Discussion on “An evaluation of asset impairments by Australian firms and whether this was impacted by AASB 136” by Bond, Govendir, and Wells

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Research Question and Findings

- How are Australian firms implementing asset impairment rules over the years 2000 to 2012?

- Main findings:

1) Most firms with at least one observable impairment indicator (i.e., BTM > 1) do not take impairments

2) The magnitude of impairment losses seems to be too small

3) Impairment realizations increase after transition to IFRS, but 1) still holds

4) Impairments are not significantly affected by CEO changes
   - Consider exploring this and other incentive variables further to help explain firm impairment decisions

Research Question and Findings

- Interesting finding that the majority of BTM>1 firms do not take impairments:
  - 30.2% of observations with BTM>1
  - but only 11.4% of BTM>1 firms report impairment losses
    - Suggesting that asset impairment rules are not followed
- Not all impairment firms have a BTM>1:
  - 57.6% of observations that take impairments have a BTM<1
    - Firm-level BTM is a noisy indicator to study impairments at the asset or cash-generating unit level

BTM as an Impairment Indicator

- The paper uses year-end (before impairment) book to market ratio of equity as an indicator, following AASB 136(IAS 36) para 12(d)
- BTM of equity is publicly observable
- Is BTM of assets a conceptually better indicator?
- Market value of assets is not observable:
  - assume book value of liabilities = market value of liabilities

BTM as an Impairment Indicator

- Suppose book value of assets is $110 with a market value of $100, then the BTM of assets is 1.1

- If the firm has liabilities with a book value of $80, then the BTM of equity is $\frac{30}{20} = 1.5$

- BTM of equity overstates the "severity" of impairment indication, unless the firm is unlevered (i.e., all equity)

Are Realized Impairments Non-Discretionary?

- The paper concludes that when to recognize impairments is discretionary, but the impairment loss amount may be considered non-discretionary, because
  - Lower earnings per share (before impairment), higher impairment amount
    - Is this sufficient to conclude that impairment amount is non-discretionary?
  - Also, lower cash flows from operating and investing, lower impairment amount, inconsistent with expectation

Are Realized Impairments Non-Discretionary?

- Non-discretionary impairments are impairments resulting from faithful unbiased application of accounting standards

- Managers may have room for discretion in estimating value in use
  - This affects the magnitude of impairment loss, which is the difference between carrying amount and the recoverable amount

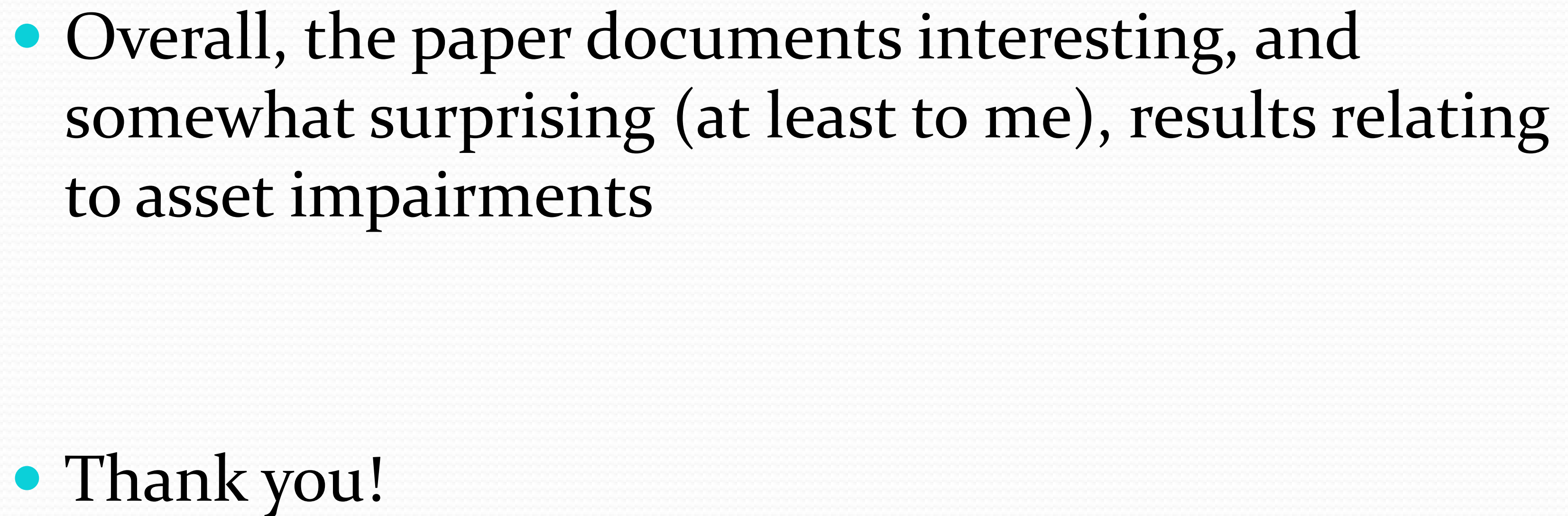
- IFRS are more prescriptive in measuring recoverable amount (value in use)
  - Does that eliminate managerial discretion?

After Transition to IFRS

- The paper finds that impairments increase after transition to IFRS
- But the association between impairment recognition and impairment indicators is still weak or non-existent, just like before IFRS
- A significant part of the post-IFRS period coincides with the global financial crisis
  - The increase in impairments after 2006 could be driven by the overall economic environments instead of IFRS

Do Auditors Play a Role?

- The paper does not look at whether auditors affect the application of asset impairments and AASB 136
- Could firms audited by reputable (Big 4) auditors exhibit a stronger link between impairment indicators and the incidence/magnitude of impairments?



Overall, the paper documents interesting, and somewhat surprising (at least to me), results relating to asset impairments
Thank you!