

Do New CEOs Practice Big Bath Earnings Management Via Goodwill Impairments?

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Research conducted during SFAS 142's adoption year (2002) and shortly thereafter indicated new CEOs exhibited big bath behavior by impairing goodwill early in their tenure. A new CEO could blame the impairment on prior management while also paving the way for enhanced future profitability. However, several studies indicate that various types of earnings management declined precipitously in recent years. We re-examine the propensity of new CEOs to take big baths relative to goodwill impairments and find no evidence of this manipulative reporting. Instead, goodwill impairments by new CEOs seem to be justified based on their firms' deteriorating performance over time.

INTRODUCTION

The big bath theory of earnings management suggests managers charge significant non-recurring items to income in periods when earnings are already depressed. These one-time hits are taken because the market punishes a company relatively the same regardless of whether the firm just misses its earnings mark or falls well below it. Thus, there exists little downside to taking a big bath, yet a clear upside occurs because recording the heavy charge now relieves future periods of the burden, thereby making it easier to reach earnings goals in later years (Henry & Schmitt, 2001). Numerous studies document the practice of big bath earnings management in general (e.g., Elliott & Shaw, 1988; Kirschenheiter & Melumad, 2002; Walsh et al., 1991).

One particular area in which big bath earnings management has been studied relates to goodwill impairments under Statement of Financial Accounting Standard (SFAS) 142, *Accounting for Goodwill and Other Intangible Assets*, which is now located in Accounting Standards Codification (ASC) topic 350. Prior to SFAS 142, goodwill was amortized against income in equal amounts each year over a period of time not to exceed 40 years. Beginning in 2002, SFAS 142 mandated that firms stop amortizing goodwill and instead test it annually for impairment. Accounting Standards Update (ASU) 2011-08 modified SFAS 142 slightly by stating that a qualitative assessment could be applied to determine whether the impairment test is needed in a given year. In particular, if economic circumstances suggest it is more likely than not that the reporting unit's fair value exceeds its carrying value, an impairment test is not needed. This qualitative assessment is highly judgmental.

Furthermore, the impairment test under SFAS 142 requires managerial judgment in allocating an entity's overall goodwill to individual reporting units and in allocating the fair value of the reporting unit

to specific assets and to goodwill. As Lhaopadchan (2010, p. 121) notes, SFAS 142 “provides managers with an immense degree of discretion in regard to reporting whether and by how much the goodwill has been impaired.” Significant research suggests managers practiced big bath earnings management in recording goodwill impairments in 2002, i.e., the initial year of SFAS 142’s adoption (e.g., Jordan & Clark, 2004; Lapointe-Antunes et al., 2008; Sevin & Schroeder, 2005).

As Pourciau (1993) notes, new CEOs have an incentive to report lower earnings early in their tenure so that later enhancements in performance can be attained. One way of doing this is to write down assets that were acquired under previous management, which is simply a special case of big bath earnings management precipitated by a change in top management. Riedl (2004) and Lapointe-Antunes et al. (2008) pointed out that the adoption of SFAS 142 in 2002 gave newly appointed CEOs the perfect opportunity to take such big baths. More specifically, the new CEO could justify his or her decision to impair goodwill because SFAS 142 now required it. Indeed, research showed that in the initial year of adopting the goodwill standard, impairments were significantly associated with CEO changes (e.g., AbuGhazaleh et al., 2011; Lapointe-Antunes et al., 2008).

Yet, the research results concerning big bath earnings management and the CEO turnover effect associated with goodwill impairments that existed in 2002 (i.e., SFAS 142’s year of adoption) and shortly thereafter may not be valid today for a few reasons. For example, the economic climate changed drastically in the U.S. in the years subsequent to 2002. In addition, the occurrence of certain forms of earnings management in the last several years appears to have decreased significantly (e.g., see Aubert & Grudnitski, 2014; Bartev & Cohen, 2009; Ibrahim et al., 2011; Lin & Wu, 2014). Is it possible earnings management related to big bath write offs of goodwill subsided during this time period as well? Finally, the goodwill impairments occurring in SFAS 142’s year of adoption appeared as below-the-line items in the earnings statement (i.e., as the cumulative effect of a change in principle). Now, goodwill impairments have a more punitive connotation as they are reported above-the-line as operating expenses; thus, newly appointed CEOs may be less willing now than in 2002 to take the big hits.

The current study examines more recent data to provide relevant, updated research on the presence of big bath earnings management associated with goodwill impairments and the relationship between CEO turnover and such impairments. The results suggest managers no longer record goodwill impairments opportunistically but rather take these hits to income when warranted by poor performance over multiple periods.

The next section examines in more depth the literature related to earnings management associated with goodwill impairments and develops the research hypothesis for the study. This is followed by sections on methodology and data collection and results. The final section contains our discussion and conclusions as well as the limitations of the study.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

The literature is reviewed first relative to the general practice of big bath earnings management effected through goodwill impairments. Then, studies directly addressing the relationship between CEO turnover and earnings management accomplished through asset impairments are discussed.

Big Bath Strategy and Goodwill Impairment

Lhaopadchan (2010) notes that evidence suggests that when an accounting standard permits managers to exercise judgment, earnings management frequently occurs (e.g., see Healy & Wahlen, 1999; Nelson et al., 2002). Because of the judgmental allocations made in applying the goodwill impairment test under SFAS 142, and the fact that the fair values of the reporting unit and its individual assets are not based on observable prices in an active market, Bloom (2009) states that the computation of goodwill impairment is susceptible to manipulation. As noted previously, a number of studies indicate that, indeed, the goodwill impairment decision under SFAS 142 has been used to practice big bath earnings management.

For example, Jordan and Clark (2004) tested for big bath earnings management relative to goodwill impairment by examining the Fortune 100 companies in the year of SFAS 142’s adoption (2002) and

found that firms impairing goodwill reported significantly lower pre-impairment earnings than did firms not impairing goodwill. However, in the prior year (2001), the earnings levels for the two groups did not differ significantly. The researchers concluded that the firms impairing goodwill in 2002 likely did so because their earnings were already depressed that year and the market would punish them relatively little for taking the big hit and reducing income even further.

Sevin and Schroeder (2005) replicated the Jordan and Clark (2004) study but expanded the sample to include randomly selected companies of various sizes (i.e., rather than the Fortune 100) and also segregated their sample into two subsamples based on entity size. For their full sample of firms, the results echoed those of Jordan and Clark (2004) and suggested the companies practiced big bath earnings management in SFAS 142's year of adoption. When the sample was split by company size, however, the subsample of large firms displayed no signs of this form of earnings management as both the impairment and non-impairment groups experienced similar earnings levels in the year of impairment. For the group of small firms, though, Sevin and Schroeder's (2005, p. 52) results "strongly suggest the presence of [big bath] earnings management." In particular, in 2002 for the subsample of small firms, the earnings of the impairment group were significantly lower than that of the non-impairment group. In the prior year, however, no significant difference existed in the income levels between these two groups.

In a later study, Jordan et al. (2007) examined the reporting of goodwill impairments in 2003 and 2004 and found that the average dollar amounts of the impairment (when the impairment was presented as an above-the-line operating expense) were significantly lower than the average amount reported in SFAS 142's transition year (2002). This suggested that firms cherry picked their impairments to result in the larger write downs being recognized in 2002 when the impairments received favorable treatment as a below-the-line item. However, even the more punitive treatment of reporting the goodwill impairments as operating expenses in 2003 and 2004 did not deter management from employing the big bath strategy in those years. In particular, similar to the results in 2002, the firms impairing goodwill in 2003 and 2004 had significantly lower pre-impairment earnings in the year of the write down than did the non-impairment entities. Yet, the two groups' earnings levels did not differ significantly in years immediately prior to the impairment year, suggesting the write downs were opportunistically taken that year because of the depressed earnings.

A few non-U.S. studies also tested for the presence of big bath earnings management in the year their respective countries adopted a standard requiring annual impairment testing of goodwill. For example, AbuGhazaleh et al. (2011) tested U.K. firms in the year they adopted IFRS 3, *Business Combinations*, and found evidence that managers exercised discretion in reporting goodwill impairments that was consistent with big bath behavior. Interestingly, the researchers' findings also indicated that the managers' discretion in reporting these impairments may also have been to convey their private information about the firm's performance.

Lapointe-Antunes et al. (2008) examined the reporting of goodwill impairments in Canada for the year of adopting Section 3062 of the Canadian Institute of Chartered Accountants' Handbook (which is similar to SFAS 142 except that the impairment loss in the transition year in Canada was given retroactive treatment and adjusted retained earnings, rather than income). Their findings suggested firms recorded higher transitional goodwill impairments to lessen the deviation from industry norms for return on equity (ROE) and return on assets (ROA). That is, recording a large transitional impairment loss in retained earnings lowered both assets and equity, thus increasing ROA and ROE, respectively.

Abuaddous et al. (2014) tested for big bath behavior in Malaysia for the first year of the Malaysian Accounting Standards Board's MFRS 136 requiring annual impairment testing of goodwill (i.e., similar to SFAS 142). Surprisingly, they found more evidence of big bath earnings management in the year prior to MFRS 136's adoption (2011) than in the year of adoption (2012). The researchers caution that their results are not generalizable outside of Malaysia, where on average goodwill comprises a much smaller portion of total assets than it does in other countries (e.g., U.S., U.K., Canada, etc.). They speculate that many Malaysian managers may have impaired their firms' goodwill just prior to MFRS 136's effective date to avoid having to apply its complex impairment testing rules.

Asset Impairments and CEO Tenure

Even before SFAS 142's requirements for goodwill impairment testing, research suggested that a change in CEO was a major factor in the decision to write off assets. For example, in examining write downs of various types of assets, Francis et al. (1996, p. 133) controlled for several important variables (e.g., book-to-market ratios, ROA ratios, etc.) and found evidence that "write offs are more frequent and larger in magnitude if there has been a change in [top] management." Similarly, Strong and Meyer (1987) analyzed an array of asset write downs and concluded that the most significant difference between firms writing assets down and those not taking write downs was a change in the CEO, with the write-down group experiencing a change in CEO while the non-write-down group did not.

A number of studies examining impairments in the transition year for the goodwill standard found that both the decision to impair goodwill and the amount of the impairment were significantly related to a change in the CEO. For example, Beatty and Weber (2006) determined that CEOs who did not make the original acquisition of the goodwill were more likely to impair goodwill (i.e., the impairment followed a change in the CEO). Likewise, AbuGhazaleh et al. (2011) and Lapointe-Antunes et al. (2008) discovered evidence that in the standard's year of adoption, goodwill impairments were positively related to a change in the CEO.

Bens and Heltzer (2004) showed that the market reaction to firms recording goodwill impairments as below-the-line items in the transition year was much less severe than when the impairments were reported above-the-line. Beatty and Weber (2006) presented evidence suggesting that managers also consider the distinction between below-the-line and above-the-line presentation to be important. The three studies in the paragraph above that showed a significant relationship between CEO tenure and the goodwill impairment decision and amount all examined impairments in the transition year. Masters-Stout et al. (2008) tested for this association in the three years following SFAS 142's transition year (i.e., 2003, 2004, and 2005) to ascertain whether this relationship held in periods where goodwill impairments were presented in a more punitive fashion (i.e., as operating expenses above-the-line).

Indeed, Masters-Stout et al. (2008) found evidence that the mean goodwill impairments of new CEOs was significantly higher than that of the more senior CEOs. The researchers also discovered that across all firms the lower the net income in the current year, the larger the impairment loss reported, which supported the notion that impairments were used to effect big bath earnings management. However, at lower income levels, new CEOs increased the amount of the impairment more than the senior CEOs, suggesting the new CEOs were more prone to impair goodwill to take a big bath.

Hypothesis Development

The current study revisits some of the issues examined by Masters-Stout et al. (2008) for a couple of reasons. First, their data is somewhat dated (i.e., 2003-2005), and the U.S. economy has been through severe shocks since the early years of SFAS 142 (e.g., the financial crisis and the Great Recession that occurred in the mid-to-late 2000s followed by a long, slow road to recovery, which is still occurring today). Thus, the results of Masters-Stout et al. (2008) may not apply today. Second, and more importantly, Masters-Stout et al. (2008) examined operating performance only in the year the goodwill impairment was reported and drew their conclusions about big bath behavior based solely on this year. A new CEO impairing goodwill in the first year or so of his or her tenure does not necessarily imply big bath earnings management, even if the earnings were depressed that year. An examination of prior years' earnings is needed to ascertain whether impairing goodwill shortly after a CEO change results from opportunistic behavior or is justified based on deteriorating performance over time.

More specifically, if earnings are depressed in the year goodwill is written down but not in prior years, the write down likely occurs more from management's opportunistic behavior to clear the decks and improve future profitability than from a desire to present real economic information about the firm. That is, as Jordan and Clark (2004) note, goodwill impairment would likely not occur within the realm of one year. Instead, deteriorating conditions for multiple periods would indicate the circumstances that gave rise to the firm's excess earnings potential no longer exist and that goodwill impairment is warranted. This leads to the following research hypothesis:

H₀: In the period 2003-2013, relative to new CEOs not impairing goodwill, new CEOs impairing goodwill will report significantly lower earnings in the year of impairment and in the two prior years.

Acceptance of H₀ suggests the impairments recorded by new CEOs were justified by their firms' declining performance over time, and as such, by recording the impairments the new CEOs were attempting to provide relevant information to financial statement users. H₀ would be rejected and evidence of opportunistic behavior would be indicated if the new CEOs impairing goodwill worked for firms reporting earnings significantly lower than firms with new CEOs not impairing goodwill in the year of impairment (i.e., year of CEO change) only. That is, if the two groups report similar earnings in the two years prior to the impairment year (i.e., CEO change year), then the group of new CEOs who impaired goodwill would seem to have done so opportunistically to take the charge because of the depressed income in the current year (i.e., big bath behavior). Taking the big hit would be made easier for the new CEOs not only because of the depressed earnings in the current year but also because the new CEOs could attribute the write offs to poor acquisition decisions made by prior management.

METHODOLOGY AND DATA

The primary purpose of this study is to ascertain whether big bath earnings management appears to be occurring following a CEO change. The population for the study is the Fortune 500 companies that experienced a change in CEO during the period 2003-2013. The transition year for SFAS 142 was 2002, and as noted previously, goodwill impairments this year were reported in the income statement below-the-line. Since 2003, these impairments have been presented as operating expenses above-the-line. Thus, for consistency purposes, 2002 is excluded from the sample period.

While not a random sample, the Fortune 500 companies are chosen for study because, as the nation's largest firms, they are more likely to have goodwill than a randomly selected sample of entities of varying sizes. To determine if a company changed CEOs during the sample period, the firm's executive summaries available in the Lexis-Nexis Academic database are examined. If a company changed CEOs more than once during the sample period, only the most recent change is included (i.e., to avoid having the same company unduly affecting the sample by occurring multiple times). Firms are omitted from the sample for the following reasons:

- Company is privately held.
- CEO position does not exist.
- No goodwill existed at the time of the CEO change.
- Company has co-CEOs.
- No CEO change occurred within the study period (i.e., 2003-2013).

The above selection process resulted in a sample of 244 of the Fortune 500 companies that changed CEOs at least once during the sample period. Masters-Stout et al. (2008) and Gabarro (1985) noted that most major changes by new CEOs occur during the first two years of their tenure. As such, the amount of goodwill impairment is examined for the year of the CEO change (period t) and the subsequent year (period t+1), which is consistent with prior research analyzing goodwill impairments and CEO change (e.g., see AbuGhazaleh et al., 2011).

A number of tests are conducted to ascertain if new CEOs used goodwill impairments to accomplish big bath earnings management. For example, if such earnings manipulation occurs, then relative to the year prior to the CEO change (period t-1), significantly more firms would be expected to impair goodwill in periods t and t+1. In addition, the magnitude of the impairments in years t and t+1 would be expected to be significantly larger than the amounts impaired in period t-1.

Another test for big bath earnings management involves comparing the earnings of the firms impairing goodwill to that of the firms not impairing goodwill. Having depressed earnings in the year an

impairment loss is recorded indicates big bath earnings management may be present (i.e., the hit to earnings may have been taken because income is already depressed and further reductions to it do little harm). However, if the earnings of the firms impairing goodwill are also depressed in the couple of years prior to the impairment year, evidence would suggest that big bath earnings management is not occurring but rather the impairment results from managers conveying pertinent information about deteriorating performance of their firms over time (e.g., see Lapointe-Antunes et al., 2008).

To evaluate this, the 244 firms that changed CEOs during 2003-2013 are segregated into two groups (i.e., those that impaired goodwill and those that did not). Next, the operating performance of these two groups is compared for the year the impairment is recorded and for the two prior years. For each year, the two groups are compared based on two measures of operating performance (i.e., whether income was positive or negative and ROA). These two measures have been consistently used in prior studies examining big bath earnings management via goodwill impairments (e.g., Abuaddous et al., 2014; AbuGhazaleh et al., 2011; Jordan & Clark, 2004; Sevin & Schroeder, 2005). Medians are used instead of means as the summary statistic for comparing ROAs because means can be heavily swayed by outlying values, particularly for small sample sizes like the ones examined here. Medians are affected very little by these outliers (Abuaddous et al., 2014; Jordan & Clark, 2004; Sevin & Schroeder, 2005). All financial data for the sample companies are obtained from the COMPUSTAT database.

RESULTS

Of the 244 Fortune 500 firms that changed CEOs during 2003-2013, 44 (18.03%) recorded a goodwill impairment in the year of the CEO change (period t), and 41 (16.80%) impaired goodwill in the year after the change (period t+1). Only 17 of the companies impairing goodwill in period t also did so in period t+1. Table 1 provides descriptive statistics for the full sample of 244 firms and for the subsamples segregated between the impairment and non-impairment entities. Panels A and B provide the statistics for the periods t and t+1, respectively.

TABLE 1
DESCRIPTIVE STATISTICS

	Full sample median	Impairment group median	Non-impairment group median	Chi-square	p-level
<u>Panel A (period t i.e., year of CEO change):</u>					
Goodwill at beginning of year (millions)	\$1,425	\$1,825	\$1,346	.444	.505
Goodwill to total assets at beginning of year	13.57%	18.23%	13.33%	.998	.318
Total assets (millions)	\$10,953	\$11,608	\$10,711	.111	.739
<u>Panel B (period t+1 i.e., year after CEO change):</u>					
Goodwill at beginning of year (millions)	\$1,559	\$1,996	\$1,428	1.437	.231
Goodwill to total assets at beginning of year	13.99%	15.03%	13.63%	1.437	.231
Total assets (millions)	\$10,896	\$10,752	\$11,040	.029	.864

Note: The chi-square test statistic is for a Mood's median test comparing the impairment and non-impairment groups. For both periods t and t+1, the full sample contains 244 firms. The impairment and non-impairment groups comprise 44 and 200 companies, respectively, in period t and 41 and 203 firms, respectively, in period t+1.

Notice that the relative magnitude of the beginning-of-the-year goodwill reported by the impairment and non-impairment groups does not differ significantly for either periods t or t+1. For example, in period t the difference in the median percent of the goodwill to total assets for the impairment and non-impairment groups of 18.23% and 13.33%, respectively, produced a chi-square statistic of .998 with a p-level of .318. A similar result occurs in period t+1. In addition, little difference exists in the size of the firms in the two groups. More specifically, in period t the median total assets for the impairment and non-impairment groups of \$11,608 million and \$10,711 million, respectively, did not differ significantly (i.e., p-level of .739). A similar finding holds true in period t+1.

If new CEOs practice big bath earnings management, then significantly more companies would be expected to impair goodwill in the year of the CEO change (period t) than in the year prior to the change (period t-1) when the predecessor CEO still held office. However, this was not the case as the number of firms impairing goodwill was exactly the same in periods t-1 and t (i.e., 44 of the 244 companies impaired goodwill each year). Only 15 of the firms impairing goodwill in period t-1 also did so in period t. A similar number of entities (i.e., 41) impaired goodwill in the year after the CEO change (period t+1). Thus, there appears to be little difference in the rate at which firms impair goodwill, regardless of whether the period examined occurs before or after a CEO change.

Of course, examining the number of firms impairing goodwill before and after a CEO change tells only part of the story. Big bath earnings management could still be indicated if the magnitude of the impairments in periods t or t+1 significantly exceeded the amount of the impairments in period t-1. Using the percent of goodwill impairment to total assets as the measure of relative size of the impairment, for the full sample of firms, Table 2 presents the results of a pair-wise t test comparing the amounts for periods t-1 and t as well as t-1 and t+1. Notice that the relative magnitude of the impairment did not differ significantly between period t-1 and either of the periods t or t+1. Simply stated, new CEOs did not impair any more goodwill than did the more senior (i.e., predecessor) CEOs. These initial tests suggest big bath earnings management does not appear to be occurring relative to CEO changes.

TABLE 2
MAGNITUDE OF IMPAIRMENT LOSS

	Year before CEO change (t-1)	Year of CEO change (t)	Year after CEO change (t+1)
Avg. percent of impairment loss to total assets	0.94%	0.58%	0.45%
t-statistic		1.062 ^a	1.553 ^b
p-level		.289	.122

^a Pair-wise t test comparing percent of impairment loss to total assets between periods t-1 and t.

^b Pair-wise t test comparing percent of impairment loss to total assets between periods t-1 and t+1.

Wilson (1996) notes that studies examining asset write downs should control for factors indicating declining economic performance since this suggests that such impairments are warranted. Prior research testing for big bath earnings management via goodwill impairments in the early years of SFAS 142 did so by comparing operating performance (income) between companies impairing goodwill and those not impairing goodwill (e.g., Jordan & Clark, 2004; Jordan et al., 2007; Sevin & Schroeder, 2005). The key indicator of big bath earnings management was that relative to companies not impairing goodwill, firms impairing goodwill had significantly lower earnings in the year of impairment but not in the year(s) immediately preceding the impairment year. This suggested that firms took the impairment primarily because earnings were depressed in the current year and it was a convenient time to take the hit.

As noted previously, operating performance is evaluated by examining the number of firms in each group reporting negative versus positive earnings as well as an overall measure of profitability (i.e.,

ROA). Table 3 presents the number of firms in the impairment and non-impairment groups reporting negative earnings as well as the number reporting positive earnings for the year of impairment and for each of the two years preceding the impairment year. Panel A provides results when the year of interest is the year of the CEO change (i.e., period t), while Panel B presents findings when the year of interest is the year after the CEO change (i.e., period t+1).

TABLE 3
NUMBER OF FIRMS WITH NEGATIVE OR POSITIVE INCOME

Panel A (year of impairment is year of CEO change):

	<u>Year of impairment</u>		<u>Prior year</u>		<u>Two years prior</u>	
	Negative <u>income</u>	Positive <u>income</u>	Negative <u>income</u>	Positive <u>income</u>	Negative <u>income</u>	Positive <u>income</u>
Impairment group	20(45.5%)	24(54.5%)	9(20.5%)	35(79.5%)	5(11.4%)	39(88.6%)
Non-impair. Group	14(7.0%)	186(93.0%)	19(9.5%)	181(90.5%)	26(13.0%)	174(87.0%)
Chi-square statistic	44.47		4.26		.087	
p-level	.000*		.039**		.768	

Panel B (year of impairment is year after CEO change):

	<u>Year of impairment</u>		<u>Prior year</u>		<u>Two years prior</u>	
	Negative <u>income</u>	Positive <u>income</u>	Negative <u>income</u>	Positive <u>income</u>	Negative <u>income</u>	Positive <u>income</u>
Impairment group	17(41.5%)	24(58.5%)	13(31.7%)	28(68.3%)	8(19.5%)	33(80.5%)
Non-impair. Group	9(4.4%)	194(95.6%)	20(9.9%)	183(90.1%)	21(10.3%)	182(89.7%)
Chi-square statistic	49.13		13.93		2.74	
p-level	.000*		.000*		.098***	

Note: *, **, and *** indicate the ratios differ between the impairment and non-impairment groups at significance levels of .01, .05, or .10, respectively.

For example, for the year of the CEO change, Panel A shows that 45.5% of the impairment firms reported negative earnings in the year of impairment while only 7% of the non-impairment group experienced negative profits that year. A chi-square test statistic of 44.47 reveals that these percentages differ significantly (i.e., p-level of .000). While at first glance this might suggest big bath earnings management, a closer look at the trend over time indicates otherwise. In particular, for the impairment group the proportion of firms with negative earnings increased from 11.4% to 20.5% to 45.5% over the three-year period ending in the year of impairment. Comparing this to the declining proportion of firms with negative earnings for the non-impairment group from 13% to 9.5% to 7% over this same period clearly suggests the firms in the impairment group were experiencing deteriorating conditions leading up to the impairment year, while the non-impairment group actually enjoyed improving conditions during this time.

For the year after the CEO change, Panel B of Table 3 provides results similar to those in Panel A. That is, for the impairment group, the ratio of companies with negative earnings grows progressively larger in the periods leading up to the year in which goodwill is impaired, while the percentage of firms with negative earnings for the non-impairment group declines steadily during this time period. It is also important to note that for each year (at least in Panel B) the impairment group experiences a significantly higher rate of firms with negative earnings than the non-impairment group (i.e, p-levels of .000, .000, and .098 in the year of impairment, year prior to impairment, and two years prior to impairment, respectively).

Table 4 provides the median ROAs for the impairment and non-impairment groups. Panel A presents the results when the impairment was taken in the year of the CEO change, while Panel B shows the

findings when the impairment was recorded in the year after the CEO change. Median ROAs are presented for the impairment year and the two years immediately preceding the impairment year.

TABLE 4
MEDIAN ROA FOR IMPAIRMENT AND NON-IMPAIRMENT GROUPS

	Median ROA			Chi-square	p-level
	Full sample	Impairment group	Non-impairment group		
Panel A (year of impairment is year of CEO change):					
Year of impairment	4.74%	0.89%	5.42%	21.74	.000*
Year prior to impairment	4.70%	3.60%	5.19%	3.99	.046**
Two years prior to impair.	4.64%	3.91%	5.06%	1.78	.182
Panel B (year of impairment is year after CEO change):					
Year of impairment	5.52%	0.15%	5.91%	8.47	.004*
Year prior to impairment	4.74%	1.01%	5.39%	10.58	.001*
Two years prior to impair.	4.70%	1.63%	5.20%	3.55	.060***

Note: The chi-square test statistic is for a Mood's median test comparing the impairment and non-impairment groups within a given year. *, **, and *** indicate the median ROAs differ between the impairment and non-impairment groups at significance levels of .01, .05, or .10, respectively.

Panel A of Table 4 shows that the median ROA for the companies impairing goodwill in the year of the CEO change was .89%, which was significantly lower than the median ROA for the non-impairment group of 5.42% (p-level of .000). For the year prior to impairment, the impairment group also experienced a significantly lower median ROA than the non-impairment group. What is even more telling, however, is that the median ROAs for the impairment group declined steadily from 3.91% to 3.60% to .89% in the years leading up to and including the impairment year, while the median ROAs for the non-impairment group consistently improved during this same three-year period (i.e., from 5.06% to 5.19% to 5.42%).

Panel B of Table 4 shows similar results when the year after the CEO change is examined. For each year (i.e., impairment year and the two years preceding impairment), the median ROA for the impairment group fell significantly below the median ROA for the non-impairment group. In addition, the median ROA for the impairment group steadily declined each period leading up to the year of impairment (i.e., from 1.63% to 1.01% to .15%), while the median ROA for the non-impairment group consistently improved during this three-year period (i.e., from 5.20% to 5.39% to 5.91%).

Overall, the results indicate that H_0 be accepted as the evidence suggests new CEOs do not practice big bath earnings management effected through goodwill impairments. In particular, the number of firms impairing goodwill and the magnitude of the impairments were relatively the same in the year of the CEO change (and the year after the change) as they were in the year before the CEO change. If new CEOs opportunistically impaired goodwill to practice big bath earnings management, then relative to the year prior to the change in CEO, significantly more companies should have impaired goodwill and in larger amounts in the year of the CEO change (or the next year at least). This did not occur though.

In addition, evidence suggests that new CEOs who impaired goodwill appeared to do so only after their companies experienced multiple years of poor operating performance (i.e., relative to the firms with new CEOs who did not impair goodwill). These results are similar to what AbuGhazaleh et al. (2011) found in their study of goodwill impairments and CEO changes in the U.K. They conclude that rather than acting opportunistically to manage earnings via goodwill impairments, "managers are more likely

exercising their accounting discretion to convey their private information and expectations about the underlying performance of the firm (p. 191).”

CONCLUSION, DISCUSSION, AND LIMITATIONS

The studies examining goodwill impairments during SFAS 142’s transition year (2002) or shortly thereafter found that managers seemed to be opportunistically reporting these hits to income, and this was especially true when a new CEO took office (e.g., Jordan & Clark, 2004; Lapointe-Antunes et al., 2008; Masters-Stout et al., 2008; Sevin & Schroeder, 2005). However, numerous studies suggest that several forms of earnings management have subsided considerably or even disappeared in recent years (e.g., Aubert & Grudnitski, 2014; Bartev & Cohen, 2009; Ibrahim et al., 2011; Lin & Wu, 2014). It is unclear what caused this more altruistic financial reporting in the recent past. Some research indicates the more transparent reporting resulted from the Sarbanes-Oxley Act and its stringent penalties for fraudulent financial reporting (e.g., Aono & Guan, 2008). Other research (e.g., Grasso et al., 2009) suggests the more altruistic reporting occurred because management and auditors changed their attitudes concerning the ethicality of earnings management following the major financial scandals in the early 2000s (e.g., Enron, WorldCom, HealthSouth, etc).

The findings of the current study suggest the more altruistic financial reporting noted recently also extends to recognizing goodwill impairments, which no longer seem to be recorded opportunistically by new CEOs wishing to take a big bath simply because current year earnings are depressed. Instead, goodwill impairments appear to be occurring only after multiple years of declining operating performance, which suggests that the firm’s excess earnings potential that originally gave rise to the goodwill has diminished.

As with most research, constraints related to time and the availability of data led to some limitations that may affect the generalizability of the current study’s results. For example, because large companies are more likely than small firms to have goodwill, we examined only the Fortune 500 firms. However, at least some research (i.e., Sevin & Schroeder, 2005) indicates that the propensity to record goodwill impairments opportunistically may be inversely related to entity size. In addition, a major focus of the current research was to evaluate the effects of CEO changes; thus, the sample included only companies that undertook such a change. Although unlikely, there exists a possibility that senior CEOs (i.e., those with longer tenure) impair goodwill opportunistically to take a big bath or, perhaps even more likely, postpone impairing goodwill to save face concerning acquisitions made under their watch. Finally, the current study makes no distinction between whether a new CEO was promoted internally or was hired externally, nor was a distinction made concerning whether the termination of the predecessor CEO was voluntary or involuntary. The results might have been different if these distinctions had been made. Future research could explore the above issues.

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