

THE ACCOUNTING TREATMENT OF GOODWILL

TRATAMENTUL CONTABIL AL GOODWILL-ULUI

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Abstract: *In the accounting sense, Goodwill can be thought of as a "premium" for buying a business. When one company buys another, the amount they pay is called the purchase price. Accountants take the purchase price and subtract it by a company's book value. The difference is called Goodwill.*

Rezumat: *Din perspectiva contabilității goodwill-ul este considerat un fel de "premiu" pentru achiziția unei afaceri. Atunci când o întreprindere cumpără o altă întreprindere ea plătește un anumit preț de achiziție. În anumite situații poate apărea un excedent a prețului de achiziție peste valoarea contabilă a activelor întreprinderii cumpărate. Această diferență se numește goodwill.*

Goodwill (GW) or the commercial fund as it is named in the French terminology, can be defined in several ways, somehow related, the most used of its acceptations being the following: the enterprise reputation; the market value of marks (brands); the difference between the cost (the price) of acquisition of enterprise and the net value of the assets of this. The accounting treatment is based on the last definition. Thus, from the accounting point of view, a GW appears as a result of the operation of acquisition of the enterprise.

In spite of the apparent simplicity in defining GW – as difference of acquisition – the accounting operation of this excess of value over the net value of the assets of the enterprise confronts with numerous dilemma and controversies. Far being the most serious between them is if GW can be considered economical assets in the technical sense of this term. Concerning this question there are sufficient arguments both pro and against. The most important argument pro results just from the manner itself of defining the assets: a controlled resource of enterprise, resulted from its previous activities and capable to relieve gains or other future economical advantages. It is as clear that GW combines all these three characteristics. The most important argument against is based on the fact that, though immaterial by its nature, GW, however, can not be integrated among the non corporal assets of the enterprise, so they are defined by the IAS 38 norm, as they represent a non separable residual value, consequently, it cannot be valorized on the market independently of the patrimonial ensemble of the sold/bought enterprise. Also, the fact that GW cannot be evaluated in a rigorous manner than in the moment of the enterprise acquisition but not after that. However, if GW is introduced in the balance assets for equality resetting between the total assets and the total liabilities, it is necessary the increase of the own capitals of the enterprise with an equivalent value.

To reckon GW as assets rises the problem of its depreciation in time, respectively of amortization. In this sense, the following accounting options were outlined:

- 1) include and maintain GW in assets without amortize or provision it;
- 2) impute GW on the own capitals;
- 3) capitalization GW and its provision if it is found that the assets acquired have depreciated;
- 4) capitalization GW and its amortization on the period of operation the assets acquired;

No matter the solution, the GW amortization will influence consistently the level of the financial results of the exercise. From this reason, the enterprises can benefit by a large margin “to adjust” the yearly results with the help of a simple enough financial-accounting mechanism : bigger current expenses with GW amortization reduce the profits of the period, reducing at the same time the future GW amortizations but decreasing the future profits. Also, this approach diminishes the total assets and the own capitals, creating the impression of a higher level of the profitability got by the enterprise. Another difficult aspect connected to GW amortization refers to the system or rhythm of amortization. The linear amortization of GW could distort the image of the economical potential of the enterprise, as from the economical point of view, GW does not behave like the most balance immobilizations which lose their value, gradually, in time, in the measure of the physical and moral wear advance. GW has a very volatile value which can register considerable fluctuations even in very short periods of time. Let us think about the enterprise image – a generating essential element of GW – can deteriorate very quickly under the influence of some relatively minor events.

How can however be established the accounting policy of the enterprise concerning GW? The international accounting experience formulated the following variants of GW treatment:

- 1) in the enterprises which make no provisions of plans of compensations for managers it is preferred a method which produces adverse effects upon the accounting results, such as GW maintain in the assets without amortization or provision or GW imputation upon the own capitals;
- 2) in the enterprises characterized by a high degree of duties it is preferred a method which does not reduce the size of the own capitals, for example GW incorporation in assets without amortization or provision;
- 3) in the enterprises whose main financial objective consists in getting a certain minimal level of profitability it is preferred a method which does not diminish the result – to maintain GW in assets without amortization and provision or imputation GW upon own capitals;
- 4) for the enterprises strongly dependent from the political point of view it is indicated the application of a method which permits the restriction of the political “visibility” especially by reducing the accounting results such as capitalization and GW amortization or capitalization and the provision of this.

Since 2004 IFRS 3 norm “Enterprises Groups” is that which establishes the accounting GW treatment, replacing IAS 22 norm. In fact, IFRS 3 norm offers rules of recognition of GW positive and negative (badwill) resulted from operations of acquisition of the enterprises. The respective norm stipulates that any cost overrun of acquisition over the right value of the net assets is a GW and must be considered as

being assets. GW is a payment to buy anticipated future economical advantages in the moment of making the acquisition operation. The estimates of these possible future advantages must be made with great prudence because, in certain situations, a GW issue can be explained by the fact that the right value of the net assets was not correctly determined. According to the IAS 22 norm, GW must be accounted at its depreciated cost with the size of the amortizations calculated and the loss of value. The GW amortization will be registered systematically, during the economical utility of this, established in function of the duration of valorization of the future economical advantages. This does not mean, however, that in all cases, with the passing of time, GW will diminish as an expression of eroding its beneficiary capacities. It is possible that, due to some specific actions of development, GW acquired must be substituted gradually by an “internal” GW. In spite of this, IAS 38 norm “non corporal Immobilizations” do not permit the introduction among the assets of GW created by the enterprise, imposing GW amortization acquired during its life. So, the method and system of amortization must reflect as faithfully as it can the rhythm hoped of the consumption of the future economical advantages which result from GW acquired. The changes of proportions in the structure, duration and rhythm of the operation of the economical advantages due to GW can justify the reexamination method of amortization.

If certain conditions appear where GW obtained by acquisition shall not generate the future economical advantages hoped by the buyer, it will be initiated, according IAS 36 norm “The Assets Depreciation”, a test of depreciation of GW and the accounting registration of the loss of constant value. A test of this kind consists in the determination of the recoverable value of the generating unity of treasury, the eventual identified loss being charged first to GW allocated to the treasury unity and after to other assets of the unity.

Another important aspect associated to the accounting treatment of GW refers to negative GW registration. IAS 22 norm stipulates that, in the measure in which the negative GW corresponds to some measurable and identifiable, predictable future losses with precision, but do not result from the duties of the enterprise, it must be registered in the account of results at incomes. But if the future, predictable losses cannot be identified and estimated rigorously, the negative GW will be registered as income as follows:

- 1) the size GW negative which does not exceed the right value of the acquired non financial assets registered as income on a systematic basis, on a duration of utilization left weight average of the acquired, redeemable, identifiable assets;

- 2) the size GW negative which exceeds the right value of acquired non financial assets must be registered immediately as an income .

The IFRS 3 norm regulates that a GW negative must be reckoned immediately as an income and introduced as such in the account of profit and loss of the enterprise.

From those exposed up to now, the result is that an essential element of accountancy practices of GW is the determining of the duration of functioning (reproduction) of this. To determine this duration the following criteria are considered:

- 1) dynamism and the perspectives of the business sector to whom GW is attached;
- 2) the phases of the lifecycle where are the main products and technologies of the enterprise which benefit of GW;
- 3) the level and structure of research-development expenses, marketing and humane resources development made by the enterprise carrying GW;
- 4) the phase of the organizational life cycle where is the enterprise;
- 5) the necessary period that a young business become stable from the financial and profitable point of view;
- 6) the degree of depreciation and obsolescence of the main technical systems used by the enterprise;
- 7) the measure in which the enterprise acquired could be administrated efficiently by other leading team;
- 8) the hope of professional life of the employees or groups of key employees;
- 9) the duration of juridicial protection of the intellectual property and rights held by the enterprise;
- 10) the duration of important agreements of delivery and acquisition achieved by the enterprise with important customers and suppliers;
- 11) the competitors' strategies;
- 12) the duration of upon the enterprise acquired;
- 13) diverse legal and contractual provisions in the measure of influencing the duration of functioning GW, etc.

CONCLUSIONS

From the accounting point of view, goodwill represents a residual value with ambiguous traits. This ambiguity leaves its mark on the practices of accountancy of the goodwill and regulations existent in this domain. The accounting practical and theoretical reflections oscillate between amortization and the calculus of a depreciation. The enterprises which want to protect against the risks of value loss, especially those quoted on the exchange, prefer the GW amortization.

REFERENCES

- 1 *International Norms IAS*
2. *International Norms IFRS*