RR 17 in an economic boom

- The impairment procedure of goodwill
Preface

We would like to thank our supervisor Åke Gabrielsson for his patience and guidance during the thesis work. We also want to thank our relatives and friends who have been supportive during this process.

Thank You

Johanna and Magdalena
Summary

In 2005 a new recommendation was implemented, IAS 36 "Impairment of intangible assets". The Swedish translation of the recommendation is RR 17. The previous treatment of impairment of goodwill was to amortize it over a certain amount of years. In order for a company to make impairment, they had to estimate the decrease in value of goodwill to be permanent. The new recommendation RR 17 on the other hand states that goodwill should be impaired as soon as an indication of impairment loss is revealed. This implies that the new recommendation shows the fair value of goodwill. Our problem description is; how does the impairment procedure of goodwill in companies applying RR 17 look like?

In order to reach the purpose of this study, which is to understand the impairment procedure of goodwill, we used four sub questions; (1) How does goodwill arise? (2) How is goodwill divided between cash generating units? (3) How do stock listed business combinations in accordance with RR 17 estimate whether an impairment loss of goodwill exist or not, in cases where goodwill exist, how is it impaired? (4) How is goodwill revalued and how often?

The study has mainly taken a hermeneutic approach because we strive to understand the impairment procedure of goodwill. We conducted a qualitative study, with semi-structured interviews. Four companies, which operate in somewhat different branches, were chosen in order to get a diversified illustration of different business areas and see if there were any differences between them.

Our central concepts present general accounting principles as well as accounting principles handling impairment of goodwill, which helps the reader to receive a better understanding of the essential concepts concerning the impairment procedure of goodwill. In the analysis we connect our empirical findings with the central concepts in order to discover more dimensions of the impairment procedure of goodwill.

The result from our interviews showed that the companies follow the recommendation RR 17. However we could identify some differences between the companies, which we believe are due to the fact that the companies operate in different business areas and are therefore faced with somewhat diverse risks. Further we could link the differences to be correlated to the mindsets and demands of the companies’ auditors.

Finally we want to make the reader aware of the fact that the recommendation RR 17 has so far only been applied in an economic boom and therefore when we conducted this study the need to impair goodwill was very small.
**Abbreviations**

**FAR** – The Institute For Accountancy Profession in Sweden

**IASB** - International Accounting Standards Board

**FASB**-Financial Accounting Standards Board

**IAS** - International Accounting Standards

ÅRL – Annual Accounts Act (Sweden)

**IASC** - International Accounting Standard Committee

**IFRS** - International Financial Reporting Standards

**IAS 36** - International Accounting Standards, number 38

**RR** – National Financial Management Authority

**RR 1** – Recommendation number 1, issued by The Swedish National Financial Management Authority (former praxis concerning goodwill)

**RR 17** – Recommendation number 17, issued by The Swedish National Financial Management Authority
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1. Introduction

This chapter presents the background of how the new recommendation concerning impairment of goodwill came into use for stock listed business combinations. After the history is presented we create a problem description and our purpose of this study.

1.1 Background description

The last couple of decades we have experienced a globalization. The globalization has expanded trade between countries around the world and the demand for easily accessible financial reports has increased. In a market economy the economic growth is dependent on effective resource allocation. In order to achieve effective resource allocation the information needs to be gathered and presented in a reliable and transparent way. A common international accounting language would contribute to a higher amount of transparency.1

Today there are two main generally accepted accounting languages; the Anglo-Saxe and the Continental accounting standard. The Continental tradition comprise of the western European countries. Great Britain, Ireland and Holland are not included though, while they together with United States belong to the Anglo-Saxon language. The Continental language is regulated in the civil law and has a strong connection to tax law. The Anglo-Saxe language is based on common law and does not have the same strong connection between accounting and taxation. According to the Anglo-Saxe tradition accounting should give a “true and fair view” of the reality.2 The financial report should as far as possible reflect the reality. The generally accepted accounting standard in US is called US GAAP, (Generally Accepted Accounting Principles).3 The size and liquidity of the American capital market are two main reasons why capital cost is kept low and many European companies are listed on the US stock exchange.4

In order to make the financial reports more comparable EU legislated in 2002 that from 2005 all business combinations should follow IFRS, (International Financial Reporting Standards). This only applies to companies listed on the stock market. The issued regulation was a movement towards harmonization of accounting standards.5 IFRS is published by the International Accounting Standards Board (IASB). The Board is based in London and has a goal “to provide the worlds capital markets with a common language for financial reports”6. IASB was founded 30 years ago and under the name IASC (International Accounting Standards Committee), In 2001 IASC was restrucrcted to IASB. IASC created standards under the name IAS (international accounting standards) however since 2003 the standards are named IFRS, the difference is mainly linguistic.7 The purpose of IASB was to create harmonization and better comparability between accounting in different countries8.

In 1989 FAR, the institute for the accountancy profession in Sweden created the Swedish National Financial Management Authority, henceforth referred to as RR (Redovisningsrådet). FAR publishes the Swedish versions of IFRS/IAS, which EU has adopted. RR publishes recommendations, which are compatible with International recommendations, as long as they

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2 Smith D, Redovisingens språk (2006) p. 69-70
3 Ibid p. 69-70
5 Government proposition 2004/ 05:24 Internationell redovising i svenska företag. p.1
7 Ibid p.12-13
8 SOU 2003:71 Internationell redovising i svenska företag. p.73
do not conflict with Swedish legislation. The recommendations that RR publish are highly approved of by accountants. According to the IAS regulation, Swedish companies would gain approval by foreign investors if they established their financial reports in accordance with IAS instead of only ÅRL. This in turn would also facilitate raise of capital since they can more easily become stock listed abroad.

1.2 Problem discussion

RR 17 is a direct translation of IAS 36 Impairment of Assets, and RR published it in 2000. RR 17 is applicable to all form of assets with some exceptions, as for example stock-in-trade and tax claims. Shares in subsidiaries, associated companies and joint ventures are the only financial assets that are included in IAS 36. According to the annual accounts act, 4 chapter 5 §, (former praxis) an asset should be impaired if an impairment loss was found to be consistent. RR 17 (the new recommendation) that was implemented in January 2002 states that “an asset should be impaired as soon as the carrying amount exceeds the recoverable amount”. In other words the difference between these two is that in the former praxis, impairment loss should be permanent in order to make impairment while in the current praxis impairment should be made as soon as an impairment loss has been indicated. The prudence concept states that “carefulness should be taken into notice when estimating the value of assets”. The value of goodwill is estimated when an impairment loss is indicated. Since 2005 all stock listed business combinations are obligated to follow IAS 36 and are therefore accepted from following ÅRL chap 7. The intangible asset that we will be focusing upon throughout the study is goodwill. RR 17, impairment of assets is applicable on goodwill.

Before RR 17 was in use, the recommendation RR 1 established how goodwill should be treated. Goodwill was then written off on a linear basis, with equal amounts each year. The time period for writing off should correspond to the value in use but it should not exceed 20 years. However there were no EG regulations forcing Swedish stock listed business combinations to follow the recommendation and therefore they could chose if they applied ÅRL or IAS when handling goodwill. RR 1 did not consider the real value of goodwill since it was amortized with equal amounts each year without revaluation of the value. Thereby the value of goodwill in the financial reports did not always reflect the real value of goodwill. The new recommendation, RR 17 was designed to be in higher accordance with true and fair view.

Earlier treatment of goodwill (using writing off) has been criticized, the main argument is that it did not show the fair value of goodwill. Goodwill was written off over a set number of

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10 SOU 2003:71 Internationell redovisning i svenska företag. p. 73
13 ÅRL 4 chap §5
17 Nyllinge et al. Ny rekommendation avseende nedskrivningar ställer stora krav på värderingar. Balans No 11, 2001 p.35
20 ÅRL 2kap § 3
years, with equal amounts independent of its fair value. This meant that the companies which were doing well and had an increasing value of goodwill, still had to write off and expense goodwill in the financial report each year. At the same time companies with a fair decreasing value of goodwill, could actually show better results by writing off goodwill on linear basis over a set number of years. As a consequence, a high amount of critique was directed towards this way of goodwill treatment. The critique towards the old treatment of goodwill is a big part of the reason behind the new way of treating goodwill, consequently impair goodwill whenever a need of impairment loss is discovered, in order to show the fair value of goodwill.  

The recommendation RR 17 focuses on the impairment need of one specific asset. In reality the recommendation is often applied to a cash-generating unit. A cash-generating unit is the smallest identifiable group of assets which generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Usually companies identify groups of units that generate cash flows, as opposed to separate assets, which can be difficult to identify cash flows for. Cash generating units could be: spheres of activities and/or regional areas, depending on how the company’s activities are worked out. The recommendation RR 17 also states that in those cases where goodwill can not be assigned to a specific assets, it should be allocated between groups of assets.

Technical problems may arise when companies group assets in different cash-generating units because the operating system of a company is not always compatible with its cash flows. A specific asset, which may be difficult to divide among cash-generating units, is goodwill. “Goodwill is the difference between the price a company pays in an acquisition of another company and the acquired company’s ownership equity”. Ownership equity in assets is what remains after all the liabilities are paid. Goodwill is therefore a balancing item and is entered as an intangible asset less accumulated impairments in the financial report. An impairment loss of goodwill is difficult to establish since goodwill does not generate any cash flow on its own and needs to be divided among cash-generating units.

RR 17 defines that goodwill should be divided at the acquisition transaction among different cash-generating units on a “reasonable and consistent basis”. This vague definition leaves space for subjective estimations. Each company is in charge of how to divide goodwill among their cash-generating units. Since goodwill does not have a market value, a valuation problem may arise when companies divide goodwill among cash-generating units. We believe there are problems regarding companies’ value estimations of goodwill. Since the value of goodwill is based on future expected generated cash flows, it leads us to our problem description.

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22 Nyllinge et al. Ny rekommendation avseende nedskrivningar ställer stora krav på värderingar. Balans No 11, 2001 p.36
24 Nyllinge et al. Ny rekommendation avseende nedskrivningar ställer stora krav på värderingar. Balans No 11, 2001 p.36
1.3 Problem description

How does the impairment procedure of goodwill in companies applying RR 17 look like?

1.4 Purpose

The purpose with our thesis is to understand the impairment procedure of goodwill in different stock listed business combinations that apply RR 17. The description of the procedure will rely on four underlying questions that will be helpful in achieving our purpose since each question is an important part of the impairment procedure.

The questions:

(1) How does goodwill arise? (2) How is goodwill divided between cash-generating units? (3) How do stock listed business combinations in accordance with RR 17 estimate whether an impairment loss of goodwill exist or not, in cases where goodwill exists, how is it impaired? (4) How is goodwill revalued and how often?

1.5 Delimitation of the study

The argument behind the delimitation's is that it would be impossible to include every perspective in our problem description, we have narrowed it down to only include the parts we find applicable for our study. We have chosen to delimit our thesis to include Swedish stock listed business combinations applying RR 17. Further we are going to focus on acquired goodwill and we will exclude the internally worked up goodwill. The valuation procedure of goodwill is based on subjective estimations and it is more common that companies identify goodwill from acquisitions than internally worked up goodwill. The reason is that internally worked up goodwill is difficult to estimate and is therefore often excluded from the financial reports, further we excluded negative goodwill from our study since it can not be impaired.

1.6 Concepts

Impairment Procedure - This concept is used when referring to the impairment of goodwill.

Carrying Amount – Corresponds to the booked value of an assets or group of assets and it is shown in the balance sheet.

Units- When we use this term we mean groups of assets.
**Theoretical Methodology**

We present the theoretical methodology first as it presents the fundamentals of how our study is constructed.

**Central Concepts**

The central concepts follow as they provide the reader with important knowledge about the impairment procedure, in order to understand our gathering of empirical data.

**Practical Methodology**

The practical Methodology is presented before our empirical findings since it describes our process of collecting empirical information.

**Empirical Findings**

We choose to present our empirical findings separate from the analysis since we want to give the reader the opportunity to interpret the collected material without influence from our analysis.

**Analysis**

Since the analysis is strongly connected to the empirical findings, it was natural to present the analysis next. The analysis connects our problem description with our empirical findings.

**Conclusions**

In the conclusions we conclude the important parts of the study. It also reflects to which extent we reached the purpose of our study.

*Model 1: Outline of the study*
2. Theoretical Methodology

This chapter presents our choice of subject and the motivation behind it. Our preconceptions are also mentioned since they could have an influence on the study. This thesis has mainly a hermeneutic approach, it is a qualitative study with a wish of achieving an understanding of the impairment procedure of goodwill.

2.1 Choice of subject

Since we studied accounting respectively finance at bachelor level we wanted to write a thesis in the accounting and finance area. We were interested in writing something about acquisitions so we initially looked at the diva portal (which contains academic publications) to get some ideas about the subject and what could be of interest to write about. When going through published articles and previous studies, we discovered that impairment of goodwill was a problematic matter. We realized that the accounting principles concerning goodwill had been changed during the years, and then our interest for the impairment of goodwill grew. After further information search regarding impairment of goodwill we came across the accounting regulation IAS 36 which treated impairment of goodwill. When gathering more information about the accounting principle we soon realized that studies had already been made within the area. Nevertheless the subject interested us as the regulation was relatively new at the moment of information seeking. We thought that if we were going to work with accounting in the future, we would most definitely come in touch with the regulation. When we had reached the decision to write about impairment of goodwill, it felt natural to focus our thesis on RR 17, which is the Swedish translation of IAS 36 and also the regulation which Swedish companies pursue. We are both focused on working in Sweden after our studies and probably most likely for a Swedish company; therefore RR 17 is of great interest for us.

2.2 Preconceptions

We are both enrolled in the International Business Program. As already mentioned we studied accounting and finance at bachelor level. During the years spent on the University we have been in contact with accounting several times. The theoretical knowledge we gained from previous years is of great importance since neither of us have any work experience in the area. None of the writers have any social interest for the impairment of goodwill outside this study, neither any personal standpoint for how goodwill should be handled in accounting. Our preconceptions concerning the subject were that it was difficult to handle in practice; however we had no opinion on how it should be handled. Our problem description should therefore not be influenced by personal opinions. Both of us have almost equivalent knowledge within the subject however the lack of practical experience in the accounting area might have caused some problems. We have both taken a course in scientific methodology on how to write academic papers which has been somewhat theoretically useful for us when writing this thesis. The bachelor level course in accounting contained a brief introduction of accounting treatment of goodwill, the course presented the scope of RR 1:00 and provided us with knowledge concerning the subject in order to ensure that we could chose relevant concepts for our problem description. Since our theoretical preconceptions are so similar, we might have missed out on some important aspects that were not included in our preconceptions. Studies with a qualitative approach can cover more aspects if the researcher has a lot of experience; it is therefore significant to know that we might have missed important aspects since we do not have much experience of thesis writing. Our problem description is built on aspects which we have found to be relevant, based on the preconceptions we have. Further we have defined our problem description from our best knowledge concerning the subject.
2.3 Perspective

When studying phenomena it is important to keep in mind that the point of view influence how the problem description is understood.\textsuperscript{29} We chose a controller focus and the choice influenced the selection and presentation of our central concepts. With controller focus we mean that we chose to focus on respondents that had access to and knowledge about the companies' controlling functions. We realized that someone who posses access to controlling functions within a company can provide more detailed information concerning accounting in a specific company than for example auditors do. Therefore we could conduct a more company specific and detailed questionnaire regarding impairment of goodwill interviewing employees than what would have been possible if interviewing many other stakeholders. We wanted to use the respondents’ statements as a base for getting a deeper understanding of the valuation procedure of goodwill, and use those statements as a complement to the central concepts in order to get a more comprehensive picture of the procedure. Our central concepts and the questionnaire are strictly linked since the questionnaire is based on the central concepts.

2.4 Scientific Approach

When conducting a study there are two commonly used directions that a researcher often takes, the positivistic approach and the hermeneutic approach. These two directions are extreme opposites and in reality most research contains fragments from both directions. A hermeneutic researcher strives to create an understanding for the phenomena that he or she is studying. A positivistic researcher on the other hand strives to find a relationship between the phenomena.\textsuperscript{30} A hermeneutic researcher does not try to find a right or a wrong, neither the absolute truth since there is no absolute truth according to the hermeneutic approach. The phenomena changes depending on which social context they operate in. It is also important to know that hermeneutic interpretations in research are based on the researcher’s preconceptions and knowledge about the subject, as the researcher is interpreting and not generalizing.

We have conducted a descriptive study and the problem description for our thesis; how the impairment of goodwill looks like, is of a typical hermeneutics character. The hermeneutic elements in our study are shown by the fact that we want to describe the reality in the social context that it operates in, and we are not trying to generalize or seek universal validity for our study.\textsuperscript{31} The problem description is not formulated in such a way that quantified data could be compiled in order to answer the problem description. The problem description is rather formulated in order to give us a deeper understanding of the impairment procedure of goodwill instead of quantifying the collected data; therefore the problem description is more of a hermeneutic nature than a positivistic one. We strive to see the impairment procedure of goodwill through the eyes of controllers. Our aim is not to try to find a connection by gathering data that a researcher with a positivistic approach would. We strive to understand the impairment procedure and therefore we have chosen to conduct a qualitative study, and we aim to apply a hermeneutic approach on our study.

\textsuperscript{29} U. Lundahl et al. \textit{Utredningsmetodik för samhällsvetare och ekonomer}. (1999) p. 62
\textsuperscript{30} Johansson et al. \textit{Att utveckla kunskap: om metodologiska och andra vägval vid samhällsvetenskaplig kunskapsbildning}. (1993). P.55
\textsuperscript{31} Andersson S, \textit{Positivism kontra hermeneutik}. (1979) p. 14
2.5 Research approach

When conducting research the relation between theory and the empirical findings is of great relevance. According to Bell a researcher has two main research approaches to choose between. The first is called a deductive research approach where the starting point of the researcher is theory and then the validity of the theory is tested through specific social phenomena. The inductive approach is the opposite; through specific social phenomena a new theory can be expressed. These research approaches cannot however be totally separated from each other since both of them contain fragments from the other one. 32 We cannot state that our study has taken a pure deductive approach or a pure inductive approach since we can find fragments from both approaches in our study.

We have formulated a problem description and from that description we have gathered information in order to create central concepts. From these central concepts we then formulated our interview questions, and the information from respondents helped us to solve our problem since the answers from the respondents provided us with a deeper understanding of the impairment procedure. This approach reflects the deductive elements in our thesis, however the questionnaire for the collected data is not purely based on the central concepts, it is also partly based on subjectively chosen questions which we thought to be of relevance in order to get a deeper understanding of the impairment procedure, and therefore we cannot exclude inductive elements in our study. Our study further contains elements from the inductive approach because some of the central concepts used are not specific for our subject but could also be used in other business research. Some concepts, such as the principle of harmonization, is not purely created for goodwill accounting and is applied overall in accounting meaning that the central concepts are too general to only fit our problem description which in turn makes it hard to argue that we have a pure deductive research approach.

We believe that it is of advantage for our study to use elements of both an inductive and a deductive approach, because we believe that both our central concepts as well as our empirical findings are very crucial for our analysis. From our central concepts we learned how to handle the impairment of goodwill theoretically, our empirical findings will help us go gain knowledge concerning how the impairment procedure of goodwill is handled in practice. Further, in the analysis we will combine the knowledge generated from our central concepts with the knowledge gained from our empirical findings in order to receive a comprehensive picture of the impairment procedure of goodwill.

2.6 Qualitative Strategy

There are two main research strategies, quantitative research strategies and qualitative research strategies. We have chosen to perform a qualitative research strategy in order to get a deeper understanding of the impairment procedure of goodwill.33 We based our choice of research strategy on our problem description, which focuses on the impairment procedure of goodwill. We want to know how the recommendation (RR 17) is interpreted among those who are using it and how the recommendation is handled in practice. Qualitative research strategies are based on how the participants in different surroundings interpret the reality, we believe this is of great importance for our study since we strive to see the world through the eyes of controllers that interpret and apply the concept RR 17. We chose not to apply a quantitative strategy on our study since a quantitative strategy means that the researcher

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32 Bryman, A, Bell, E, Företagsekonomiska forskningsmetoder. (2005) p. 25
33 Andersen, Den uppenbara verkligheten- val at samhällsvetenskaplig metod. (1998) p. 31
should observe the reality from outside and the collected data should be quantified rather than be interpreted.

In qualitative research the focus is concentrated on words in the collected data rather than to quantify the material, qualitative interviews are frequently used as a method of collecting data in qualitative studies. The reader should keep in mind that the researcher is interpreting the data based on his or her knowledge and preconceptions, which puts a great amount of responsibility on the authors. An often criticized aspect of qualitative research is that qualitative data are difficult to generalize. However, our purpose is not to generalize or quantify the information that we collected through the interviews. Our purpose with the study is to get a deeper understanding of what the impairment procedure of goodwill looks like in reality as opposed to how the procedure is handled and described in theory, therefore the qualitative approach is of best practice for our study.

2.7 Collection and Criticism of literature

When our problem description was defined we could chose relevant material for our study by using relevant search words.

The words we used most frequent for the search of the literature, scientific articles and periodicals in accounting were, IAS 36, RR 17, "good accounting practice", "true and fair view", impairment, assets, goodwill, harmonization, "principle of comparability", "prudence concept", IASB, IASC and "cash generating units". We searched for these words in both English and Swedish and we also combined the words when searching. We used the combinations: "impairment of goodwill", "impairment of assets", and "goodwill divided among cash generating units".

When collecting information we kept in mind that the information we found could be biased, such information does not necessarily need to be excluded. However we thought it was important for us as authors to understand and reflect about the material we used. Bell presents important questions to keep in mind when evaluating sources;

- When and under which circumstances was the source created?
- Is the source typical or uncommon compared to other similar material?
- Is the source complete? Has it been modified?

When it comes to the collection of scientific articles the University on-line library has been a helpful resource. The scientific articles were found through databases. The databases we used most frequent when searching for articles were Emerald and Business Source Premier. Both these databases consist of articles from different periodicals and other publications. Most of the articles in this study came from Emerald because it contained most relevant information for our study. All material found in Emerald and Business Source premier has been peer reviewed, in addition we asked ourselves the questions presented above when evaluating if we should use the material.

When it comes to the collection of books, it was mainly used for the methodology part of the study and the method book; research for business students (Bryman) has been frequently used for the construction of the method chapter. This book was well known for us due to the course

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35 Bell J, Introduktion till forskningsmetodik (1993) p. 69
in scientific methodology that we took at the intermediate level. We believe that the credibility of the contents in this book is high because we have found several other researchers that have referred to this book in their research.

Regarding to the use of magazines, we know that Balans is not a scientific magazine but its contents is useful for our thesis since its content is focused on accounting principles used in Sweden. The magazine is known to be one of the best accounting and auditing magazines in Sweden. The overall principle for all periodical magazines is that they comprise of small abstracts, for that reason we used several editions in our study.\textsuperscript{36} We searched in Balans magazines published between 2001-2008. Since the new recommendation of RR 17 was implemented in 2005 we used earlier magazines from 2001 because we wanted to know how it was before the implementation.

We also used SOU (Swedish Government Official Report) and government proposition, which were relevant for our thesis since they contain the background to why RR 17 became implemented. When handling the collected information we kept in mind that the information we selected might have been used for a different purpose than in our research.\textsuperscript{37} We wanted to use as much peer reviewed articles as possible in order to receive a high credibility. When selecting which articles to use we kept in mind the questions presented by Bell. We believe that among the sources used the Internet sources have the least credibility. When searching for information among web sites of different organizations we kept in mind that they subjectively choose which information they want to publish, as well as which information they choose not to publish. However we think that our research does not contain any search for sensitive information which we have reasons to believe has been left out or modified.

The respondents participating in this study are all native Swedish speaking and the interviews were conducted in Swedish. The reader should know that it was sometimes difficult to find an accurate translation when presenting the interviews in English. It is important to point out that some parts of the interviews were probably affected by the translation from Swedish to English, since some dimensions of the language could not be captured by the translation.

\textsuperscript{36} Bell J, \textit{Introduktion till forskningsmetodik} (1993) p. 69
3. Central Concepts

This chapter contains the theoretical framework of the thesis. First, we present the concepts concerning accounting principles that are essential in order to understand the underlying factors of the development of the recommendation RR 17. Further the impairment procedure of goodwill is presented. In order to get a deeper understanding about impairment of goodwill the accounting is crucial. The new recommendation which listed companies are obligated to follow is very essential since most companies have goodwill. Consequently it is very important for our study to include all relevant accounting principles and thereafter present the procedure concerning impairment of goodwill. In this following chapter goodwill will be defined. Thereafter we will explain impairment and when it is necessary to impair. Indication of impairment loss is also discussed. Goodwill does not generate any cash flow on its own and it is therefore divided between cash generating units. This essential part will be presented in an own section.

3.1 Harmonization

The history of bookkeeping takes us a long way back in time. It is not known who invented accounting. Traces lead back to Italy in 13th and 14th centuries where double-entry bookkeeping made its entry. Until 16th century companies’ did not have any external pressure of uniformity in accounting as accounting was primary made for the owner. Most business transactions were closed in the short-term. Normally it only lasted until a trading unit had been exchanged; therefore no consideration was taken to periodic profits and allocation. Businessmen had very few fixed assets at that time and there was no need to calculate depreciation.38 During the last centuries the trend has moved towards a climate with larger companies with a lot of various assets. Today we are living in a globalised world with multinational corporations operating around the world, and companies today have many different stakeholders. A Swedish company can have the assembly line in China while their sales department is located in Japan and the headquarter is in Sweden. The competition has increased as a result of the globalization. Companies compete for financial capital, market shares and potential profits. The need for a common accounting standard has increased in order to receive better comparable information about different actors on the market39. During the last decades the trend in accounting has resulted in two main generally accepted accounting languages, the Anglo-Saxe and the Continental standards.40

There is no country that has an identical financial accounting practice even though they belong to the Anglo-Saxe or Continental accounting language. The United States, United Kingdom and the Netherlands are the stand setters of the Anglo-Saxe language. The accounting is based upon common law and the purpose is to provide the shareholders and the creditors with financial statements.41 In Anglo-Saxe countries and especially the above-mentioned countries, the capital which corporations dispose of is mainly coming from shareholders, the stock or bond market.42

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38 Hendriksen et al. Accounting Theory (1992) p.35
40 Smith, Redovisningens Språk (2006) p. 67
41 Mueller et al. Accounting an international perspective (1991) p.15
42 Mueller et al. Accounting an international perspective (1991) p.15
The other large accounting language (the continental) is based on code law. Many countries in Europe and also Japan use this approach. Compared to the common law that use stock and bond markets to raise finance, continental countries mainly use banks to supply corporations’ with capital. The capital gain of business ownership is concentrated since there are large banks operating on the market. The financial statements adopting the continental view are designed to meet government requirements when computing income tax.43

A harmonization of accounting principles is necessary since capital is spread across the world, due to multinational corporations, which requires a comparability of the companies’ financial statements. Investors need the information in order to select an investment that fulfills their requirements.44 Further a harmonization of accounting principles facilitates an effective resource allocation.45 EU’s objective is to achieve a common accounting language for listed companies. The reasons are to achieve resource allocation and harmonization which helps keeping costs down.46 The Continental view has during the last years been strongly influenced by Anglo-Saxe view and one of the reasons is that the US capital market is one of the greatest in the world. As a step towards better comparability and harmonization of the two main accounting principles, EU legislated in 2002 that all business combinations should follow IFRS/IAS. These recommendations issued by IASB are strongly influenced by the Anglo-Saxe accounting language, which is based on the tradition that accounting should give a true and fair view of reality. The term states that bookkeeping should reflect reality. However one has to keep in mind that the concept true and fair view has not been free from influence by commercial interests and by interests of accountants during the years.47

3.2 Swedish Legal System and Good Accounting Practice.

In many Anglo-Saxe countries the accounting legislation is supplemented by private or public sector bodies, which issue recommendations and requirements. For instance, in US the FASB give out accounting recommendations. It is not common within countries that use the continental approach to have organizations, which give out accounting recommendations, and there is no room for supplement. Sweden which is using the continental approach however has supplementary recommendations issued by accounting regulatory bodies. Even though Sweden belongs to the Continental view which is based on code law, Sweden is thereby distinguished from the other continental countries. In Sweden the RR has the main responsibility to issue accounting standards for stock listed companies. In other words, Sweden is a country that accepts “a binding link between tax rules and accounting rules”48. The annual accounting act regulates when and how Swedish companies should present their accounts. In the 2-chap §2 the annual accountings act states “accounting should be in accordance with good accounting practice”49. In Sweden good accounting practice arise when two conditions have been fulfilled. The condition is “(1) an accounting recommendation has been made by a recognized authoritative body. (2) The method is used widely and applied by a large and representative circle of companies.”50 RR publishes recommendations that are

43 Ibid. p.10-13
47 Smith, Redovisningens språk (2006) p. 67-71
compatible with International recommendations, as long as they do not conflict with Swedish legislation.\footnote{SOU 2003:71 p 135} RR 17 is more or less a direct translation of IAS 36 since the regulation is not in conflict with Swedish legislation. Good accounting practice includes the legislation and recommendations in accounting and further the praxis in the accounting area. In order to clarify good accounting practice, praxis and expertise statements help to interpret when the accounting regulations are sometimes outdated. In those cases the legislator can refer to good accounting practice.\footnote{Blake et al The relationship between tax and accounting rules- Swedish case, European Business Review Vol. 97 No.2 1997}

### 3.3 True and Fair View

In 1995 a new annual account act was implemented. (ÅRL 1995: 1554), because the fourth directive which EU issued had to be implemented. At the same time the new concept was implemented, the true and fair view ÅRL chap 2 3\S.\footnote{Burrowes et al. An Alternate approach in implementing the 4th Directive territorial claim to financial reporting and auditing in Sweden Managerial auditing journal. 14/6 1999} “The balance sheet, income statement and the disclosures shall in accordance establish in its entirety and give a true and fair view of the companies position and the result” \footnote{ÅRL chap 2 § 3} In the annual accounting act both good accounting practice and true and fair view are thereafter stated since 1995. Before 1995 the Anglo- Saxe approach was not reflected in the Swedish annual accounting act, it only presented good accounting practice.

The Swedish concept: good accounting practice resembles the concept true and fair view which plays a central part in the Anglo-Saxe language. Both these concepts are mentioned in the Annual Accounting act but in different paragraphs, which indicate that their legal meaning is not identical.\footnote{ÅRL 2 chapter 2, 2 and 3 §} Good accounting practice is based on practice, norms and laws. The development in Accounting is rapid and the legislator therefore refers to good accounting practice because laws are sometimes outdated. RR 17 considers the term true and fair view which is shown by the fact that an impairment test should be made at the end of each reporting period and an asset should be impaired as soon as an impairment need is discovered. Conducting impairment as soon as the need is discovered gives a fair view of reality. Previous regulation stated that an impairment loss should be permanent in order to make impairment. The concept true and fair view is therefore of great importance for our thesis. The difference between good accounting practice and true and fair view is that the former states how the companies do their accounting while true and fair view is used in order for the readers of the financial statement to be guided correctly.\footnote{Artsberg, Redovisningsteori- policy och praxis, p.157} There have been discussions whether Sweden should make an override to true and fair view or not, and some argue that an override to true and fair view is necessary for Swedish companies. One argument is that it would help Swedish companies to conduct their accounting in accordance with international accounting standards. Another argument against it is that it could lead to contradiction between the auditor and the client.\footnote{Blake, International accounting harmonisation- a comparision of Spain, Sweden and Austria, European Business Review Vol. 98 No 3 1998}

Since the continental approach is moving towards the Anglo- Saxe approach, true and fair view has become very essential within the accounting area. True and fair view has different meanings within different countries. The Swedish meaning of the word lies between the
German and the British. We will shortly explain both of these since it becomes essential in defining the Swedish meaning. The British definition of true and fair view is that the definition is "the final goal". At the end of the goal, true and fair view will be achieved. The German definition takes another direction, it is “about” and if the fourth directive of the EU is followed, only then a true and fair view will be achieved. The Swedish definition is somewhere between these two.

Due to harmonization the need of the principle of comparability is of importance for companies in different countries. The prudence concept is sometimes in a conflict with true and fair view since it demands cautious valuations while true and fair view presupposes reflections of reality in accounting. The prudence concept has been an important aspect in Sweden for a long time. In the annual accounting act two central principles are in accordance with RR 17, the principle of comparability and the prudence concept. The continental way of following the prudence concept is related to the taxation. Earlier in history it was common that the companies saved reserves during good periods in order to use the reserves in the future. The prudence concept is defined in the annual account act ÅRL 2 Chap 4, 3 as: "The valuation of the different items, and in some cases sub-items shall be made with reasonable caution"

The principle of comparability implies that companies should as far as possible apply the same accounting principles from year to year. If companies change their accounting principles they should also recount earlier year’s results to make the financial reports more comparable to each other. If a company for some reason changes the accounting principles, information about the changes should be apparent in the financial report. Stellan Nilsson a lector at Umeå School of Business and Economics states that the principle of comparability is of great importance for the harmonization of accounting standards.

The prudence concept means that “carefulness should be taken into notice when estimating the value of assets” When estimating the value of assets, assumptions should not be too uncertain. When calculating the value of assets the acquisition value should be the base, and according to the principle it is easier to justify depreciation of assets than revaluation. From the stakeholders point of view it is better to receive information about lower result, than to receive information about high results that are later found to be overestimated and corrected with lower results.

We have now presented; the principle of harmonization, true and fair view, the prudence concept and the principle of comparability. These are fundamental principles, which many accounting methods are based on. These concepts are important for the reader to keep in mind, in order to understand the fundamentals of accounting. In the following sections we will present the valuation procedure of goodwill.

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58 Nilsson, Redovisningens normer och normbildare p.42
59 Nilsson, Redovisningens normer och normbildare p. 42-43
60 Ibid p. 42-43
61 Artsberg, Redovisningsteori- policy och praxis p.160
62 ÅRL 2 Chap 4, 3
63 Nilsson, Redovisningens normer och normbildare ( 2005 ) p. 40
64 Ibid p.40
65 Government prop. 2004/05:24 p. 104
66 Nilsson, Redovisningens normer och normbildare ( 2005 ) p. 35
3.4 How does Goodwill arise and how is it defined?

Goodwill is a very controversial matter since the standards concerning goodwill have been many. Bithell (1882) defined goodwill early in; A Counting House Dictionary, as “a willingness of an owner of a business to relinquish the expectation of the business by transferring it for a consideration to someone else”67. A company can have a well-known trademark, a wide range of customers or other existing circumstances which gives the company a higher estimated value than its ownership equity. The explanation is that a potential buyer would expect such factors to generate a higher amount of cash flow in the future, and would therefore be willing to pay more in acquisition today than the estimated value of the company’s ownership equity.68

The FASB (Financial Accounting Standard Board), which is the American correspondence to IASC, has defined goodwill since 2001 as “the difference between the amount paid for the company and amount assigned to the acquired company’s assets and liabilities”69. As mentioned before, goodwill is a controversial matter and the definitions have been many. Therefore the debate concerning goodwill has been continuously returning and the approach on how to handle goodwill has varied between time and country. A. Seetharaman, M. Balachandran and A.S. Saravanan from the faculty of Management in Malaysia published an article in 2004 where they stated that IASC has a responsibility to find a solution for how goodwill should be treated in order to achieve harmonization of the accounting norms, approaches and regulations world-wide.70

In 2005 the IASC put forth a new recommendation where they defined goodwill as “goodwill which is acquired through an acquisition can be seen as a payment for future economic advantages which are not possible to identify on their own, neither are they possible to separately be showed in the reports”71. IASC presents requirements and treatment of acquired goodwill in IFRS 3.

In this thesis we have chosen to use the definition of goodwill that is set by the IASC because the standard RR 17 is based on this definition. The companies, which we have included in our study, are obliged to follow RR 17 and have therefore probably been in contact with the definition of goodwill that the standard presents. Further we think that this definition is detailed and therefore clarifies goodwill in a concrete way. There are two different kinds of goodwill; Goodwill that arise when a company acquires another company and goodwill that is worked up internally in the company. Internally worked up goodwill is difficult to estimate and so uncertain that it can not be included in the financial report.72 Acquired goodwill is entered in the balance sheet. In an acquisition of two companies, a synergy effect may arise. This synergy effect will show if the value of the business combination is larger than the companies separated from each other.73 Goodwill alone can not generate any cash flow and can therefore not be acquired without acquiring an entire company or at least a remarkable

67 T Seetharaman et al. Accounting treatment of goodwill: yesterday, today and tomorrow Problems and prospects in the international perspective. Journal of intellectual Capital Vol. 5 nr 1
70 T Seetharaman et al. Accounting treatment of goodwill: yesterday, today and tomorrow Problems and prospects in the international perspective. Journal of intellectual Capital Vol. 5 nr 1
part of a company. Goodwill is the difference between the price paid in acquisition when a company acquires another company and the ownership equity received from the acquired company. The surplus amount is reduced with possible overvaluations, and the amount that is left is referred to as goodwill. An example of a possible overvaluation is a building which the acquired company has entered to an acquisition value in the book-keeping (in accordance with good accounting practice) while the acquiring company enters the same building to a market value in their bookkeeping (because the market value at the time of acquisition will represent the new owners acquisition value).  

* The difference between the value that the acquired and the acquiring company enters in the bookkeeping at the time of acquisition. This example is simplified. In reality taxes are taken into consideration.

<table>
<thead>
<tr>
<th>Price paid in acquisition</th>
<th>100</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acquired ownership equity</td>
<td>-70</td>
</tr>
<tr>
<td><em>Overvalued building</em></td>
<td>-5</td>
</tr>
<tr>
<td>--------------------------</td>
<td>-----</td>
</tr>
<tr>
<td>Goodwill</td>
<td>25</td>
</tr>
</tbody>
</table>

*Figure 1. Goodwill calculations in acquisition*

Since goodwill does not alone generate any cash flow it therefore must be allocated between assets or units of assets. RR 17 states that when dividing goodwill among cash generating units companies must:

First estimate whether goodwill can be assigned to a unit. And if they estimate that goodwill can be assigned to a unit they should further.  

“estimate the value of goodwill in a reasonable and consistent way that can be assigned to the cash generating unit”.  

If goodwill can be assigned to assets or units of asset, which are called cash generating units, it should then be assigned to the cash generating units where it belongs.

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3.5 Cash Generating Units

A cash-generating unit is defined as "the smallest identifiable group of assets that generates cash inflows which are largely independent of the cash inflows from other assets or groups of assets". A cash-generating unit can be explained as the smallest group of assets that is independent from other groups of assets. It is also essential that running payments can be tied to and established for the unit and separated from other units. Regional areas and different areas of production are examples of cash generating units. Large companies can have many cash generating units and sometimes they can be difficult to identify and keep apart. While small companies may only be able to identify one cash-generating unit. The companies need to make careful estimations when dividing assets into cash generating units and the method used when establishing cash generating units should be used consistently over time. Important when identifying cash generating units is how the company is operated because decisions in how the company’s assets should be handled are crucial. In order to clarify we present an example:

A company has several different lines of assembly that produce different products. These lines could be identified as separate cash generating units. However, if for example contracts with retailers presuppose that products from different assembly lines must be delivered in order for the retailer to order products from the company, then the cash flows from the assembly lines are not independent of each other. And should therefore belong to the same cash generating unit.

To further exemplify we present an example taken from IAS 36 p.260:

“A bus company runs five different bus routes for a municipality in accordance with an agreement which contains demands on minimum traffic for all routes. The bus company has information about the size of the resources that are tied to each bus route and also the cash flows that the bus routes generate. One bus route is loss making. Since the bus company can not withdraw one separate bus route the five bus routes together constitute the smallest identifiable group of assets that generates cash inflows which are largely independent of the cash inflows from other assets or groups of assets”.

3.6 Impairment

IASB gives out recommendations that are influenced by the Anglo- Saxon approach. Within the Anglo- Saxe approach there is an external pressure coming from the shareholders in order to provide them with reliable information. A Couple of years ago the method to reduce the value was made by writing off (amortization), while today impairment is used. The new recommendation impairment of assets, in our case goodwill, has some advantage compared to the old recommendation. The disadvantage with the former praxis was that goodwill was amortized over a decided time period, regardless of the value of goodwill that the company in reality had. After the set time period passed, goodwill did not show any value for the shareholders when reading the financial reports while in reality it was possible that goodwill continued generating cash flows. The impairment test used today might be of better meaning.

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80 Internationell redovisningsstandard i Sverige (2007)IFRS/IAS p.460
when using the financial reports because it gives the stakeholders a more accurate view of reality, it shows the reduction or increase in goodwill’s value. The readers of the financial reports will therefore benefit more with the current system of managing goodwill.\(^81\) However investors think impairment of goodwill is a costly acquisition\(^82\).

<table>
<thead>
<tr>
<th>Price of acquisition</th>
<th>80</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acquired Equity</td>
<td>60</td>
</tr>
<tr>
<td>Goodwill</td>
<td>20</td>
</tr>
</tbody>
</table>

*Figure 2 Goodwill estimations*

To explain why we illustrate an example where a company acquires another company: If the acquired ownership is 60 but the price paid is 80 it indicates that the buyer estimates that the surplus amount will generate future cash flows and is therefore willing to pay these extra 20 and does not see it as a loss. However if these 20 are impaired shortly after the acquisition the stakeholders might see it as pure loss making deal. Therefore the management needs to be careful and try to avoid impairment of goodwill because it might indicate that the economic forecast of future cash flows was overestimated\(^83\). When no impairment loss is discovered the goodwill balance will stay the same from year to year\(^84\). However, in the case of an indication (given by the internal and external factors presented below) of an impairment loss, first, a recoverable amount should be calculated. If the recoverable amount together with the share of goodwill which has been ascribed to the asset or group of assets is higher than the fair value, the asset or group of assets should be impaired\(^85\) “The recoverable amount is the highest of fair value less cost to sell and value in use”\(^86\). Next, in order to make impairment, the impairment amount needs to be distributed in two steps:

1. “first, to reduce the carrying amount of any goodwill allocated to the cash-generating unit (group of units)”
2. “then, to the other assets of the unit (group of units) pro rata on the basis of the carrying amount of each asset in the unit (group of units).” \(^87\)

When following the recommended procedure above there are some restrictions concerning when an asset should be impaired. An asset or unit of assets should never be impaired if an impairment results in a value of the assets below zero, since assets can not have a negative value in the bookkeeping because the minimum value they can have for the company is no value at all. Further the carrying amount of an asset should not be impaired to a value which is lower than the highest of the assets value in use and the assets fair value less costs to sell. When impairment is carried out, the carrying amount of goodwill as well as for other assets is entered in the financial reports as an expense for the company the period in which it is carried out. Therefore an impairment loss can be seen in the net profit. The net profit shows the

\(^81\) Wines et al. *Implications of the IFRS goodwill accounting treatment*. Managerial Auditing Journal Vol. 22 No 9, 2007 p. 867


\(^83\) Ibid


\(^87\) *Internationell redovisningsstandard i Sverige* (2007) IFRS/IAS p.466
result where incomes from sales are reduced with all expenditure. The recommendation RR 17 is worked out in a way so that the need of impairment should be identified for separate assets. In reality however, the need for impairment is usually identified for groups of assets. It is often difficult if not impossible to assign cash flows to separate units. The reason is that separate asset do not generate cash flows, however combined groups of assets do. The expression cash-generating unit is important when establishing the recoverable amount. The recoverable amount is the highest of; value in use and fair value less cost to sell. It should be estimated when a need for impairment is indicated. The recoverable amount should be established for groups of assets (cash generating units) whenever it is not possible to establish the amount for separate assets. The recommendation RR 17 presents guidelines for when the recoverable amount and the value in use should be estimated for a cash-generating unit instead of for a separate asset.

When “the value in use can be presume to have a value close to the assets fair value less cost to sell”

When “the asset does not give rise to cash inflows which are independent of cash inflows from other assets”

### 3.7 Indication of Impairment Loss

The new recommendation RR 17, handling impairment of assets requires that business combinations should test assets annually for an impairment loss. RR 17 states that an impairment loss test should be made as soon as an impairment loss has been indicated. The former praxis (ÅRL 4 chap. 5 §) on the other hand stated that an impairment loss had to be permanent in order to make impairment. The difference is that the former praxis had a demand for duration of decrease when valuing assets in order to make impairment. While in the new praxis such a demand of duration does not exist. RR 17 is consistent with the concept “true and fair view” which is adopted from the Anglo-Saxon accounting language, and means that good accounting should reflect the reality. An impairment loss test should be made for separate units if possible. In those cases when is not possible to identify cash flows for separate assets then an impairment loss test should be conducted on cash generating units (groups of assets). When testing if assets need to be impaired, there are a couple of indicators which the recommendations presents as relevant factors to look at in order to estimate if their is a need for impairment of an asset or group of assets.

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89 Nyllinge P, Winkvist M, ”Ny rekommendation avseende nedskrivningar ställer stora krav på värderingar” Balans No 11 2001 p.36
91 Nyllinge P, Winkvist M, ”Ny rekommendation avseende nedskrivningar ställer stora krav på värderingar” Balans No 11 2001 p.35
92 Ibid. p 35
93 Ibid. p.35
<table>
<thead>
<tr>
<th>Internal factors</th>
<th>External factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>The asset is obsolete or damaged</td>
<td>Reduced market value</td>
</tr>
<tr>
<td>Restructure of the company</td>
<td>Technological changes</td>
</tr>
<tr>
<td>Yield on asset lower than expected</td>
<td>Increased market interest rate</td>
</tr>
<tr>
<td></td>
<td>Ownership equity exceeds market value</td>
</tr>
</tbody>
</table>

Source: FAR Förlag p. 451-452 Internationell redovisningsstandard i Sverige IFRS/IAS 2007

Chart 1. Internal and external factors of an impairment loss

In the end of each closure period an indication of an impairment loss of the assets should be tested according to RR 17. A test should also be conducted whenever there is an indication of a possible decrease in value of the asset. The recommendation includes both tangible and intangible assets with a couple exceptions that are specified in IAS 36. The recommendation also includes such financial assets as: joint ventures, subsidiaries and associated companies. Tangible and intangible assets differ in nature. Tangible assets have a limited economic length of life and should therefore be written-of proportionally each year during their economic length of use. Intangible assets and goodwill on the other hand have indefinite useful life whereas they needs to be tested for an impairment loss need every closure period. There are two main groups of the indications of impairment loss, external and internal, which are presented in the standard. The external indicators indicate that an impairment need is necessary if, the asset has a decreasing market value, changes in technology, increasing market interest rates and if the ownership equity exceeds the stock value. The internal indications indicate that the assets are out of date or damaged. Another indication of internal factor is if a restructuring causes the assets not to be in use. Also Internal reports can indicate that the return will be lower than expected if for instance the maintained cost has increased. The need of impairment can be indicated by an indication factor alone as well as by several indicators at the same time. In case of an indication of an impairment loss, a recoverable amount should be calculated for separate assets if possible, or on cash generating units.

3.8 Recoverable Amount

The recoverable amount is the value that is estimated when a need for impairment loss is indicated. The recoverable amount it established as the “highest of: value in use and fair value less cost to sell”.

When one of these two values is higher than the assets carrying amount, the asset does not need to be impaired. Hence it is not necessary to calculate both the value in use and the fair value less cost to sell, if one of them is higher than the assets carrying amount”. The recoverable amount should when possible be calculated separate for each asset. In case where it is impossible to calculate the value on separate assets, the recoverable amount should be establishes for cash-generating units. In case of goodwill, it is impossible to

95 Internationell redovisningsstandard i Sverige (2007) IFRS/IAS p.449
divide among separate assets. Therefore the recoverable amount will be established on cash-generating units.\textsuperscript{100}

3.8.1 Value in Use

The recommendation RR 17 defines the value in use as: "Value in use is the present value of the future cash flows expected to be derived from an asset or cash-generating unit."\textsuperscript{101} The value is computed through estimations of the future in and outflows that the asset gives rise to within the activity and also disposes of the activity. Guiding principles are presented in RR 17 concerning how estimations of the value in use should be calculated. The value is calculated with a discount of the future payments with an appropriate discount factor. The choice of discount factor is based on the demands on return, which the company has on different assets. It is the management of the company who decides what discount factor to use. The discount factor reflects the time value of money and the risks that are associated with the assets. The discount factor used should comply of a capital cost which is weighted between the company’s own equity and the company’s borrowed liabilities. If the risks associated with the asset change, then the discount rate also might change. According to RR 17 the future cash flows calculation of value in use should estimate the assets in existing condition.\textsuperscript{102}

As mentioned in a previous section, goodwill is an estimation of cash flows generated in the future. According to RR 17 companies should, based on their best abilities, estimate the current economic conditions that will be during what is left of an assets remaining period of use.\textsuperscript{103} Hence future generated cash flows should be based on these estimations. Economic forecasts in the long run are often very uncertain because future development and growth are difficult to foresee.\textsuperscript{104}

In and outflows of tax payments and outflows in the financing activity are not included in the estimation of future cash flows. Risks that already have been taken into account when the future cash flows were computed are not taking into consideration again. In order to value goodwill, the value in use needs to be calculated. The value in use can be calculated high if the valuation of goodwill is on the limit to overvaluation while using a low discount rate.\textsuperscript{105} On the other hand a lower value is received if chosen to use the lowest possible value for goodwill and at the same time use a high discount rate. The estimation of present cash flows derived from goodwill varies together with subjective estimations of risks and the time value of money.

In order to calculate the cost of capital, the WACC -model is used (Weighted Average Cost of Capital). The WACC-model takes into consideration both equity and debt of a company. In order to be able to calculate these part we need to know how much of the capital compound of debt respectively equity. The weights need to be multiplied by the rate of return of both debt and equity, thereby the WACC is calculated. The problem that may arise when using the

\textsuperscript{100} Wines et al. \textit{Implications of the IFRS goodwill accounting treatment.} Managerial Auditing Journal Vol. 22 No 9 2007
\textsuperscript{101} Internationell redovisningsstandard i Sverige (2007)IFRS/IAS p.450
\textsuperscript{102} Nyllinge P, Winkvist M, "Ny rekommendation avseende nedskrivningar ställer stora krav på värderingar" Balans No 11 2001 p.37
\textsuperscript{103} Internationell redovisningsstandard i Sverige (2007)IFRS/IAS p.455
\textsuperscript{104} Nyllinge P, Winkvist M, "Ny rekommendation avseende nedskrivningar ställer stora krav på värderingar" Balans No 11 2001 p.37
\textsuperscript{105} Wines et al. \textit{Implications of the IFRS goodwill accounting treatment.} Managerial Auditing Journal Vol. 22 No 9 2007
WACC-model is that it might not be appropriate to use the same WACC on all division since the risk level might differ between the divisions.106

3.8.2 Fair Value less Costs to Sell

“Fair value less costs to sell is the amount obtainable from the sale of an asset or cash-generating unit in an arm’s length transaction between knowledgeable, willing parties, less the costs of disposal”107. Under the condition that the parties are willing and also have all available knowledge, the fair value less cost to sell is the amount received in a sale reduced with the price of disposal.

Summary of central concepts

We have connected relevant concepts to our problem description, which is describing the valuation procedure of goodwill. The concepts we have identified as relevant in order to conduct the study are: Goodwill, cash generating unit, impairment, indicators of impairment loss and recoverable amount. These concepts describe the valuation procedure of goodwill theoretically. Our empirical findings presented later are the practical description of the valuation procedure of goodwill. In order to reach the main purpose of the study we need to present the theoretical as well as the practical sections, which we later combine in an analysis.

<table>
<thead>
<tr>
<th>Concepts</th>
<th>Connection to problem description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Goodwill</strong></td>
<td>The value of goodwill needs to be estimated and assigned to assets or cash generating units.</td>
</tr>
<tr>
<td></td>
<td>In order to make impairment, goodwill needs to be allocated among cash generating units.</td>
</tr>
<tr>
<td><strong>Cash generating unit</strong></td>
<td>The value of goodwill assigned to an asset or unit of assets should be impaired first, then the assets of the unit should be impaired.</td>
</tr>
<tr>
<td></td>
<td>Companies use indicators to estimate if an impairment test is necessary or not.</td>
</tr>
<tr>
<td><strong>Impairment</strong></td>
<td>Has to be established when a need for impairment is indicated.</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Indicators</strong></td>
<td></td>
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<tr>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Recoverable amount</strong></td>
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</tr>
</tbody>
</table>

Model 2. Summary of Central Concepts
4. Practical Methodology

This following chapter will present how we collected data. In order to be able to understand the empirical findings it is essential that the readers know the practical procedure.

4.1 Choice of company

The first criteria for the choice of companies was that they had to be Swedish companies obligated to apply RR 17. This criterion applies to stock listed business combinations required to follow RR 17 and therefore excluded from applying ÅRL. In order to get information concerning which companies were stock listed business combinations we looked at Dagens Industri for a list of companies on the large cap list. The large cap list consists of the largest stock listed companies. It would not be possible for our study to include companies that are not stock listed business combinations since they do not have to apply RR 17. The second criteria were that the chosen companies should have goodwill. We therefore looked at annual reports for stock listed business combinations to ensure that they had goodwill. Most stock listed business combinations have acquired goodwill since they have subsidiaries.

Except from the two criteria mentioned in the previous section, we wanted to have companies operating in different areas to ensure a diversified illustration of the impairment procedure of goodwill. Our purpose was to see how the impairment procedure of goodwill looked like; therefore it was of interest to study a wider range of branches. Companies in the same branch may have the same procedure so we found it more interesting to see if there were any differences between different branches. In other words all companies that fulfilled the requirements had the same chance to be chosen independents of the branch. We chose four companies operating in different industries from the large cap list, Lindab, Atlas Copco, Boliden and Stora Enso. We looked at their financial reports to ensure that they had goodwill and then contacted the companies in order to conduct our interviews. The reason for choosing four companies is that we estimated that it would provide us with sufficient material in order to give us a deeper insight in the impairment procedure of goodwill. Research concerning interviews has shown that a high amount of interviews does not establish a better result. What influences the result is to be well prepared and it is essential to carefully choose companies.\textsuperscript{108} We were afraid that if we chose more companies it would result in too much material to compile and analyze, which could result in a poor analysis.

4.2 Selection of interview method

First we wanted to conduct face-to-face interviews in order to see the respondents’ facial expressions and body language when interviewing them. Since our thesis is applying a qualitative approach, interviews with a small sample are of best relevance, because we want to get a deeper understanding. This kind of interviews would give us the best data due to the physical contact, and the interviewer can see if the respondent understands the question correctly. Our respondents are representing stock listed business combinations located in the southern part of Sweden. Face to face interviews would be of best practice but the different locations of the respondents made it difficult to conduct face-to-face interviews. Therefore we chose to conduct telephone interviews instead.

The advantages with telephone interviews are that they can reach more respondents, however there will not exist any physical contact. A severe loss is more common with telephone interviews. When performing a telephone interview the respondent can decide not to fulfill the interview because it is easier than in a face-to-face interview to quit in the middle of the interview. If that occurs, the interview can still be analyzed from the information received but it can be a poor analysis.\textsuperscript{109} We also had the possibility to conduct a survey however we chose to perform interviews instead of a survey since interviews made it possible for us to personally ask the questions and interpret the answers. An interview also leaves more room for open questions than a survey does and open questions allow the respondent to give some extra information which he or she thinks is relevant, which is important since the data collected when performing qualitative research should be interpreted and analyzed and not only compiled.\textsuperscript{110}

4.3 Construction of interview questions

The central concepts are chosen because they are of relevance for our problem description; the impairment procedure of goodwill. The presented empirical data stems from to the central concepts. Therefore we have constructed our interview questions from our central concepts. The central concepts are the starting point in the procedure of constructing interview questions. From these concepts the interview questions are formulated with direct connections to the problem description (impairment procedure of goodwill). When constructing the interview questions we have kept in mind that the central concepts and the empirical findings will be compared in the analysis.

First we asked the respondents about their position in the company in order to get a better understanding about the respondent’s connection to the company. Further the interview guide is organized in themes consisting of the five central concepts, goodwill, cash generating units, impairment, indication of impairment loss and recoverable amount. The concepts are presented in the model below. Each one of these five concepts are used as a theme in the interview guide and contains questions concerning the theme; we used open questions in order to get as much information as possible from the respondents. Further the themes consist of questions that reconnect to our problem description. When constructing the question we tried from our best ability to avoid leading questions and to use a language the respondents would understand.\textsuperscript{111}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{diagram.png}
\caption{Construction of interview guide}
\end{figure}

\textsuperscript{109} Janes J, Survey research design, Library High Tech Vol 19 No 4 2001
\textsuperscript{110} Bryman, Alan Kvantitet och kvalitet i samhällsvetenskaplig forskning (1997) p. 132
\textsuperscript{111} Bryman et al. Företagsekonomiska forskningsmetoder. (2003) P.369
4.4 Study procedure

In order to get in contact with prospective respondents we contacted the operator for Stora Enso, Boliden and Lindab by phone and explained the purpose of our study. The operators helped us to get in contact with an appropriate employee who could participate in our study. We came in contact with the respondent for Atlas Copco through a friend who works for the company. Our friend recommended us to contact Johanna because she worked with acquisitions. We contacted Johanna by email and she was positive about participating in our study. The other respondents were also positive about participating.

4.4.1 Access

It was easy to convince the contacted respondents to participate. It was more difficult to find an appropriate time for the interviews since the respondents were quite busy. Fortunately the authors had the possibility to be very flexible in deciding when to perform the interviews and therefore we managed to book the telephone interviews. We really wanted the respondent to choose the time and day for the interview that suited him or her best. We reasoned that if the respondents would choose the time that suited them best, they would have time to prepare and be less stressed during the interview. In the chart below we present an overview of the conducted interviews.

<table>
<thead>
<tr>
<th>Company</th>
<th>Bo Eriksson</th>
<th>Ragnvald Jonsson</th>
<th>Svante Gustavsson</th>
<th>Johanna Tesdorpf</th>
</tr>
</thead>
<tbody>
<tr>
<td>Position</td>
<td>Head of risk management</td>
<td>Head of accounting and taxes</td>
<td>Previously worked as controller and management accountant for a subsidiary</td>
<td>Works with acquisitions of subsidiaries</td>
</tr>
<tr>
<td>Wanted to have the questionnaire before the interview</td>
<td>no</td>
<td>yes</td>
<td>Yes</td>
<td>yes</td>
</tr>
<tr>
<td>Type of interview</td>
<td>phone</td>
<td>phone</td>
<td>phone</td>
<td>phone</td>
</tr>
<tr>
<td>Time</td>
<td>30 min</td>
<td>30 min</td>
<td>25 min</td>
<td>25 min</td>
</tr>
<tr>
<td>Comments</td>
<td>Calm and had a lot of knowledge concerning the subject even though he had not seen our questionnaire in advance.</td>
<td>Gave a well-involved impression. Had opinions concerning the impairment procedure of goodwill.</td>
<td>Much theoretical knowledge and helpful. Not totally familiar with all parts of the practical impairment procedure of goodwill at Lindab.</td>
<td>Well prepared and helpful, she had studied the questionnaire in detail and more or less answered many questions by own initiative.</td>
</tr>
</tbody>
</table>

Chart 2. Access
The respondents were located in Stockholm and had really busy workdays so we decided that telephone interviews would be most convenient for them and for us. The respondents were offered to get the questions sent by email in advance in order to prepare. All of them except Bo Eriksson, Stora Enso wanted the questions in advanced. The respondent for Stora Enso had done interviews concerning the same issue before and therefore he felt no need to look at the questions before the interview. We found the respondents very positive and helpful when answering the questions. We felt that they took their time to answer and there was no stress during the interviews.

4.4.2 Interview technique

When collecting the empirical data we used semi-structured interviews because we wanted to ask open questions and complement with follow-up questions when needed. "An interview is a conversation with a clear purpose which usually occurs between two persons (sometimes more) and is lead by one person in order to gather information"\(^{112}\) When conducting a semi-structured interview the researcher uses a questionnaire as a base for the question asking. The questions are divided into themes. The researcher is allowed to ask questions that are not included in the questionnaire, depending of how the respondent answers the questions. Some questions included in the questionnaire may not bring the answers that the researcher hoped for when formulating the questions and the researcher has to come up with new questions. The respondent directs the interview to a large extent; however the researcher sticks to the questions in the questionnaire if possible.\(^ {113}\) The semi-structured interview is flexible because the respondent can formulate the answers freely. We chose this interview technique because of its flexibility.

We did not have much knowledge about all the problems tied to the impairment procedure. Therefore when needed we wanted to be able to add questions during the interview when our knowledge about the impairment procedure grew. It was also of great importance for us to conduct semi-structured interviews because of our lack of knowledge within the area we needed a questionnaire to fall back on. We estimated the interviews to take around 25 minutes and they lasted between 25 to 30 minutes. As mentioned earlier three of the respondents wanted to see the questions before the interviews, and we did not identify any difficulties for the respondents to understand the questions.

Before we started each interview we asked if we could tape the conversation and all respectively agreed. During the interviews some questions were added as a complement to the question in the interview guide, meaning we asked more about something whenever we thought the answer from the respondent was not sufficient. All respondents gave some examples from the reality connected to the impairment procedure of goodwill.

Both of us were present during the interviews because our lack of experience, we thought it would help us receive as much information as possible. We made two interviews each and the one of us, who was not conducting the interview, could add a question when needed in order to obtain as much information as possible. The taping was essential in order for the transcriptions to be made properly. The transcriptions of the interviews were made directly after each interview when we still had it fresh in mind and could diminish misunderstandings. From the transcriptions of the interviews we conducted our empirical findings, which in turn were analyzed, together with our central concepts. Our empirical findings were created when all four interviews had been conducted and transcribed. We offered the respondents to get the

\(^{112}\) Ely et al. *Kvalitativ forskningsmetodik i praktiken.* (1993) p. 65

transcriptions of the interviews but they all declined. The respondents for Atlas Copco, Boliden and Lindab wanted us to send them the presentation of our empirical data in order to ensure that we had interpreted and presented their answers correctly.
5. Empirical Study

We collected our empirical data through telephone interviews. In order to present our study in a clear way we have chosen to present our empirical findings in a thematic order. We present the answers from each respondent separately and the themes we are using are a direct reflection of the themes in the central concepts chapter.

5.1 Reflections concerning the empirical study

The assembly of empirical data for this study is a bit more excessive than what is presented however the major parts of the interviews are presented in this chapter. Our interview guide is created thoroughly from our central concepts, and the respondents’ answers are of great relevance for our study because these empirical findings will be the base for our analysis. We have therefore tried from our best ability to present the respondents answers as accurately as possible.

This approach puts a great amount of responsibility on the authors when choosing data subjectively. We understand that subjectively chosen data could lead to biased presentations of our findings. We tried to be as objective as possible when presenting the information, in the sense that we tried from our best ability to present the respondents answers as accurately as possible and we had no incitements for manipulating the answers from the respondents. However we cannot exclude the possibility that we did not interpret all of the answers in the exact way the respondent had in mind when delivering the answer. In order to avoid wrongly interpreted presentations and information, to some extent at least, we have chosen to use quite many quotations when presenting the empirical data. This allows the reader to receive unbiased information that has not been modified or interpreted by the authors. We want the reader to be able to interpret the empirical material on his or her own and then we present our analysis in the subsequent chapter. The respondents are all native Swedish speaking, therefore we conducted the interviews in Swedish and then translated them into English. The reader should know that some dimensions of the language might have been lost or modified because of the translation even though the authors tried to be as accurate as possible when translating.

5.1.1 Presentation of our empirical findings

We present the four respondents separately, our argument is simply that we believe that this outline is easy to follow and straightforward. For each respondent we first, give a brief presentation of the company which the respondent is representing and then we explain the respondents connection to the company and last, we present their answers in the same thematic order for all respondents.

5.2 Stora Enso

Stora Enso is a forest company specializing in magazine papers and newsprints. The international corporation was grounded in 1998 in Finland and has at the time of writing 44 000 employees around the world.

The respondent Bo Eriksson, has a degree in business and is currently employed as the head of risk management and has worked within the corporation since 1998. His main responsibility is to be updated concerning the biggest risks that the corporation may be faced with.
5.2.1 Goodwill (Stora Enso)

When identifying goodwill at Stora Enso they use a model in order to estimate future prices because prices generate future cash flows. "We have a model which we created ourselves, it calculates prices and budgetary prices". In order to estimate future cash flows they look at the long trend price on the market. There are some problems in using the model because it is quite detailed. BE explains that it is quite easy to conduct calculations but difficult to apply the calculations in reality because of the uncertainties in the estimations. "The problems are usually not the calculations, but to handle the calculations and use them in reality". Usually when acquiring big subsidiaries an external consultant is hired to estimate the value of the company. When acquiring a company everything has to be market valued as for example the stock and patent rights. In those cases BE says that the model they use can become complex. They have to look at the acquired patents rights because patent rights are valued and depreciated and BE explains that often when patent rights are included in the acquisitions you should not really end up with any goodwill. However if the price paid in acquisition exceeds the value of the acquired company including patent rights they identify the exceeding amount as goodwill. "If we then have not filled out the whole price of acquisition we classify the rest as goodwill".

Besides the excess amount paid in acquisition which the company assigns to goodwill BE explains that if the model used to estimate goodwill shows that an acquisition has resulted in synergies, the company identifies the synergies as goodwill. A synergy can for example be that the company estimates increasing sales in the future as a result of the acquisition. "If there are synergies from the acquisition we assign them to goodwill".

5.2.2 Dividing Goodwill among Cash Generating Units (Stora Enso)

When goodwill has been estimated it has to be divided among cash generating units. BE does not identify any problems with this procedure, he explains that "goodwill ends up where it belongs….if goodwill covers several areas of production, we divide and assign goodwill between the different areas of production". A crucial factor for deciding how much of the goodwill to assign to which area of production is the production capacity, meaning that goodwill should be assigned to the unit where the synergies from the acquisition are estimated.

BE explains that,

<table>
<thead>
<tr>
<th>Material Rights</th>
<th>Cash Generating Units</th>
</tr>
</thead>
<tbody>
<tr>
<td>They always end up within the unit we put them in while goodwill can end up in another place. For example, if you buy a paper mill belonging to the emballage area but the mass, which the paper mill purchases comes from another area of production, but increases the integrated production then goodwill can be, assigned to the unit which gets the synergies.</td>
<td></td>
</tr>
</tbody>
</table>

5.2.3 Cash Generating Units (Stora Enso)

BE explained that cash generating units at Stora Enso are normally identified as being different areas of production. The mills they have are not cash generating units since all mills can produce the same products and they are therefore not independent. "The marketing function is being held together centrally which means that different areas of production are usually identified as cash generating units". The criteria used in the company when establishing cash generating units is that they should be independent but still have an influence on the entity of the company. Problems identifying cash generating units usually
arise when presenting the choice of units for the auditors, because the auditors often want a deeper reasoning than that the unit is independent but has an influence on the entity. "They want the reasoning to be deeper and to show how we sell and how the market works". He says that there are practical problems when arguing how the organization works, such as principles of governance.

5.2.4 Impairment (Stora Enso)

At Stora Enso they follow the recommendation RR 17 when they impair goodwill. Recall from our core concepts where we presented that when following RR 17 goodwill should be impaired first, and if the need to impair remains you then impair the assets which goodwill has been assigned to. BE says that they follow this procedure when they impair.

If you have goodwill you impair it first. If the need to impair remains you have to impair the assets as well...when it comes to goodwill and you cannot defend the fair value then you have to conduct a detailed calculation for every unit.

BE explains that there is a lot of calculating involved and stresses the importance of being consistent when conducting these calculations since there are many different methods and models for these calculations on the market. He explains that they have to make a valuation of all tangible and intangible assets and then compare the value to the price paid in acquisition. If they get a negative difference, it is goodwill and a positive difference is negative goodwill. When asked about the difficulties in performing these calculations BE said; "It is not more complicated than that, just a lot of counting".

In the financial report of 2007 we found an impairment of goodwill of 158,9 MEUR which was the result of selling a subsidiary.

5.2.5 Indicators (Stora Enso)

The indicators used are the internal and external factors specified in RR 17 that we have presented in the core concepts. According to BE they do not use any indicators outside the ones presented in RR 17. "We make an impairment test every year, every third quarter of a year, if there are no unexpected changes in the indicators". BE says that one important and frequently used external factor which is of important for Stora Enso is the market value. In some areas of production they have assets with an active market, and in those cases they can look at the market value of the asset. If the asset does not have a market value they have to look at other external factors such as changes in the interest rate. He explains that a drastic change in the interest rate can be a triggering factor for the company to conduct a new impairment test. "In the model we use we know which parts that are essential; the price of the product if it has a market value, price changes of essential raw materials and the discount factor".

5.2.6 Recoverable Amount (Stora Enso)

BE states that their is no clear market value for a paper mill, mainly because the plants are often located in more or less designated areas and it is difficult to find a buyer for these plants. Therefore when conducting an impairment test they calculate the value in use and use it as the recoverable amount. BE explains that;

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114 Internationell redovisningsstandard i Sverige (2007) IFRS/IAS p.466
When valuing a paper mill, there is no fair value less cost to sell... then you have to go out to the market and ask who is interested in buying a plant for four billions, it does not work since there is no given market. If you have a real estate company there may be a market price and an active market in the area, production equipment located in uninhabited areas do not have a market, it is as simple as that.

BE states that they follow the traditional method of using WACC when calculating the value in use. "We use the risk free rate by looking at 10-year long obligations, we use it as a base and then we add a risk and calculate it in a ordinary way, we look at the long term equity" He explains that different areas of production can be assigned with different risk factors, and therefore the risk premium in the WACC-model can differ between different assets.

Looking at the financial report of Stora Enso for 2007 we found that in order to calculate the value in use the company used a discount rate between 8,5-11,8%. They used a discount rate before tax. The percentage used varied depending on where in the world the different areas of production were located. The company's average WACC in 2007 was a cost before tax at 9,1%. 116

BE explains that "internal fuss" in the company can sometimes be a problem that occurs when someone does not want to impair. An easy way of hiding a need to impair is to change the discount rate and BE says that changes in the discount rate are sometimes implied by colleagues making comments such as; "can you not change the discount rate". However BE stresses that when you have the responsibility and a principle you stick to it. Further he points out that;

There are always possibilities to fibble with these things, the ones appointed with an operational responsibility or management who do not want to impair do always have opportunities to conduct, it is the art of bookkeeping. However in practice the frame of accounting rules is followed.

5.3 Boliden

Boliden is a Swedish mining and smelting company, founded in 1932. At the moment of writing, the corporation has about 4500 employees around the world. They mainly produce; lead, gold, zinc, silver, gold and copper.

The respondent Ragnvald Jonsson, is currently in charge of accounting and taxes and he reports directly to the CEO. He has worked within the corporation since the early 70s and he therefore knows the company very well. He has studied business at university level, however he has no degree in business.

5.3.1 Goodwill (Boliden)

RJ explains that when establishing goodwill, the price of metal (the two main important metals for Boliden are zinc and copper) on the market and the foreign exchange market are the most important factors. "They are very steering for us and for the assumptions we make". Just as Stora Enso they also look at the long-term trend price when estimating future cash flows. Calculations are then made in order to determine the future cash flows for each cash-generating unit. The board of directors determines the guidelines for the calculations.

RJ explains that there are no problems in estimating future cash flows. He means that the metals that Boliden provides are something that the world would not manage a day without

even if people do not reflect about the importance of these metals "nobody thinks about this, but that is the way it is".

Further he argues that in most countries the infrastructure is built from these metals. He says that as the development in China and Asia is taking speed the demand for metals is going up, and the prediction of future consumption is what determines the future cash flows. He explains that Boliden is operating on a market which has high volatility of prices and that has to be considered when estimating future cash flows, however he says that these predictions are not that difficult to make. During the last years prices of metals have increased. "Five years ago the price of copper was 2000 dollars and today it is up at 8000 dollars, and actually the prices of all metals has increased the last couple of years". RJ points out the importance of predicting the future changes in prices.

5.3.2 Dividing Goodwill among Cash Generating Units (Boliden)

When it comes to goodwill it is allocated to the business area smelting plant because it is there the synergies from goodwill have been identified. "The goodwill which we have, we have allocated it at a business area level because of the synergies". He says that examples of different cash generating units in Boliden are different areas of production. RJ does not identify any problems related to dividing goodwill between cash generating units, or in the case of Boliden between business areas. He says that this is made together with the acquisition analysis when an acquisition is made.

5.3.3 Cash Generating Units (Boliden)

RJ states that because of the organizational structure of Boliden there is no problem identifying different cash generating units. "The company compounds of a number of mines and smelting plants, these are independent units and therefore also separate cash generating units". He explains that each unit generates its own cash flow and says that it is obvious, because at Boliden they have independent operations in form of independent smelting plants. The plants are generating the company's cash flow and therefore there are no difficulties in determining the cash generating units.

5.3.4 Impairment (Boliden)

RJ points out that since the new recommendation came into use they have not impaired goodwill. "In line with the new accounting principles we have stopped to write down goodwill, it is were it is and changes a bit together with the changes in currency rates". He emphasizes that if there, contrary to expectations would arise a need to impair then they would impair goodwill.

RJ explains that the present value is compared to the carrying amount when testing the need to impair. "We calculate future cash flows, and calculate the present value of them by using a discount rate". Then if the fair value is higher that the present value calculated using the discount rate, then they conduct impairment. "Now I have this unit which is worth this much, and then I compare it to the fair value and if the fair value is higher than the present value, then we impair".

RJ adds that he thinks that the new accounting principle concerning goodwill is somewhat strange. He explains that recessions in the economy will strike even harder against companies as a result of the new recommendation handling impairment of goodwill;
What we will see now if the economic cycle changes into recession is that there will be big strokes when one is forced to impair goodwill instead of writing down linearly during 10-20 years...the need to impair will increase, not for us but if you look at all the companies, the amount of bankruptcies will increase.

RJ thinks that the new accounting principle concerning goodwill would be a disadvantage for many companies in an economic recession. He thinks that it was easier to handle impairment of goodwill before this new recommendation came into use, and he says that the consequences of following RR 17 will be shown in the future.

We could see in the financial report of 2007 that the goodwill which the company had 2007 came mainly from the synergies of acquiring the subsidiary Outokumpu in the end of 2003, and there was no need to impair in 2007.117

5.3.5 Indicators (Boliden)

If no special circumstances provide they make an impairment test once every year, using the indicators specified in RR 17. "If something dramatic happens we make an impairment test more frequently, however it is very rare and in practice it is enough to do the test once every year". He says that they use the indicators presented in RR 17 and points out that increased market interest rates and the market price of metals are specifically important indicators for Boliden. These indicators are important parameters in the estimations they make and they are included in the yearly budget and strategy. Further he explains that it is important to observe potential changes on the market.

5.3.6 Recoverable Amount (Boliden)

RJ says that the recoverable amount equals the value in use. They calculate the recoverable amount as the value in use. They do not use the fair value less cost to sell, because there is no active market in order to calculate this value. "Fair value does not exist in our line of business, it is not an option". He says that the only time they would use the fair value less costs to sell would be if they had plans to sell a mill and if they then had any indications of what the market would give for the mill. In the smelting and mining industry the future cash flows are deciding the value in use and thereby also the recoverable amount. "I am sure that the fair value less costs to sell is used in other lines of business, however in the mining and smelting industry only future cash flow estimations are used as the recoverable amount".

Appreciating the cost of capital, using the WACC-model, makes the calculations. A discount rate of 12% weighed capital cost is used. Further the discounted cash flows less tax are then compared to the carrying amount. According to RJ the last conducted impairment test showed that there was no need to impair at the end of the financial year 2007.

In the financial report for 2007 we can see that Boliden used 10- year long-term obligations and as RJ also explained, they used as discount rate of 12% before tax.118

RJ means there are no direct problems when conducting these calculations because as long as the right model is used. The estimations included in the model are based on assumptions. "These assumptions are subjective judgements but I have never experienced problems with the estimations, nor problems in getting support from the auditors".

118 Ibid p.78
5.4 Lindab

Lindab is a Swedish corporation operating in the steel industry. The company was founded in 1956 and the corporation has 5000 employees around the world at the time of writing.

The respondent Svante Gustavsson, which has a Master in Business, has worked as Management accountant for a subsidiary and he has also worked as a controller at the head office in Sweden. He was working for 3 years as management accountant and six months as a controller for Lindab. At the moment of writing he has his own consulting company.

5.4.1 Goodwill (Lindab)

When identifying goodwill, they look at the synergies from company acquisitions. "The subsidiary in US acquired a unit and of course this discussion concerning goodwill arose". The synergies from acquisition are based on future profits in the profit and loss statement. These estimations can be difficult to make and therefore they look at what would be historically reasonable when conducting future estimations. "There are big factors of uncertainty concerning goodwill, so of course we have to look at what is historically reasonable".

SG explains that there are some problems when calculating the estimated synergies from the acquisition of a subsidiary. He means that the estimated synergies are something that is non-existing, and will not be realised until after the acquisition. He explains that even when spending a lot of time and effort in estimating these future synergies, they cannot be sure that the estimations will be correct.

He gave us an example to illustrate;

| There was a quite high factor of uncertainty, we had to take into consideration different kind of savings in purchase and we saw almost immediately that we could purchase plate cheaper and that the savings in purchase were quite sure...we were not sure about how fast we could start selling it and looking in the rear view mirror, the staff showed not to be as efficient as we had hoped and we had to turnover quite many of the staff. |

SG means that is difficult to estimate all of the factors that can affect the future synergies and thus the size of goodwill. The company has to estimate the future synergies keeping in mind the level of uncertainties that is included in the calculations.

5.4.2 Dividing Goodwill among Cash Generating Units (Lindab)

SG explains that Lindab has two big areas of business. One is profile that produces components for the construction sector. The other one is ventilation that produces systems for ventilation. Each business area has different units of production. Goodwill is divided between these areas of production.

In the financial report for 2007 we can see that the goodwill which Lindab had 2007 stemmed from the synergies of acquisitions of subsidiaries and there was no need to impair in 2007.119

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5.4.3 Cash Generating Units (Lindab)

SG says that different areas of business are usually identified as different cash generating units. He explains that the assets are divided into groups at the lowest possible level, which is a cash-generating unit. Calculations are made for each business area separately, when needed they even conduct calculations at lower levels of the organization. The business area ventilation has a separate calculation for US. "They calculate the future cash flows by using their own model". He explains that the different areas of production are strongly integrated and functioning as a unit, and therefore it is unusual to conduct the estimations at lower levels of the organization than at business unit level.

SG says that there are difficulties when forecasting the amount of sales that the different business units generate, and there can be fluctuations in the payments from customers. He says that it can strike hard against the planning if a big customer does not pay in time.

5.4.4 Impairment (Lindab)

SG points out the importance of indicators when estimating an impairment loss. If all indicators show that the forecasted estimations of future cash flow are too high, then there most certainly is a good reason for impairment. SG says that when deciding a need to impair, they often base the decision on historical data. "We look at what the 12 month prognoses and all indicators in the historical data show". The barometers for recessions have to be taken into account as well. He says that the market price of steel is very important for Lindab to include in the calculations when looking for an impairment need. He says that when impairing goodwill they first in accordance with RR 17, impair goodwill, then if the need to impair remains, they impair the assets to which the impaired goodwill is assigned. He stresses that his answer concerning impairment might not be 100% representative for Lindab because he has not been in full contact with the corporation level, but been a Management Accountant for a subsidiary.

He says that the advantage with the former method of writing down was that goodwill was written down over time until it eventually disappeared. He gave us an explanation;

Take the internet boom as an example; gigantic companies were bought for gigantic amounts of money, with extremely high risks and looking at the results presented before and after writing down goodwill there could be enormous differences…on one hand there was a clarity in it, you knew that goodwill was written down each year but I do not mean that it was always better because sometimes there was no real need to write down goodwill.

SG says that if everyone would follow the frame of principles accurately, then the new method of impairing goodwill would be great. He means that some might want to impair because of tactical reasons in order to decrease the result one specific year. "If the arbitrariness was removed…if there was an unambiguous model for how to handle the valuation it would be better".

5.4.5 Indicators (Lindab)

At Lindab they use the internal and external indicators presented in RR 17 as indications for the need to conduct an impairment test. SG especially specifies economic cycles and the price of raw material to be important indicators for Lindab. The indicators are formally checked once every year as long as the company shows stable profits. He argues that if a company shows good profits there is seldom a need to discuss impairment of goodwill. Whenever profits are decreasing, these factors are checked for more frequently, as each quarter of a year
or even every month, depending on surrounding factors. When they look at those surrounding factors, discussions are made concerning the potential future risks of the company.

### 5.4.6 Recoverable Amount (Lindab)

The recoverable amount used is the value in use. They do not use the fair value less cost to sell because there exists no clear active market in order to estimate the market value of the company or the assets. According to SG they use the WACC-model when estimating the value in use, he says that when looking at how other companies calculate the value in use he has found that others also use the WACC-model.

The discount rate they use is 10.5% before tax and the period of forecasting is five years when calculating the value in use. The value in use for 2007 with the given preconditions, did not result in a need to impair goodwill.

In the financial report for 2007 we can see that Lindab used a 10.5% discount rate before tax with a period of forecasting of five years.120

### 5.5 Atlas Copco

Atlas Copco is a Swedish Industrial company. The company was founded in 1873, and has at the moment of writing around 33,000 employees. The company develops and manufactures industrial tooling and equipment.

The respondent Johanna Tesdorpf works with acquisitions of subsidiaries and she has a degree in business. She has worked for the company since 2000.

#### 5.5.1 Goodwill (Atlas Copco)

The goodwill that Atlas Copco has comes from the synergies of acquisition. When they acquire subsidiaries they have the ambition to integrate the subsidiaries substantially in the corporation, the subsidiaries should not belong to a separate unit but be a part of the entire operation. JT means that they acquire companies for a reason and the reason is that there are synergies between them and the acquired unit. JT says that when estimating goodwill they estimate future cash flows meaning that they estimate how sales and costs will develop in the future.

#### 5.5.2 Dividing Goodwill among Cash Generating Units (Atlas Copco)

JT explains that when acquiring a company that they divide between different divisions they try to divide goodwill in the same way. When acquiring a company they look at where all the different parts of the acquired subsidiary belong. She explains that if all the parts of an acquired company can be assigned to the same unit then it is simple because goodwill does not need to be divided. "When the acquired company is divided between different units, we also divide goodwill, trying to understand how big part of goodwill that belongs where".

#### 5.5.3 Cash Generating Units (Atlas Copco)

JT states that the cash generating units are equal to the different divisions at Atlas Copco. Atlas Copco has three different areas of business and within every area of business there are a number of divisions, and these divisions are the company's cash generating units. She explains that they do not identify cash flows at lower levels than the divisional level. She

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means that it depends on that they integrate their companies so much that they cannot do follow ups at lower levels.

She does not see any problems with identifying cash generating units. "No there are no problems, this is how we work and the auditors are agreeing with us. There are no problems".

5.5.4 Impairment (Atlas Copco)

JT says that each year when they conduct impairment loss tests they do a valuation of each division, since the divisions are their cash generating units. These valuations are made in order to see if there is a need to impair or not. They have a model that is updated every year, and usually most of the divisions stay the same. Last year they acquired the subsidiary Byopack, which now is a cash generating unit on its own because is an own division.

JT explains that they conduct an impairment loss test each year in September. A couple of years ago they made a big impairment because of a big acquisition made in US when they acquired Rental service that became an own business area. They acquired it during the years 97, 98 and 99 for a lot of money, but because of the market situation they had to make a huge impairment.

"I think the impairment was conducted in 2004". Apart from that impairment, she says that they have not conducted more than small impairments of goodwill. These impairments have been conducted for various reasons, such as when units have been moved or shutdown. She says that at the moment the economic situation looks good and therefore there is no need to impair;

Now we are experiencing a time with enormous growth and profitability, there has not been much need for impairment but now we will see what happens in the future, if the situation changes and if we are faced with an economic recession.

When impairing, they impair goodwill first and if the need to impair remains then they impair the cash-generating unit which goodwill belongs to. She refers to the procedure as being "just a book keeping technique". Further she point out that at Atlas Copco they follow accounting rules and regulations.

In the financial report for 2007 we could see that the calculated recoverable amount was higher than the book value and therefore no impairment was conducted121.

5.5.5 Indicators (Atlas Copco)

JT means that at Atlas Copco they look at all of the indicators presented in RR 17. She says that they investigate all of those factors. Once every year they make a thorough analysis of the company where they estimate the future and then all of these factors are included. She explains that the company's planning processes include an analysis of the surrounding environment as well as an internal analysis of the company. Apart from what RR 17 recommend they also use the company's own planning processes when estimating the need to impair in the future.

5.5.6 Recoverable Amount (Atlas Copco)

The recoverable amount used is calculated as the highest of value in use and fair value less costs to sell and is calculated once a year. Once every year they let the divisions update their prognoses for their operation and then they make a valuation. These valuations then show whether there is a need to impair or not.

JT means that when calculating the value in use they use the WACC-model, and they use the same discount rate on all of their cash generating units. She explains that the capital structure and the cost of capital is not the same for all units but;

It would be very complex if we would decide different costs of capital for different units, we have said that in order to avoid these problems we use the compounded group's cost of capital, we use it for all acquisitions.

Looking at the financial report for 2007 we could see that Atlas Copco used a 11,8% discount rate before tax, with a period of forecasting of five years\(^{122}\).

JT says that when calculating the fair value less costs to sell they follow the same procedure as when calculating the recoverable amount. Meaning that they let the different divisions make new prognoses for their operations and then they make a valuation.

6. Analysis

Our analysis connects to our research approach where we explained that we were going to combine our knowledge gained from our central concepts with the knowledge generated from our empirical findings in order to get a comprehensive picture of the impairment procedure of goodwill. In the following section we present our analysis. We use the same thematic order as in the central concepts and the empirical findings. However the thematic order will not be as strict as in the previous chapters since some conclusions drawn are based on connections between different themes.

6.1 Goodwill

Two of the respondents told us they identify problems when estimating goodwill. BE said that the problems arise because the model that they use when estimating goodwill is quite detailed, he explained that there could be difficulties when estimating the components used in the model. When calculating how much sales that will generate from an acquisition it is not difficult to conduct calculation however it is quite complicated to implement them in reality. When acquiring companies, everything needs to be valued based on market prices for example patent right which are valued and depreciated. At Stora Enso they seem to think that acquisitions are complicated matters and therefore they chose to outsource the valuation process when they acquire companies. Remember from the theory where we presented that the estimations of present cash flow derived from goodwill vary together with estimations of risks and the time value of money. It can be difficult to estimate the potential risks that the company might experience in the future. The future demand of a company's products can be hard to predict accurately and hence the sales are difficult to predict. This difficulty to predict the future is probably one of the reasons for companies to outsource such kinds of calculations, in order to avoid subjective estimations. Further we believe that in some cases the auditors recommend or even require an outsourcing of these activities in order to ensure objective estimations.

At Stora Enso there seems to be no problem dividing goodwill between cash generating units. When dividing goodwill among different units, it is the unit that gets the increased synergies that will end up with goodwill. In other words goodwill is assigned to the units where the synergies from the acquisition are anticipated which means that goodwill can be assigned cross different areas of production. This procedure is well in accordance with the concepts we have presented. BE stresses that there is no problem in dividing goodwill between cash generating units however we think that this procedure should be handled carefully. It is important to assign goodwill to the part of the operation where the synergies from acquisitions will be shown in the future, in order to decrease the risks of impairing goodwill in the future. In order to secure reliable estimations it is crucial to have a good knowledge of the company as well as the market that it operates in. For instance if a company faces a recession which turns out to be deeper than expected the future synergies may as a result be lower than expected and a need to impair goodwill might arise.

The most central aspects for Boliden when determining goodwill, is the price of metals and the foreign exchange market. The main metals that Boliden provides are zinc and copper. RJ emphasis that these factors are crucial for the assumption they make when estimating goodwill. They are a base for calculating the future cash flows. Boliden is operating in a volatile market, which is important to consider when estimating future cash flows. In the

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moment of writing we are experiencing a severe financial crisis; as a result the prices of metals have decreased rapidly in the last months.

We believe that if the prices of metals will continue to decrease the actual decrease might be larger than Boliden predicted. This could lead to a lower result than expected and the need to impair goodwill might arise. In the moment of writing the Swedish krone has depreciate against foreign currencies such as the Euro and the Dollar. In a financial crisis a small country such as Sweden is usually affected by a decreasing currency. The price of metals and the foreign exchange market which are the most important factors for Boliden when estimating future synergies are affected by the financial crisis. We think that these factors in combination may be severe enough to enforce an impairment of goodwill in the future. However the reader has to be aware of the fact that these are the authors’ predictions, in reality Boliden might have foreseen the financial crisis and therefore also forecasted the changes in these factors in an accurate way. We will be able to see the real effect in their future financial reports.

In Boliden goodwill is assigned to the business area smelting plant. Just as we presented in our central concepts RJ states that the reason is that the synergies from goodwill have been identified there. RJ can not identify any problems when dividing goodwill between cash generating units. Since they started to apply RR 17 they have not impaired goodwill but of course they would impair if necessary. As we wrote above, we suspect that a need to impair might arise in the future as a result of the financial crisis.

As the other respondents and in line with our central concepts SG explains that they look at the synergies from acquisitions when estimating goodwill\textsuperscript{124}. SG means that there are difficulties when estimating goodwill since there is a large factor of uncertainty in the estimations. In order to reduce the uncertainties they look at what is historically reasonable. The synergies are non-existing at the time of acquisition but will be realized in the future\textsuperscript{125}. Even if they spend a lot of time conducting these estimations they can not secure an accurate estimation since it is difficult to foresee all the factors that need to be taken into consideration when estimating the synergies. We have to keep in mind that when we conducted the interviews SG was no longer working for Lindab, he quit a year after the new recommendation came into use. Therefore he does not have the same insight in the procedure of impairment in Lindab as the other respondents have in their companies. Nevertheless he has a lot of knowledge about the impairment procedure of goodwill and he worked for Lindab during many years so we decided that his answers are relevant for our study. Lindab provides the construction industry with materials, the authors believe that due to the financial crisis the construction industry is faced with decreasing orders and as a result decreasing profits. The opinion of the authors is that Lindab is negatively affected by the financial crisis that might result in a need to impair goodwill in the future.


\textsuperscript{125} Internationell redovisningsstandard i Sverige (2007) IFRS/IAS p.462
Lindab has two large business areas that they divide goodwill between. Those are profile, which manufactures components for the construction sector and the other one is ventilation that manufactures system solution for ventilations. Compared to our core concepts we find it correct to treat these business areas as separate units as long as the cash flows from each of these units are independent and separable from each other126.

When calculating the size of goodwill Atlas Copco predict how costs and sales will evolve in the future. JT explains that the goodwill they have at Atlas Copco comes from the synergies of acquisitions. They try to integrate their subsidiaries as much as possible in order to make them a part of their operation. She emphasizes that synergies are the reason why they acquire subsidiaries. This seems to be in accordance with our core concepts that explain that a synergy effect will arise whenever the value of a business combination is greater than the value of the companies separate from each other127. For the authors it appears very logical that a company acquires another company because they estimate a positive synergy effect in the future.

Regarding how goodwill is divided among cash generating units (different divisions in Atlas Copcos case ) JT states that sometimes goodwill can be assigned to only one unit and in those cases it is easy since then goodwill does not have to be divided at all. In those cases where they divide the acquired company between different units they also have to divide goodwill and estimate how much of goodwill that belongs to which unit. For the authors it seems to be less complex to treat acquired subsidiaries as separate units since they then avoid the procedure of dividing goodwill between different units. On the other hand the authors think that it might conflicts with Atlas Copcos operational guidelines to treat subsidiaries as totally separate units since they want to integrate their subsidiaries as much as possible.

When comparing the answers from the respondents, we found that two out of four identified problems concerning the estimation of goodwill. The problems seem to arise because of difficulties to estimate the size of the potential future synergies. Looking at the different branches that the companies operate in, we can see that that all four companies are sensitive to changes in the economic cycle. When comparing between the companies, all four companies are looking at the long-term trend prices when establishing goodwill. The uncertainty of the changes in the economic cycle might be one reason to why the synergies are difficult to estimate. When looking at the long time trend, the companies can only speculate and try to estimate how deep a recession will be or how strong a booming will be, and the economic cycle of course influences the size of the synergies.

As we explained in the central concept, one company acquires another company if they estimate that there will be positive synergies from the acquisition in the future128 However the authors mean that the size of the synergies can be difficult to estimate and there is a risk of being forced to impair goodwill in the future if a company overvalues the size of goodwill today. Impairing goodwill affects the result of a company negatively at the same time as it sends out bad signals to the shareholders, hence impairing goodwill usually has a negative effect for companies. The authors mean that as long as a company's management has a long-term focus they should supposedly have very small incentives to overestimate the size of goodwill since an overestimation today increases the risk of impairing in the future.

128 Ibid p.641
6.2 Cash Generating Units

From the core concepts we know that a cash-generating unit is; "the smallest identifiable group of assets that generates cash inflows which are largely independent of the cash inflows from other assets or groups of assets".\(^{129}\)

There are differences in how the companies identify their cash generating units. RJ explains that in Boliden each smelting plant and mine is a cash-generating unit. He means that because of the organizational structure of Boliden there are no difficulties in determining the cash generating units. The authors mean that the units at Boliden are generating cash on their own and therefore it seems to be reasonable to identify them as cash generating units if we look at the definition in RR 17.

Also in the other three companies cash generating units are identified as different areas of production. BE says that they have the criteria that each unit should be independent but at the same time have an influence on the entity. According to the central concepts; the operation payments should be tied and established for the unit and separated from other units, we find this to be valid for Stora Enso. BE mentions that the auditors sometimes want a deeper reasoning than that the unit is independent but has an influence on the entity. The auditors seem to take more aspects than the definition of a cash generating units in RR 17 into account when identifying cash generating units. They want to know the sales of the company and how the market works. Looking at these demands of the auditors it seems that it can be quite complex to identify cash generating units in some cases, especially since there are indications that some auditors find RR 17 to be insufficient when determining cash generating units.

Both JT and SG say that the different areas of production are used when identifying cash generating units. However in Atlas Copco they take it one step further since each business area compounds of a number of divisions and each division is a cash-generating unit. They integrate their companies to a large extent, and therefore it is not possible to identify separate cash generating units at a lower level than the divisional level, the auditors are according to JT agreeing on this point.

For the authors it appears that in order to be in agreement with the auditors it might be an advantage if the cash generating units are broken down further than to business area level. This is what Atlas Copco does, and their auditors seems to be more convinced about this method, compared to the auditors at Stora Enso.

The authors mean that when establishing cash generating units, the organizational structure of a company seems to be crucial. When following the definition in RR 17 companies have to identify which parts of the organization that generate inflows independent of inflows from other units, and it depends on the structure and organization of the company. None of the four respondents seem to find it hard to identify their cash generating units. It all depends on the companies’ organizational structure. The conclusions we draw are that in order to determine cash generating units the organizational structure of a company is crucial together with the mindset of the companies’ auditors. The authors suspect that the demands of the auditors concerning the requirements for establishing cash generating units may vary significantly between different auditors as well as between different companies. Some auditors may find the recommended requirements in RR 17 to be sufficient while other may demand a deeper reasoning. The authors mean that the requirements from the auditors are probably linked to

the auditors risk assessment for a specific company, if the risk is estimated to be high then the requirements of a deeper reasoning would also increase.

6.3 Impairment

The impairment test of goodwill used today (RR17) gives a more appropriate view of the reality compared to the amortization used earlier. The value of goodwill is tested each year and only reduced when the book value is higher than the recoverable amount, instead of the previous straight-line amortization used to reduce the value each year. The opinions about the new recommendation differ between the respondents.

BE explained that Stora Enso made impairment during 2007. Remember from our core concepts where we explained that investors consider impairment of goodwill as an expensive matter since it indicates that the acquired company was worth less then estimated. We want the reader to observe that in this case the impairment was conducted because they sold a subsidiary and not because goodwill was overestimated.

RJ thinks the new way of impairing goodwill has some disadvantages compared to the former praxis. He means that the new recommendation will force companies to make big impairments in economic recessions and he thinks that the amount of bankruptcies will increase. He also mentions that the old way of treating goodwill was easier to handle. He explains that the effect of the new recommendation will be shown in the future. The authors agree with RJ because the new recommendation has only been in practice when the economy has been in a boom and therefore companies have not yet been forced to impair goodwill and they have therefore not experienced the negative effects (in form of big impairments effecting the result of the company negatively) of the recommendation.

SG says that there are several things that need to be taken into consideration when looking for an impairment need. One thing is, if the forecasted estimations of future cash flows are too high since they base their decision on historical data. Barometers for recessions have to be taken into account and also the market price of steel. He also emphasis that some might want impair because of tactical reason in order to decrease the result one specific year. The authors mean that in accordance with the prudence concept the investors rather receive a lower result that is realistic than an overestimated result that has to be corrected and impaired in the future. Further the author mean that boosting the result one year only to correct it in the future is a short-term focus, which affects the company negatively in the long run and can be avoided to some extent by using bonus programs for managers which are based on long term performance.

JT explains that the economy has experienced a time with enormous growth and profitability, and therefore there has not been much need for impairment. She said that we would see what happens in the future when we are faced with a recession. The authors mean that the number of companies forced to impair goodwill will probably increase as a result of the financial crisis and the reason is that the estimated future cash flows will be lower than expected.

When looking at the four companies financial reports we could see that one of the companies had impaired during 2007, however the impairment was the result of selling a subsidiary. The

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131 Nilsson, Redovisningens normer och normbildare (2005) p. 35
reader should keep in mind that in 2007 the economy was still in a Boom, however during 2008 the economy suffered a severe crisis and in the moment of writing we are in a deep recession. RJ emphasized that in a recession many companies will have to impair and it will increase the number of bankruptcies. The reader should observe the fact RR 17 has been applicable from 2005, and during the years the economy has consistently been in a Boom. Usually companies have therefore not needed to impair goodwill. In the financial reports for 2008 and a couple of years ahead we will be able see the effects of RR 17 when the economy is in a recession.

The authors believe that companies will impair goodwill to a significantly higher extent during the next coming years. This will strike particularly hard against companies that are sensitive to changes in the economic cycle. Many companies might experience decreasing sales, decreasing growth and together with a big impairment of goodwill it might lead to a critical economic situation for several companies. On the other hand an impairment of goodwill in an economic recession shows the fair value of goodwill to the shareholders compared to the old recommendation that meant writing goodwill off on a linear basis over a curtain number of years. Was the old recommendation of a better meaning in a recession? Some may argue that the former recommendation made it easier for companies to survive a recession, on the other hand, the old recommendation did not show a fair value of goodwill since it was written of on a linear basis. The new recommendation is clearly more in accordance with the concept true and fair view. Because it shows the fair value of goodwill since goodwill is only impaired when an impairment loss in reality is discovered and not on regular basis.

Even though our choice of companies was to get a diversified sample of companies, the impairment of goodwill seems to be similar for all these companies. We can conclude that the responding companies follow the recommendation in RR 17 and that only one company, Stora Enso made impairment during 2007.

6.4 Indicators

Recall our core concepts where we presented that according to RR 17 companies should annually look for indicators of impairment loss. In our core concepts we presented the internal as well as external factors that according to the standard usually are of importance for companies when they estimate the need to impair.

BE says that usually they look for indicators once every year in accordance with the standard, however there are factors which can make them look for the need to impair more frequent. For assets which have an active market and therefore a market value, significant changes in the market value of these assets are treated as a signal to look for the need to impair more frequent then once every year. For assets that do not have a market value, significant changes in the interest rate are used as an indicator to conduct the impairment test more often than once every year.

The company operates in the magazine papers and newsprint's industry and the authors think it seems reasonable that changes in market value of assets and the interest rate are important indicators for a need to impair at Stora Enso.

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132 Nyllinge P, Winkvist M, "Ny rekommendation avseende nedskrivningar ställer stora krav på värderingar" Balans No 11 2001 p.15
RJ explains that they follow the guidelines in RR 17 when looking for indicators of the need to impair. The most important factors for Boliden are the interest rate and market price of metals. He says that if something dramatic happens they conduct an impairment test more than once every year. Since Boliden is a mining and smelting company producing metals it is quite obvious to the authors that the market price of metals that is volatile and sensitive to changes in the economic cycle, and the interest rate are important indicators for the company.

SG says that Lindab is very sensitive to changes in the economic cycle and therefore it is a very important indicator for the company, together with the price of raw material. As long as the company shows stable profits they conduct an impairment test once every year, but more frequent whenever profits are declining. Lindab operates in the steel industry so the authors mean that it is logical that the price of raw material is crucial for the company. Since the price of steel usually decreases in an economic recession it is further reasonable that the economic cycle is an important factor for Lindab.

JT does not point out any specific main indicators that are especially important for Atlas Copco. However the authors believe that probably there are factors that are more important than others when estimating the need to impair in Atlas Copco. Looking at the nature of the company they provide machines for the construction market, a market that is very sensitive to economic cycles since it suffers from decreased orders during economic recessions. We therefore estimate that the economic cycle is an important factor for Atlas Copco, together with interest rate risks since even small changes in the interest rate can have a significant impact for such a big company as Atlas Copco.

All four respondents say that they follow RR 17 and use the indicators presented in the standard. However for Boliden, Lindab and Stora Enso the indicators are more or less important for the companies because these companies operate in different business areas and are therefore faced with somewhat different risks. We were somewhat surprised that the respondent for Atlas Copco did not identify indicators that were more significant for the company then other. However maybe the purpose was to stress that they take all of the indicators into consideration and make a thorough analysis even though some indicators might be more crucial for the company than others.

We believe that the economic crisis we are experiencing at the moment of writing is a reason for the companies to look for indicators more often than once every year. SG clearly stressed that changes in the economic cycle are of great importance for Lindab when looking for indicators. The companies are operating in different areas, however the indicators which are influencing their need to impair, such as the price of materials and the interest rate are strictly linked to the changes in the economic cycle. The economic recession will have an impact on the indicators used by the companies as well as all other indicators presented in RR 17 and we assume that those changes will influence the companies to look for indicators of the need to impair more frequent than once every year. All four respondents mentioned the fact that there sometimes are reasons for looking for the need to impair more frequent than once every year, such as when profits are decreasing or if something dramatic happens. We mean that the economic crisis is severe enough to be refereed to as a dramatic happening and further it will result in decreasing profits for many companies.
6.5 Recoverable Amount

We want to remind the reader that; "The recoverable amount is defined in our core concepts as the value which is estimated when a need for impairment loss is indicated. The recoverable amount it established as the “highest of; value in use and fair value less cost to sell.” When one of these two values is higher than the assets carrying amount, the asset does not need to be impaired. Hence it is not necessary to calculate both the value in use and the fair value less cost to sell, if one of them is higher than the assets carrying amount."133

The respondents for Stora Enso, Boliden and Lindab explained that in their line of business only the value in use is calculated and used as the recoverable amount. The reason is that there does not exist any clear or reliable market value for the mills and plants of these companies. Only JT says that at Atlas Copco they calculate both the value in use and the fair value less cost to sell.

All four respondents say that they use the WACC- model when calculating the value in use. BE highlighted the fact that when someone does not want to impair, they can change the discount rate used in the WACC- model in order to get a more favorable result. However he stressed that when they have set a principal regarding impairment they stick to it and generally accounting rules are followed.

RJ mentioned the fact that the discount rate is based on subjective estimations, however he emphasized that he never experienced any problems connected to the estimation of the discount rate. Further he said that they have always gotten support form their auditors concerning these estimations.

SG explained that when looking at how other companies in their line of business calculate the value in use, he has found that other companies also use the WACC-model.

JT says that at Atlas Copco they use the highest of value in use and the fair value less cost to sell when establishing the recoverable amount. According to JT they use the same discount rate for all cash generating units even though the capital structure and the cost of capital is not the same for all units. She explains that it would be too complicated to set different costs of capital for different units.

JT argued that in order to calculate the fair value less costs to sell for the different divisions, they perform prognoses for their operation and then they estimate the value of the assets with the help of these prognoses.

Since the four companies operate in different areas of business their components in the WACC model differ because of the different capital structures of the companies. There are several ways for companies to change the result calculated with the WACC- model and still be within the lines of accounting rules. Companies can change which discount rate they use, they can change their capital structure, meaning the debt to equity ratio. If the proportion of debt increases, the discount rate can be lowered everything else equal. Such actions can be used to achieve a favorable result and these methods are not prohibited. However the risk factor included in the WACC-model should be based on realistic assumption and using the same WACC for different division of a company may be inappropriate if the risk level differs.


significantly between the divisions. Only at Lindab they use different discount rates for
different divisions. On the other hand it is much more complex and time consuming to
calculate different risks for each division and the risk level might differ so little that at
Boliden, Stora Enso and Atlas Copco the benefits might not exceed the costs of conducting
such complex calculations. Further we mean that the discount rate partly is a matter for the
auditors and that they would react if they thought it was unrealistically estimated.

The authors believe that the economical crisis might increase the risk level of these companies
since they operate globally and have a high amount of export. The crisis might force the
companies to increase the discount rate used in the WACC-model.
### 6.6 Impairment Procedure

In the table below we present a summary of the impairment procedure within each company.

<table>
<thead>
<tr>
<th>Industry</th>
<th>Stora Enso</th>
<th>Boliden</th>
<th>Lindab</th>
<th>Atlas Copco</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nature of the company</td>
<td>Forest industry.</td>
<td>Mining and smelting industry.</td>
<td>Steel industry.</td>
<td>Industrial company.</td>
</tr>
<tr>
<td>Goodwill</td>
<td>Mainly from acquisitions. It can be difficult to estimate the size of goodwill because the estimations are predictions based on historical data.</td>
<td>Mainly from acquisitions. No problems concerning the estimations of goodwill.</td>
<td>Mainly from acquisitions. There are problems connected to estimating the size of goodwill.</td>
<td>Mainly from acquisitions. No problems concerning the estimations of goodwill.</td>
</tr>
<tr>
<td>Cash generating units</td>
<td>At business area level; different areas of production are separate units.</td>
<td>At business area level; mines and smelting plants are separate units.</td>
<td>At business area level; each business area is a separate unit.</td>
<td>Breaks down business area level and threats the underlying divisions as cash generating units.</td>
</tr>
<tr>
<td>Have impaired since RR 17 came into use</td>
<td>Yes. Because they sold a unit/subsidiary. When impairing they first impair goodwill and then if the need to impair remains they impair the asset.</td>
<td>No. If they would impair they first impair goodwill and then if the need to impair remains they impair the asset.</td>
<td>No. If they would impair they first impair goodwill and then if the need to impair remains they impair the asset.</td>
<td>No. If they would impair they first impair goodwill and then if the need to impair remains they impair the asset.</td>
</tr>
<tr>
<td>Main important indicators</td>
<td>Market value and in those cases where a market value cannot be established, they look at the interest rate.</td>
<td>Market price of metals and the interest rate.</td>
<td>Economic cycles and prices of raw materials.</td>
<td>All indicators presented in RR 17 are important according to the respondent.</td>
</tr>
<tr>
<td>Recoverable amount</td>
<td>Only value in use, which is based on historical data and subjective estimations regarding the future.</td>
<td>Only value in use, which is based on historical data and subjective estimations concerning the future.</td>
<td>Only value in use, which is based on historical data and subjective estimations concerning the future.</td>
<td>The highest of value in use which is based on historical data and subjective estimations concerning the future and fair value less costs to sell which corresponds to the market value.</td>
</tr>
</tbody>
</table>

**Model 3. Impairment procedure of goodwill within each company**

**Explanation of the model**

The authors draw the conclusion that the impairment procedure of goodwill is similar between companies operating in different branches. The differences of the impairment procedure of goodwill that we were able to locate were related to the nature of the specific
company. Because of the unlike nature of the companies their operational structure differs and they are to a certain extent faced with somewhat different risks. In the table above we have tried to show the specific characteristics of the impairment procedure within each respective company and identified some differences in the nature of the companies.
7. Conclusions

In this section we will resume the discussion concerning our purpose of the study and present our main conclusions.

Main Purpose of the Study

The purpose of our thesis is to look at the impairment procedure of goodwill in different stock listed business combinations that apply RR 17. As an aid to reach our purpose we used four underlying questions:

How does goodwill arise?

In our study we have focused on acquired goodwill that arises when an acquiring company pays more when acquiring another company than the ownership equity it receives. The reason to pay more is that management estimates future synergies from the business combination.

How is goodwill divided between cash-generating units?

Companies assign goodwill to the units where the synergies (goodwill) from an acquisition are estimated to be shown.

How do stock listed business combinations in accordance with RR 17 estimate whether an impairment loss of goodwill exist or not, in cases where goodwill exists, how is it impaired?

In accordance with RR 17 companies calculate the recoverable amount and if the recoverable amount for a group of assets is higher than the carrying amount for the assets, than the company should impair.

In cases where goodwill exists a company first impair goodwill and then if the need to impair still remains they should impair the group of assets which goodwill was assigned to.

How is goodwill revalued and how often?

Goodwill is revalued by looking for indicators showing a potential need to impair. The indicators that are especially important for a certain company depends on which business area the company operates in and which risks are tied to the branch and the specific company. If there are no extraordinary circumstances goodwill is revalued once every year.

Remember our main purpose of the study that is; to look at the impairment procedure of goodwill in different stock listed business combinations which apply RR 17. The sub-questions are important in order to reach our main purpose because they give us a step-by-step description of the impairment procedure of goodwill. Looking at the impairment procedure of goodwill we can conclude from our study that companies follow the recommendation RR 17. However we could identify some other factors affecting the procedure, such as the branch that a company operates and the mind-sets and demands from the companies’ auditors. In the model below we show which parts of the impairment procedure that are affected by the companies’ branch and their auditors.
The left column of the model presents the impairment procedure of goodwill in accordance with RR 17. To a great extent the four companies followed RR 17 in more or less the same way, however we could identify some differences tied to the impairment procedure between the companies which we mainly believe depends on the fact that we chose companies operating in different branches. In the right column the identified differences are presented. Together with the recommendation RR 17 we have found that the nature of the company and the mind-set of the auditors are important factors influencing the impairment procedure of goodwill.
SUMMARIZING THE CONCLUSIONS

We have strived to get a comprehensive picture of the impairment procedure of goodwill by 1) Looking at the theoretical accounting recommendation RR 17 together with other relevant central concepts. and 2) by conducting interviews regarding the impairment procedure in order to complement our theoretical material with the respondents practical knowledge and experience.

We have found that the impairment procedure is generally in accordance with the recommendation RR 17. Further the mind-sets of the respondents seem to be that accounting rules and regulations are important to follow. The differences between the companies' impairment procedures are correlated to the different nature of the companies and to various requirements from their auditors. Since the companies operate in different branches they are also faced with different risks, and there are differences in their capital structure. We found the nature of the company to be significantly crucial for which indicators a company looks for when estimating the need to impair. The capitals structure of the company is important because it decides how the recoverable amount should be calculated. For example companies which have plants located in designated areas do not seem to calculate the fair value less costs to sell because there is no clear market value for their plants.

We do not get the impression that the respondents find the standard to be complex, however there are some indications supporting a statement that the standard may be somewhat insufficient concerning how cash-generating units should be established. Hence the auditors' opinions and requirements seems to be important when establishing cash generating-units because some auditors want a deeper reasoning concerning a company's cash-generating units.

The recommendation RR 17 is in accordance with true and fair view and is very beneficial for companies when the economy is in a boom and the need to impair is very low. However the respondents expressed a worry about applying the commendation in a recession because companies will have to impair to a greater extent than in a booming.

7.1 Suggestions for Future Research

Our study was performed during a peek in an economic boom, as a consequence the need to impair was very low. We think it would be interesting and relevant to perform a study concerning impairment of goodwill when the economy is in recession. A possible study could be to investigate whether RR 17 would increase the number of bankruptcies in a recession.

7.2 Criteria of truth

7.2.1 Credibility

The credibility of the research is dependent of how the researcher presents the material since a social reality can be described in many different ways. In order to ensure a high amount of credibility we let the respondents take part of the material we had collected during the interviews. The reason was that in the case of misunderstandings they would be discovered and corrected. Three out of four respondents wanted to look at our empirical material before we presented it. These respondents approved of the material and we thereby felt comfortable when using the collected material in our study. We can ensure the credibility of the empirical data based on the interviews with Boliden, Lindab and Atlas Copco. The credibility in our

study can also be highlighted by the fact that the respondents had a wide knowledge within
the subject, which we base on the fact that all respondents had several years of work
experience within the area.

7.2.2 Dependability

Dependability means that all parts of a study can be inspected.\textsuperscript{136} We have tried to involve the
reader as much as possible in our thesis by giving a detailed description of the different parts
of our study. We have presented the background to our problem discussion and presented an
outline of the study. Further, explained the procedure of data collection and our choice of
respondents. We presented our choice of sources and criticism of sources so that the reader
would be given axes to theories and concepts surrounding our study. The reader has access to
all the compiled material used in the study since we have presented our sources and the
procedure of our thesis.

7.2.3 Conformability

“Conformability is concerned with ensuring that, while recognizing that complete objectivity
is impossible in business research, the researcher can try to show that he or she has acted in
good faith.” \textsuperscript{137} Our main objective with the thesis has been to not let personal opinions
concerning the impairment procedure influence the result of the study. In this case we did not
have any personal opinion about how the impairment procedure of goodwill should be
handled. However we reasoned that opinions could be built up and affect the analysis during
the creation of the thesis and therefore we still thought it was relevant for us to keep the
importance of conformability in mind. Further we kept in mind that the theories taught in
school probably affected our way of thinking when conducting the study. Still we did not
have much experience concerning the impairment procedure of goodwill and it was probably
therefore easier to be objective compared to if we have had more experience.

7.2.4 Transferability

Transferability is when the collected data from a study can be transferred on other
surroundings.\textsuperscript{138} We believe that our study has a high amount of transferability. The
companies included in our study are well established within their markets and the respondents
included in our study were appointed to represent their companies in order to ensure that the
proper information would be accessible. All stock listed business combinations within the
large cap had the same chance to be chosen and it was not pre- decided which companies we
were going to interview. We therefore believe that we have transferability in our thesis,
because we could just as well have chosen four other companies within other branches.

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**Respondents**

Eriksson Bo, Stora Enso

Jonsson Ragnvald, Boliden

Gustavsson Svante, Lindab

Tesdorpf Johanna, Atlas Copco
Appendix 1: Interview guide (English)

Which position do you have? Former education? Previous employment's?

Which tasks are included in your employment?

How long have you worked for the company?

Cash generating units

How do you do about when you identify/establish cash generating units? Could you give us any examples?

Apart from the method you mentioned, are there any other methods which you use?

What problems arise when establishing cash generating units? Could you give us an example?

How do you solve them?

Goodwill

How do you go about when you estimate the size of the future cash flows which goodwill compounds of? Why this procedure?

Are there any problems related to this procedure? If yes, why?

How do you solve these problems?

How do you proceed when you divide goodwill among cash generating units? Could you give us an example?

What problems arise when you divide goodwill among cash generating units?

How do you solve these problems?

Indicators: Internal/external

How do you go about when you estimate if goodwill needs to be impaired? Why do you work this way?

Which indicators do you look for when you estimate the need to impair goodwill? Why these indicators?

To what extent do you look at the internal/external indicators recommended in RR 17? (present the factors for the respondent)

Which additional indicators do you use and why?

How frequently do you look into these indicators and why?

Valuation

Describe the process when you establish the recoverable amount for cash generating units which contain goodwill? Could you give us an example, are there any possible problems?
How do you avoid these problems and why?

Describe the process when you establish the fair value less costs to sell for cash generating units which contain goodwill? Are there any problems?

How do you avoid these problems and why?

Describe the process when you establish the value in use for cash generating units which contain goodwill? Are there any problems?

How do you avoid these problems and why?

Describe the process when you establish which discount rate to use on a cash generating unit which contains goodwill and why?

Are there any problems and why? If yes, how you do to avoid these problems?

**Impairment**

Describe the process when you impair a cash generating unit which contains goodwill. Are there any problems? If yes, could you give us an example?

How do you avoid these problems?

How frequent do you check if there is a need to impair and why this frequent?

Does the frequency differ between different units and why? Could you give us an example?

Is there anything you would like to add concerning goodwill, the valuation and distribution of goodwill, respectively the need to impair goodwill?
Appendix 2: Interview guide (swedish)

Vilken ställning har ni? Bakgrund- Utbildning? Tidigare arbete?
Vilka arbetsuppgifter ingår i din tjänst?
Hur länge har du jobbat inom företaget??

**Kassagenererande enhet**

Hur går ni tillväga när ni identifierar/ fastställer kassagenererande enheter? Exemplifiera
Finns det några andra metoder ni använder er av?
Vilka problem uppstår när ni fastställer vad som är kassagenererande enheter? Exemplifiera
Hur löser ni detta problem?

**Goodwill**

Hur går ni tillväga när ni uppskattar storleken på de framtida kassaflöden som utgörs av goodwill? Varför?
Medför denna procedur några problem? Varför?
Hur löser ni dessa problem?
Hur går ni tillväga när ni delar upp goodwill mellan kassagenererande enheter? Exemplifiera
Vilka problem uppstår när ni delar upp goodwill på kassagenerande enheter?
Hur löser ni detta?

**Indikatorer: Interna/externa**

Hur går ni tillväga för att bedöma om ett nedskrivningsbehov av goodwill föreligger? Varför arbetar ni så?
Vilka indikatorer undersöker ni för att bedöma om ett nedskrivningsbehov av goodwill föreligger? Varför just dessa?
I vilken utsträckning undersöker ni på de interna/ externa faktorer som RR 17 rekommenderar? (Läs upp de externa/ interna indikationerna för respondenten)
Vilka andra indikatorer använder ni er av och undersöker? Varför dessa?
Hur ofta undersöker ni dessa indikatorer? Varför just den tidsperioden(varför så ofta) ?

**Värdering**

Hur ser processen ut när ni beräknar återvinningsvärdet på de kassagenerande enheter som innehåller goodwill? Exemplifiera möjliga problem
Hur undviker ni dessa problem? Varför?
Hur ser processen ut när ni beräknar nettoförsäljningvärdet på de kassagenerande enheter som innehåller goodwill? Några problem?

Hur undviker ni dessa problem? Varför?

Hur ser processen ut när ni beräknar nyttjandevärdet på de kassagenerande enheter som innehåller goodwill?

Hur undviker ni dessa problem? Varför

Hur fastställer ni vilken diskonteringsränta ni använder på en kassagenerande enheter som innehåller goodwill? Varför detta sätt?

 Vilka problem medför denna procedur? Exemplifiera

Hur gör ni för att undvika dessa problem?

**Nedskrivning**

Hur går ni tillväga när ni skriver ner en kassagenererande enhet som innehåller goodwill? Medför det några problem? Exemplifiera

Hur gör ni för att undvika dessa problem?

Hur ofta kontrollera ni om det föreligger ett nedskrivningsbehov? Varför?

Varför just denna tidsperiod?

Hur skiljer sig åt mellan olika tillgångar? Varför? Ge exempel

Är det någonting ni vill tillägga beträffade goodwill, dess värdering, fördelning resp nedskrivningsbehov.