

## COMPARATIVE ANALYSIS OF ACCOUNTING FOR GOODWILL: DOMESTIC PRACTICE AND INTERNATIONAL EXPERIENCE

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*Abstract.* In this article, we performed a comparative analysis of similarities and distinctions of the national and international standards of accounting for goodwill. In the research we studied the description of economic category "goodwill", its quality and components. We showed that the disclosures that are related to goodwill are frequently not submissive with the policy in accounting standards, consequently the research aims to improve the accounting regulations for goodwill from the perspective of a modern economic environment. Special attention was focused on the objectives and functional mechanism of the harmonization for accounting in Ukraine. We gave the ways for development of the Ukrainian legislation about goodwill in agreement with international principles.

*Key words:* goodwill, intangible assets, intellectual capital, internal goodwill, IFRS, US GAAP, comparative analysis

### 1. Introduction

The criterion for successful of business management is the timely availability of reliable information on all existing assets. A key role in this context is played intangible resources which are not always reflected in the account, but a significant influence on their bottom line. One of the essential assets that provides accounting information relevance and impact on investment attractiveness is goodwill. The ambiguity of interpretation and variation in approaches to keeping it generates much discussion and goodwill makes one of the most problematic categories in general accounting methodology not only in Ukraine, but throughout the world. Not enough research on recognition and reflection on the accounts of accounting goodwill in the economic literature and regulations governing the accounting for intangible assets, confirming the relevance of this study.

History of goodwill accounting begins in 1981, when the first standard was in a beginning of the developing process. It was published in 1983 as IAS 22 (1983) "Accounting for Business Combinations" and was adopted in 1985 as an effective date of IAS 22. In 1993 and in 1998 IAS 22 was revised. The Standard covers both the acquisition of one enterprise by another and also situation where the acquirer cannot be identified. In 2001 an Exposure Draft of Business Combinations was published together with related exposure drafts proposing amendments to IAS 36 and IAS 38. In 2004 IFRS 3 was published and it superseded IAS 22. In 2008 and in 2010 IFRS 3 was revised [1]. Some of most significant changes about goodwill were exclusion of goodwill amortisation and obligation to perform impairment of goodwill annually instead.

Goodwill is an integral part of life cycle of an enterprise and one of the factors of successful entering in the international market. However, the legal framework of Ukraine concerning the nature, assessment of goodwill and check for impaired requires changes and improvements.

### 2. Materials and Methods

Theoretical and methodological basis of the paper are the international financial reporting standards, laws and legal documents on IFRS implementation in Ukraine, scientific works of domestic and foreign scientists, proceedings of the conference, international projects.

The study used the general scientific and special methods of learning: generalization - for determining and disclosing the essence of the concept of "goodwill"; comparison, group - for the analysis and comparison of national and international accounting standards goodwill; specification - for identifying promising solutions to issues in the recognition of goodwill accounting.

### 3. Results and Discussion

**3.1. The chronological Worldwide Overview of the Accounting Standards for Goodwill.** There are different types of goodwill. Acquired goodwill is the goodwill generated due to acquisition. It can be positive (acquired price > net value of the assets) or negative (acquired price < net value of the assets) [2]. Internally generated goodwill is the goodwill generated by the business on its own. It is the excess of the market value of the business over the book value of the business. Accounting treatment of each type of goodwill is different from each other and from standard to standard. The accounting treatment of each type of goodwill is discussed below on the basis of five standards under discussion.

At the international level goodwill is regulated by IFRS 3 "Business Combinations". Goodwill arising from a business combination is determined as: "consideration transferred to obtain control plus amount of non-controlling interest (using either option) plus fair value of previously-held equity interest less fair value of the identifiable net assets of the acquiree (100%)", see paragraph 32, under IFRS 3 Revised 2008 (IFRS 3R). IFRS 3 compares for the result of goodwill two facts, "being the excess of the cost of the business combination over the acquirer's interest in the net

fair value of the identifiable assets, liabilities and contingent liabilities. In a business combination achieved in stages, goodwill was determined as the sum of goodwill arising at each stage of the acquisition”.

In general goodwill divided into two kinds of positive and negative. Negative goodwill occurs when the acquisition-date fair value of net assets exceeds the cost actually paid for them. Negative goodwill highly regressive reputation enterprise that sell. The cost of negative goodwill recognized as income in the amount that exceeds the fair value of non-monetary assets. “A bargain purchase is a business combination in which the net fair value of the identifiable assets acquired and liabilities assumed exceeds the aggregate of the consideration transferred, the non-controlling interests and the fair value of any previously held equity interest in the acquired company. A bargain purchase might happen, for example, in a business combination that is a forced sale in which the seller is acting under compulsion. However, the recognition and measurement exceptions for particular items, as discussed in chapter 8, might also lead to the recognition of a gain (or a change in the amount of a recognized gain) on a bargain purchase” [3].

On the order of recognition of goodwill accounted for using the provisions of international standards, where these features of the transaction. Under paragraph 48 of the IFRS 3R, “the acquirer recognizes an increase (decrease) in the provisional amount recognized for an identifiable asset (liability) by means of a decrease (increase) in goodwill. However, new information obtained during the measurement period may sometimes result in an adjustment to the provisional amount of more than one asset or liability. For example, the acquirer might have assumed a liability to pay damages related to an accident in one of the acquired company’s facilities, part or all of which are covered by the acquired company’s liability insurance policy. If the acquirer obtains new information during the measurement period about the acquisition-date fair value of that liability, the adjustment to goodwill resulting from a change to the provisional amount recognized for the liability would be offset (in whole or in part) by a corresponding adjustment to goodwill resulting from a change to the provisional amount recognized for the claim receivable from the insurer” [4]. At the beginning and end of each reporting period the company which acquired another company has the duty of disclosing the quantity of moving goodwill for the next period. Deloitte economists have exposed individually the following items: “ the gross amount and accumulated impairment losses at the beginning of the reporting period; additional goodwill recognized during the reporting period, except goodwill included in a disposal group that, on acquisition, meets the criteria to be classified as held for sale in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations; adjustments resulting from the subsequent recognition of deferred tax assets during the reporting period in accordance with IFRS 3R paragraph 67; goodwill included in a disposal group classified as held for sale in accordance with IFRS 5 and goodwill derecognized during the reporting period without having previously been included in a

disposal group classified as held for sale; impairment losses recognized during the reporting period in accordance with IAS 36. (IAS 36 requires disclosure of information about the recoverable amount and impairment of goodwill in addition to this requirement); net exchange rate differences arising during the reporting period in accordance with IAS 21 The Effects of Changes in Foreign Exchange Rates; any other changes in the carrying amount during the reporting period; and the gross amount and accumulated impairment losses at the end of the reporting period” [5].

As for the recognition of goodwill in reporting the information on intangible assets is a significant basis for decision-making. Consider recommendations standards. “Goodwill arising on the acquisition of a subsidiary is recognized as an asset at the date that control is acquired (the acquisition date). Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interest in the acquired company and the fair value of the acquirer’s previously-held equity interest (if any) in the entity over the net fair value of the identifiable net assets recognized. If, after reassessment, the Group’s interest in the net fair value of the acquired company’s identifiable net assets exceeds the sum of the consideration transferred, the amount of any non-controlling interest in the acquired company and the fair value of the acquirer’s previously-held equity interest (if any), the excess is recognized immediately in profit or loss as a bargain purchase gain”, under IFRS 3R. Additionally, the same instruction, stipulates that “goodwill is not amortized, but is reviewed for impairment at least annually. Any impairment loss is recognized immediately in profit or loss and is not subsequently reversed. On disposal of a subsidiary, amount of goodwill attributed to it is included in the determination of the profit or loss on disposal”. Under IFRS, IAS 36 – Impairment of Assets, goodwill is allocated to Cash Generating Units (CGU), and the test for impairment, including goodwill, is on the entire CGU. Nevertheless a enterprise ought to recognize which CGU the goodwill applies to. An impairment loss is recognized, if and only if, the carrying amount of the cash-generating unit to which the goodwill has been allocated exceeds the recoverable amount of the cash-generating unit. The impairment loss should be allocated first to reduce the carrying amount of any goodwill allocated to the cash-generating unit and secondly to the other assets of the unit pro rata on the basis of the carrying amount of each asset in the unit. Another important point is that under IFRS, it is not permissible to reverse impairments previously recognized for goodwill. In particular, IAS 36 requires the reversal of an impairment loss for an individual asset other than goodwill, or a cash-generating unit, if and only if there has been a change in the estimates used to determine the recoverable amount since the last impairment loss was recognized.

Consider the features of accounting for goodwill of the United States General Accepted Accounting Principles (US GAAP ). As a result of the US’s powerful economic position on the market and the permanent progress of business combinations on the global markets we monitor how the US GAAP influences the IFRS, in particular as the

American regulatory body has a consulting position in the IASB meetings. Under the US GAAP there is a two-step approach to goodwill [6]: "1. Compare fair value of the reporting unit with its carrying amount including goodwill. If fair value is greater than carrying amount, no impairment (skip step 2). 2. Compare 'implied fair value' of goodwill (which is determined based on a hypothetical purchase price allocation) with its carrying amount, recording an impairment loss for the difference". As for the other accounting treatments concerning goodwill, the US GAAP does not differ considerably from the IFRS.

Regulation of accounting for goodwill in Ukraine as the Tax Code Ukraine and National Accounting Standard 19 "Business Combinations" [7]. Both the above regulations acts fix recognition of goodwill as the difference between the value - market (fair value identifiable assets and liabilities) and the net (the acquirer), indicating that it can occur only when calculating these values, in the acquisition (association) enterprises. Accordingly, under national law specifies only the goodwill on acquisition and understanding of internal goodwill generally absent. Goodwill is as a rule recognized at the time of the consolidation, and it represents the variation between the acquisition cost and the fair value of the assets acquired, at the date of the transaction. Internally generated goodwill is not recognized under the Ukrainian law, because it is well thought-out to be an unidentifiable source, meaning it can not be evaluated at a credible cost. Also, goodwill isn't usually amortized during a period of using.

The procedure of the recognition of internal goodwill asset (capitalization costs of establishing the internal elements of goodwill) is based on the current method under UAS 8 "Intangible Assets" [7]:

1. Purchased or acquired intangible assets shown in the balance sheet if it is probable to obtain future economic benefits, which associated with its use, and its cost can be measured reliably.

2. Intangible assets acquired as a result of the development shall be reflected in the balance sheet provided that the company intends, technical ability and resources to bring the intangible asset to the state in which it is suitable for sale or use; possibility of future economic benefits from the sale or use of the intangible asset; information for reliable determination of the costs associated with the development of an intangible asset.

If the asset doesn't meet the specified criteria for recognition the costs associated with its creation or acquisition are expensed in the reporting period in which they were made. Therefore, not all components are subjected to internal goodwill asset recognition criteria.

### **3.2. Comparative analysis of accounting for goodwill under IFRS, US GAAP, UAS**

In 2001, the FASB issued SFAS 141. Following that, after three years, the IASB issued their individual standard permitted the same, "Business Combinations". The FASB and IASB planned a convergence program since 2004 and for years later, in 2008 both regulating parts announced revised versions of their standards concerning the matter of business combinations. As a result, the SFAS 141R becomes

successful from December the 15th 2008, and the IASB's IFRS 3R becomes useful from the 1st of July 2009 [4]. As said by Deloitte specialists, "the most fundamental change affects the biggest number: goodwill. In the first year of IFRS 3 adoption, goodwill accounted for 53%, £21bn, of acquisition values for the FTSE 100 and for the S&P 100 in 2007, 48%, or \$490bn. Under FASB 141 (R), the factors that constitute goodwill are now required to be disclosed, as has always been the case under IFRS 3. Such factors include intangible assets not separately identifiable, such as workforce, synergies of cost and synergies of scale. Financial regulators are making this a priority area for scrutiny, as it presents a significant opportunity for improved reporting".

Normative base of goodwill accounting, which we used, are based on International Financial Reporting Standards (IFRS), US Generally Accepted Accounting Principles (US GAAP) and Ukrainian accounting standards (UAS). It is advisable to compare the international environment and the use of the Ukrainian legislation of goodwill (see. Table 1).

The table shows that IFRS and NAS in the allocation of goodwill include similar recommendations. However, the Ukrainian legislation doesn't set clear guidelines on the conditions and stages of checking the impairment of goodwill. It should be noted that Ukraine, nowadays is characterized by the practice of checking impairment full range of assets. In other words, domestic law allows restoration utility of the usefulness of goodwill, which is prohibited in IFRS and US GAAP.

The other difference which has to be taken into deliberation is the recognition of cash-generating units (or reporting units under US GAAP). In the case of identification of cash-generating unit under IFRS more cash-generating units can be identified as reporting units in the case of SFAS 142. SFAS 142 claims that a reporting unit cannot be identified at a lower stage than an operating segment. IAS 36-Impairment of Assets doesn't have a limit. Therefore a cash-generating unit can be recognized at a lower level and the impairment test would be done at a lower level in association with US GAAP [10].

The important difference relates to the impairment test of goodwill. The process of impairment of goodwill differs considerably between the two accounting necessities. In accordance with SFAS 142.18 a two step practice is regulatory. In the first step the fair value of the reporting unit is expected. Consequently the fair value of the reporting unit is compared with its moving value. When the fair value is lower than its carrying amount the next operation needs to be performed. Than the implied fair worth needs to be determined. The fair value of the reporting unit needs to be owed to all assets and liabilities. The indirect fair value is then compared with the carrying amount to establish if impairment has occurred.

The other differences between the impairments test regarding IAS 36 and SFAS 142 are the following: under IAS 36 the liabilities of the cash-generating unit would not be included in the calculation of the carrying amount of the unit (unless they were unable to be factored out of

Table 1.

## Comparative analysis of accounting goodwill under IFRS, US GAAP, UAS

Object	IFRS	US GAAP	UAS
Allocation of goodwill	Goodwill is allocated to each unit that generates cash	Goodwill is allocated to each reporting unit	Goodwill is allocated to each group of assets that generates cash flows
Terms inspection of impairment for goodwill	1. The net value generating unit cash, which includes goodwill > its recoverable amount.	1. The net value of the reporting unit > fair value of the reporting unit. 2. The net amount of goodwill > The estimated fair value of goodwill	1. Reduction of the market value of the asset during the period in significantly greater value than expected. 2. The excess of net assets over their market value.
Stages of verification	One	Two	The legislation is not regulated
Measuring goodwill	The excess of the cost of the business combination over the acquirer's interest in the net value of the acquiree's assets, liabilities and contingent liabilities	Fair value of the reporting unit with its carrying amount.	The difference between the cost of the acquisition and the acquirer's share of the fair values of net assets acquired
Amortization of goodwill	Prohibits the amortization of goodwill acquire in business combination and instead annually or more frequently	Implied fair value' of goodwill (which is determined based on a hypothetical purchase price allocation) with its carrying amount, recording an impairment loss for the difference	Goodwill shouldn't be amortized on a systematic basis over its useful life.
Reversal of impairment	Prohibited	Prohibited	Allowed

the recoverable amount calculation). IAS 36 would also not proceed to step 2, but would calculate the write-down at the completion of the step 1. The write down under IFRS would amount to 300 current units-carrying amounts less the fair value of the cash generating unit (1.500 - 1.200). The fair value under IFRS is different in comparison with US GAAP because IFRS do not take into consideration the effect of the existing liabilities. As stated before in the second step SFAS 142 determines the fair value of reporting unit by determining fair values of all recognizable assets and liabilities as if the unit was acquired in a business combination on the day of impairment test. In the previous illustration IFRS did not take unrecognized trademarks (Deloitte, 2004) into consideration [10].

The important difference refers to the recognition of contingent liabilities. Under IFRS 3.51 requires the recognition of goodwill estimate the fair value of the assets, liabilities and contingent liabilities. Contingent liabilities be recognized separately only if fair value can be measured reliably. The recognition of goodwill Standard number 141 does not allow the recognition of contingent liabilities (Conversion of assets and 141.43). Should the contingent liabilities initial amount of goodwill on acquisition is higher than in other cases where contingent liabilities will not be as an item in the balance sheet.

As for the complexity and long duration of the inspection, the American standards are paying more attention to determine the fair value of goodwill and reporting units than international and domestic accounting rules. So it would be wise for the Ukrainian enterprises to carry out the following checks property and to put particular emphasis

on accurate assessment of goodwill and the development of appropriate guidelines, which conduct is enshrined in law.

#### 4. Conclusions

The main idea of our research was to study the accounting regulations concerning goodwill and to determine the level of harmonization of the Ukrainian regulations with the IFRS. In order to realize our aim, we primary made a methodical analysis of international and national set of laws. At the international level there are exact regulations, such as IFRS 3 "Business Combinations", so we consider that our comparison may be damaging to Ukrainian law, at least incompletely. Our explanation to this matter would recommend adopting the whole version of the IFRS at a national height, or the version of them according to the national requirements, by creating National Accounting Regulations. Also we must find the right way for organizing the debates between the educational and professional bodies. That's how we'll reach the best solution of all. It's necessary to focus on Ukrainian Accounting Standards which control the order of business combinations and groups the consolidated financial statements consecutively to agree them with International Financial Reporting Standards. We believe that we have achieved our preliminary intention and managed to authenticate our supposed theory of the importance of harmonization of accounting in the world.

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