousness of the impairment test conducted by companies (Hoogervorst, 2012; EFRAG, 2013; KPMG, 2014) while audit firms and academics highlight the degree of subjectivity inherent in the impairment test (Li, Shroff, Venkataraman & Zhang, 2011; Ramanna & Watts, 2012) which may limits its effectiveness (KPMG, 2014).

In an attempt to evaluate the reliability of the impairment testing of goodwill and hence to assess goodwill impairment analyses reported by companies, regulators, such as the US Securities and Exchange Commission (SEC) has made use of the companies' market capitalization. For example, the SEC, in its comment letters sent to US listed companies, requested the companies to provide explanation on the non-impairment of goodwill, as their market capitalization fell below the book values of the net assets (Regions, 2009; Murphy, 2012). Accordingly, audit firms advised their clients to provide detailed disclosures of goodwill impairment when the companies experienced such condition (Ernst & Young, 2011).

One possible implication of the lack of reliability of the impairment testing of goodwill is that goodwill impairment losses were reported late on the financial statements. Prior studies (e.g., Li et al., 2011; Ramanna & Watts, 2012; KPMG, 2014) documented that goodwill impairment charges lag behind the economic impairment. Li et al. (2011) conjectured that companies may have used the discretion inherent in the impairment testing of goodwill to delay the reporting of goodwill impairment losses.

Despite concerns raised by the Chairman of the IASB and academics on the reliability of the impairment testing of goodwill and the late reporting of goodwill impairment losses, there has been no prior research to our

knowledge that examine the late reporting of goodwill impairment losses by listed companies in an emerging market. Morck, Yeung, and Yu (2000) argued that compared to the developed markets, the stock prices in the emerging markets are less reflective of the firm-specific information. Therefore, it is an empirical issue to evaluate the appropriateness of the application of the market capitalization in relation to goodwill impairment reported by listed companies in an emerging market. The present study aims to fill this void.

Specifically, the objective of our study is twofold. First, to examine the extent to which the declined in the companies' market capitalization below the book value of the net assets represents an appropriate proxy for an indication that goodwill may be impaired by listed companies in Malaysia, as an example of listed companies in an emerging market. Using results from the first research objective, our second research objective is to explore cases of late reporting of goodwill impairment losses by Malaysian listed companies.

The remainder of this paper is structured as follows. Section 2 presents prior literature on goodwill impairment testing and triggering events for the impairment test. Section 3 describes our research method. Section 4 reports the findings while Section 5 concludes the paper.

2. Prior Literature

2.1 Impairment Testing of Goodwill

The introduction of the International Financial Reporting Standard (IFRS) 3 *Business Combinations* by the IASB lead to the prohibition of an amortization of goodwill. The IFRS 3 also requires companies to perform an impairment review of goodwill annually or more frequently if events or changes in circumstances indicate that the goodwill might be impaired (IASB, 2006a). The purpose of the impairment test is to ensure that the carrying amount of the assets (inclusive of goodwill) reported on the balance sheet do not exceed their recoverable amount (IASB, 2006b; Ernst & Young, 2008). In performing the impairment test, managers are required to use judgment and estimations (Ernst & Young, 2007). To limit the risk of an over-optimistic or over-pessimistic estimation applied by the managers, Malaysian Financial Reporting Standard[2] (FRS) 136 *Impairment of Assets* (similar to the IAS 36) provides safeguards in the form of a list of indicators that the assets may be impaired (see Figure 1). Nevertheless, the standard emphasizes that the list is not exhaustive (IASB, 2006a; IASB, 2006b).

- Market value of the asset declined significantly
- Increased in the market interest rates
- Evidence is available of obsolescence or physical damage of an asset
- Significant changes with an adverse effect on the entity which affect the asset
- Evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected
- Dividend for an investment in a subsidiary, jointly controlled entity or associate
- Significant changes with an adverse effect on the entity
- The carrying amount of the net assets of the entity is more than its market capitalization

Figure 1. List of indictors that an asset (goodwill) may be impaired
Source: MASB (2006: FRS 136, paragraph 12)

From Figure 1, it is observed that the first six indicators provided by the FRS 136 relate specifically to company's assets. Information concerning these indications can only be accessed internally by the management. The remaining two indications relate to the economic environment in which the assets (inclusive of goodwill) operate.

This study focuses mainly on the market capitalization, the last indicator presented in Figure 1, for three main reasons. First, a decline in a company's market capitalization beyond the book value of its net assets implies that the market regards the business as being overvalued (Ernst & Young, 2008). It suggests that investors perceive the company's value to be worth less than the amount presented on the balance sheet. Thus, if the decline is not due to short term volatility in the market, it is one of the factors that can potentially increase the risk for impairment (Price water house Coopers, 2009).

Second, FRS 136 (paragraph 90) requires a company to perform an impairment test of goodwill at least annually (MASB, 2006). Thus, we argue that because a company would normally carry out the impairment test at the balance sheet date, the declined in the market capitalization below the book values of the net assets, which existed prior to the impairment test, might influence the test itself. Even if a company is applying value-in-use as

a basis of a recoverable amount of its cash-generating-units (CGUs) containing goodwill, the declined in the market capitalization might influence the manager's estimation of future cash flows of the CGUs. Hence, there is a possibility for an impairment loss to occur if the recoverable amount of the CGUs is lower than its carrying amount. Third, unlike other indicators noted above, a decline in the market capitalization below its book value is observable externally. Thus, we would be able to examine the decline in the market capitalization.

2.2 Application of the Market Capitalization

In evaluating the reliability of an impairment testing of goodwill undertaken by companies, and hence the reporting of goodwill on the financial statements, the US SEC normally refers to the companies' market capitalization (Fox III, 2008; Jacobs, 2008; Latham & Watkins, 2009; Murphy, 2012). This is evidenced from the SEC comment letters, which requested US listed companies to explain reasons for their goodwill impairment analyses (see for example Regions, 2009).

Apart from regulators, prior studies (e.g., Beatty & Weber, 2006; AbuGhazaleh, Al-Hares, & Roberts, 2011; Ramanna & Watts, 2012) have also employed the companies' market capitalization (with modification) in analyzing goodwill impairment reported by US listed companies. For example, Beatty and Weber (2006), in their analysis of goodwill impairment by US listed companies, selected companies that faced a decline in the market values below the book values of the net assets. Further, they imposed an additional selection criterion that the gap between these two values shall not exceed the amount of goodwill balance reported on the financial statement. By applying the companies' market capitalization (with modification), these prior studies have made an implicit assumption that a decline in the firms' market values below the book values of the net asset is a good indication of goodwill impairment.

2.3 Other Triggering Events and the Importance of Disclosure of Goodwill Impairment

Apart from the declined in the market capitalization below the book value of the net assets, as discussed in Section 2.1, there are other indicators or triggering events that have been highlighted by prior studies. For example, Comiskey and Mulford (2010), in their analysis of disclosure of triggering events for goodwill impairment test by US listed companies, explain that the triggering events vary from company to company. In addition to the market capitalization, other factors, such as the duration and severity of the decline (Latham & Watkins, 2009) and the performances of the reporting units or the CGUs containing goodwill also play their roles in the recognition of goodwill impairment losses (Comiskey & Mulford, 2010).

Prior studies also point out that the declined in the market capitalization below the book value of the net assets does not necessitate companies to take goodwill write-offs (KPMG, 2014). This is because there are situations where the CGUs containing goodwill are insensitive to the market capitalization as an indicator (Ernst & Young, 2011). As a result, the recoverable amount of the CGUs exceeds the market capitalization (Ernst & Young, 2011). In these situations, Ernst & Young (2011) suggested companies to disclose sufficient information to indicate reasons for reporting the goodwill impairment and to describe factors which may lead to impairment losses in the near future.

The emphasis on providing detailed information concerning goodwill impairment as discussed above is in line with the disclosure requirements as stipulated by the IAS 36 and hence the FRS 136. As discussed earlier, when IFRS 3 was introduced, the standard prohibited an amortization of goodwill and requires companies to perform an impairment test of goodwill at least annually. The IASB board members argued that with the abolition goodwill amortization, the impairment test of goodwill, as stated in IAS 36, does not meet the requirement of a "rigorous and operational impairment test" (IASB, 2006 a & b: Basis for Conclusion). As a result, the IASB decided to improve the reliability of the impairment test through disclosure requirements (IASB, 2006b: Basis for Conclusion). This was done by requiring companies to disclose enough information to allow users to evaluate the reliability of the impairment test and at the same time maintaining an appropriate balance in the magnitude of the disclosures (IASB, 2006b: Basis for Conclusions). Thus, it is important for companies to provide detailed disclosure of goodwill impairment including triggering events that may lead to goodwill impairment losses in order to assist users to evaluate the reliability of the impairment test and hence the reporting of goodwill on the financial statements.

3. Method

3.1 Data Source

To evaluate the extent to which the declined in the market capitalization below the book value of the net assets represents an appropriate proxy for an indication that goodwill may be impaired, we compare two types of information, which represent the observed practice vs. stated explanation. The data compared are: (i) the

market-to-book ratio at the balance sheet date, which is obtained from Datastream, and (ii) reasons for companies reporting goodwill impairment (both zero and goodwill impairment losses) disclosed in the Notes to the financial statement. The market values are the fiscal year-end price per share multiplies with the total number of shares outstanding.

3.2 Sample Selection

We analyze the appropriateness of the declined in the market capitalization from 2006 to 2007. 2006 represents the first year of the FRS 3 (similar to the IFRS 3 issued by the IASB) implementation in Malaysia. We also examine the disclosure and the market capitalization in the following year in order to assess the relative disclosure of goodwill impairment over time. Table 1 shows that the number of firm-years that are available for the analysis is 760. The analysis is conducted in two ways. First, it is performed across companies within one year of the FRS 3 implementation. This covers 294 companies with financial year ended December 2006 and a further 235 companies with financial year ended non-December 2007. Second, the analysis is conducted on a subset of companies over a period of two years. This includes 258 companies with data available for the financial years ended December 2006 and December 2007.

Table 1. Sample selection

Total number of companies with:	
Financial year ended December 2006	294
Financial year ended non-December 2007	235
Financial year ended December 2007	258
	787
Less: annual reports unavailable	(27)
Total final number of companies	760

From the results of the first research objective, we explore in detailed cases of late reporting of goodwill impairment losses. To identify companies that appear to delay reporting their goodwill impairment losses, we focus on selected companies in which their annual reports are available throughout several years and reported goodwill impairment losses. Our exploration is guided by four key items that have been employed by prior studies and disclosure requirements of the FRS 136 (see Figure 2 – extracted from Abdul Majid, 2013).

- Goodwill movement.
- Segment results – i.e. cash-generating-units (CGUs) containing goodwill.
- Financial performances of the company - i.e. operating income, profit or loss from ordinary activities pre-tax and pre-goodwill impairment loss, net income available to equity holders pre-goodwill impairment loss, and basic earnings per share.
- Market-to-book ratio.

Figure 2. Key items that were employed in exploring cases of late reporting of goodwill impairment losses
Source: Abdul Majid (2013)

4. Results and Discussion

4.1 Results of the Appropriateness of the Declined in the Market Capitalization

In analyzing the appropriateness of the declined in the market capitalization below the book value of the net assets, as a proxy for an indication that goodwill may be impaired, we compared two types of information, which represent the observed practice vs. stated explanation. As noted in Section 3.1, observed practice refers to the market-to-book ratio at the balance sheet date, which is obtained from Datastream while the stated explanation refers to reasons for reporting goodwill impairment (both zero and goodwill impairment losses) disclosed in the Notes to the financial statement.

The comparison of these two types of information leads to observation of three groups, as follows:

- Group 1 - companies with poor disclosure, which do not provide reasons for reporting goodwill impairment in the Notes to the financial statement (see the illustrative example in Appendix A).
- Group 2 – companies whose market-to-book ratio reflects their stated reasons for reporting goodwill impairment as disclosed in the Notes to the financial statement (see the illustrative example in Appendix B).

- Group 3 – companies whose market-to-book ratio conflicts with their stated reasons for reporting goodwill impairment as disclosed in the Notes to the financial statement (see the illustrative example in Appendix C).

One striking issue that emerges from the close inspection of the annual reports, particularly the Notes to the financial statement, is that companies' disclosure related to the impairment testing of goodwill is not encouraging. In all three groups, the majority of the companies do not disclose information concerning CGUs containing goodwill and discount rates applied, the two essential disclosure requirements that were required by the FRS 136. Further, although Groups 2 and 3 disclosed reasons for reporting goodwill impairment, the disclosures are inadequate, especially for users of annual report to evaluate the reliability of the impairment testing of goodwill. Not only that these disclosures were aggregated but they are also boilerplate in nature. These findings are consistent with the results documented by the Financial Reporting Council (FRC) in the UK in 2008. The study found that even though all of the 32 UK listed companies which they have analyzed disclosed information regarding an impairment testing of goodwill, many of these disclosures are generic in nature and 'inappropriately aggregated' (FRC, 2008). The FRC considered such disclosures as providing little information to users of financial statement in understanding factors influencing valuation of goodwill and in evaluating the estimation made by the management concerning the impairment test (FRC, 2008).

Table 2 reports the number of companies in each of the three groups. Panel A of the table shows that overall approximately one-third of the companies with financial year ended December 2006 do not disclose reasons for reporting goodwill impairment (companies in Group 1). The number of companies in Group 1 reduces slightly from 33% to 30% for the financial year ended non-December 2007. Panel B of the table shows that the lack of disclosure reduces over time as the proportion of companies which fall into Group 1 (poor disclosure) decreases from 31% (for the financial year ended December 2006) to 19% (for the financial year ended December 2007). Perhaps, this reflects increased understanding of the standard.

Groups 2 and 3 comprise those companies who disclosed their reasons for reporting goodwill impairment in the Notes to the financial statement. For Group 2, the reasons disclosed coincide with their observed practice (market-to-book ratio). Table 3 (panel A) shows that of the 170 companies with financial year ended December 2006, 45% of the companies are classified into Group 2. The proportion remained similar (45%) for companies with financial year ended non-December 2007. The comparison of the frequency of companies in Group 2 over time shows that the proportion increases to 53% for the financial year ended December 2007, suggesting that the disclosure improves over time.

For Group 3, their disclosed reasons conflicted with the observed practice (market-to-book ratio). Table 3 (panel A) shows that for companies with financial year ended December 2006, 55% of the companies fall into Group 3. For companies with financial year ended non-December 2007, the percentage of companies that fall into Group 3 remained similar at 55%. The comparison of companies in Group 3 over a period of two years shows an improvement in the disclosure, in that, the number of companies in Group 3 reduces to 47% over the year.

Table 2. Breakdown of companies' disclosure of goodwill impairment into three different groups

Panel A: Analysis conducted across firms within one year of implementing FRS 3	Number of companies					
	December-2006			Non-December-2007		
	All	GWIL(IL)	GWIL(0)	All	GWIL(IL)	GWIL(0)
Reason for reporting goodwill impairment not disclosed (Group 1)	92 (33%)	17 (24%)	75 (36%)	68 (30%)	17 (33%)	51 (29%)
Reason for reporting goodwill impairment disclosed (Groups 2 & 3)	189 (67%)	53(76%)	136 (64%)	156 (70%)	34 (67%)	122 (71%)
Total	281 (100%)	70 (100%)	211 (100%)	224 (100%)	51 (100%)	173 (100%)
Panel B: Analysis conducted on a subset of firms over a period of two years implementing FRS 3						
Reason for reporting goodwill impairment not disclosed (Group 1)	78 (31%)	6 (12%)	72 (36%)	49(19%)	9(15%)	40(21%)
Reason for reporting goodwill impairment disclosed (Groups 2 & 3)	170 (69%)	43 (88%)	127(64%)	206(81%)	52(85%)	154(79%)
Total	248 (100%)	49 (100%)	199 (100%)	255 (100%)	61 (100%)	194 (100%)

GWIL(IL) denotes reporting goodwill impairment loss; GWIL(0) denotes reporting zero goodwill impairment.

In addition to the descriptive analysis, we conducted a non-parametric test to assess whether the three groups (Groups 1-3) differ with regard to their market-to-book ratio. A Kruskal-Wallis test shows that there is a statistically significant difference in the market-to-book ratio among the three groups with $\chi^2(2)$ of 85.337 and p-value of 0.000. Further, the mean rank for Group 1 is 366.26, for Group 2 is 464.80 and for Group 3 is 293.75. These statistically significant results indicate that the market-to-book ratio differ among the three groups, suggesting that companies take into consideration the declined in the market capitalization when providing the disclosure of goodwill impairment in the Notes to the financial statement.

In sum, assuming that the disclosed reasons reflect the true and fair view of the companies' goodwill reported on the balance sheet as they have been audited, the findings that nearly equal proportions of companies are classified into Groups 2 and 3 imply that the declined in the market capitalization below the book value of the net assets is not an ideal proxy for an indication that goodwill may be impaired. This is because for approximately half of the companies that disclosed their reasons (i.e. companies in Group 3), their market capitalizations do not fully reflect the condition of the CGUs containing goodwill disclosed in the Notes to the financial statements.

Table 3. Analysis of companies' disclosures in relation to the declined in the market capitalization for Groups 2 and 3

Panel A: Analysis conducted across firms within one year of implementing FRS 3	Number of companies					
	December-2006			Non-December-2007		
	All	GWIL(IL)	GWIL(0)	All	GWIL(IL)	GWIL(0)
No conflict between the market-to-book ratio & Notes to the financial statement (Group 2)	77 (45%)	28 (65%)	49 (39%)	93 (45%)	26 (50%)	67 (44%)
Conflict between the market-to-book ratio & Notes to the financial statement (Group 3)	93 (55%)	15 (35%)	78 (61%)	113 (55%)	26 (50%)	87 (56%)
Total	170 (100%)	43 (100%)	127 (100%)	206 (100%)	52 (100%)	154 (100%)
Panel B: Analysis conducted on a subset of firms over a period of two years implementing FRS 3	**Number of companies**					
	December-2006			December-2007		
	All	GWIL(IL)	GWIL(0)	All	GWIL(IL)	GWIL(0)
No conflict between the market-to-book ratio & Notes to the financial statement (Group 2)	84 (44%)	33 (62%)	51 (37%)	83 (53%)	21 (62%)	62 (51%)
Conflict between the market-to-book ratio & Notes to the financial statement (Group 3)	105 (56%)	20 (38%)	85 (63%)	73 (47%)	13 (38%)	60 (49%)
Total	189 (100%)	53 (100%)	136 (100%)	156 (100%)	34 (100%)	122 (100%)

GWIL(IL) denotes reporting goodwill impairment loss; GWIL(0) denotes reporting zero goodwill impairment.

4.2 Results of the Late Reporting of Goodwill Impairment Losses

The results from the first research objective show that there are three distinct disclosure groups: (i) Group 1, companies with poor disclosure, (ii) Group 2, companies where their disclosed reasons coincide with the observed practice, and (iii) Group 3, companies where their disclosed reasons conflicted with the observed practice. To address the second research objective, we selected 20 companies from Group 3, and imposed an additional criterion that these companies must have reported goodwill impairment losses during any of the financial year.

Table 3 shows that in total there are 59 companies that fulfilled these requirements (i.e. 20 companies with financial year ended December 2006, 26 companies with financial year ended non-December 2007, and 13 companies with financial year ended December 2007). Thus, the 20 companies selected represent one-third of all

of the companies which reported goodwill impairment losses and are classified into Group 3. These 20 companies comprise seven companies with financial year ended December 2006, seven companies with financial year ended non-December 2007, and six companies with financial year ended December 2007. These companies not only fall into Group 3 and have reported goodwill impairment losses but they also have annual reports available throughout the period of investigation. These criteria are imposed because in order to identify companies that delayed reporting the impairment losses, we have to trace the goodwill impairment losses back from the write-off year to the acquisition year (i.e. the year the goodwill was acquired).

Guided by the four key items, as presented in Figure 2, we found that of the 20 companies analyzed, four companies appear to delay reporting goodwill impairment losses. In this study, delayed in reporting goodwill impairment losses is said to occur when three conditions are met: the market-to-book ratio is less than one, the segment (CGU) to which goodwill is allocated experienced losses, and the company's financial performance is lower than that of the previous year. Yet in all the three conditions, managers do not report goodwill impairment losses immediately in the income statement. Of the four companies identified, two cases of companies (i.e. LRG1 Ltd, and LRG2 Ltd[3]) will be discussed in this paper. This is because each of these companies illustrates additional issues for companies that delayed reporting goodwill impairment losses. Tables 4 and 5 present the analyses of goodwill movement for the two companies.

Table 4 shows that LRG1 Ltd acquired goodwill in 2003 amounted to RM587 872 (see item 1b). In 2004, the company's financial performances declined with its net income available to common equity holders (pre-goodwill impairment loss) reduced to negative RM1 524 000 (see item 3c) and its basic EPS fell to negative 2.93 cents (see item 3d). Likewise, the market-to-book ratio is less than one (see item 4). In 2005, at the end of the third year of acquiring the goodwill, the declined in the company's financial performance and its market value affected the segment result containing goodwill (i.e. electrical and mechanical engineering) (see item 2).

From the analysis of goodwill movement from 2003 to 2007, presented in Table 4, it appears that managers of LRG1 Ltd waited until the company's performance was getting better than the previous year before reporting goodwill impairment losses. Thus, the impairment losses reported by LRG1 Ltd in 2006 and 2007 are considered as delayed in reporting goodwill impairment losses.

Table 4. Analysis of goodwill movement for LRG1 Ltd from 31 December 2003-2007

	Pre-FRS 3 (RM)			Post-FRS 3 (RM)	
	2003	2004	2005	2006	2007
1. Goodwill data					
(a) Opening goodwill balance	-	587 872	587 872	589 889[4]	393 950
(b) Additions	587 872	-	109 196	-	-
(c) Goodwill impairment	-	-	(109 196)[5]	(195 939)	(393 950)
(d) Closing goodwill balance	587 872	587 872	587 872	393 950	-
2. Segment result Impaired goodwill is allocated to the Electrical & Mechanical engineering CGU	4 505 161	4 098 834	(16 222 151)	(14 152 837)	408 468
3. Financial performances					
(a) Operating income	5 620 000	(1 421 000)	(17 991 000)	(13 044 000)	(9 131 000)
(b) Profit/(loss) from ordinary activities pre-tax & pre-goodwill impairment loss	13 546 000	1 192 000	(38 393 000)	(19 596 000)	5 302 000
(c) Net income available to equity holders pre-goodwill impairment loss	11 220 000	(1 524 000)	(38 574 000)	(20 577 000)	4 013 000
(d) Basic EPS (cents)	70.12	(2.93)	(74.39)	(38.89)	5.01
4. Market-to-book ratio	2.05	0.80	0.81	2.28	2.17

LRG2 Ltd is the second case of a company that delayed reporting goodwill impairment loss. Table 5 shows that the company acquired goodwill amounting to RM40 876 000 in 2004 (see item1b). At the end of the year, the

segment to which the goodwill is allocated reported a negative result (see item 2). Likewise, the market-to-book ratio was less than one (see item 4). The poor financial performance of the CGUs containing goodwill and the company's market capitalization, which prolonged to 2006, also affected the overall performances of the company. In 2006, the net income available to equity holders (pre-goodwill impairment loss) was reduced to negative RM41 642 000 and the basic EPS dropped to negative 10.93 (see item 3d). Within 2005 to 2006, LRG2 Ltd was expected to report goodwill impairment losses, yet none were reported. In 2007, when the market-to-book ratio rose above one and its financial performance improved compared to the previous year, the company reported goodwill impairment loss amounted to RM13 000 000 ~~000~~ (see item 1c). Again, in 2008, the same amount of goodwill impairment loss was reported.

Table 5. Analysis of goodwill movement for LRG2 Ltd from 31 December from 2003-2008

	Pre-FRS 3 (RM'000)			Post-FRS 3 (RM'000)		
	2003	2004	2005	2006	2007	2008
1. Goodwill data						
(a) Opening goodwill balance	400	402	40 876	40 876	40 876	27 876
(b) Additions	2	40 876	-	-	-	-
(c) Goodwill impairment	-	(402)	-	-	(13 000)	(13 000)
(d) Closing goodwill balance	402	40 876	40 876	40 876	27 876	14 876
2. Segment result						
Impaired goodwill is allocated to a						
Bio-healthcare CGU	-	(1 381)	(3 462)	(6 214)	(6 027)	(5 364)
3. Financial performance						
(a) Operating income	44 838	50 048	39 947	(5 411)	5 459	63 507
(b) Profit/(loss) from ordinary activities						
pre-tax & pre-goodwill impairment loss	22 242	40 963	25 155	(13 238)	1 841	47 597
(c) Net income available to equity holders						
pre-goodwill impairment loss	5 807	18 293	4 962	(41 642)	(19 422)	15 835
(d) Basic EPS (cents)	1.63	4.83	1.28	(10.93)	(8.39)	0.73
4. Market-to-book ratio	1.22	0.83	0.63	0.79	1.26	1.04

When LRG2 Ltd reported goodwill impairment losses in 2007 and 2008, the company disclosed in the Notes to the financial statement that the impairment losses were based on the assessment of future trends in the bio-healthcare industry (i.e. the CGU containing goodwill). If this is the case, the company should have reported goodwill impairment loss at least in 2006 as the CGU was not performing for the past three years (see item 2). Thus, LRG2 Ltd illustrates a company that delayed in reporting goodwill impairment losses. What is interesting for LRG2 Ltd is that in 2008, the company disclosed the sensitivity analysis stating that if the discount rates were to increase by 2% or the future planned revenues were to reduce by 2%, an additional goodwill impairment loss of RM14 876 000 would be recognized. It appears that the company planned to fully impair its goodwill in the next year (i.e. 2009) because by recognizing goodwill impairment loss amounted to RM14 876 000, the goodwill balance becomes nil (see item 1d). LRG2 Ltd is added as part of the discussion in this study as it demonstrates that the goodwill impairment losses reported were small and too late. On May 7, 2009, the company was de-listed by Bursa Malaysia stock exchange pursuant to Paragraph 8.15(6) of the Listing Requirements (compliance with the shareholding spread requirement due to take-over offer) (Bursa Malaysia, 2009). The case of delayed in reporting goodwill impairment losses for LRG2 Ltd has not captured the external auditor's attention, as in the audit report for 2007 and 2008, the auditors provided clean opinions regarding the company's goodwill.

These two companies (i.e. LRG1 Ltd and LRG2 Ltd) provided evidence of companies that delayed reporting goodwill impairment losses. Such delayed reflects the exercise of managerial discretion in terms of timing their reporting of the impairment losses. This finding is consistent with Hayn and Hughes (2006), who find that goodwill write-off of 1 276 acquisitions by US listed companies from 1988-1998, lag behind the economic impairment of goodwill. Hilton and O'Brien (2009) opine that one of the reasons for companies to inflate the asset values (by not reporting the impairment losses when they are due) is because of the desire to create an 'illusion of financial strength'. Perhaps, this is also what drives the two companies discussed above to delay in reporting their goodwill impairment losses.

5. Summary and Conclusion

The present study has addressed two research objectives. First, it has examined the appropriateness of the declined in the market capitalization below the book value of the net assets as a proxy for an indication that goodwill may be impaired. Using the findings from the first research objective, the study has explored cases of late reporting of goodwill impairment losses by Malaysian listed companies. Two primary findings are obtained. First, results show that as a stand-alone, the declined in the market capitalization below the book value of the net assets is not an ideal proxy for an indication that goodwill may be impaired. This is because it does not fully reflect the condition of the CGUs containing goodwill, disclosed in the Notes to the financial statement. Second, results also show that when the declined in the market capitalization is examined in relation to the financial performance of companies and their segment results, it becomes a useful starting point in identifying cases of late reporting of goodwill impairment losses by Malaysian listed companies.

The results of this study contribute to the literature on managerial discretion by showing that the market capitalization, which has been applied by studies that examined listed companies in developed markets, is a useful starting point in identifying cases of companies that delayed reporting their goodwill impairment losses in the emerging market of Malaysia. Our study also contribute to the literature by showing the degree of discretion managers have in determining the timing and amount of goodwill impairment losses reported after the implementation of FRS 3. To get a more comprehensive view of the cases of late reporting of goodwill impairment losses, future work could examines motives for the late reporting. Finally, this study provides important implications for policy makers and relevant authorities. To enhance the quality of financial reporting, the relevant authorities need to closely monitor the disclosure of goodwill impairment by listed companies in the emerging market of Malaysia.

Acknowledgements

We gratefully acknowledge the financial support from the RACE research grant via the Universiti Utara Malaysia.

References

Abdul Majid, J. (2013). *Accounting choices relating to goodwill impairment: Evidence from Malaysia* (Unpublished PhD thesis). University of Glasgow, Scotland, United Kingdom.

AbuGhazaleh, N. M., Al-Hares, O. M., & Roberts, C. (2011). Accounting discretion in goodwill impairments: UK evidence. *Journal of International Financial Management & Accounting, 22*(3), 165-204. http://dx.doi.org/10.1111/j.1467-646X.2011.01049.x

Beatty, A., & Weber, J. (2006). Accounting discretion in fair value estimates: An examination of SFAS 142 goodwill impairments. *Journal of Accounting Research, 44*(2), 257-288. http://dx.doi.org/10.1111/j.1475-679X.2006.00200.x

Bursa Malaysia. (2009). *Delisting of THG from the official list of Bursa Malaysia Securities Berhad*. Retrieved from http://www.thgroup.com.my/News/070509.html

Comiskey, E. E., & Mulford, C. W. (2010). Goodwill, triggering events, and impairment accounting. *Managerial Finance, 36*(9), 746-767. http://dx.doi.org/10.1108/03074351011064636

EFRAG. (2013). *Questionnaire on the subsequent measurement of goodwill. Feedback statement*. European Financial Reporting Advisory Group (EFRAG). Retrieved from http://www.efrag.org/files/EFRAG%20public%20letters/IFRS%203%20PIR/Feedback_statement_goodwill.pdf

Ernst & Young. (2007). *IAS 36 Impairment testing: Practical issues*. Retrieved from http://www.ey.com/BE/en/Issues/IFRS/IFRS

Ernst & Young. (2008). Impairment of fixed assets and goodwill. In *International GAAP 2008. Generally Accepted Accounting Practice under International Financial Reporting Standards* (pp. 1033-1108). United Kingdom: John Wiley & Sons Inc.

Ernst & Young. (2011). Impairment of fixed assets and goodwill. In *International GAAP 2011. Generally Accepted Accounting Practice under International Financial Reporting Standards* (pp. 1075-1166). United Kingdom: John Wiley & Sons Inc.

Fox III, R. G. (2008). *Remarks before the 2008 AICPA National Conference on current SEC and PCAOB developments*. Speech by SEC staff. Retrieved from http://www.sec.gov/news/speech/2008/spch120808rgf.htm

FRC. (2008). *Review of goodwill impairment disclosures. October 2008*. Financial Reporting Council. Retrieved from http://www.frc.org.uk/press/pub1744.html.

Hayn, C., & Hughes, P. J. (2006). Leading indicators of goodwill impairment. *Journal of Accounting, Auditing & Finance, 21*(3), 223-265.

Hilton, A. S., & O'Brien, P. (2009). Inco Ltd.: Market value, fair value, and management discretion. *Journal of Accounting Research, 47*(1), 179-211. http://dx.doi.org/10.1111/j.1475-679X.2008.00314.x

Hoogervorst, H. (2012). *The imprecise world of accounting*. Speech delivered at the International Association for Accounting Education & Research (IAAER) conference, Amsterdam, 20 June 2012. Retrieved from http: http://www.ifrs.org/Alerts/Conference/Pages/HH-speech-Amsterdam-June-2012.aspx.

IASB. (2006a). IFRS 3 *Business Combinations*. *In International Financial Reporting Standards as at 1 January 2006* (pp. 273-394). International Accounting Standards Board (IASB), London: IASCF Publications Department.

IASB. (2006b). *IAS 36 Impairment of Assets*. *In International Financial Reporting Standards as at 1 January 2006* (pp. 1449-1595). International Accounting Standards Board (IASB), London: IASCF Publications Department.

Jacobs, S. C. (2008). *Current developments in the division of corporation finance*. National conference on current SEC and PCAOB developments. Retrieved from http://www.sec.gov/news/speech/2008/spch120908wc-slides.pdf

KPMG. (2014). *Who cares about goodwill impairment? A collection of stakeholder views.* Retrieved from http://www.kpmg.com/CN/en/IssuesAndInsights/ArticlesPublications/Documents/Who-cares-about-goodwill-impairment-O-201404.pdf

Lapointe-Antunes, P., Cormier, D., & Magnan, M. (2008). Equity recognition of mandatory accounting changes: The case of transitional goodwill impairment losses. *Canadian Journal of Administrative Sciences, 25*(1), 37-54. http://dx.doi.org/10.1002/CJAS.41

Latham & Watkins. (2009). Declining market capitalizations and the impairment of goodwill. *Client Alert 806*, 1-5.

Li, Z., Shroff, P., Venkataraman, R., & Zhang, I. (2011). Causes and consequences of goodwill impairment losses. *Review of Accounting Studies, 16*(4), 745-778. http://dx.doi.org/10.1007/s11142-011-9167-2

MASB. (2006). *FRS 136 Impairment of Assets*. Reporting Foundation and Malaysian Accounting Standards Board (MASB). Kuala Lumpur.

Morck, R., Yeung, B., & Yu, W. (2000). The information content of stock markets: why do emerging markets have synchronous stock price movements?. *Journal of Financial Economics, 58*, 215-260. http://dx.doi.org/10.1016/S0304-405X(00)00071-4

Murphy, M. (2012). SEC makes Barnes & Noble justify unimpaired goodwill. *The Wall Street Journal CFO report*.

Pricewaterhouse Coopers. (2009). *TS insights. Market turmoil and goodwill implications - a study of the market response to goodwill impairment announcements*. Retrieved from http://www.pwc.com/en_US/us/transaction-services/assets/ts-insights-goodwil-impairments.pdf

Ramanna, K., & Watts, R. L. (2012). Evidence on the use of unverifiable estimates in required goodwill impairment. *Review of Accounting Studies, 17*, 749-780. http://dx.doi.org/10.1007/S11142-012-91885

Regions Financial Corporation. (2009). *Note 10. Intangible assets.* Retrieved from http://www.sec.gov/Archives/edgar/data/1281761/000119312509121765/filename1.htm

Notes

Note 1. Speech delivered at the International Association for Accounting Education & Research (IAAER) conference, Amsterdam, 20 June 2012 (Retrieved from http: http://www.ifrs.org/Alerts/Conference/Pages/HH-speech-Amsterdam-June-2012.aspx).

Note 2. The Malaysian Accounting Standard Board (MASB) has a convergence policy towards the international accounting standards issued by the IASB. Nonetheless, the implementation dates of these standards by MASB

differ from the IASB. As a result, IFRS 3 and IAS 36 issued by the IASB are renamed to FRS 3 and FRS 136, respectively by the MASB.

Note 3. In this paper, the name of the company is anonymized because of the critical comments made about it, which could be priced sensitive if quoted out of context of the study.

Note 4. The company has restated its opening goodwill balance in 2006 from RM587 872 to RM589 889 without any information on the difference of RM2 017 disclosed in the Notes to the financial statement.

Note 5. Goodwill impairment loss of RM109 196 is because of a subsidiary acquired, which led to the creation of new goodwill upon acquisition. Thus, the goodwill impairment loss is immediately upon acquisition.

Appendix A

An illustrative example of poor disclosure (Group 1)

Goodwill

	Group 2007 RM(millions)	Group 2006 RM(millions)
Balance at 1 January – at cost	26 349	26 349
Less: Accumulated impairment loss	(1 475)	-
Balance at 31 December	24 874	26 349

Goodwill arose from acquisition of an overseas subsidiary in previous year.

Appendix B

An illustrative example of disclosure wherein the market-to-book ratio reflected the stated reason for reporting goodwill impairment (Group 2)

Goodwill

	Group 2007 RM(millions)	Group 2006 RM(millions)
Balance at 1 January – at cost	26 349	26 349
Less: Accumulated impairment loss (**note a**)	(1 475)	-
Balance at 31 December	24 874	26 349

(a) Impairment tests for goodwill

The Group undertakes an annual test for impairment of its cash-generating units. Based on the impairment test, an impairment loss of RM1 475 million has been recorded in the Consolidated Income Statement for goodwill arising from acquisition of an overseas subsidiary. No impairment loss was required for the carrying amounts of the remaining goodwill assessed as at 31 December 2007 as their recoverable amounts were in excess of their carrying amounts.

Goodwill is allocated to the Group's cash-generating units identified according to the business segment and the country of operations. The following cash-generating units, being the lowest level of asset for which there are separately identifiable cash flows, have carrying amounts of goodwill that are considered significant in comparison with the Group's total goodwill.

	2007 RM (millions)	2006 RM (millions)
Cellular		
Malaysia	23 627	23 627
Indonesia	1 247	2 722
	24 874	26 349

Appendix C

An illustrative example of disclosure wherein the market-to-book ratio conflicted with the stated reason for reporting goodwill impairment (Group 3)

Goodwill

	Group 2007 RM(millions)	Group 2006 RM(millions)
Balance at 1 January – at cost	26 349	26 349
Less: Accumulated impairment loss	(1 475)	-
Balance at 31 December	24 874	26 349

Impairment testing for cash-generating units containing goodwill

For the purpose of impairment testing, goodwill is allocated to to the Group's cash-generating units identified according to the business segment and the country of operations. The aggregate carrying amount of goodwill as at 31 December 2007 is RM24 874 millions, which is allocated to the cellular divisions in Malaysia and Indonesia.

These divisions' impairment test was based on its value-in-use. The value-in-use calculation applies a discounted cash flow model using the bio-healthcare division's pre-tax cash flow projections based on financial forecasts covering a five-year period. Cash flows beyond the five-year period are extrapolated using estimated growth rates.

Copyrights

Copyright for this article is retained by the author(s), with first publication rights granted to the journal.

This is an open-access article distributed under the terms and conditions of the Creative Commons Attribution license (http://creativecommons.org/licenses/by/3.0/).