

Karol Marek Klimczak
Katedra Finansów
Akademia Leona Koźmińskiego

Anna Pikos
Katedra Zarządzania
Akademia Leona Koźmińskiego

Marta Dynel
Zakład Pragmatyki Językowej
Wydział Neofilologiczny
Uniwersytet Łódzki

**UNCERTAINTY IN THE FINANCIAL STATEMENTS: THE
STUDY OF GOODWILL DISCLOSURES IN POLISH**

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1. INTRODUCTION

Financial reporting by stock-exchange listed companies is associated by the public with numbers, but recent developments lead to an increased role of narratives in the communication of financial information. First of all, the International Financial Reporting Standards require companies to disclose a variety of descriptive information in addition to the core financial statements. Secondly, every annual financial statement is accompanied by a management report, which is required across Europe by the new accounting directive of the European Union (2013/34/EU). The scope of the management report is broader than that of the financial statements, as it includes non-financial performance indicators and a discussion of strategy, but it must be aligned with the financial statements. Thirdly, the need for stronger narrative reporting is recognized as an element of rebuilding the trust in financial markets after years of underperformance. The narrative reporting reform in the United Kingdom is a good example of this trend.

The goal of this paper is to explore how the preparers of financial statements deal with uncertainty in communicating the future prospects of their companies on the basis of disclosures concerning goodwill. Goodwill disclosures offer an interesting setting, because according to IFRS 3 goodwill from acquisitions must be tested for impairment. Thus, preparers need to verify if the carrying amount of goodwill, which arose as a result of past acquisitions, corresponds with the value of expected future economic benefits associated with the business acquisition. The methodology of impairment tests requires the preparers to develop forecasts and make judgements about the uncertain future.

The preparers of financial statements, as they are referred to in the IFRS, face a difficult task when they need to communicate the results of goodwill tests. On the one hand, their professional ethics requires that the test results be reliable. On the other hand, they must be aware of the inherent uncertainty. They are likely to realise, that the users of financial statements may assume the preparer's modify the test results to avoid an impairment. In fact, of the companies studied here only one reported an impairment of goodwill in recent years, and even that was not a result of impairment testing.

For our study we use the 2013 consolidated financial statements of companies listed at the Warsaw Stock Exchange. We select large companies, included in the WIG30 index, so that we can assume they allocate sufficient resources to the reporting processes. We exclude banks, because their reporting is distinct and subject to additional regulation. We identified nine companies in the WIG30 index, other than banks, which report goodwill in their assets: Asseco Poland, Grupa Azoty, Boryszew, Cyfrowy Polsat, Energa, Eurocash, Kernel, Tauron, and TVN (Table 1).

Table 1.

Overview of the companies studied [EUR million, %]

Name	Sector	Market Cap	Sales	Growth in sales	Growth in EBIT
Asseco Poland SA	Software	857	1 423	6.67	-6.20
Boryszew SA	Commodity Chemicals	53	996	-15.44	-33.00
Cyfrowy Polsat SA	Broadcasting & Entertainment	3 937	702	4.77	0.30
Energa SA	Conventional Electricity	2 152	2 757	2.26	52.82
Eurocash SA	Food Retailers & Wholesalers	1 178	3 989	-0.23	-24.10
Grupa Azoty SA	Specialty Chemicals	1 790	2 369	38.35	88.02
Kernel Holding SA	Farming & Fishing	525	2 150	29.63	-23.83
TAURON PE SA	Conventional Electricity	2 145	4 615	-22.68	-10.24
TVN SA	Broadcasting & Entertainment	1 191	375	-1.87	0.77

Source: Infinancials

In our exploration of annual report narratives we use the methods of discourse analysis. We use genre analysis, following Fairclough's (1995) view that discourse is shaped by genres and that it is the combination of genres, styles and discourses that can help explain the way narratives are used. As Fairclough put it in his later work: "particular representations (discourses) may be enacted in particular ways of acting and relating (genres), and inculcated in particular ways of identifying (styles)" (2003: 29). A genre is commonly defined similarly to the *Webster's New Encyclopedic Dictionary* as "a category of artistic, musical, or literary composition", which points to the traditional view of genre analysis as the study of the context, communicative aim, form, style and content of narratives, which aims to find commonalities between narratives of a given genre and differences in comparison to other genres. Genre analysis has been used in the analysis of professional discourse in order to explain why professionals use

language the way they do (Bhatia, 1993). Notably, “professional discourse seems to operate simultaneously at four somewhat distinct and yet overlapping levels, or concepts of space, identified as discourse as *text*, discourse as *genre*, discourse as *professional practice*, and discourse as *professional culture*” (Jones, 2014: 76). In this paper we approach the discourse of financial statement narratives as a genre.

2. The regulatory context

Unlike the major international markets of Frankfurt, Paris or London which evolved over many decades, the Polish stock market needed to be created from basics after the fall of communism in 1989. The new national accounting law was initially created with the purpose of increasing tax revenue and serve the needs of creditors, rather than those of investors, which was a response to the concerns associated with the turbulent development of the free market in the initial stage. The future of the Polish accounting regime was uncertain at the time (Jaruga, 1993). It wasn't until 1991 that the Warsaw Stock Exchange began operations with 9 companies listed initially. In subsequent years, the dynamic development of the capital market was accompanied by rapid regulatory adjustments (Dobija & Klimczak, 2010). The number of listed companies exceeded 200 in the year 2000, while in 2013 there were 459 companies listed in the main market and a similar number listed in the alternative market called NewConnect, positioning the Warsaw Stock Exchange as the leading market in the region.

The Warsaw Stock Exchange can be described as a tightly regulated market, a characteristic to which its success is often attributed (Stringham, Boettke, & Clark, 2008). In 2004, Poland joined the European Union, and adopted EU regulations, including the requirement for consolidated financial statements to be prepared in accordance with the International Financial Reporting Standards (Grabinski, Kedzior, & Krasodomska, 2014). The main act regulating companies whose shares are traded in a regulated market in Poland is the Act of Parliament (29.07.2005), which incorporates EU company law directives relating to accounting. Reporting requirements are set in the Regulation of the Minister of Finance (19.02.2009), which enumerates the required contents of annual, semi-annual and quarterly reports but allows companies to include additional information.

3. Analysis of goodwill disclosures

The format of the descriptions of goodwill testing is predictable. They contain elements of accounting policy referring to goodwill, a description of the key assumptions and methods used in the tests and the conclusions. The degree of detail in the descriptions varies greatly, however. Most companies do not report the recoverable amounts, that is the amounts calculated as part of the test. Grupa Azoty is the only exception. Preparers state that they have carried out sensitivity analysis in Tauron, Energa and Asseco Poland. Only Asseco Poland presented the results of sensitivity analysis concerning the assumed discount rates and growth rates.

The descriptions of goodwill testing are written in a factual style, the preparers avoid adjectives, adverbs and other signals of evaluation (Hunston & Thompson 2000: 1-27). Preparers use a strategy called depersonalization, which allows them to detach themselves from the text, reducing their perceived responsibility for the information they communicate (Martín-Martín 2008). Depersonalization is usually achieved by using the word Group as the subject, as in the example of Kernel where we read that "the Group reviews its subsidiaries" ["Grupa dokonuje przeglądu poszczególnych jednostek"], and in the statement of Energa we find that "the Group has carried out impairment testing" ["Grupa przeprowadziła test na utratę wartości"].

When the results of judgments are communicated, however, preparers resort to the impersonal as in the statement of Eurocash, where we find that "as a result of the effected analysis, it is confirmed an impairment is not required" ["w wyniku przeprowadzonej analizy potwierdzono brak konieczności dokonania odpisu aktualizującego z tytułu utraty wartości"]. Note that in the Polish language the personal pronoun is omitted and a special kind of impersonal verb conjugation is used, rather than the passive voice.

Alternatively, judgments are attributed to the management, especially when the assumptions of tests are concerned, which may be a signal of subjectivisation. The subjectivisation strategy allows the preparers to express a judgment as the personal perspective of the management, rather than as an objective fact (Martín-Martín 2008). The following excerpt from Kernel is indicative of this strategy:

The management believe, that any possible changes in the key assumptions, on the basis of which the recoverable amount was calculated (...), would

not cause a situation in which their book value would exceed the recoverable amount. [Kernel]

[Kierownictwo uważa, że wszelkie możliwe zmiany w kluczowych założeniach, na podstawie których wyliczono kwotę odzyskiwalną (...), nie spowodowałyby sytuacji, w której ich wartość księgowa przekroczyłaby wartość odzyskiwalną]

These statements seem puzzling, given that no sensitivity analysis is performed in most cases. Sometimes the statements attributing judgements to the management are particularly awkward, as in the case of Boryszew:

A change of factors is not probable (...). The Management believe that even if justified and probable changes in the key assumptions took place, (...) the book value (...) would not exceed the recoverable amount. [Boryszew]

[Nie jest prawdopodobna zmiana czynników (...). Zarząd (...) uważa, że nawet gdyby zaszły uzasadnione i prawdopodobne zmiany w głównych założeniach (...), to wartość bilansowa (...) nie przekroczyłaby jej wartości możliwej do odzyskania.]

This statement may have been crafted by the auditors of Boryszew, which would explain its unusual style, but the reader may nevertheless wonder which changes are of concern. Is it the probable ones which are claimed not to exist, or the improbable ones, which can occur? How is it then, that even improbable changes would not cause changes in the results of impairment tests? We can demystify these statements by examining the management reports.

4. Contrast with management report narratives

Management report narratives are structured and formatted in various ways, even though the minimum content is prescribed by law. The documents are about 100 pages long, with the majority of the document devoted to mandated content, written in a technical manner, with repetitions, as the same events require disclosures under various headings. Asseco Poland and Eurocash prepared graphical documents, using colours, graphs and creative formatting, with the main points communicated clearly at the beginning and mandated content placed in the latter parts of the document. TVN, a media company, prepared a consistently formatted document, but refrained from using graphics. The other companies formatted their reviews following the content requirements of the law, with many detailed subsections. The style varies from factual and impersonal, similar to financial statements, to personal and speculative. Adjectives

and adverbs are used freely. In some cases the style is impersonal, the word “Group” is often used as the subject, but the personal pronoun “we” is just as common.

We contrasted the narratives concerning goodwill impairment testing found in the financial statements with relevant sections of the management report. The cases which involve the greatest uncertainty seem to be the most interesting objects of analysis. Boryszew allocated the largest amount of goodwill to its German subsidiaries, especially Theysohn Kunststoff GmbH and Boryszew Kunststofftechnik GmbH. There is a hint in the financial statements that growth of sales in these companies may be weak, because the note states, without any explicit reason, that the acquisition of new contracts is seen as probable. This signals that a judgement was made by the preparers as to whether new contracts should be included in the test. Little discussion of these subsidiaries can be found in the management report, until one notices, that the two subsidiaries are included in Boryszew Automotive Plastics Group, or BAP, which is in turn included in the Automotive segment, the results of which are in fact discussed in the document as follows:

Lower sales were associated with a decrease of demand in the European automotive industry and lower sales as a result of contractual discounts and the contract lifecycle. In 2013, old contracts gradually expired and were not being (...) replaced (...). In the case of BAP Group companies we expect, that [the situation will improve] in mid 2015. [Boryszew]

[Niższa sprzedaż była związana z obniżką popytu w europejskiej branży motoryzacyjnej oraz z mniejszą sprzedażą na skutek kontraktowych obniżek cen i cyklu życia kontraktów. W roku 2013 stare kontrakty stopniowo wygasły i nie były (...) zastępowane (...). W przypadku spółek Grupy BAP oczekujemy, że [poprawa sytuacji] nastąpi w połowie 2015 roku.]

We noticed immediately, that the style of the narrative is less factual and includes an explicit reference to an expectation, which signals uncertainty. Such a reference did not appear in the financial statements, where only the one unusual sentence indicated that uncertainty might exist. Uncertainty was not directly communicated in the financial statement, but a hint was left for a professional reader to follow. It seems unlikely that a lay person would notice it, and even less likely that they would be able to correlate it with relevant information in the management report.

Overall, the discourse in the management report is less factual, and refers to expectations, while the descriptions of impairment testing referred to assumptions. In the financial statements, the concern is that the assumptions may change in the future,

while in the management report the authors discuss their hopes for the future. This difference is particularly clear in the case of Asseco Poland, the only company that included a sensitivity analysis in the note, disclosing the assumed discount rates and growth rates along with a comparison with their critical rates beyond which impairment would need to be recognised. The figures presented in the table are not discussed, but it is clear that the safety margin is the lowest for Matrix IT Ltd, a major subsidiary. The commentary in the management report regarding Matrix IT Ltd reveals the underlying causes, but the authors make an effort to situate these problems in the past and to use positive words when referring to the present:

The year 2013 was challenging for the company [Matrix IT], mostly because of economic slowdown and postponement of IT investments by clients. (...) In the fourth quarter of 2013 the company had to write down receivables of NIS 2 million because of the bankruptcy of two clients in the Israeli market. Despite the aforementioned difficulties Matrix IT managed to maintain its strong market position and strengthen its core operations, i.e. the sale of proprietary software (...). [Asseco Poland]

[Rok 2013 był dla spółki rokiem wymagającym, głównie ze względu na spowolnienie gospodarcze i przekładanie przez część klientów spółki inwestycji w IT na okresy przyszłe. (...) W czwartym kwartale 2013 roku spółka musiała utworzyć odpis na należności w wysokości 2 mln NIS w związku z bankructwami dwóch klientów na rynku izraelskim. Mimo wyżej opisanych trudności Matrix IT zdołał utrzymać swoją mocną pozycję na rynku i wzmocnić swoją działalność corową tj. sprzedaż własnego software'u (...).]

5. Conclusions

The analysis of narratives concerning goodwill impairment testing in financial statements and management reports of Polish listed companies reveals a range of strategies. The authors of financial statements rely on depersonalization and subjectivisation to avoid the risk of being accused of misleading the users (i.e. they hedge). The narratives in financial statements are written in a factual, impersonal style, evaluative terms are avoided, and the use of depersonalisation is common. Exceptions to these rules exist in the form of statements communicating judgements attributed to the management, where subjectivisation is used. In contrast, management report narratives are often written in a personal style and use evaluation freely.

Our analysis of interconnections between financial statements and management reports reveals that the narratives in financial statements do not contain explicit

references to sources of uncertainty, but they contain hints that can lead a professional reader to discover relevant information. It appears that the authors of financial statements assume a professional reader will be able to read between the lines, and they refrain from communicating negative information about the company explicitly. This can be associated with their reliance on a factual style. Negative information included in the financial statements, even in a note, becomes a fact, whereas the same information included in the management report is only a story. The cases we examine do not appear to involve fraud or potential financial distress, but the omission of potentially significant negative signals leads us to question the ways integrity of the financial statements and their preparers are defined by the professional community.

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Niepewność w sprawozdaniach finansowych: analiza informacji o goodwill w języku polskim

Streszczenie

Celem artykułu jest opisanie w jaki sposób osoby przygotowujące sprawozdania finansowe komunikują niepewność dotyczącą przyszłych wyników finansowych spółek. Badaniu poddano noty dotyczące testów na utratę wartości firmy, ponieważ zarówno założenia, jak i wyniki tych testów są obciążone istotną niepewnością ze względu na konieczność sporządzenia prognoz finansowych. Badania pokazały, że niepewność nie jest komunikowana w sprawozdaniach finansowych, choć doświadczony czytelnik może znaleźć w nich wskazówki prowadzące do informacji zawartych w sprawozdaniu zarządu. Skontrastowanie sprawozdań finansowych ze sprawozdaniem zarządu uwidoczniło kluczowe różnice w stylu tych tekstów.

Słowa kluczowe: komunikacja, finanse, lingwistyka

Uncertainty in the Financial Statements: The Study of Goodwill Disclosures in Polish

Abstract

The goal of this paper is to explore how the preparers of financial statements deal with uncertainty in communicating the future prospects of their companies. We study narratives in goodwill disclosures as a special case, with the aim of broadening our understanding of how narratives are constructed. We focus on goodwill impairment tests, because the assumptions and results of these tests are subject to uncertainty and are associated the preparers' expectations of future performance. We find that uncertainty is not communicated at all, but hints are left, which may point a professional reader towards relevant information in the management report. We contrast the financial statement narratives with the management report, to highlight key differences in style.

Keywords: communication, finance, linguistics