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Former Executives as Supervisors: Conflicts of Interest and Accounting Discretion

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ABSTRACT   Due to their information advantages, former executives are routinely appointed to supervisory roles within the same firm. This practice of transitioning is often criticized based on concerns about former executives' lack of independence and potential conflicts of interest. As supervisors, one of their main tasks is to oversee the financial reporting process and to challenge management's assumptions and the projections that shape reporting outcomes. This study examines the effects of transitioning managers on accounting discretion in the context of goodwill impairments. Based on a hand-collected sample of such transition events, we find a decreased propensity and lower magnitude of goodwill impairments following transitions. This effect is robust when controlling for the underlying economic situation of the firms. Further analyses reveal that the effect is muted for transitions of more experienced executives, for transitions into more independent boards, and for transitions after longer cooling-off periods. Overall, our findings suggest that former executives who become supervisors tend to impact the way accounting discretion is exercised. Thereby, we add to the assessment of an important governance phenomenon and relate to regulatory debates around mandatory cooling-off periods and the impairment-only approach for goodwill accounting.

1.   Introduction

In this paper, we empirically investigate how former executives who serve on the same firm's supervisory board affect the usage of accounting discretion in the context of goodwill impairments. Do former executives use their information advantage to be more effective supervisors or do reputational concerns and their lack of independence exacerbate the strategic exercise of accounting discretion?

Former executives are routinely appointed to supervisory bodies within the same firm (Andres et al., 2014; Evans et al., 2010). While information asymmetries are a key constraint for effective monitoring (Bebchuk & Weisbach, 2010; Harris & Raviv, 2008), former executives possess information advantages that potentially increase their ability to effectively monitor current management (Duchin et al., 2010). Yet, critics lament former executives' lack of independence regarding their previous colleagues and strategic decisions they made during their executive

tenure (Fahlenbrach et al., 2011). One of the key concerns refers to reputational incentives of the former executive (Brickley et al., 1999). For these reasons, supervisory board appointments of former executives are often strongly opposed by institutional investors and proxy advisors. For example, the proxy advisor Glass Lewis states in its voting guidelines that they 'apply extra scrutiny to former executives who are proposed as candidates for election to the supervisory board' (2023). While accounting standards limit the room for discretion to some extent, prior literature has documented considerable effects of accounting discretion (e.g., Burgstahler et al., 2006; Glaum et al., 2023). Against this background, examining whether transitioning executives influence the use of accounting discretion is highly relevant as the way in which discretion is exercised affects stakeholders' ability to obtain a true and fair view of the firm's economic situation (Andreicovici et al., 2020; Ball et al., 2000; Filip et al., 2015; Hayn & Hughes, 2006).

The existence of a supervisory board and non-executive directors is motivated by the agency problem between shareholders and executives (Adams et al., 2010; Bebchuk & Weisbach, 2010; Dey, 2008). While also having an advisory role, non-executive directors are primarily tasked with monitoring and disciplining management. One of their main monitoring tasks is to oversee the financial reporting process and particularly to challenge management's assumptions and projections that shape reporting outcomes.

Supervisory board members do not directly make decisions on firms' accounting policies. Accounting is part of the day-to-day operations for which executives are responsible. Nevertheless, there are at least three avenues through which supervisors can influence the usage of accounting discretion. First, in many jurisdictions they have the legal duty to examine financial statements. Anecdotal evidence suggests that supervisors focus on accounting items containing a large degree of discretion, such as impairments.[1] Second, supervisory board members are typically involved in drafting business plans specifying key assumptions and forecasts about the business.[2] After transitioning, a former executive could, for example, push for more optimistic cash flow projections for a cash-generating unit with allocated goodwill to minimize the risk of having to impair goodwill related to acquisitions made during her executive tenure. Third, there are informal interactions and channels of communication through which supervisors can exert influence (e.g., Block & Gerstner, 2016). Irrespective of the specific avenue, we expect the influence of supervisors on accounting matters to be even more pronounced in the case of a former executive. This is due to (a) the information advantage compared to other supervisors, which typically translates into more influence of the former executive on the supervisory board (Fahlenbrach et al., 2011; Harris & Raviv, 2008), and (b) the likelihood of a closer working and even personal relationship with current executives.

We use goodwill impairments as the setting to answer our research question about accounting discretion for two main reasons. First, goodwill as a balance sheet position matters in terms of magnitude. Average goodwill balances have grown significantly in recent years, with studies documenting an average of 15–20 percent of total assets (Chung & Hribar, 2021; Filip et al., 2021), rendering it the single largest balance sheet item for many firms (EFRAG, 2016). Second, the impairment-only approach applicable under IFRS and US-GAAP is characterized by considerable leeway for managers to exercise discretion (Amel-Zadeh et al., 2023; Bartov et al., 2021; Godfrey & Koh, 2009). The *value in use* calculation relies on assumptions and forecasts (e.g., about discount rates, growth rates, and cash flows) that are at least partly unverifiable (Ramanna

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[1]See e.g., the guidelines for supervisory board members published by the influential German Hans Böckler Foundation (Hans-Böckler-Stiftung, 2010).

[2]These strategic parameters typically become the basis for key accounting decisions. The German real estate company Vonovia, for example, states that the value in use that enters the impairment test as a benchmark was 'derived from the five-year plan at Group level approved by the management board and the supervisory board' (Vonovia, 2021).

& Watts, 2012). In line with this, the former IASB chairman notes: 'Most elements of goodwill are highly uncertain and subjective, and they often turn out to be illusory. Given its subjectivity, the treatment of goodwill is vulnerable to manipulation of the balance sheet and the P&L' (Hoogervorst, 2012).

The effect of a former executive on the supervisory board on goodwill impairments is not clear ex-ante. On the one hand, their information advantage can make former executives more effective supervisors. M&A decisions that give rise to goodwill are typically made on a top executive level (Greene & Smith, 2021; Harford & Schonlau, 2013), plausibly exacerbating a former executive's information advantage with respect to related accounting issues. They know 'where to look' and can better assess related management estimates. Hence, if they strive to be 'good stewards' of the corporate assets and act as impartial advisors (Donaldson & Davis, 1991), we expect goodwill impairments to be close to economic impairments, enabling shareholders to obtain a true and fair view of the economic situation. Relative to the managerial tendency of postponing and attenuating goodwill impairments (Filip et al., 2015; Glaum et al., 2018; Ramanna & Watts, 2012), we would expect to see more frequent and larger impairments.

On the other hand, executives are often personally attached to acquisitions and their success or failure reflects back on them, even after having left the executive board (Ball et al., 2000).[3] In line with the signaling perspective (Prendergast & Stole, 1996), managers' career concerns create incentives for bold and visible acquisitions during their tenure to provide a signal to the labor market (Firk et al., 2023; Yim, 2013). After their executive tenure, the attachment to their acquisitions together with reputational concerns lead to a plausible incentive to postpone goodwill impairments to avoid the impression of a bad investment (Brickley et al., 1999; Hoogervorst, 2012). Hence, we would expect former executives being present on a supervisory board to exacerbate the tendency to postpone goodwill impairments, leading to fewer and lower impairments.

We conduct our analysis in the German setting in which executive transitions are prevalent, making this a high-power setting. Furthermore, the two-tier board structure in Germany ensures a clean separation between executive and supervisory board members. If these bodies are separated, the information advantage of former executives relative to other supervisors is plausibly more pronounced, maximizing their influence on the board. We collect 111 transition events from 2005 to 2019 by using the Hoppenstedt Aktienführer database on board memberships as a first indication and manually check all events using online sources. 77.5 percent of these transition events are related to former CEOs or CFOs. In 48.6 percent of the cases, the former executive becomes chairman of the supervisory board, while in 42.9 percent, the former executive (additionally) joins the audit committee. Hence, it is common for former executives to take over important roles on the supervisory board, plausibly augmenting their influence in overseeing the accounting process.

We test our predictions by exploiting the staggered occurrence of executive transitions. We find that transitioning firms exhibit a decreased propensity for goodwill impairment as well as reduced impairment amounts in the five-year period following executive transitions. The probability of goodwill impairment decreases by about 11 percentage points in the post-transition period, which is meaningful compared to a 31 percent baseline probability among firms that impair their goodwill balances in our sample period. Average impairment amounts decrease by up to 0.17 percentage points relative to total assets or almost 20 percent of the average goodwill

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[3]One example is Bayer AG and its acquisition of Monsanto during the CEO tenure of Werner Baumann. The acquisition led to significant costs for Bayer due to claims for damages related to Monsanto's herbicides. Even years after the acquisition, Baumann has been heavily criticized for the deal by investors and the press (https://www.sueddeutsche.de/wirtschaft/bayer-baumann-bilanz-anderson-1.5759793, accessed 8th August 2024).

impairment size. This translates to a reduction of approximately €48 million based on sample averages.[4] While we expect the most significant impact of a former executive's incentives to occur during the first years after the transition, we find consistent results if we analyze their entire supervisory board tenure.

Of course, firms should only record goodwill impairments in cases where this is justified by the economic situation. When we focus on firms with economic impairment indicators, we document an even stronger effect of a recent transition on the impairment propensity. Furthermore, our results on decreased impairment amounts are robust to correcting for expected levels of impairment. Another concern is that governance mechanisms emerge as a firm's choice and that the transition decision is not exogenous. To mitigate endogeneity concerns regarding the transition timing, we test whether firms' responses to exogenous shocks that likely trigger economic goodwill impairments differ between firms with a former executive on the supervisory board versus firms without. Hence, the appointment decision lies in the past and is arguably exogenous with regard to the subsequent shock. Using extreme increases in the Economic Uncertainty Score for Germany (Baker et al., 2016) as exogenous shocks[5], the results suggest that firms with former executives on the supervisory board have a significantly lower propensity to react with goodwill impairments.

Additional analyses suggest that the negative effect increases when the former executive has a more influential role on the board, which plausibly increases their influence on accounting policies. Regarding potential moderating factors, we first show that the effect is stronger for less experienced transitioning managers, consistent with more experience being associated with enhanced monitoring abilities and reduced reputational concerns in later career stages. Second, we document that the effect is concentrated in transitions to smaller supervisory boards, in which a former executive likely has a stronger influence. Finally, we show that the effect is concentrated in transitions with a shorter cooling-off period between board memberships, consistent with longer cooling-off periods reducing conflicts of interest.

We contribute to the literature in several ways: First, we answer to calls for more research on firm-level implications of structural differences in governance bodies (Adams et al., 2010; Bebchuk & Weisbach, 2010; Dey, 2008; Larcker & Tayan, 2023). The board characteristic we study is executive transitions, which occur in several corporate governance cultures with two-tier boards. Prior literature also documents the presence of former executives in the mono-tier boards of Anglo-American firms (Daniele et al., 2024; Evans et al., 2010; Fahlenbrach et al., 2011), which is why we expect our evidence to generalize beyond the German governance context. Earlier studies on executive transitions focus predominantly on performance and stock price effects (e.g., Andres et al., 2014; Grigoleit, 2011; Grigoleit et al., 2011). Our setting allows us to speak to managers' conflicts of interest in exercising accounting discretion. We further extend recent US-based evidence on short-term CEO retention after CEO changes (Daniele et al., 2024). CEO retention is observed in mono-tier boards with CEO duality, when the departing executive steps down as CEO but continues as Chairman. In contrast, we focus on transitioning managers who leave their executive position and enter a new position as a supervisory board member, in many cases after a cooling-off period. Thus, while CEO retention is characterized by much greater continuity, the two-tier system provides a clear-cut setting to analyze medium-term effects of executive transitions on accounting discretion.

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[4]The 20 percent decrease is calculated based on the sample average impairment amount conditional on observing a goodwill impairment, which equals 0.89 percent of total assets. The 48 million Euro reduction is calculated by multiplying the unconditional average firm size of 28 billion Euros in total assets with the coefficient of – 0.17 (Table 3 Panel B column (1)).

[5]Events that led to these drastic increases are, e.g., the financial crisis of 2008/09 and Brexit. These shocks likely triggered economic impairments of goodwill positions.

Second, we contribute to the literature on determinants of goodwill impairment (Beatty & Weber, 2006; Ramanna & Watts, 2012). More specifically, we examine the impact of (former) executives' incentives on firms' goodwill impairments. Prior studies show increased goodwill write-offs in years after executive turnover (Glaum et al., 2018), in line with big bath accounting (Pourciau, 1993; Strong & Meyer, 1987). We focus on a special case of turnover, namely executive transitions, and thereby speak to executives' influence on goodwill impairments beyond their executive board tenure. Contrary to big bath predictions, we show a negative effect on goodwill impairments after executive transitions to the supervisory board. Our hand-collected dataset thus enables us to draw a more nuanced picture of executive transitions and the usage of accounting discretion in this context.

Finally, our findings also have at least two important regulatory implications. We show that longer cooling-off periods between serving in the executive and the supervisory board can mitigate the negative effect on timely loss recognition. This finding informs the regulatory debate around mandatory cooling-off periods. Furthermore, our results also contribute to the debate around accounting for goodwill and the impairment-only approach. Since its inception, this approach has been highly contentious (Giner & Pardo, 2015). Both the FASB and the IASB have recently decided to retain it, but particularly the IASB has complemented it with new disclosure requirements, testament to the perceived importance of information on goodwill for users of financial statements.

2.   Institutional Setting and Conceptual Underpinnings

2.1. *Executive Transitions in the German Corporate Governance Context*

The German corporate governance system requires a two-tier board structure for limited liability firms. According to the German Stock Corporation Act, the executive board deals with day-to-day business and the supervisory board acts as a monitoring and advisory body. While the latter is not supposed to interfere with the daily management of the company's operations, it can still influence executives by exerting 'ex ante control' through bylaws specifying board consent requirements for certain decisions, setting incentives through the remuneration system, or by regularly advising on and monitoring strategic decisions (Block & Gerstner, 2016). Supervisors are elected by the shareholders[6] and, in turn, appoint managers to the executive board.

While the same person cannot serve on both boards at the same time, transitions of former executives to the supervisory board are common. Since 2005, the non-statutory German Corporate Governance Code requires detailed justifications during the annual shareholders' meeting when a direct transition without any cooling-off period is intended. However, the German Corporate Governance Code is based on the comply-or-explain principle, limiting the bite of this requirement. Since 2009, a minimum cooling-off period of two years for transitions from executive to supervisory roles is required by law. Responding to major concerns from industry, legislators included an exception according to which shareholders representing more than 25 percent of the votes can request that the election of a former executive to the supervisory board is put on the annual general meeting agenda. If elected, the former executive can immediately transition to the supervisory board. While acknowledging the important expertise of former executives, the legislator aimed to strengthen the independence of supervisory boards. However, the law was not well received by most executives in German listed corporations. They mostly lamented the loss of expertise and know-how during the cooling-off period and the inflexibility of the new law.

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[6]This applies to shareholder representatives. Under the German model of codetermination, employees separately elect employee representatives to the supervisory board. Their number depends on the firm's size and industry.

Outside of Germany and closely related governance cultures such as Austria and Switzerland, executive transitions occur in several corporate governance cultures and are similarly discussed and criticized. Prior literature also documents the presence of former executives in the mono-tier boards of Anglo-American firms (Daniele et al., 2024; Evans et al., 2010; Fahlenbrach et al., 2011), where similar independence concerns emerge.

2.2. Goodwill Accounting under IFRS

Goodwill positions emerge from M&A activities if the price paid for a target exceeds the net fair value of the acquired assets. Similar to US GAAP, IFRS require the application of the so-called 'impairment only approach' for subsequent measurement, according to which goodwill is subject to at least annual impairment tests (IAS 36.96).[7] The impairment test is conducted at the level of a *cash-generating unit* (CGU)[8] and requires the comparison of the current balance sheet amount with the recoverable amount, defined as the higher of the fair value minus selling costs and the value in use (IAS 36.9). If the carrying amount exceeds the recoverable amount, allocated goodwill must be written down first (IAS 36.104). Impairment tests rely on the estimation of forward-looking fair values and values-in-use that require detailed business plans with assumptions about cash in – and outflows, long-term growth rates, discount factors, etc. While accounting standards limit the exercise of discretion, all of this information is naturally subjective and hard to verify or audit (Glaum et al., 2018; Lawrence et al., 2013; Ramanna & Watts, 2012). Against this background, the IASB has voiced significant concerns about the accounting for goodwill: 'Most elements of goodwill are highly uncertain and subjective, and they often turn out to be illusory. Given its subjectivity, the treatment of goodwill is vulnerable to manipulation of the balance sheet and the P&L' (Hoogervorst, 2012).

Empirical evidence suggests that the impairment-only approach has led to a significant increase in companies' goodwill balances and to untimely impairments (Chung & Hribar, 2021; Hamberg et al., 2011). André et al. (2016) show that only around 20 percent of firms with impairment indicators actually recognize impairment losses. In line with this, a study by the European Securities and Markets Authority (ESMA) suggests that impairment losses during the financial crisis 2007/08 were limited to a few industries, despite the overall deterioration of the market environment and outlook (2013). Although IFRS require disclosures related to goodwill impairment testing, these were often found to be of a boilerplate nature and not entity-specific, significantly impeding investors' ability to evaluate the reliability of the assumptions (ESMA, 2013).

2.3. Empirical Predictions

Monitoring management is delegated to the board of directors due to the collective action problem among shareholders (Bebchuk & Weisbach, 2010; Jensen & Meckling, 1976). Theoretical evidence suggests that directors generally have incentives to build a reputation as effective monitors to avoid personal costs associated with lax monitoring and to be rewarded with additional board seats (Fama, 1980; Fama & Jensen, 1983; Fich & Shivdasani, 2007). Yet, prior studies still document incentive problems in the relationship between shareholders, directors, and managers (Berle & Means, 1932; Dey, 2008). In response to governance scandals, policymakers often react with regulations intended to strengthen board independence (e.g., the 2002 Sarbanes-Oxley Act following the Enron scandal (Adams et al., 2010)). Prior empirical work indeed shows

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[7]The impairment-only approach has been applicable under US GAAP since 2001 and under IFRS since 2005.

[8]Since by its very nature goodwill cannot be separated from the company itself, sold to a third party, or itself generate independent cash inflows, it is allocated to CGUs for the purpose of impairment testing (IAS 36.80).

benefits of increased board independence (e.g., Chhaochharia & Grinstein, 2007; Duchin et al., 2010).[9] Theoretical evidence, however, indicates that the endogenous board selection process without regulation could lead to more effective monitoring (Harris & Raviv, 2008; Hermalin & Weisbach, 1998), e.g., through hiring more well-informed insiders.

Former executives serving as supervisors inherently embody this effectiveness-independence tradeoff. On the one hand, they have firm – and industry-specific knowledge. Prior studies identify information access to be the key impediment for effective monitoring by outside directors (Bebchuk & Weisbach, 2010; Harris & Raviv, 2008). Thus, inside information enhances former executives' ability to monitor and challenge management and the validity of their estimates.[10] In line with this, empirical evidence suggests that retaining former CEOs as directors is positively related to the probability of forced CEO turnover in the case of underperformance (Bresser & Thiele, 2008; Fahlenbrach et al., 2011). Underscoring that their information advantage matters when it counts, Oehmichen et al. (2014) find a positive performance effect of former executives for firms operating in particularly complex environments.

On the other hand, if a former executive serves on the supervisory board of the same firm, independence is questionable, and one can presume conflicts of interest in monitoring and advising former colleagues. No clean transfer of power takes place and former executives might be reluctant to accept strategic changes. They might even undermine the authority of the new top management team (Fahlenbrach et al., 2011; Oehmichen et al., 2014). In support of this argument, Evans et al. (2010) document negative performance effects of the decision to retain former executives on the board of directors. Furthermore, Andres et al. (2014) find disproportionately high executive compensation for firms in which a former CEO serves on the supervisory board. Hence, prior literature documents that appointing former executives as supervisors does not necessarily improve monitoring and can even exacerbate agency issues. Furthermore, executives are often personally attached to strategic decisions such as large acquisitions and their success or failure reflects back on them even after they have left the executive board (Ball et al., 2000). During their executive tenure, managers' career concerns create incentives for bold and visible acquisitions to signal their expertise to the labor market (Firk et al., 2023; Yim, 2013). Later, however, reputational concerns create incentives to postpone impairments related to these acquisitions to avoid the impression of a bad investment (Brickley et al., 1999; Hoogervorst, 2012). Thus, while both former executives and other supervisory board members share reputation incentives for being effective monitors, former executives have additional reputation incentives stemming from decisions they made during their executive tenure.

Since accounting belongs to the day-to-day operations for which executives are responsible, it lies outside the direct influence of supervisory board members. Yet, prior studies document an association between accounting outcomes and supervisory board characteristics (Cascino & Gassen, 2015) and there are at least three avenues through which supervisors can influence the usage of accounting discretion. First, in many jurisdictions, supervisors have the legal duty to conduct an examination of financial statements and management reports.[11] This examination

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[9]For a comprehensive review, see Bebchuk and Weisbach (2010).

[10]The nomination of a former executive for a supervisory board position is typically motivated with firm – and industry-specific information advantages. While firms could also retain such information and advisory advantages through consulting contracts with former executives, prior studies argue that monitoring and advising goals are most effectively achieved through a board position (e.g., Evans et al., 2010). Based on our review of the transition cases in our sample, financial knowledge is typically not the main reason stressed during the nomination. Nevertheless, former executives are often candidates with financial expertise and their election would hence help the company to fulfill the legal requirement of having at least one financial expert on the supervisory board (codified in §100 (5) AktG).

[11]In Germany, this duty is codified in §§ 267 (1) and 316 of the German commercial code (however, similar requirements exist in other legal environments, e.g., in the US). Importantly, this duty applies to all individual members and cannot be

should go beyond the external audit's function and include an assessment of the appropriateness of management's assumptions and predictions (Hans-Böckler-Stiftung, 2010).

Second, supervisory board members are involved in drafting business plans that become input parameters for accounting decisions like goodwill impairments. Filip et al. (2015) argue that executives tend to upward bias business plans' predicted cash flows to convince, among others, auditors that recognizing an impairment loss is unnecessary although it seems economically justified. Similarly, a former executive on the supervisory board could, for example, push for more optimistic cash flow projections to minimize the risk of goodwill impairments related to acquisitions made during her executive tenure. Third, there are informal channels of communication through which supervisors can exert influence (Block & Gerstner, 2016). Overall, we expect these formal and informal avenues to be more evident in the case of a former executive who possesses an information advantage compared to other supervisory board members and likely has a closer working or even personal relationship with current executives.

We focus on goodwill impairments to answer our research question for two main reasons. First, goodwill represents a significant balance sheet position in terms of magnitude and impairments potentially have a large impact on net income. Second, the impairment-only-approach provides considerable room for discretion. Prior studies have investigated the impact of managerial incentives on goodwill impairments. The literature finds that goodwill impairment typically lags several years behind economic impairment of goodwill (e.g., Filip et al., 2015; Hayn & Hughes, 2006). Beatty and Weber (2006) show that capital market concerns affect managers' impairment decisions, in line with evidence suggesting that capital markets overvalue firms with overstated goodwill positions and revise their expectations downward when an impairment is announced (Li et al., 2011; Li & Sloan, 2017). Other studies show a negative association between CEO overconfidence and the likelihood as well as timeliness of goodwill impairments (Chung & Hribar, 2021) and increased goodwill impairments in the years following executive changes (Glaum et al., 2018). In a similar vein, former executives arguably have strong personal preferences regarding goodwill impairments because they are personally attached to acquisitions and the success of these projects has implications for their reputation.

Against this background, we develop the following alternative predictions: First, former executives have superior information and can better assess the validity of managements' assumptions that form the basis for impairment tests. If they strive to build a reputation as 'good stewards' of corporate assets (Donaldson & Davis, 1991) and vigilant directors (Fama, 1980; Fama & Jensen, 1983), we expect them to place a larger weight in their utility function on incentives stemming from their current position as supervisors and a smaller weight on incentives from reputational concerns related to decisions made during their executive tenure. This should translate into goodwill impairments that are closer to economic impairments of goodwill. Relative to the managerial tendency of postponing and attenuating goodwill impairments (Filip et al., 2015; Glaum et al., 2018; Ramanna & Watts, 2012), this should result in more frequent and larger impairments.

Second, reputational concerns from their executive tenure could outweigh monitoring incentives from their current position in a former executive's utility function. This lack of independence of a former executive creates incentives to attenuate the recognition of goodwill impairments to avoid the impression of a bad investment (Brickley et al., 1999; Hoogervorst, 2012). Under this prediction, the presence of a former executive on the supervisory board could exacerbate the tendency to postpone goodwill impairments, leading to fewer and potentially lower impairments.

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outsourced to a certain committee, but of course by its very nature, the audit committee will be more directly involved with accounting questions.

3. Research Design and Data

3.1. Methodology

To analyze the general impact of an executive transition on firms' goodwill impairments, we estimate the following ordinary least squares (OLS) regression model:

$$GWImp_{i,t} = \alpha + \beta\, Post_{i,t} + \Sigma\, \gamma\, Fin.Controls_{i,t} + \Sigma\, \delta\, Gov.Controls_{i,t} + \Sigma\, \vartheta\, FE + \varepsilon_{i,t}. \quad (1)$$

In this model, we use manager transitions from the executive to the supervisory board as staggered treatment events and compare the goodwill impairment patterns in post-transition firm-years to other firm-years. In line with this, $GWImp_{i,t}$ refers to our two outcome variables with which we capture the extensive as well as the intensive margin of firms' goodwill impairments. The first outcome variable is a binary variable equaling one if firm i impairs its goodwill position in year t. The second outcome variable equals the ratio of goodwill impairments to total assets of firm i in year t. In our main tests, we use two variants of our variable of interest, $Post_{i,t}$: $Post$ $(5Y)_{i,t}$ is a binary, firm-year-variant variable equaling one in the five years t after a former management board member of firm i joins its supervisory board. Thus, the variable equals zero (a) for all firms without executive transition, (b) for firms with transition in years prior to the transition, and (c) for firms with transition in years after the fifth year following a transition event. We choose five years in the main specification, because we expect the potential effect of an executive transition on firms' goodwill impairments to be strongest directly after the board transition.[12] On the one hand, former executive board members plausibly have the most firm – or project-specific knowledge in the years directly following the transition, which would support them in their supervisory responsibilities. On the other hand, the independence of supervisors who have previously served on the executive board is arguably the most questionable in the years directly following the transition. To mitigate concerns that the results are driven by the length of the post-period, we use an alternative, firm-year variant explanatory variable, $Post\ (ET)_{i,t}$, that equals one in each year t in which a former executive is present on the supervisory board of firm i.

In line with prior related studies, we include several financial and governance control variables to capture time-varying differences between treatment and control observations. $Fin.Controls_{i,t}$ is a vector of firm-level financial control variables including the return on assets measured as the ratio of EBITDA plus goodwill impairment to total assets, firm size measured as logarithm of lagged total assets, firms' lagged leverage, the logarithm of lagged total goodwill, the book-to-market ratio, firms' annual cumulative stock return and volatility, as well as an indicator variable equaling one if an acquisition proxied by a goodwill increase took place in the past five years to address the concern that recent acquisition patterns before the transition affect the likelihood of a subsequent goodwill impairment. $Gov.Controls_j$ is a vector of firm-level governance control variables including ownership dispersion, the percentage of shares held by management, the executive experience of supervisory board members in years, the size of the management as well as of the supervisory board, audit quality proxied by a binary variable equaling one for Big4 auditors, and the number of analysts covering the firm. While these variables already control for differences between treatment and control firm-years, we weigh the observations using entropy balancing weights in several specifications to mitigate remaining concerns of systematic differences between the transitioning and the non-transitioning firms. The weights are estimated based on firm size, profitability, leverage, book-to-market ratio, and goodwill balance. We sequentially

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[12]This assumption is in line with initial reactions from the industry when the topic of a mandatory cooling-off period came up. Managers feared that even after a two-year period between executive board service and entering the supervisory board, a manager's firm-specific knowledge could be outdated (e.g., interview with Jürgen Hambrecht, former CEO of BASF SE: https://www.egonzehnder.com/de/insight/interview-mit-jurgen-hambrecht-basf, accessed 8th August 2024).

include industry, firm, year, and industry-year fixed effects to control for time-invariant industry and firm characteristics as well as for time trends. Importantly, the inclusion of firm fixed effects allows us to compare the impairment patterns of the same firm in years with versus years without a former executive on the supervisory board. Finally, standard errors are clustered by firm in all specifications.

One major concern in our baseline analysis is that the transitioning firms exhibit differing goodwill impairment patterns because they have different underlying economics that lead to differing impairment needs (e.g., because transitioning executives make systematically better M&A decisions). We use two approaches to mitigate concerns regarding the economic substance of goodwill impairments. First, we refine our analysis from equation (1) by only including firm-year observations with indications of a required goodwill impairment. We use a negative concurrent stock market return as proxy for required impairments (e.g., Glaum et al., 2018; Ramanna & Watts, 2012). This proxy assumes that stock prices incorporate the economic outlook of the underlying firm. Hence, declining prices reflect a deteriorating economic situation, pointing towards the need for goodwill impairment. Reducing the sample to firms with this indication of a required impairment therefore holds the underlying economics constant.

Second, we substitute the dependent variable with an abnormal impairment amount for each firm-year. *Abnormal Impairment Amount* is calculated as the difference between the observed goodwill impairment amount and an expected goodwill impairment amount. We estimate the expected goodwill impairment amount per firm-year by using the coefficients of industry-year cross-sectional regressions (see Table 4 for details). The abnormal impairment amounts correct for expected impairment amounts due to underlying economics in the industry-year. Thus, we test the impact on the additional, potentially discretionary impairments. For both approaches, we apply the same OLS regression model as in equation (1) and include firm, year, and industry-year fixed effects. Standard errors are clustered by firm in all specifications. We include one specification for both approaches in which observations are weighted using the same entropy balancing method explained above.

The second major concern is that firms endogenously decide when a former executive transitions to the supervisory board. For example, they could do so in response to certain economic developments that also impact their goodwill impairments. To alleviate concerns about the endogenous timing of these transitions, we exploit exogenous shocks in the economic environment and test how transitioning firms impair their goodwill positions after those shocks compared to non-transitioning firms. In particular, we use extreme increases in the Economic Uncertainty Score for Germany (Baker et al., 2016) as exogenous shocks that likely trigger economic impairments of goodwill. Importantly, firms cannot respond to the economic shock by transitioning a former executive to the supervisory board. While the decision to transition a manager is still endogenous in the first place, the transitioning decision is fixed when the shock occurs. Therefore, these shocks are arguably exogenous with respect to the timing of the manager transitions.[13] We exploit these exogenous shocks by estimating the following OLS regression model:

$$GWImp_{i,t} = \alpha + \beta_1 Post_{i,t} + \beta_2 Post_{i,t} x\ Shock_t + \Sigma\ \gamma\ Fin.Controls_{i,t}$$
$$+ \Sigma\ \delta\ Gov.Controls_{i,t} + \Sigma\ \vartheta\ FE + \varepsilon_{i,t}. \qquad (2)$$

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[13]We test whether there is an association between the occurrence of a shock in the next period and the decision to appoint a former executive to the supervisory board in a given period. The coefficient is close to zero and insignificant at conventional levels (all *p*-values are above 0.5).

$GWImp_{i,t}$ is the binary variable equaling one if firm i impairs its goodwill position in year t. $Post_{i,t}$ is the binary variable $Post\ (ET)_{i,t}$ that equals one in each year t in which a former executive is present on firm i's supervisory board.[14] $Shock_t$ is an indicator variable that captures the occurrence of a shock measured by Baker et al.'s (2016) economic uncertainty score. The variable defines year t as a shock year when it includes a month-over-month increase in the Germany-specific uncertainty score exceeding the 95th percentile.

It could be the case that the shock occurs early in the financial year and former executives in the supervisory board help current executives to better adjust real operations in response to the shock, leading to lower or no impairment needs at fiscal year-end. To rule out this real operations channel, we perform additional tests in which we restrict the shock events to extreme increases in the last three months of a calendar year. In a three-month (or shorter) period, firms are unlikely to adjust their real operations in response to a shock.[15] Hence, if we still observe a differential impact of former executives in the supervisory board on firms' goodwill impairments, this impact is likely to result from accounting discretion rather than from adjusted operations. Finally, we show the robustness of our inferences to a broader definition of uncertainty shocks using the 90th percentile of the score distribution. For all tests, we use the same financial and governance control variables as presented in equation (1) and include firm, year, and industry-year fixed effects. Standard errors are clustered by firm in all specifications.

Next, we want to shed light on the potential channels through which supervisory board members can influence how accounting discretion is exercised. To do so, we exploit the different roles that former executives take on the supervisory board and limit our treatment definition to those cases in which the former executive has a more influential role. In particular, we consider transition cases in which the former executive either serves as a chairperson or is a member of the audit or nominations committee and restrict the definition of the $Post_{i,t}$ variable accordingly.

Finally, we shed light on potential moderating effects, namely executive board experience, supervisory board size, and a cooling-off period between executive and supervisory board memberships. We do so by limiting our sample to transitioning firms and estimating the following regression equation:

$$GWImp_{i,t} = \alpha + \beta_1 Post_{i,t} + \beta_2 Split\_Post_{i,t} + \Sigma\ \gamma\ Fin.Controls_{i,t}$$
$$+ \Sigma\ \delta\ Gov.Controls_{i,t} + \Sigma\ \vartheta\ FE + \varepsilon_{i,t}. \tag{3}$$

In this model, $GWImp_{i,t}$ refers to our two dependent variables outlined above that capture the extensive and intensive margin of goodwill impairments. $Post_{i,t}$ is the binary variable $Post\ (5Y)_{i,t}$ that equals one in the five years t after a former executive joins the supervisory board of firm i. $Split\_Post_{i,t}$ is a binary, firm-year invariant variable equaling one in the five years after a board transition for those firms whose transitioning managers have above-median executive board experience, are part of a supervisory board with an above-median board size, or adhere to a minimum two-year cooling-off period between executive and supervisory board memberships,

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[14]This is likely a conservative definition as we expect the differential impact of a former executive to be strongest immediately after the transition. Since this definition of Post includes executives that have transitioned long before the shock, this should work against us finding a significant difference in their reaction to economic shocks between firms with and firms without former executives as supervisors.

[15]The calendar year corresponds to the financial year for almost all of our sample firms, meaning that these firms indeed would only have three months to adjust real operations before preparing the annual reports. We acknowledge that these real operational changes are just one way how firms could react to economic shocks. They could, of course, also use accruals-based strategies to minimize the need to record impairment losses. These strategies, however, tie in closely with the reporting discretion we seek to capture. While a former executive generally might be able to exert influence in both real operations and accounting discretion, thus affecting goodwill impairments, separating out these late-year shocks enables us to more cleanly capture the accounting-discretion avenue that we study in this paper.

<div align="center">

Table 1.   Sample.

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Panel A: Transition Events			
Year	# Transitions	CEO/CFO (%)	Chair (%)	Audit Committee (%)
2005	6	83.3	40.0	40.0
2006	6	83.3	50.0	50.0
2007	9	100.0	66.7	33.3
2008	13	84.6	75.0	16.7
2009	6	83.3	66.7	66.7
2010	8	62.5	50.0	50.0
2011	9	77.8	33.3	44.4
2012	8	75.0	50.0	37.5
2013	15	60.0	26.7	53.8
2014	10	80.0	30.0	40.0
2015	4	75.0	50.0	25.0
2016	10	80.0	55.6	44.4
2017	4	75.0	50.0	75.0
2018	1	100.0	100.0	100.0
2019	1	100.0	0.0	0.0
Total	**111**	**77.5**	**48.6**	**42.9**

respectively.[16] We use the same financial and governance controls as in equation (1) and include firm and year fixed effects. Standard errors are clustered by firm in all specifications.

3.2. Data Collection & Descriptives

The first step in our data collection involves the identification of transition events in listed German corporations. We define the supervisory board entry of a manager who has previously served on the executive board of the same firm as a transition event. Based on the German Hoppenstedt Aktienführer database on executive and supervisory board members of listed German firms, we extract those directors who have at some point since 2005 (i.e., the introduction of the impairment-only approach) served on both the executive and the supervisory board of the same company. Our sample period ends in 2019, since the Hoppenstedt Aktienführer database ceased coverage in this year. We manually verify the events through online research to ensure the reliability of the gathered events. In this process, we mainly rely on information from investor relations websites, annual reports, proxy statements, press releases, and in some cases when direct sources are unavailable, newspaper articles. In total, we can verify 111 transition events over the 2005–2019 period.

Table 1 Panel A provides an overview of our event sample. On average, 7.4 transition events took place per year. At least one transition occurred in each year since 2005, with a maximum of 15 transitions occurring in 2013. 77.5 percent of the transitioning managers served either as CEO or as CFO during their executive board tenure. Regarding their roles in the supervisory board, 48.6 percent of the former executives became the chairperson on the supervisory board and 42.9 percent became a member of the audit committee.

For the remaining variables we use several data sources for availability reasons. We rely on two data sources for data on firms' goodwill impairments that are relevant for our dependent variables: We start by using goodwill impairment data from S&P Global IQ (S&P). To expand the coverage, we further incorporate goodwill impairment data from LSEG Workspace (former

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[16]Hence, for example, with respect to executive board experience, *Post (5Y)* and *Split_Post* capture the impact of transitioning managers with below – versus above-median executive board experience on firms' goodwill impairments in the five years after the transition, respectively.

Number of Individual Firm-Years	Transition	No Transition	Total Sample
Panel B: Sample Selection			
Total firm-years of listed German firms (2005–2019)	984	13,687	14,671
Less firm-years with missing or no goodwill	(269)	(8,400)	(8,669)
Firm-years with goodwill	715	5,287	6,002
Less firm-years with missing control variables	(403)	(4,134)	(4,537)
Final sample	312	1,153	1,465

The table provides an overview of the sample. Panel A depicts the transition events of managers from executive to supervisory roles within the same firm over the period from 2005 (i.e., the adoption year of the impairment-only approach for goodwill) to 2019. In total, 111 transitions occurred over the whole period *(# Transitions)*. *CEO/CFO (%)* refers to the percentage share of transitions in the respective year, for which the former executive board member was either CEO or CFO. *Chair (%)* depicts the yearly percentage share of transitions, for which the new supervisory board member enters as chairperson of the board. *Audit Committee (%)* presents the percentage share of transition events in each respective year, for which the new supervisory board member becomes part of the audit committee. Panel B provides an overview of the sample selection process. The sample in our baseline analysis (Table 4) comprises 1,465 firm-year observations over the 2005–2019 period. We only include firm-years with a positive goodwill position and with non-missing control variables.

Refinitiv/EIKON) and use this data when we have no impairment data from S&P. When there are differences in the values of S&P and LSEG Workspace, we manually check the observation against the respective annual report and record the correct value accordingly. The remaining financial and capital market variables as well as data on the respective auditor are extracted from Compustat Global. For the governance variables on shareholder dispersion, management holdings, executive board size, and supervisory board size, we rely on data from Hoppenstedt Firmendatenbank, a data source covering governance variables for German companies. Finally, we use S&P data on the number of analysts following the respective firm.

Table 1 Panel B provides an overview of the sample selection process. We begin with all firm-years of listed firms in Germany between 2005 and 2019, totaling 14,671 observations. Next, we eliminate observations with either no information on their goodwill position or with a goodwill position equal to zero. Finally, we eliminate all observations with missing control variables as defined above. This selection process results in a final sample of 312 firm-year observations of transitioning firms and 1,153 firm-year observations of non-transitioning firms.

We present descriptive statistics for all relevant variables separately for transitioning and non-transitioning firms in Table 2. The table only includes firm-year observations that we use in our baseline analysis (Table 3). Transitioning firms, on average, are larger in size proxied by total assets and have larger goodwill positions. They are also slightly more profitable in terms of return on assets and exhibit lower impairment to total assets ratios. The remaining financial variables are economically similar for both transitioning and non-transitioning firms. With respect to the governance variables, transitioning firms exhibit a lower ratio of management shareholdings, have larger executive and supervisory boards, are less likely to be audited by a big4 audit company, and have slightly more analysts following them.

4.   Empirical Results and Discussion

4.1. Base Effect

We begin our empirical analysis by examining the base effect of the supervisory board presence of a former executive on firms' goodwill impairments. To do so, we estimate various specifications of equation (1) and report the results in Table 3. Panel A presents the results using the indicator for goodwill impairments as the dependent variable. The coefficient estimate on

Table 2.   Descriptive Statistics.

N = 1,465	Transition (N = 312)		No Transition (N = 1,153)		
	Mean	SD	Mean	SD	Diff.
Financial Variables					
Total Assets (EUR million)	59,385	269,096	19,417	103,390	39,968***
Return on Assets	0.12	0.07	0.10	0.08	0.01**
Leverage	0.57	0.17	0.57	0.18	− 0.01
Goodwill (EUR million)	1,917	4,737	1,381	3,837	536**
Impairment (1 = Yes)	0.13	0.33	0.16	0.36	–0.03
Impairment to Goodwill (%)	1.28	7.95	1.81	10.02	− 0.54
Impairment to Total Assets (%)	0.03	0.17	0.16	0.87	− 0.13***
Book-to-Market	0.46	0.61	0.47	0.57	− 0.01
Stock Return	0.02	0.04	0.02	0.04	0.00
Stock Volatility	0.09	0.05	0.09	0.04	0.00
Acquisition in Past 5 Years	0.90	0.30	0.87	0.34	0.03
Governance Variables					
Shareholder Dispersion	50.08	23.36	49.08	22.33	1.00
Management Shareholdings	1.46	2.94	4.36	14.95	− 2.90***
EB Experience (Years)	7.95	8.56	0.00	0.03	7.95***
EB Size	4.19	1.99	3.24	1.83	0.95***
SB Size	10.64	5.37	8.41	5.70	2.23***
Auditor Independence (1 = Big4)	0.65	0.48	0.73	0.45	− 0.07**
Number of Analysts Following	12.27	10.56	9.63	8.98	2.64***

The table presents descriptive statistics for the variables used in the main analyses of this paper. The sample comprises all 2005–2019 firm-year observations used in the baseline analysis (Table 3), split between firm-years with former executives on the supervisory boards and those without. *Total Assets* and *Goodwill* are denominated in million EUR (EUR values as extracted from Compustat). *Return on Assets* is computed as the ratio of current EBITDA to the sum of total assets plus goodwill impairments. We measure *Leverage* as the ratio of lagged total liabilities to lagged total assets as extracted from Compustat. *Impairment* is a binary indicator variable equaling '1' in firm-years in which the goodwill position is impaired. *Impairment to Goodwill* and *Impairment to Total Assets* are computed as the ratio of goodwill impairment to lagged goodwill and to lagged total assets, respectively. *Book-to-Market* equals the ratio of total book value of common equity to end-of-year market capitalization, both winsorized at the 1st and 99th percentile. *Stock Return* is computed as the average daily stock return in a given year plus the ratio of paid dividends to end-of-year market capitalization. We define *Stock Volatility* as the annual standard deviation of daily stock returns. *Acquisition in Past 5 Years* is a binary dummy variable one if an acquisition took place in the past five years and the goodwill position increased. With respect to the governance variables, *Shareholder Dispersion* equals the share of free float stocks to total stocks as extracted from the Hoppenstedt database. *Management Shareholdings* equals the percentage share of stocks hold by the management, extracted again from the Hoppenstedt database. We construct *EB Experience* as the number of years the transitioning supervisor served as an executive board member in the respective firm before joining the supervisory board. *EB Size* and *SB Size* equal the number of members in the executive board and the supervisory board, respectively, and are extracted from Hoppenstedt. *Auditor Independence* is a binary indicator variable equaling '1' if the firm is audited by a Big4 audit company in the respective year. Finally, *Number of Analysts Following* equals the number of analysts that cover the respective firm-year, as extracted from SNL Financial.

Post (5Y) is negative and statistically significant, at least at the five percent level throughout all specifications. In our baseline specification in column (1), the coefficient equals – 0.119, indicating that firms with former executives in their supervisory board are 11.9 percentage points less likely to impair their goodwill position in the five years after the transition. When tightening the fixed effects structure and using entropy balancing weights in columns (2) to (4), the coefficient stays between – 0.104 and – 0.114 and is statistically significant at least at the five percent level. Using the alternative specification of the *Post* variable in columns (5) and (6) leads to qualitatively similar results that are significant at the one percent level with industry and year fixed effects and close to the ten percent significance level with firm and industry-year fixed effects *(p-value = 0.13)*. Thus, the findings suggest that the presence of former executives on the supervisory board exacerbates the tendency to postpone goodwill impairments, consistent

with the lack of critical distance between the former executive and former colleagues or the fear of reputational damage setting incentives not to impair.

Next, we examine the intensive margin of firms' goodwill impairments by using the ratio of goodwill impairments to total assets as the dependent variable. Panel B of Table 3 presents the corresponding results. Our coefficient of interest is negative throughout all specifications and varies between – 0.142 and – 0.232. The baseline estimate in column (1) equals – 0.17 and is statistically significant at the one percent level. Thus, in the five years after a transition, transitioning firms incrementally reduce their yearly goodwill impairments on average by 0.17 percentage points of total assets. This is approximately 20% of the average impairment amount (conditional on observing a goodwill impairment in a firm-year). In absolute terms, this translates to a reduction in the impairment amount of 48 million Euros based on sample averages. The coefficient further decreases when using the alternative specification of the *Post* variable in columns (5) and (6), significant at the one percent level with industry and year fixed effects and close to the ten percent significance level with firm and industry-year fixed effects. Overall, the results are still consistent with former executives on the supervisory board having a negative impact on firms' goodwill impairments.

4.2. Economic Substance

Next, we incorporate the economic substance of goodwill impairments to mitigate concerns that the transitioning firms exhibit different underlying economics that could ultimately lead to differing goodwill impairment patterns. Table 4 presents the results of these analyses. Columns (1) to (3) depict the results based on the reduced sample including only firm-year observations with indications of a required goodwill impairment (i.e., a negative concurrent stock market return). The results support the baseline findings. In all specifications, the estimates are negative, ranging from – 0.126 to – 0.191, and statistically significant at least at the ten percent level. Hence, focusing on firms that show signs of a required goodwill impairment and thereby controlling for differences in the underlying economics, transitioning firms are less likely to impair their goodwill positions in the post-transition years compared to non-transitioning firms. Comparing the results to our baseline analysis in Table 3, the coefficients are even larger in absolute size.[17]

Columns (4) to (6) of Table 4 depict the results using the abnormal impairment amount as the dependent variable. Throughout all specifications, the coefficients again are negative and statistically significant, at least at the ten percent level. Given that the abnormal impairment amounts correct for expected impairment amounts due to underlying economics in the industry-year, the results suggest that former executives serving on the supervisory board influence the way in which accounting discretion is exercised, resulting in reduced impairment amounts compared to non-transitioning firms.

4.3. Exogenous Shocks

The second main concern from our baseline analysis relates to the endogenous timing of executive transitions. To mitigate this concern, we exploit exogenous shocks based on the Baker et al. (2016) economic uncertainty score and present the results in Table 5. Panel A depicts the results using the baseline specification of the *Shock* variable. Columns (1) and (2) refer to the

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[17]In addition, we perform untabulated robustness tests based on the previous year's book-to-market ratio as an alternative proxy for required goodwill impairment. Again, this proxy relies on market-based indicators assuming that a book value of equity exceeding the market value indicates the need for impairment. Reducing the sample to firm-year observations with a previous year's book-to-market ratio of above one yields qualitatively consistent results.

Table 3. Impact of Former Executives in the Supervisory Board on Firms' Goodwill Impairments.

Panel A: Occurrence of Goodwill Impairments

DV: Indicator Variable for GW Impairment	(1)	(2)	(3)	(4)	(5)	(6)
Post (5Y)	− 0.119***	− 0.104**	− 0.114***	− 0.105**		
	(0.034)	(0.050)	(0.033)	(0.047)		
Post (ET)					− 0.132***	− 0.112
					(0.038)	(0.073)
Financial Controls	YES	YES	YES	YES	YES	YES
Governance Controls	YES	YES	YES	YES	YES	YES
Industry Fixed Effects	YES	NO	YES	NO	YES	NO
Firm Fixed Effects	NO	YES	NO	YES	NO	YES
Year Fixed Effects	YES	NO	YES	NO	YES	NO
Industry-Year Fixed Effects	NO	YES	NO	YES	NO	YES
Sample	Unweighted	Unweighted	EB	EB	Unweighted	Unweighted
Observations	1,465	1,280	1,465	1,280	1,465	1,280
R-sq	0.175	0.531	0.214	0.575	0.179	0.531

Panel B: Size of Goodwill Impairments

DV: GW Impairment scaled by Total Assets	(1)	(2)	(3)	(4)	(5)	(6)
Post (5Y)	− 0.170***	− 0.157	− 0.158***	− 0.142*		
	(0.040)	(0.102)	(0.036)	(0.081)		
Post (ET)					− 0.197***	− 0.232
					(0.052)	(0.169)
Financial Controls	YES	YES	YES	YES	YES	YES
Governance Controls	YES	YES	YES	YES	YES	YES
Industry Fixed Effects	YES	NO	YES	NO	YES	NO
Firm Fixed Effects	NO	YES	NO	YES	NO	YES
Year Fixed Effects	YES	NO	YES	NO	YES	NO
Industry-Year Fixed Effects	NO	YES	NO	YES	NO	YES
Sample	Unweighted	Unweighted	EB	EB	Unweighted	Unweighted
Observations	1,465	1,280	1,465	1,280	1,465	1,280
R-sq	0.077	0.358	0.086	0.396	0.080	0.358

The table presents the results from OLS regressions of firms' goodwill impairments on former executives in the supervisory board. The sample comprises up to 1,465 firm-year observations over the 2005–2019 period as described in Table 1. Panel A depicts the results on the occurrence of goodwill impairments. The dependent variable is a binary dummy variable equaling '1' in years in which firms impair. Panel B presents the results on the size of goodwill impairments. The dependent variable equals firms' goodwill impairments scaled by the previous year's total assets. We define *Post (5Y)* as a binary indicator variable that takes on the value of '1' in the five years after a board transition. *Post (ET)* is a binary variable that equals '1' whenever a former executive is present on the supervisory board of the respective firm. For details on the remaining control variables, see Table 2. Entropy balancing weights for the regressions in columns (3) and (4) are estimated based on firm size, profitability, leverage, book-to-market ratio, and goodwill balance. We include industry, firm, year, and industry∗year fixed effects in the regressions, but do not report the coefficients. The table reports OLS coefficient estimates and (in parentheses) standard errors. Standard errors are clustered by firm in all specifications. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels (two-tailed), respectively.

Table 4.   Economic Substance of Goodwill Impairments.

DV:	Impair (Y/N) if Return < 0			Abnormal Impairment Amount		
	(1)	(2)	(3)	(4)	(5)	(6)
Post (5Y)	− 0.155**	− 0.191*	− 0.126*	− 0.163*	− 0.234*	− 0.199**
	(0.077)	(0.113)	(0.071)	(0.087)	(0.123)	(0.094)
Financial Controls	YES	YES	YES	YES	YES	YES
Governance Controls	YES	YES	YES	YES	YES	YES
Firm Fixed Effects	YES	YES	YES	YES	YES	YES
Year Fixed Effects	YES	NO	YES	YES	NO	YES
Industry-Year Fixed Effects	NO	YES	NO	NO	YES	NO
Sample	Unweighted	Unweighted	EB	Unweighted	Unweighted	EB
Observations	349	202	349	1,079	1,028	1,028
R-sq	0.500	0.732	0.544	0.184	0.249	0.191

The table presents the results from OLS regressions of firms' decision to impair in columns (1) to (3) and of firms' abnormal impairment amounts in columns (4) to (6). The sample comprises up to 1,079 firm-year observations over the 2005–2019 period. For the regressions in columns (1) to (3), we only include those firm-years that exhibit a negative concurrent annual return as a proxy for a required impairment of goodwill. In columns (4) to (6), the dependent variable *Abnormal Impairment Amount* is calculated as the difference between the observed goodwill impairment amount and an expected amount that is based on industry-year cross-sectional regressions of the ratio of goodwill impairments to total assets on the explanatory variables return on assets, total assets, leverage, book-to-market ratio, stock return, and stock volatility. When estimating the cross-sectional regressions, we omit observations from industry-years with fewer than ten observations. We define *Post (5Y)* as binary indicator variable that takes on the value of '1' in the five years after a board transition. We include financial controls, governance controls, as well as firm, year, and industry∗year fixed effects in the regressions, but do not report the coefficients. Entropy balancing weights for the regressions in columns (3) and (6) are estimated based on firm size, profitability, leverage, book-to-market ratio, and goodwill balance. The table reports OLS coefficient estimates and (in parentheses) standard errors. Standard errors are clustered by firm in all specifications. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels (two-tailed), respectively.

unweighted sample, whereas columns (3) and (4) are based on the entropy balanced sample. Throughout all specifications, the estimate on the interaction term is negative and statistically significant at least at the ten percent level. Furthermore, the coefficients are similar in size compared to the findings in Table 3. With the tightest specification, i.e., firm and industry-year fixed effects with the entropy balanced sample in column (4), the estimate equals − 0.146 and is statistically significant at the one percent level, indicating that transitioning firms are 14.6 percentage points less likely to impair their goodwill position in response to an exogenous shock, which plausibly signals economic impairment of goodwill. This evidence mitigates concerns that our baseline findings are due to the endogenous timing of manager transitions in response to certain economic conditions.

Panel B depicts the results using adjusted specifications of the *Shock* variable. Columns (1) and (2) show the estimates of the tightened definition of shock years, i.e., years in which an extreme increase in the uncertainty score occurs within the last three months of the calendar year. In both columns, the coefficients are negative, statistically significant at least at the ten percent level, and similar in size compared to the findings of Panel A. Given that differential operational responses to economic shock are unlikely to occur within such a short timeframe, these findings suggest that transitioning firms indeed use their accounting discretion and refrain from impairments, leading to a reduction in impairment probability. In columns (3) and (4), the estimates are based on a broader definition of uncertainty shocks using the 90th percentile of the score distribution as a threshold. Overall, the results are consistent with our prior findings.

Table 5.   Decision to Impair in Response to Exogenous Shocks.

DV: Indicator Variable for GW Impairment	(1)	(2)	(3)	(4)
Panel A: Baseline Specification				
Post (ET) x Uncertainty Shock	**− 0.072***	**− 0.113****	**− 0.080***	**− 0.146*****
	(0.040)	**(0.049)**	**(0.044)**	**(0.051)**
Post (ET)	− 0.062	− 0.076	− 0.057	− 0.078
	(0.061)	(0.076)	(0.063)	(0.080)
Financial Controls	YES	YES	YES	YES
Governance Controls	YES	YES	YES	YES
Firm Fixed Effects	YES	YES	YES	YES
Year Fixed Effects	YES	NO	YES	NO
Industry-Year Fixed Effects	NO	YES	NO	YES
Sample	Unweighted	Unweighted	EB	EB
Observations	1,443	1,280	1,443	1,280
R-sq	0.391	0.534	0.426	0.579
Panel B: Adjusted Specifications				
Post (ET) x Uncertainty Shock (q4)	**− 0.087***	**− 0.152****		
	(0.046)	**(0.064)**		
Post (ET) x Uncertainty Shock (p90)			**− 0.076***	**− 0.125****
			(0.042)	**(0.052)**
Post (ET)	− 0.083	− 0.104	− 0.069	− 0.081
	(0.055)	(0.073)	(0.058)	(0.075)
Financial Controls	YES	YES	YES	YES
Governance Controls	YES	YES	YES	YES
Firm Fixed Effects	YES	YES	YES	YES
Year Fixed Effects	YES	NO	YES	NO
Industry-Year Fixed Effects	NO	YES	NO	YES
Sample	Unweighted	Unweighted	Unweighted	Unweighted
Observations	1,443	1,280	1,443	1,280
R-sq	0.390	0.533	0.391	0.534

The table presents the results from OLS regressions of firms' decision to impair. The sample comprises up to 1,443 firm-year observations over the 2005–2019 period. The dependent variable is a binary variable equaling '1' in years in which the firm impairs. *Post (ET)* is a binary variable that equals '1' whenever a former executive is present on the firm's supervisory board. *Uncertainty shock* is an indicator variable that captures the occurrence of a shock measured by Baker et al.'s (2016) economic uncertainty score. In Panel A, we report our baseline specification that defines a year as a shock year when it includes month-over-month changes in the Germany-specific uncertainty score above the 95th percentile. In Panel B, we tighten the definition of a shock to the occurrence of an extreme increase in the last 3 months of a calendar year (columns (1) and (2)) and show the robustness of our inferences to a broader definition of uncertainty shocks using the 90th percentile of the score distribution (columns (3) and (4)). Entropy balancing weights in columns (3) and (4) of Panel A are estimated based on firm size, profitability, leverage, book-to-market ratio, and goodwill balance. We include financial controls, governance controls, as well as firm, year, and industry∗year fixed effects. The table reports OLS coefficient estimates and (in parentheses) standard errors clustered by firm. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels (two-tailed), respectively.

4.4. Board Roles

Next, we seek to shed light on the potential channels through which supervisory board members can influence how accounting discretion is exercised. Table 6 presents the results of our analysis using the *Post* variable that is limited to those transitioning cases in which the former executive takes on a specific role in the supervisory board. Column (1) reports the results based on transition events where the former executive either becomes the chairperson, a member of the audit committee, or a member of the nomination committee (*Any Major Role*). Columns (2) and (3) incorporate only those transition cases in which the former executive is the chairperson or audit committee member, respectively. In the first two specifications, the coefficients are both close to

Table 6. Major Supervisory Board Roles and Firms' Decision to Impair.

DV: Indicator Variable for GW Impairment	(1)	(2)	(3)
Any Major Role x Uncertainty Shock	− 0.191*** (0.060)		
SB Chair x Uncertainty Shock		− 0.199** (0.082)	
Audit Committee x Uncertainty Shock			− 0.124* (0.064)
Financial Controls	YES	YES	YES
Governance Controls	YES	YES	YES
Firm Fixed Effects	YES	YES	YES
Industry-Year Fixed Effects	YES	YES	YES
Observations	1,280	1,280	1,280
R-sq	0.536	0.534	0.533

The table presents the results from OLS regressions of firms' decision to impair. The sample comprises up to 1,280 firm-year observations over the 2005–2019 period. The dependent variable is a binary dummy variable equaling '1' in years in which firms impair. *Any Major Role* is a binary variable that equals '1' whenever a former executive is present either as chair of the supervisory board, member of the audit committee, or member of the nomination committee in the respective firm. *SB Chair* is an indicator that equals '1' whenever a former executive is present as chair of the supervisory board. *Audit Committee* is an indicator that equals '1' whenever a former executive is present as member of the audit committee. *Uncertainty shock* is an indicator variable that captures the occurrence of a shock measured by Baker et al.'s (2016) economic uncertainty score. We include financial controls, governance controls, as well as firm and industry∗year fixed effects in the regressions, but do not report the coefficients. The table reports OLS coefficient estimates and (in parentheses) standard errors. Standard errors are clustered by firm in all specifications. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels (two-tailed), respectively.

− 0.2 and statistically significant at least at the five percent level. Hence, transitioning firms in which new supervisors have a major role or serve as the chairperson are almost 20 percentage points less likely to impair their goodwill positions. For former executives in the audit committee, the estimate is smaller in absolute terms but still significant at the ten percent level. Overall, the coefficient estimates are larger in absolute size compared to the baseline findings in Table 3, especially in columns (1) and (2). This is consistent with major supervisory board roles increasing former executives' influence, which ultimately exacerbates the negative effect on goodwill impairments.

4.5. Moderating Factors

Finally, we analyze how executive board experience, supervisory board size, and adherence to a two-year cooling-off period moderate how former executives on the supervisory board influence the way in which accounting discretion is exercised. The impact of executive board experience is not clear ex-ante. One the one hand, supervisors with a long executive board term could be especially captured, in which case we would expect fewer and lower goodwill impairments. On the other hand, these supervisors benefit from their extensive firm-specific knowledge and their experience. This could be helpful in appropriately using the accounting discretion provided, ultimately leading to more effective monitoring and goodwill impairments closer to the economic situation. In this case, we would expect more and higher impairments. To test this, we split our treatment events into subsamples with transitioning managers having below – versus above-median executive board experience and estimate equation (3). Table 7 columns (1) and (2) present the results. In line with our previous findings, the baseline estimate is negative in both specifications and statistically significant at the five percent level. In addition, the estimate size is similar to the results shown before, indicating that transitioning firms with below-median

Table 7.   Moderating Effect of Executive Board Experience, Supervisory Board Size, and Cooling-Off Period.

DV:	Impair (Y/N) (1)	Imp. to TA (2)	Impair (Y/N) (3)	Imp. to TA (4)	Impair (Y/N) (5)	Imp. to TA (6)
Post (5Y)	− 0.114** (0.048)	− 0.086** (0.042)	− 0.171*** (0.058)	− 0.147* (0.080)	− 0.150*** (0.052)	− 0.107** (0.050)
Post (5Y) – High EB-Exp	**0.054** **(0.096)**	**0.117** **(0.091)**				
Post (5Y) – Large Board			**0.084** **(0.068)**	**0.095** **(0.076)**		
Post (5Y) – Cooling-Off					**0.137**** **(0.066)**	**0.098** **(0.083)**
Financial Controls	YES	YES	YES	YES	YES	YES
Governance Controls	YES	YES	YES	YES	YES	YES
Firm Fixed Effects	YES	YES	YES	YES	YES	YES
Year Fixed Effects	YES	YES	YES	YES	YES	YES
Observations	460	460	460	460	460	460
R-sq	0.488	0.238	0.486	0.237	0.493	0.238

The table presents the results from OLS regressions of firms' decision to impair (columns (1), (3), and (5)) and impairment amounts scaled by total assets (columns (2), (4), and (6)), respectively. The sample comprises 460 firm-year observations over the 2005–2019 period and includes only firm-years from the treated group of firms that experience at least one transition in the sample period. We define *Post (5Y)* as binary indicator variable that takes on the value of '1' in the five years after a board transition. *High EB-Experience* captures above median tenure in the executive board of a transitioning executive. *Large Board* is an indicator equal to '1' if a firm has a board size above our sample median. *Cooling-Off* is a dummy variable that equals '1' if the transitioning manager has been out of the executive board for at least two years when entering the supervisory board. We include financial controls, governance controls, as well as firm and year fixed effects in the regressions, but do not report the coefficients. The table reports OLS coefficient estimates and (in parentheses) standard errors. Standard errors are clustered by firm in all columns. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels (two-tailed), respectively.

executive board experience supervisors are 11.4 percentage points less likely to impair their goodwill positions. With respect to above-median executive board experience supervisors, the results reverse. In both specifications, the coefficient β_2 is positive but statistically insignificant. These results suggest that a high degree of executive board experience could help the supervisory board fulfill its tasks by using their firm-specific knowledge. Hence, the length of the executive board tenure seems to matter for the link between the presence of a former executive on the supervisory board and firms' goodwill impairment patterns.

Next, we investigate the moderating role of supervisory board size as a proxy for board independence. The influence of an individual supervisory board member is arguably smaller the larger the board size (Larcker & Tayan, 2023). Furthermore, a larger board requires more compromises to achieve consensus leading to less extreme decisions (Cheng, 2008). Thus, larger boards arguably hinder former executives from influencing the way in which accounting discretion is exercised. In line with this, we expect supervisory board size to mitigate the previously shown effect. Again, we split the events into firms with below – versus above-median supervisory board size and estimate equation (3). The results are presented in Table 7, columns (3) and (4). Consistent with our main results, the coefficients are negative and significant for the below-median board size cases, indicating that these transitioning firms are less likely to be impaired in the five years after a transition. On the other side, the coefficients for the above-median board size cases again are positive but not significant at conventional levels. Hence, the effect at least seems to be muted for transitions into larger and, thus, more independent supervisory boards,

consistent with our expectations. Further, the results corroborate prior findings that large boards attenuate abnormal outcomes (Cheng, 2008).[18]

Finally, we analyze whether compliance with a cooling-off period has an impact on the baseline effect. We use two years as a benchmark to align our specification with recent regulatory advances (e.g., in Germany). In general, a longer cooling-off period should increase the independence of the supervisory board and mitigate potential conflicts of interest of the former executives. In this case, we would expect a positive effect on goodwill impairments. To test this hypothesis, we split the treatment firms based on whether the transition case adheres to a two-year cooling-off period. Using this sample split, we estimate equation (3) and show the results in Table 7, columns (5) and (6). The estimate for firms with immediate transitions without a two-year cooling-off period is negative and statistically significant at least at the five percent level in both specifications. The coefficient estimate in column (5) equals – 0.15 and is larger in size compared to our baseline results in Table 3. This provides at least some suggestive evidence that immediate transitions with no cooling-off period are even more critical, as former executives in the supervisory board might be less independent and conflicts of interest might therefore be stronger. On the other side, firms that comply with a two-year cooling-off period exhibit positive coefficients. In column (5), the coefficient equals 0.137 and is statistically significant at the five percent level. This result suggests that transitioning firms that adhere to the two-year cooling-off period are more likely to impair their goodwill positions in the five years following a transition. With regard to the impairment size in column (6), the coefficient again is positive but insignificant. Overall, conflicts of interest tend to be particularly prevalent for immediate transitions, leading to the negative impact of former executives in the supervisory board on goodwill impairments. On the other side, the results suggest that compliance with a cooling-off period at least removes the negative impact of a former executive on the supervisory board on firms' goodwill impairments. Hence, a cooling-off period might mitigate conflicts of interest and increase the independence of the supervisory board, ultimately resulting in more effective supervision.

4.6. Robustness Tests

We perform several robustness tests to substantiate the above-presented results and to mitigate some additional concerns. First, we employ stacked regression designs to account for the staggered nature of our treatment events. Recent advances in the methodological literature have raised concerns about the impact of heterogeneous treatment effects in difference-in-differences regressions with staggered treatment assignment (e.g., Baker et al., 2022). We follow the stacked approach outlined in Cengiz et al. (2019) and construct separate datasets for each treatment year cohort. Each of these datasets includes both the treated firms from the respective cohort and all control firms that never experience an executive transition to the supervisory board during our sample period. Results are tabulated in Panel A of Table 8. In addition to the raw stacked regression, we include specifications using entropy balancing weights and propensity score matching to account for selection on observable characteristics. Across all specifications, we find a negative coefficient that is in line both in terms of magnitude and in terms of significance with our baseline findings. Figure 1 depicts the coefficient of interest from the stacked regression with matching in event time. In addition, the small and statistically insignificant coefficients in the pre-period lend support to the parallel-trends assumption.

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[18]In untabulated robustness tests, we use alternative proxies for supervisory board independence, namely gender ratio, the number of additional board positions held by the members, the board-level average tenure of the members on the supervisory board, the boards' nationality mix, as well as the standard deviation of the board members' ages. Across all proxies, the results are qualitatively and quantitatively similar to the results in Table 7, columns (3) and (4).

Table 8. Robustness.

DV: Indicator Variable for GW Impairment	(1)	(2)	(3)	(4)	(5)	(6)
Panel A: Stacked Regression						
Post x Treatment	− 0.118**	− 0.116*	− 0.093*	− 0.091	− 0.140*	− 0.172*
	(0.059)	(0.065)	(0.049)	(0.055)	(0.078)	(0.101)
Specification	Stacked	Stacked	Stacked + EB	Stacked + EB	Stacked + PSM	Stacked + PSM
Financial Controls	YES	YES	YES	YES	YES	YES
Governance Controls	YES	YES	YES	YES	YES	YES
Firm Fixed Effects	YES	YES	YES	YES	YES	YES
Year Fixed Effects	YES	NO	YES	NO	YES	NO
Industry-Year Fixed Effects	NO	YES	NO	YES	NO	YES
Observations	9086	9041	9086	9041	738	584
R-sq	0.437	0.644	0.507	0.663	0.589	0.690
Panel B: Selection Model						
Predicted Treatment	− 0.399*	− 0.481**	− 0.429*	− 0.472*	− 0.614**	− 0.465
	− 0.215	− 0.219	− 0.225	− 0.281	− 0.292	− 0.331
Financial Controls	YES	YES	YES	YES	YES	YES
Governance Controls	RED	RED	RED	YES	YES	YES
Year Fixed Effects	NO	YES	YES	NO	YES	YES
Industry Fixed Effects	NO	NO	YES	NO	NO	YES
Sample	All	All	All	Matched	Matched	Matched
Observations	351	350	350	149	149	147
R-sq	0.161	0.201	0.243	0.27	0.345	0.412

The table presents the results of robustness tests. Panel A reports the estimation results from regressions on stacked datasets. We construct separate datasets for each treatment year cohort. Each of these datasets includes both the treated firms from the respective cohort and all control firms that never experience such a transition. In Columns (3) and (4), entropy balancing weights are estimated based on firm size, profitability, leverage, book-to-market ratio, and goodwill balance. In Columns (5) and (6), we match the respective treated firms in each cohort to control firms based on the five-year pre-treatment mean of the same set of control variables using propensity score matching (1:1, nearest neighbor, no replacement). In all specifications, we retain observations from a five-year window around the cohort year. We then stack these separate datasets together. The dependent variable is a binary variable equaling '1' in firm-years in which goodwill is impaired. Panel B depicts the results of firm-level regressions using the predicted treatment estimates of a first-stage selection model as an explanatory variable. The selection model includes an indicator variable equaling one for managers in the second half of their career as well as pre-event year firm characteristics as control variables. Columns (1) to (3) rely on a broad control sample of CEO switches where the leaving CEO does not enter the supervisory board. Due to data availability, the selection model includes the control variables *Size*, *Ann. Stock Return*, and *Acquisition in Past 5 Years*. Further, data availability restricts the governance control variables in the second stage regression to *EB Experience* and *Audit Quality*. Columns (4) to (6) are based on a reduced control sample including CEO switches that are matched to the transition cases based on industry and switching year. We include financial controls, governance controls, as well as industry, firm, year, and industry-year fixed effects in the regressions. The table reports OLS coefficient estimates and (in parentheses) standard errors clustered by firm. ∗∗∗, ∗∗, and ∗ indicate statistical significance at the 1%, 5%, and 10% levels (two-tailed), respectively.
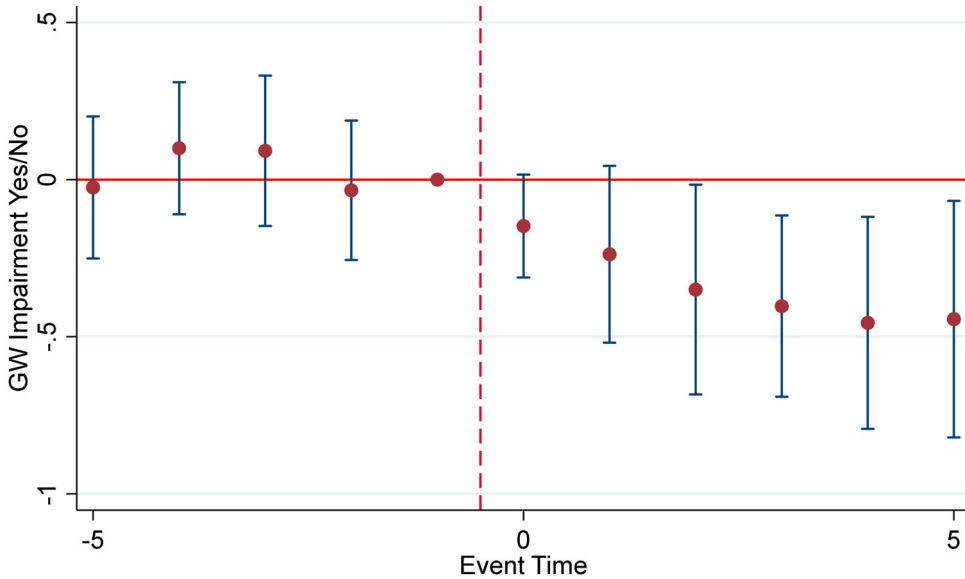
Figure 1. Event Study Graph. The figure plots the coefficient of interest (indicating the transition of a former executive) from a stacked difference-in-differences regression in event time. We construct separate datasets for each treatment year cohort. Each of these datasets includes both the treated firms from the respective cohort and all control firms that never experience such a transition. For each treatment cohort, we match the respective treated firms to control firms based on the five-year pre-treatment mean of the control variables firm size, profitability, leverage, book-to-market ratio, and goodwill balance using propensity score matching (1:1, nearest neighbor, no replacement). We retain observations from a five-year window around the cohort year. We then stack these separate matched datasets together. The dependent variable is a binary indicator variable equaling '1' in firm-years in which the goodwill position is impaired. The stacked regression includes both firm and industry-year fixed effects, as well as the sets of governance and financial control variables. Standard errors are clustered at the firm level. Coefficients are estimated relative to the base period t-1 and depicted with their 90% confidence intervals.

Another remaining concern relates to the endogenous appointment of a former executive to the supervisory board. For example, former executives with good firm performance during their tenure might be more likely to be elected to the supervisory board. However, good performance during the executive term might also have an impact on goodwill impairments. While the results on the economic substance and exogenous shocks mitigate this concern to some extent, we implement a two-stage estimation, modeling the decision to appoint a former executive in the first stage. We construct a control sample of CEO exits without transition (i.e., the leaving CEO does not enter the supervisory board) and model the decision to transition a former executive for treatment and control firms based on average firm characteristics over the past five years prior to the executive board exit. As a quasi-exogenous variable in the selection equation, we include a binary indicator variable equaling one if the leaving manager is in the second half of her professional career, i.e., she is at least 45 years old. This indicator variable is a significant predictor of the transition decision. Next, we rerun the base analysis using the predicted treatment estimates from the selection equation as an explanatory variable of interest. As the dependent variable, we take the average value of the goodwill impairment indicator variable over the five years following the manager switch. Hence, one observation enters the equation per exit event. We include several control variables, again using the average values over the following five years, as well as year and industry fixed effects. In addition, we include the same pre-switch control variables that are used in the selection equation.

Table 8, Panel B includes the results of these tests. Columns (1) to (3) show the results using a broad control sample of CEO exits, whereas in columns (4) to (6) the control events are matched to the transition cases based on industry and exit year to ensure similar economic conditions. The selection model in columns (1) to (3) includes the control variable size, performance proxied by annual stock return, and the indicator variable for acquisitions in the past 5 years. Data availability restricts the governance control variables in the second stage regression to executive board experience and audit quality, whereas all financial controls from equation (1) are included. In columns (4) to (6), we expand both the first and the second stage regression and include all financial control variables from equation (1) as well as the governance control variables executive board experience, executive board size, supervisory board size, and audit quality. Throughout all specifications, the coefficient estimates are negative and larger in absolute terms compared to the results in Table 3. Further, the estimates are significant at least at the ten percent level in five out of six specifications. Using year and industry fixed effects as well as the matched control sample leading to a much smaller sample (column (6)), the estimate is still close to the ten percent significance level. Overall, the baseline results are confirmed when controlling for the endogenous transitions decision by using the first-stage selection model.

We run a battery of additional robustness tests and tabulate the results in the Online Appendix. First, we tackle the concern that our treatment sample might include only routine executive changes whereas the control sample includes all non-routine changes triggered by very weak performance prior to the manager leaving the executive board. To alleviate this concern, we use the control sample of CEO exits without transition constructed above for the selection test (Table 8, Panel B) and exclude all cases with a negative three-year average stock market return prior to the executive board exit (both for the treatment and control firms). The estimates are consistent with the baseline findings and show that the results are not driven by bad performers in the control group.

Second, we use an indicator variable for years between executive and supervisory board memberships to examine the potential impact of big bath accounting in years before the former executive joins the supervisory board. The estimates suggest that our main results are not driven by big bath patterns in prior periods leading to lower impairments in the periods of interest.

Third, we account for the fact that a few firms have a tradition of transitioning former executives to their supervisory boards. We exclude firms that have a former executive on their supervisory board in at least 50 percent of the sample years to rule out that our results are driven by these regularly transitioning firms. Results are in line with our main findings.

Fourth, we run several additional robustness tests related to methodological concerns. Our results are robust to altering the length of the post-period to three years as well as to changing the dependent variable capturing the intensive margin to impairment amounts scaled by lagged goodwill. In addition, we employ logit regressions, considering the binary nature of the dependent variable (i.e., the indicator variable for goodwill impairments). The results indicate a lower probability of impairments in the post-transition years, supporting the baseline finding.

Finally, we conduct a falsification test, in which we randomly assign transition events across our sample, estimate our baseline regression model (Table 3 column (2)), and repeat this simulation 500 times. The average effect is insignificant with the approximately symmetric distribution of t-statistics being centered around zero. Importantly, our estimated t-statistic (i.e., from Table 3 column (2)) is in the far-left tail of this distribution with only 2.2 percent of simulated t-statistics being to the left of it. Thus, the results suggest that it is highly unlikely that a significant treatment effect like the one we estimate is driven by pure chance or a general trend in the dataset.

5. Conclusion

This paper investigates how the presence of former executives on the supervisory board of the same firm affects the exercise of accounting discretion within that firm. We focus on goodwill impairments since there is considerable managerial discretion in this accounting item. Based on a hand-collected sample of executive transitions within German listed companies, we show a decreased propensity and magnitude of goodwill impairments following the transitions. This baseline effect is consistent across several specifications and suggests that a lack of independence and reputational concerns negatively impact goodwill impairments.

Our results highlight how an important feature of a firm's governance choices relates to accounting outcomes and, in particular, accounting discretion. In doing so, they provide a more nuanced picture of accounting discretion in the context of executive transitions. Due to the prevalence of executive transitions in many corporate governance cultures, including the Anglo-American one, we expect our findings to generalize well beyond the German setting. Furthermore, the findings also relate to the literature on determinants of goodwill impairments. Accounting rules for goodwill impairments continue to be on the agenda for both the FASB and the IASB. At the same time, recurring governance scandals spur regulatory debates on attempts to increase the independence of supervisory boards. Thus, our findings also inform the regulatory process around the impairment-only approach as well as around governance-related regulations like mandatory cooling off periods.

Our study has at least two limitations. First, our study shares the challenges prevalent in the impairment literature that the underlying economic impairment is inherently unobservable and that firms are required to perform goodwill impairment tests on the level of CGUs while our proxies for economic impairments are at the firm level (e.g., André et al., 2016; Beatty & Weber, 2006; Glaum et al., 2018; Ramanna & Watts, 2012). Related to the former point, we conduct several tests in which we proxy for the economic substance of impairments, which at least mitigates such concerns. Regarding the latter point, our analyses are conducted at the firm level as more granular data is not publicly available. If firms in the future must disclose information about the performance of individual business combinations as proposed by the IASB (IASB, 2024), future studies could potentially use these disclosures to circumvent this limitation. Second, corporate governance choices, including the selection of executives, the length of an executive's tenure, and subsequent executive transitions to supervisory roles, are not exogenous (Larcker & Tayan, 2023). We attempt to mitigate endogeneity concerns by conducting a series of robustness tests including alternative research designs based on exogenous economic shocks and a selection model. Nevertheless, we acknowledge that selection concerns always remain as they are not fully addressable.

Notes

1. See e.g., the guidelines for supervisory board members published by the influential German Hans Böckler Foundation (Hans-Böckler-Stiftung, 2010).
2. These strategic parameters typically become the basis for key accounting decisions. The German real estate company Vonovia, for example, states that the value in use that enters the impairment test as a benchmark was 'derived from the five-year plan at Group level approved by the management board and the supervisory board' (Vonovia, 2021).
3. One example is Bayer AG and its acquisition of Monsanto during the CEO tenure of Werner Baumann. The acquisition led to significant costs for Bayer due to claims for damages related to Monsanto's herbicides. Even years after the acquisition, Baumann has been heavily criticized for the deal by investors and the press (https://www.sueddeutsche.de/wirtschaft/bayer-baumann-bilanz-anderson-1.5759793, accessed 8th August 2024).
4. The 20 percent decrease is calculated based on the sample average impairment amount conditional on observing a goodwill impairment, which equals 0.89 percent of total assets. The 48 million Euro reduction is calculated by

multiplying the unconditional average firm size of 28 billion Euros in total assets with the coefficient of – 0.17 (Table 3 Panel B column (1)).

5. Events that led to these drastic increases are, e.g., the financial crisis of 2008/09 and Brexit. These shocks likely triggered economic impairments of goodwill positions.

6. This applies to shareholder representatives. Under the German model of codetermination, employees separately elect employee representatives to the supervisory board. Their number depends on the firm's size and industry.

7. The impairment-only approach has been applicable under US GAAP since 2001 and under IFRS since 2005.

8. Since by its very nature goodwill cannot be separated from the company itself, sold to a third party, or itself generate independent cash inflows, it is allocated to CGUs for the purpose of impairment testing (IAS 36.80).

9. For a comprehensive review, see Bebchuk and Weisbach (2010).

10. The nomination of a former executive for a supervisory board position is typically motivated with firm – and industry-specific information advantages. While firms could also retain such information and advisory advantages through consulting contracts with former executives, prior studies argue that monitoring and advising goals are most effectively achieved through a board position (e.g., Evans et al., 2010). Based on our review of the transition cases in our sample, financial knowledge is typically not the main reason stressed during the nomination. Nevertheless, former executives are often candidates with financial expertise and their election would hence help the company to fulfill the legal requirement of having at least one financial expert on the supervisory board (codified in §100 (5) AktG).

11. In Germany, this duty is codified in §§ 267 (1) and 316 of the German commercial code (however, similar requirements exist in other legal environments, e.g., in the US). Importantly, this duty applies to all individual members and cannot be outsourced to a certain committee, but of course by its very nature, the audit committee will be more directly involved with accounting questions.

12. This assumption is in line with initial reactions from the industry when the topic of a mandatory cooling-off period came up. Managers feared that even after a two-year period between executive board service and entering the supervisory board, a manager's firm-specific knowledge could be outdated (e.g., interview with Jürgen Hambrecht, former CEO of BASF SE: https://www.egonzehnder.com/de/insight/interview-mit-jurgen-hambrecht-basf, accessed 8th August 2024).

13. We test whether there is an association between the occurrence of a shock in the next period and the decision to appoint a former executive to the supervisory board in a given period. The coefficient is close to zero and insignificant at conventional levels (all *p*-values are above 0.5).

14. This is likely a conservative definition as we expect the differential impact of a former executive to be strongest immediately after the transition. Since this definition of Post includes executives that have transitioned long before the shock, this should work against us finding a significant difference in their reaction to economic shocks between firms with and firms without former executives as supervisors.

15. The calendar year corresponds to the financial year for almost all of our sample firms, meaning that these firms indeed would only have three months to adjust real operations before preparing the annual reports. We acknowledge that these real operational changes are just one way how firms could react to economic shocks. They could, of course, also use accruals-based strategies to minimize the need to record impairment losses. These strategies, however, tie in closely with the reporting discretion we seek to capture. While a former executive generally might be able to exert influence in both real operations and accounting discretion, thus affecting goodwill impairments, separating out these late-year shocks enables us to more cleanly capture the accounting-discretion avenue that we study in this paper.

16. Hence, for example, with respect to executive board experience, *Post (5Y)* and *Split_Post* capture the impact of transitioning managers with below – versus above-median executive board experience on firms' goodwill impairments in the five years after the transition, respectively.

17. In addition, we perform untabulated robustness tests based on the previous year's book-to-market ratio as an alternative proxy for required goodwill impairment. Again, this proxy relies on market-based indicators assuming that a book value of equity exceeding the market value indicates the need for impairment. Reducing the sample to firm-year observations with a previous year's book-to-market ratio of above one yields qualitatively consistent results.

18. In untabulated robustness tests, we use alternative proxies for supervisory board independence, namely gender ratio, the number of additional board positions held by the members, the board-level average tenure of the members on the supervisory board, the boards' nationality mix, as well as the standard deviation of the board members' ages. Across all proxies, the results are qualitatively and quantitatively similar to the results in Table 7, columns (3) and (4).

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Supplemental Data and Research Materials

Supplemental data for this article can be accessed online at https://doi.org/10.1080/09638180.2024.2427172.
Online Appendix A: Descriptive Statistics; Online Appendix B: Additional Robustness Tests; Online Appendix C: Falsification Test

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