

REVIEW OF ACCOUNTING FOR GOODWILL: HISTORICAL TO CURRENT PERSPECTIVES

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Abstract

Accounting for goodwill is one of the most controversial issues in financial reporting. It has been on the agenda of the International Accounting Standards Board (IASB) as well as the Accounting Standards Board of Australia, the UK, and the US. IASB has also identified accounting for intangible assets (including goodwill) as a high priority. The objective of the present paper is to review the developments of accounting standards for goodwill made by the USA, UK, Canada, Australia, and the IASB. Reference to accounting and financial regulations is made to explore the effect of standard developments in promoting uniformity of practice in accounting for goodwill. Content analysis approach is adopted in this study. It concludes that the current regulations to account for goodwill provide little and further developments are still ahead.

Keywords: Goodwill, IASB, Financial Reporting, Accounting Standards, Review, Uniformity

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Introduction

Developments of accounting standards for goodwill have been given considerable attention for some time by the accounting profession and standard-setting bodies in the US as well as abroad. In spite of the massive investment of time and resources in recent years, improvements are still in progress to achieve significant moves in present day financial reporting. This paper reviews the developments of accounting standards considers the current statutory position of accounting for goodwill approved by the USA, UK, Canada, and Australia. It ends with a particular emphasis on developments made by the IASB in promoting uniformity of practice in accounting for goodwill.

The paper analyses and compares these different regulations issued by international accounting standard-setting bodies' documents to address the fundamental assumptions underlying the objectives of accounting for goodwill. Content analysis approach is adopted in this study. Content analysis can, sometimes, be subject to personal judgment and thus bias. But in terms of studying historical data, its main advantage is objectivity, in addition to its ability to provide unobtrusive evidence of historical trends (for example, Aronoff 1975, West 2007). Content analysis was, therefore, considered preferable to this study, given its analytical and comparative nature of historical regulations.

Some International Developments

US GAAP

In August 1970, The Financial Accounting Standards Board (FASB) issued the Accounting Practice Board (APB) Opinion No. 17 "Intangible Assets" to give guidance for the accounting treatment of intangibles in the US. The Opinion require purchased intangibles, whether identifiable or unidentifiable, be capitalized and systematically amortized over the estimated life of each specific asset, but not exceeding 40 years. The Opinion had not been significantly updated or amended until the FASB included to its agenda a project to reconsider APB No. 17 in August 1996. The project addressed fundamental issues relating to accounting for goodwill and other purchased intangible assets. In September 1999, the FASB issued an exposure draft of a proposed statement "Intangible Assets", calling for reducing the amortization period for goodwill from 40 years to 20 years. Early 2000, Congressional hearings provided that many were not satisfied with this proposal. In both Senate and House committee hearings, the focus was on urging the FASB to ensure that the new standard is to accounting for goodwill in such away to meet its meant objectives. In February 2001, the FASB issued a revised exposure draft that proposed changes to accounting for goodwill, including its non-amortization and a goodwill impairment approach.

In July 2001, the FASB issued the new Statement of Financial Accounting Standards (SFAS) 142 "Goodwill and Other Intangible Assets". The new standard requires goodwill be recognized, as the prior standard did under the purchase method, but does not require the amortization of goodwill. Instead, it requires goodwill be reviewed if evidence exists that goodwill of a reporting unit's goodwill is less that its carrying amount. Other purchased intangibles with an indefinite life should be

capitalized and not be amortized; instead, they should be subject to a fair value impairment test, whenever an event occurs indicating that the asset may be impaired. When the life of such assets is determined to be finite, then they should be amortized over their useful life. They still should be tested for impairment, but in accordance with the requirements set out on SFAS 144 "Accounting for the Impairment or Disposal of Long-Lived Assets".

The fair value impairment test procedures are set out in SFAS 142, requiring that goodwill is reviewed for any impairment at least annually and whenever events or circumstances occur that would likely reduce the fair value of a reporting unit below its carrying amount. The annual impairment does not have to be performed at the end of the fiscal year as long as it is performed at a consistent date every year. The statement incorporates a two-step approach to test for impairment. Step 1 requires entities to compare the fair value of a reporting unit with its carrying amount (book value), including goodwill. If the fair value is greater, goodwill of the reporting unit is not considered impaired and no further testing needed. If the fair value is less than its carrying amount, then go to the next step. Step 2 requires the entity to compare the "implied fair value of the goodwill" with its carrying amount. If the carrying amount is greater, impairment loss equal to the difference is recorded. For example, the fair value of the reporting unit is treated as the purchase consideration combination (including unrecognized intangible assets that would be recognized in an acquisition). Any remainder is deemed to be the implied fair value of goodwill, which will include any internally generated goodwill. An impairment loss is recognized (before operating income) to the extent that the carrying amount of goodwill exceeds its implied fair value. Once the goodwill impairment loss is recorded, it cannot be reversed. In order to estimate the fair values, the SFAS 142 recommends the present value technique using estimates of future cash flows.

With respect to the principles of accounting for negative goodwill, the SFAS 141 "Business Combinations", which was also issued on July 2001 and superseded APB No. 16, specifically dealt with the matter. The Statement states that goodwill, under the purchase method of accounting for business combinations, is the difference between the consideration paid and the sum of the fair values net assets acquired. Any excess over the consideration paid (excess net assets) be allocated as a pro rata reduction to all acquired assets except (1) financial assets other than investments accounted for by the equity method, (2) assets to be disposed of by sale, (3) deferred tax assets, (4) prepaid assets relating to pensions or other post-retirement benefit plans, (5) any other current assets. When the allocation reduces these assets to zero, any remaining balance of "excess net assets" is treated as extraordinary gain in the period in which the business combination is completed. If negative goodwill arises in a business combination that involves contingent consideration, part or all of the negative goodwill will be treated as if it were a liability, notwithstanding it does not meet the definition of a

liability. There is to be no negative goodwill carried forward on the statement of financial position.

UK GAAP

In December 1984, the Accounting Standards Committee (ASC) issued Statement of Standard Accounting Practice SSAP 22 "Accounting for Goodwill". SSAP 22 recommended that purchased goodwill should be written off to reserve in the period in which it is acquired or by systematic amortization over its estimated useful life through the profit and loss account. No maximum or minimum period was specified for the amortization period, but the chosen period has to be disclosed. Internally generated goodwill is not allowed to be recognized. Negative goodwill should be credited to a reserve at the time of acquisition.

SSAP 22 received much criticism that was mainly related to the differential treatment between accounting for goodwill and purchased intangibles. Thus, SSAP 22 was revised on July 1989 and subsequently the ASC issued two Exposure Drafts in 1990. The first ED 47 "Accounting for goodwill". ED 47 eliminated the option to write acquired goodwill off to reserve at the date of acquisition. In addition, it required the recorded goodwill to be systematically amortized over a period not to exceed 20 years. In that draft, it was argued that capitalization and amortization of goodwill would lead to improved accountability and would also bring the UK into line with the most of the world such as Australia, Canada, and USA. The second Exposure Draft was ED 52 "Accounting for Intangible Fixed Assets". ED 52 did not distinguish between acquired and internally generated intangibles but mandated that initial recognition can occur only if historical costs are known or reasonably ascertainable. Intangible assets are to be amortized over their useful lives, up to maximum of 40 years. That document superseded Technical Release TR 780 "Accounting for Intangibles Assets" issued earlier in 1990 by the ASC.

In 1993, the Accounting Standards Board (ASB), which replaces the ASC, started their work on this issue with a new version of the discussion paper "Goodwill and Intangibles Assets". In that discussion paper, the ASB outlined the main criticism of ED 4, which was related to the force annual amortization of goodwill.

In June 1986, the Accounting Standard Board (ASB) issued the Financial Reporting Exposure Draft (FRED 12) "Goodwill and Intangibles Assets". The Draft recommended that purchased goodwill be capitalized and purchased intangible assets be recognized separately from goodwill when their value can be measured reliably. Furthermore, any recognized intangibles are amortized over not more than 20 years, but exceptionally, amortization to be avoided altogether and an impairment review applied instead. In December 1997, the ASB issued the Financial Reporting Standard (FRS 10) "Goodwill and Intangibles Assets" which changed the goodwill treatment and is still in operation. FRS 10 Section 2 defines purchased goodwill as 'the difference between the cost of an acquired entity and the aggregate

of the fair values of that entity's identifiable assets and liabilities'. Negative goodwill arises when the aggregate fair values of the identifiable assets and liabilities of the entity exceed the acquisition cost. Intangible assets are defined as 'non-financial fixed assets that do not have physical substance but are identifiable and are controlled by the entity through custody of legal rights'. FRS 10 recommends that positive purchased goodwill as well as purchased other intangibles should be capitalized and systematically amortized over not more than twenty years. It requires an estimate of the useful economic life to be made and the chosen period to be disclosed and justified. Internally generated goodwill should not be capitalized. While internally developed intangible assets may be capitalized only if it has a readily ascertainable market value.

FRS 10 requires goodwill and other intangibles that are amortized over a period not exceeding 20 years be initially reviewed for impairment at the end of the first full year following acquisition, with full review being required in subsequent periods only if the initial review indicates a potential impairment. Further, it requires goodwill and other intangibles that are amortized over a period exceeding 20 years (and goodwill and other intangibles that are not amortized ¹) to be reviewed for impairment at the end of each reporting period regardless whether there are indications of impairment. In general, FRS 10 impairment reviews are performed in accordance with the requirements set out on FRS 11 "Impairment of Fixed Assets and Goodwill", which is broadly consistent with IAS 36, except that the "cash-generating unit" is referred to as the "income-generating unit" in FRS 11.

Canadian GAAP

The Accounting Research Committee's Recommendations on "Business Combinations" were issued in December 1973 as Section 1580 of the Canadian Institute of Chartered Accountants (CICA) handbook. Section 1580 "Business Combinations" provides Standards covering purchased goodwill and apply to business combinations after March 31, 1974. Paragraph 54 does not define goodwill but 'is commonly considered to be a composite of all the factors which cannot be individually identified and valued and which contribute to or accompany the earnings capacity of a company'. It arises when the purchase price exceeds the acquiring company's interest in the identifiable net assets. Any purchased goodwill is regarded as having a finite life and is systematically amortized over its useful life, which may not exceed 40 years. The straight-line method of amortization should be applied. Where there has been a permanent impairment in value of the unamortized portion of goodwill, it should be written down. The write-down should be treated as a charge against income. Section 3060 Capital Assets "Intangible Properties" was released in July 1900 and was applicable to accounts with year-ends after December 31, 1991. Paragraph 6 of Section 3060 defines 'intangibles properties' as capital assets that lack physical substance. Examples of intangible properties include brand names, copyrights,

franchises, licenses, patents, software, subscription lists, and trademarks. Section 3060 requires intangible properties to be recorded at cost and to be amortized over the shorter of their useful life or 40 years.

In late 1998, the Accounting Standards Board (AcSB) of the Canadian Institute of Chartered Accounts issued an Invitation to Comment entitled "Methods of Accounting for Business Combinations: Recommendation of the G4+1 for achieving Convergence". This invitation to Comment solicited views of a group of standard-setters known as the G4+1, which includes representatives from the accounting standards boards of Australia, Canada, New Zealand, the United Kingdom and the United States. Representatives of the IASC participate as observers. In September 1999, the AcSB issued an exposure draft entitled "Business Combinations" that deals with the accounting for goodwill including the proposed goodwill impairment approach. The AcSB proposes to supersede the existing Business Combination, Section 1580 and revise certain paragraphs of the existing Capital Assets, Section 3060 as they relate to accounting for intangible assets. The Canadian responses to the draft provided strong support for the AcSB's approach of working closely with the FASB and stressed the importance of harmonizing business combination standards in Canada and the United States.

Australian GAAP

In May 1983, the Australian Research Foundation (AARF) issued an Exposure Draft (ED 23) in 'Accounting for Goodwill' for comment. Ninety-one submissions were received on ED 23. The number of respondents was double the usual number submitted to exposure drafts, which are normally 40 to 50 responses. Most respondents made effective comments on the draft. The draft was subsequently revised and issued as Australian Accounting Standard (AAS) 18 by the AARF in March 1984 and became operative as at March 31, 1985.

The AAS 18 was entitled 'Accounting for Goodwill'. Paragraph 14.1 of the standard defined goodwill as 'the future benefits from unidentifiable assets'. Identifiable assets were defined as 'those assets, which are capable of being both individually, identified and specifically brought to account'. Unidentifiable assets were 'those assets which are not capable of being individually identified or accounted for'. Purchased goodwill must be measured as 'the excess of the cost of acquisition incurred by the entity over the fair value of the identifiable net assets acquired'. Purchased goodwill to be recognized as an asset and systematically amortized over its useful life, which may not exceed 20 years. At each balance date, the unamortized balance of goodwill needs to be reviewed and written down to the extent that it is no longer supported by probable future economic benefits. Any resultant loss must be accounted for as an expense immediately in the statement of financial performance. The upward revaluation of goodwill was prohibited. Where a discount on acquisition arises, this

was to be accounted for by reducing proportionately the fair values of the non-monetary assets acquired, with any remaining balance to be classified as revenue in the profit and loss account. The standard requires disclosure of the following.

- The unamortized balance of goodwill at the reporting date.
- The amount of goodwill amortized as an expense, including any expense resulting from a review of the goodwill balance.
- The period over which goodwill is being amortized.

In December 1985, AARF issued the Accounting Guidance Release No. 5 (AGR 5) "Accounting for Intangible Assets Recognized in Accordance with Statement of Accounting Standards AAS 18 'Accounting for Goodwill'". The reason behind the issuance of AGR 5 was the belief that the advent of AAS 18 led many companies to overcome the requirement to amortize goodwill against income by recording new types of intangibles not covered by AAS 18, which would therefore not need to be amortized. AGR 5 was issued to remind preparers of financial statements of the requirement for identifiable assets to be recognized in the accounts and to be amortized via systematic charges against income over the period of time during which the benefits are expected to arise this is according to AAS 4 'Depreciation of Non-Current Assets'.

In July 1986, the National Companies and Securities Commission (NCSC), which was a body that responsible for supervising the administration of companies' legislation in Australia, released a policy statement (Release 135) titled "Revaluation of Intangible Assets". The release statement was mainly concerned with revalue amounts in prospectuses of the intangible assets, the year and basis of valuation and whether the valuation was a directors' or independent valuation. In April 1988, The ASRB approved an accounting standard on the subject of goodwill and issued ASRB 1013, with application to all companies with financial years ending on or after June 19, 1988. In August 1989, ED 49 'Accounting for Identifiable Intangible Assets' was issued by the AARF. Intangible assets were defined as 'non-monetary assets without physical substance and includes but is not restricted to brand names, copyright, franchises, intellectual property, licenses, masthead, patents and trademarks'. ED 49 proposed that if identifiable intangible assets satisfy the assets recognition criteria of SAC 4 "Definition and Recognition of the Elements of Financial Statement", then they should be recognized as assets. According to SAC 4, the assets recognition criteria are:

(1). It is probable that the future benefits or services potential embodies in the identifiable intangible assets will eventuate; and

(2). It possesses a cost or the value that can be measured reliably'.

ED 49 allowed that the acquired and internally generated intangibles were to be recognized in the accounts. Purchased identifiable intangible assets should be recorded at their cost of acquisition while internally

generated identifiable intangible assets should be recorded either at the costs incurred in the current reporting period or 'at the lowest cost at which assets could currently be obtained in the normal course of business as determined by independent valuation'. Subsequent to recognition, all intangibles were to be amortized over the period of time in which benefit were expected to arise. No upper limit for amortization period was specified. The amortization period could exceed 20 years provided that detailed disclosures were given. Amortisation was required even if there were annual revaluations of intangibles. It also noted that the carrying amount of identifiable intangibles assets should not exceed its recoverable amount. ED 49 allowed for revaluations of intangibles. The amount of the revaluation had to be determined by independent valuation and the revaluation increments or decrements accounted for in accordance with AASB 1010 'Accounting for Revaluation of Non-Current Assets'. In 1990, the NCSC issued a draft policy statement titled: "Identifiable Intangible Assets Valuations". This statement follows the release of ED 49 to mainly consider alternative methodologies for the valuation of various classes of identifiable intangibles, with particular reference to brand names, trademarks, mastheads, and licenses. It recommended the comparative royalty method as a "primary valuation methodology" in spite of its practical limitations, whereas the ED 49 recommended the replacement cost methodology. This recommended approach implied quantifying the saving made from owning as assets either by capitalizing or discounting the current benefits.

In 1991, the legislative system governing the Australian companies reporting requirements went through major administrative changes. The corporation Act (1989) and the Australian Securities Commission Act (1989) replaced the former Companies Act and Code. Australian Securities Commission (ASC) and the AASB replaced the former NCSC and the ASRB respectively. The AASB has the same responsibilities and power as the ASRB. All standards that have been previously approved by the ASRB have effect as if they had been issued by the AASB. For the purpose of investigating the impact of ED 49 on accounting practice for identifiable intangible assets, reference is made to Ryan et al (1993) "Australian Company Financial Reporting". They surveyed the accounting policies adopted for goodwill and identifiable intangible assets by the top 150 Australian listed holding companies for the period from 1989 to 1992. Tibbits (1993) provided the financial information in relation to accounting for identifiable intangible. Table 2 presents the analysis of accounting for trademarks and brand names. It reveals that there was a diversity of accounting methods for companies with trademarks and brand names. As noted from the above table, three methods dominated which were "assets without amortization", "assets with amortization", and "assets with periodic revaluation". The other method represented a distinct minority. However, one can argue that there was a significant degree of non-compliance with the Ed 40, but it was almost equally apparent that the draft increased the

number of companies adopting the capitalization and amortization method. It was also clear that the predominant practice of amortization was 20 years or estimated life whichever is the shorter. Presumably, those companies that adopted a non-amortization approach believed that amortization was not necessary because the assets involved were subject to revaluation on a regular basis. This can be consistent with previous studies such as Carengie and Kallio (1988) and Greenwell and Tibbits (1992). Amortisation charge the early years which then increased over the twenty- year period. PN 39 sets the ASIC's view with respect to accounting for goodwill, subsequent to recognition. It indicated that the method of amortization (ISOYD), only in rare cases, satisfies the requirement of AASB 1013.

In December 1995, the AASB and the Public Sector Accounting Standards Board (PSASB) issued Ed 68 "Amortisation of Purchased Goodwill Amendments to AAS 18/AASB 1013" for comments. According to Spencer (1996), a total of 28 submissions were received and reviewed. It was found that there was no support for the straight-line rule of amortization to be prescribed method by the standard. In June 1996, the ASSAB, consequently, revised and issued a new version of the ASSB 1013. The revised standard that was effective from 30 June 1996, introduced the requirement to employ the straight-line basis of amortizing goodwill over the period in which benefits are expected, the period must not exceed twenty years. The standard did not provide reasons for the prescription of a specific method of amortization. However, Spencer (1996) argued that the imposition of the straight-line method stemmed from the fact that AASB was dissatisfied by ED 68 responses that the pattern of expected benefit resulting from goodwill could be arbitrarily determined. In May 1997, the AASB and PSASB withdrew AGR 5 because they considered that prepares now understood the necessity to comply with the requirements of AAS 4/AASB 1021 'Depreciation'.

In June 1999, the Public Sector Accounting Standards Board (PSASB) and AASB released Accounting Interpretation AI 1 regarding the amortization of identifiable intangible assets under AASB 1021/ AAS 4 "Depreciation of Non-Current Assets". The controversy that surrounded AI 1 illustrated that there were different interpretations in relation to the general accounting requirements for identifiable intangible assets included in AASB 1021/AAS 4. The AI 1 stated that there was a need for guidance on the issues whether identifiable intangible assets including brand names, mastheads, licenses and trademarks fall within the definition in AASB 1021/ AAS 4 of 'depreciable assets' and have depreciable amounts. The guidance statement took the view that at the time identifiable intangible assets are initially recognized and/pr upon subsequent revaluation, most have limited useful lives for the purposes of applying AASB 1021/ AAS 4. The AI 1 "Amortization of Identifiable Intangible Assets" made reference to various requirements of AASB 1021/ AAS 4. For instance, paragraph 3.2 stated that assets usually fall within the definition of depreciable assets irrespective of

whether the periods over which the future economic benefits embodied in the assets are expected to be consumed are not precisely ascertainable because they extend for some considerable time into the future. Further, paragraph 5.5, which is related to the amortization of identifiable intangible assets, does not presume a maximum useful life of those assets. Thus, the AI 1 set out the Boards' views that brand names, mastheads and similar identifiable intangibles are depreciable assets and have depreciable amounts for the purpose of AASB 1021/AAS 4.

In ay 2000, the ASIC issued the Media Release (00/264), concerning the results of ASIC surveillance program on 100 financial reports of listed entities for the last six months of 1999. It reported that some entities were still refusing to amortize intangible assets, claiming that they did not amortize because the assets had indefinite lives, or that amortization would be immaterial because of the long lives of the assets and the residual values at the end of their lives. The Release outlined that it is unlikely that ASIC will accept a claim that the life of an intangible asset is unlimited; nor would it accept a claim that the life should be regarded as unlimited because a precise estimate of useful life cannot be made. In June 2000, the AASB identified the accounting for intangible assets (including goodwill) as a high priority. The board has since considered a number of draft strategy and issues papers, some of which are discussed below. In September 2000, the AASB considered a "Strategy Paper: Intangible Assets" for the purpose of identifying key issues to be addressed in a project to review the accounting for intangible assets (identifiable or unidentifiable, purchased or internally generated) and for identifying a strategy for progressing the project. The AASB staff started the project in December 2000 by reviewing the AARF and AASB project files, including comments on ED 49, which was issued in August 1989. Keith Alfredson (2001), chairman of the AASB, discussed the more important aspects of the history, and the reason for the failure by Australian standard-setters to formulate an accounting standard for identifiable intangibles. A major part of Alfredson (2001) paper focused on the key proposals, and reactions to, the 1989 ED 49. Reasons for these reactions, and subsequent actions by standard-setters, on ED 49 were also outlined. Alfredson (2001) argued that given the majority of the 1989 ED 49 respondents did not support the proposal to require all identifiable intangible assets to be amortised, it requires no stretch of the imagination to conclude that Australian companies will almost overwhelming support the no-amortization approach to goodwill and identifiable intangible assets with indefinite lives. If Australia had proposed this approach in 1989, it may well have been condemned internationally as being "too creative" (Alfredson, 2001).

In February 2001, the AASB called for the preparation of key issues papers dealing with accounting for intangibles. For instance, it addressed the issues that deal with recognition, measurement, amortization and reevaluation of identifiable intangible assets acquired as part of an entity or operation. It also addressed the issue

that deals with accounting for internally generated intangible assets. Basically, these papers considered harmonization the AASB with the FASB/IASB for the accounting treatment of goodwill and other intangible assets. In October 2001, the AASB announced the Intangible Assets Field Testing exercise, following the issuance of Statement of Financial Accounting Standards (SFAS) 141 "Business Combinations" and SFAS 142 "Goodwill and Other Intangible Assets". The field testing was to assess the feasibility of applying the key principles of the US approach to goodwill and intangible assets in the context of the Australian business and reporting environment. It was conducted via hard copy questionnaire to members of the Group of 100. It solicited key views including: (1) criteria for identifying and recognizing intangible assets separately from goodwill; (2) subsequent measurement of identifiable intangible assets; (3) identifying reporting units and (4) goodwill impairment testing procedures. It was completed in December 2001, as planned.

The results of this field testing exercise revealed that the majority of the field testers considered SFAS 142 provides sufficient guidance for determining useful life, and for determining the fair value of indefinite life intangible assets for the purpose of impairment testing. The majority of the field testers also indicated that they would determine reporting units using the same approach as those used to determine reporting segments under AASB 1005 "Segment Reporting", which is broadly consistent with IAS 14 "Segment Reporting". With respect to the issue of goodwill impairment testing procedures, the majority of field testers suggested that they would perform internal assessments of the fair value of the reporting unit either using discounted cash flow techniques and/or a multiple of earnings approach. They also thought that applying the minority interests' percentage ownership would be an appropriate method of attributing a portion of the fair value of the reporting unit as well as the implied value of goodwill to minority interests.

To summarize, the approach that currently considered by the AASB is consistent with the positions being adopted by the IASB, including that goodwill and other intangible assets with definite lives would only be charged against profits where they are impaired or worth less than their carrying values. In addition, the AASB has made tentative decisions that goodwill (measured as a residual) should be explained in the context of the conceptual nature of goodwill and it should be tested for impairment as at the date of initial recognition, irrespective of indication of impairment, to capture the impact of any changes which have occurred subsequent to negotiation of the acquisition price. The AASB has decided, in its December 2001 meeting, to consider the accounting requirements of SFASs 141 and 142, the field testers comments on the FASB approach, and the current position being adopted by the IASB in its Business Combinations project. This project comprises two phases. Phase one is concerned with accounting for intangible assets (including goodwill) acquired as part of an entity or operation, and is likely to be progressed in the short

term. Phase two focuses on accounting for internally generated intangible assets, and will be progressed in the long run. In the future, the AASB is expected to monitor the progress of the IASB Business Combinations project and consider the implication of FASB/IASB decisions in the context of the Australian reporting environment (AASB, 2002).

International GAAP

In November 1983, the International Accounting Standards Committee (IASC) approved the International Accounting Standards IAS 22 'Accounting for Business Combinations' that contained the principles for accounting for goodwill. IAS 22, being concerned with business combinations, does not define goodwill. It also does not address the issues of revaluation of goodwill as well as accounting for internally generated goodwill. For the purpose of improved international accounting standards (IASs), the IASC issued exposure draft (ED 32) "The Comparability of Financial Statements" in January 1989. ED 32 proposed amendments to IAS 22 as well as other IASs. The draft defined goodwill as the difference between the cost of acquisition and the fair values of net identifiable assets acquired. The draft proposed that positive goodwill be recognized in the statement of financial position as 'goodwill on consolidation' and to be systematically amortized over its useful life. The amortization period should not exceed five years unless it was justified but in all circumstances the maximum useful life not to exceed twenty years. The standard was revised in 1993 as part of the project on Comparability and Improvements of Financial Statements. It became (IAS 22(revised 1993)).

In June 1995, the IASC issued ED 50 'Intangible Assets' for comments. Many submissions were received and reviewed. Subsequently, the IASC issued another draft ED 60 'Intangibles Assets' in 1997 that amended ED 50. It recommended that acquired and internally generated intangibles, except internally generated goodwill, should be recognized at cost where expected benefits are probable and the cost of each asset can be measured reliably. Intangible assets should be amortized over the best estimate of its useful life with a reputable presumption that the useful life will not exceed 20 years from the date when asset is available for use. If the amortization period exceeds 20 years, the evidence that rebuts the presumption is to be disclosed and such assets are to be subject to annual impairment test. Intangible Assets may be revalued to fair value only after a reference to an active secondary market is made. The credit on revaluation is to be transferred to a revaluation surplus.

In September 1998, the IASC issued the IAS 38 'Intangible Assets' that contains the principles for accounting for goodwill and identifiable intangibles. It was applicable to periods commencing from 1 July 1999. It applied to intangible assets that are not specifically dealt with in other International Accounting standards. The IAS 38 replaced the IAS 9 'Research and Development costs'. Various paragraphs of the IAS 22 (revised 1993) were revised in 1998 to be consistent with

IAS 36 'Impairment of Assets', IAS 38 'Intangibles Assets and other International Standards and the treatment of negative goodwill was also revised by the recently restructured International Accounting Standards Board (IASB). However, the part of interest for the purpose of this study is to consider IAS 38 and the treatment of goodwill and negative goodwill in IAS 22 (revised 1998).

Intangible assets are defined in IAS 38 as 'identifiable non-monetary assets without physical substance held for use in the production or supply of goods or services, for rental to others, or for administrative purposes' (paragraph 2). The standard requires the recognition of acquired intangibles where it is probable that future economic benefits will flow to the enterprise and the cost can be measured reliably. They are initially recognized at cost as long as the cost can be reliably measured. IAS 38 also specifically states that internally generated goodwill, brand names, mastheads, publishing titles and items similar in nature should not be recognized as assets. Subsequent to initial recognition of an intangible asset at cost, IAS 38 allows an intangible asset to be measured using either the benchmark or the allowed alternative treatment. The benchmark method requires intangibles to be carried at cost less any accumulated amortization and any accumulated impairment losses. An impairment loss is the amount by which the carrying amount of assets is reduced by to reflect its recoverable amount. The allowed alternative method requires intangibles to be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortization and any subsequent accumulated impairment losses, provided the fair value can be reliably measured. The fair value of intangible assets can be measured reliably only if it is determined by reference to an active market. An active market exists if, and only if, all the following conditions are met:

- the items traded within the market are homogeneous;
- willing buyers and sellers can normally be found at any time; and
- prices are available to the public.

However, both methods are restrained by the amortization and impairment requirements, along with the need to determine fair value in an active market in the allowed alternative method.

In relation to the amortization of intangible assets, IAS 38 requires intangible assets to be amortized over the best estimate of the asset's useful life with the reputable presumption that the useful life not exceeds 20 years. The standard allows the amortization for a longer period that is more than 20 years, providing the extension is justified by persuasive evidence. It identifies such circumstance as rare. The residual value of an intangible asset should be assumed to be zero but with two exceptional rare cases. A commitment to purchase by a third party or the existence of an active market for the asset at the end of the asset's useful life. Further information on accounting for goodwill and negative goodwill arising on acquisition is found in the International Accounting Standard IAS 22

(revised 1998) 'Business Combinations'. IAS 22 is consistent with what was proposed in the IAS 38, but it also requires IAS 36 "Impairment of Assets" to be applied to the carrying amount of goodwill. In particular, IAS 36 specifies indicators of impairment and requires goodwill to be written-down to its recoverable amount where that amount is less than goodwill's carrying amount, but only when impairment is indicated. Recoverable amount is defined as the higher of net selling price and value in use. IAS 36 states that the impairment loss arises where the carrying amount of the identifiable net assets plus the carrying amount of any purchased goodwill attributable to a cash-generating unit² exceeds the recoverable amount of the unit. The impairment loss must be recognized by the first reducing the carrying amount of goodwill allocated to the unit, and then reducing the carrying amount of other assets of the unit. In relation to goodwill that is amortized over a period not exceeding 20 years, goodwill should be subject to an annual impairment test in accordance with IAS 36 even if there is no indication that it is impaired. Negative goodwill that relates to expectations of future losses and expenses that should be recognized as income in the income statement when the future losses and expenses are recognized. If these future losses and expenses are not recognized then the amount of goodwill should be recognized as income on a systematic basis over the remaining weighted average useful life of the identifiable acquired assets. Where negative goodwill should be recognized as income when the future economic benefits embodied in the identifiable assets acquired are consumed.

In July 2001, the IASB identified the accounting for intangible assets (including goodwill) as a high priority. The International board has commenced a project on Business Combinations including purchased intangibles. This project re-examines all of the issues related to business combinations, including the recognition and measurement of acquired goodwill and intangible assets, and the amortization and impairment approaches. For the short term, this project involve revising IAS 22 and may result in either the amendment of IAS 22 or the issuance of a new International Financial Reporting Standard (IFRS) with guidance to supplement IAS 22. Revisions to IAS 38 and IAS 36 may be involved, particularly in the longer term. In March 2004, IFRS 3 "Business Combinations" was issued and superseded IAS 22 and becomes effective from January 1 2005.

In 2008, IFRS 3 "Business Combinations" was reissued and is effective for annual reporting periods beginning on or after July 1 2009. IFRS 3 should be applied, when an entity acquires the net assets of another entity, by the acquirer. The consolidated financial statements should be prepared in accordance with IAS 27. IFRS 3 requires that the acquisition method should be applied to all business combinations. As stated by IFRS 3, the application of the acquisition method involves four steps: identifying an acquirer; determining the acquisition date; recognizing and measuring the identifiable assets, assumed liabilities, and any non-controlling interest in the

acquiree; and recognizing and measuring goodwill or a gain from a bargain purchase.

IFRS 3 defines the acquirer in a business combination as 'the entity that obtains control of the acquiree in the business combination'. According to IAS 27 "Consolidated and separate Financial Statements", control is defined as 'the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities'. The third step in applying the acquisition method involves recognizing and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree. The fourth step is about recognizing and measuring the acquiree's intangible assets including goodwill. Pursuant to IAS 38 "Intangible Assets", when an intangible asset is recognized, an assessment must be made of whether it has a limited or unlimited useful life. If the intangible asset has a limited useful life, it must be systematically amortized over its useful life. On the other hand, if the intangible asset has an unlimited useful life, the asset must not be amortized, but subject to impairment review test in accordance with IAS 36 "Impairment of Assets". Impairment review test for intangible assets with unlimited lives must be carried out annually by comparing the carrying amount of the asset with its recoverable amount. If the recoverable amount of the intangible asset is less than its carrying amount, an impairment loss must be recognized. Impairment review test can be conducted at any other times than annually where there is an indication of impairment.

Conclusion

This paper reviews the developments of accounting standards as well as considered the statutory regulation of accounting for goodwill in USA, UK, Canada, Australia, and the IASB. In the USA, SFAS 142 requires that purchased goodwill and other intangibles with indefinite lives should be capitalized and not be amortized; instead, they should be subject to annual impairment test and written down only when they are impaired. The recognition of most internally generated intangibles is not allowed. In the UK, FRS 10 requires that purchased intangibles should be capitalized and systematically amortized over a period not to exceed 20 years. The straight-line method is recommended for amortization. The impairment review alternative is available when goodwill is not amortized, or is amortized over a period of more than 20 years. An impairment review is also required without regard to the amortization period only when there is an indication of impairment. Internally generated intangibles, except goodwill, may be capitalized only if they have a readily ascertainable market value. In Canada, Section 1580 requires that purchased goodwill should be capitalized and systematically amortized over its useful life, which may not exceed 40 years. The straight-line method of amortization should be applied. It also requires that goodwill should be written down when there has been a permanent impairment in its unamortized value. Internally generated goodwill should not be recognized on the balance sheet. Section 3060 of the Canadian

GAAP requires that intangible properties should be capitalized and amortized over the shorter of their useful life or 40 years.

In Australia, AAS 18/AASB 1013 requires that purchased goodwill should be capitalized and systematically amortized over a period not to exceed 20 years. It requires the straight-line method to be used for amortization. Internally generated goodwill should not be capitalized. The goodwill standard does not cover identifiable intangible assets; therefore, companies select methods to suit their own purposes. However, the absence of regulation for identifiable intangibles in Australia was one of the major reasons that led the Australian position to be attacked. According to IASB and under the IAS 38, purchased intangibles should be capitalized and amortized over a period not to exceed 20 years. Most of internally generated intangibles should not be recognized. Further, IAS 36 requires that, only when impairment is indicated, goodwill should be written down to its recoverable amount where that amount is less than goodwill's carrying amount. In conclusion, the developments discussed above provide a little and further developments to accounting for goodwill are still ahead.

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