REMARKS ON THE ACCOUNTING TREATMENT OF GOODWILL AT THE LEVEL OF BLOCKS OF TRADING COMPANIES

Violeta Isai
violeta.isai@yahoo.com
Daniel Bolea
Dunarea de Jos niversity of Galați, Romania
Faculty of Economic Sciences

This paper presents the accounting treatment of goodwill, namely, its recognition, assessment and accounting, as part of the patrimonial assets of an economic entity. Specific, due to its structure, to any blocks of companies, the goodwill represents the cost surplus of an active block to the market value of the net purchased assets. Why would anyone pay for a company more than its actual accounting worth? Because the extra price is usually attributed to those intangible elements that cannot be assessed separately but whose horizon of expectation is usually related to prospective economic advantages such as the clientele, the top commercial location, the employees' level of training, market shares, good relationships with the employees, the suppliers, the banks etc. Many of the Romanian economic entities were sold at a price that was inferior to their accounting value because, following their assessment, the experts were able to ascertain the following: the existence of fixed assets that needed to be scrapped; the existence of stocks that were either depreciated or difficult to sell; the existence of outstanding debts that were either uncertain of lost for good; the existence of major debts carrying interest. The effect of such assessments led to a reduced marked value of all assets and an increased market value of the debts, or in other words, the possibility of a badwill occurrence. The relationship goodwill – badwill, specific to the blocks of trading companies, represents a current challenge in the recognition and evaluation of the goodwill in compliance with the current Romanian legislation as harmonized with the international accountancy standards.

Key words : positive goodwill, negative goodwill, tangible assets, goodwill generated in-house, retrievable value

1. Introduction

The researchers admit that the doctrine and practical development of accountancy is highly dependent upon the cultural environment it evolves in, as viewed from all its perspectives: economic, social, legal, fiscal, political and even religious. On the other hand, accountancy is also regarded as an instrument that both influences and transforms the environment it functions in. Therefore, as a social activity, specific to humans, accountancy is also influenced by the environment it functions is.

In so far as the accounting language is concerned, it would be ideal that there were only one accounting language in the entire world. However, many countries use different accounting languages. Moreover, the interpretation of results also differs from one country to another. We are now in the age of globalizing economies, by the globalization of the financial markets. Standard international accountancy is a very delicate procedure because of the economies that are built on different cultures. Let's take for instance the definition of "Assets" in three conceptual frameworks. Contrastive presentation of ways of defining assets:

International Accounting Standards Board (*IASB*)(conceptual assets)

- Resources controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

Financial Accounting Standards Board (FASB)(SFAC 6 – Elements of Financial Statements)

- Probable economic advantages, held or controlled by an enterprise as a result of certain transactions of previous events.

Accounting Standards Board (ASB)(Chapter 4: The elements of financial statements.)

- Rights or other access to future economic benefits controlled by an entity as a result of past transactions or events.

2. Recognizing goodwill according IAS 38

According to IAS 38 „Intangible assets" these goods are non-monetary identifiable and without physical substance. Therefore, the essential recognition criteria of any intangible assets are the following:

- their identifiable character;
- the control and the reliability of the future general economic assessments if these elements.

The revised IAS 38 details the recognition criteria that are stated in the conceptual framework for intangible assets such as: the probability criterion is considered to be always satisfied for intangible assets that are purchased separately or by a trade block.

The just value of an intangible asset that is purchased by a group of companies may usually be determined with sufficient reliability so that it may be recognized separately from the goodwill. (Gîrbină 2007)

The term *goodwill* is widely used by economists, legal experts, and many more with different meanings. In so far as accountancy is concerned: the tangible elements of the goodwill are recorded in the balance sheet individually and are classified according to their nature; the intangible elements of the goodwill are divided into two groups: 1. some are accounted for and assessed separately and recorded in the balance sheet individually, being classified according to their nature; 2. the others are not individualized and are joined in a unit, named goodwill, an accounting term that is recorded in the balance sheet. The goodwill is made of intangible elements, including the right to contract, that is the amount that is paid to owned to the previous dweller for the transfer to the buyer of the rights resulting both for agreements as well as the legislation on commercial property, intangible elements that are not subjected to any assessment or separate recognition in the balance sheet and that concurs to the maintenance and development of the company activity potential (Lassègue, 1998). In most of the cases the goodwill reflects the good reputation of the company. Form an accounting point of view, the goodwill occurs when a buyer pays more for a company than the actual market worth of the bought net assets if purchased separately. The goodwill is destined to the purchase of some fixed tangible assets (shops, warehouses etc.) that may lead to an increased economic potential because of their strategic positions in so far as the top commercial location, commercial networks, outlet market, equipments and qualified personnel etc. are concerned. We should not confuse this term with the notion of trade balance. Goodwill represents the intangible assets that are not subjected to any separate assessment or accounting in the balance sheet and that concurs to the creation and development of any enterprise. The notion of goodwill is close to that of :purchase difference" that appears in the context of consolidated accounts, on titles acquisitions. What is more, the notions of goodwill are used in Anglo-Saxon bookkeeping procedures. Goodwill is refers to overall elements, compulsorily intangible, nondetachable from the economic entity (enterprise) and non-evaluable if isolated; these elements contribute to a value of the enterprise that is superior to the value of its components.

Criteria that contribute to goodwill are:

- managerial quality, technical competence and information acquired by the personnel ;
- industrial know-how ;
- establishing the supply resources;
- clientele, top commercial location, outlet market, studies and researches;
- reputation, the enterprise image.

Goodwill is a part of the trade balance that is not recorded in all the other patrimonial elements but that contribute to the maintenance and development of the unit's activity potential. Goodwill is given by all the factors that allow a company to obtain a profitability of the assets that is greater than the average among which we point out: the clientele of the company, the top commercial location, the advantages of having a monopoly, good management, the efficiency of production, the quality and the fame of the offered goods and services, good personnel relationship.

In Opinion No.17, the Commission of Accounting Principles states the benefits that result from purchasing goodwill disappear in time. It is difficult for a company to maintain the level of profits above the average, except for the cases in which new factors of goodwill would appear and would replace the old one.

3. Assessing goodwill

In drafting the financial statements, the intangible assets are not permitted in goodwill, unless they have already been purchased and have not been created and developed in the context of the activities performed by the enterprise.

As a value, goodwill is more substantial than the amount of all its elements is appraised separately and, what is more, some of these elements are worthless as they are not part of the company themselves.

Most of the accountants are asking themselves whether goodwill can really be amortized or will depreciate on account of a test? More precisely, goodwill may also depreciate without appreciating itself? Part of the answer may be found in the IV Directive as well as some national referrals (for instance, the French and the Romanian one) mention a rapid amortization (for a period of at least five years). The depreciation may be established exactly when the amortization does not lad to relevant or reliable information. The difficulty also arises from the fact that goodwill needs to be taken as an entire unit but made of different elements with extremely different statues. Some have an objective value that is appraised though the information offered by the market. Others enjoy a legal protection and may or may not be limited in time. Finally, some others are affected by the consequences of a moral wear-and-tear and are depreciated in time though effects that cannot be avoided. For these controversial aspects, the doctrine is greatly divided.

The American and international bookkeeping referential have resorted to the practice of amortization (for 40 years in US GAAP and for 20 years, the presumption being however to be criticized in the context of its application is many countries of the standard IAS 22 Business combinations that is currently abolished). The American normalizers reached the conclusion that the most relevant and reliable solution is to resort to a depreciation test, in order to determine the loss of value (impairment). The international normalizers resorted to a quasi-equivalent solution in order to ensure the convergence of the two references known worldwide. In fact, the answers to the controversies that are noted in time for the amortization of goodwill are related to the concept of the balance sheet. In a balance sheet of a patrimonial type (under a legal influence) , the principles of prudence and independence of exercises incite to the practice of a amortization even hasty ones. On the other hand, in a balance that is oriented towards enterprise management, the principle of continuing the exploitation incited to replacing amortization by the effects of a depreciation test (a reversible loss of value, thus the practice of provisions).

Goodwill is determined as a difference between the added value (utility value) or the purchase cost, as case may be, of the trade balance and the market value of the identifiable net assets, recorded in corresponding accounts (the value of the other assets, the value of the stocks etc.). If the trade balance is not encumbered with debts, than the market value of the net assets identified separately coincides to the market value of those particular elements. If the trade balance is encumbered by debts, than by the market value of the net assets identified separately, we understand the market value of these elements diminished by the value of the liabilities. (Patruţ 2005)

According to IAS 22 „Business combinations", goodwill may be:

♦ positive - when a business acquisition cost is greater than the just value of the identifiable smaller assets and liabilities, on the date then business is purchased. Such goodwill is to be amortized in a period of 5 – 20 as of the acquisition. What is more, in case of depreciation, it may be subjected to provisions.

♦ negative – when the just value of the identifiable assets and liabilities on the date the business is purchased is greater than the cost of the business acquisition.

The negative goodwill is neither amortizable nor provisional. It needs to be recognized as an income:

-on the date the business is purchased, for that part of its value that supersedes the just values of the non-monetary purchased assets;

-systematically, as long as the amortizable assets survive, for that part of its value that does not supersede the just values of the non-monetary purchased assets.

4. Study case

Enterprise S.C. ALPHA S.A. purchases enterprise S.C. BETA S.R.L. Following the assessment carried out by experts, it is established that taking over S.C. BETA S.R.L. is worth 30 million lei. The accounting value of S.C. BETA S.R.L. is of 25 million lei, a fact that determined the recognition of a positive goodwill worth of 5 million lei.

The extra paid price, of 5 million lei, is, as a rule, attributed to those intangible elements that may not be assessed separately but from which S.C. ALPHA S.A. expects major economic advantages.

In agreement with IFRS 3, the goodwill purchased following a block of companies will be evaluated, after the initial recognition, at the level of cost diminished with the losses accumulated during depreciation. Consequently, goodwill will not be amortized, but will be checked annually or whenever there are signals that is suffered a loss or depreciation. It is well known that, according to IAS 22, goodwill needed to be amortized systematically, all through its useful lifetime. IAS 22 also provided the criticized assumption according to which the useful lifetime to goodwill could not supersede 20 years from its initial recognition.

If we consider the merger of enterprises, the just vale of an investment made by a company – mother to branch, is compared to the just value of the net assets of the branch that are identifiable on acquisition. If the value of the investments is greater than the net assets, then the difference is represented by *an acquisition of goodwill*. This needs to be recognized as a non-amortizable asset that needs to be tested for depreciation at least annually, in compliance with the provisions according to IAS 36 „The depreciation of assets". After the initial recognition the acquirer will asses goodwill at a cost minus the losses accumulated after depreciation.

5. Conclusions

The issue of goodwill brings the professional accountants to reflect upon a series of controversies, of which the most important are placed in the area of recognition and depreciation.
The analysis regarding the treatments of goodwill may generate certain conclusions regarding typologies that are ambiguous, with frontiers that are difficult to delineate, with accounting principles or rules that are insufficiently developed.

In such a context, goodwill represents a residual value with ambiguous characteristics that are yet to be analyzed in the recognition areas of accountancy. The theoretical reflections hesitate between the calculus of a depreciation and amortization and the appraised companies are trying to minimize the financial impact of the loss of value. For this reason, certain accounting referrals suggest the amortization of goodwill in lack of a better solution.

Following the convergence of the two major accounting systems, the solution suggested by the American and international referral seems to conciliate the theoretical vision and the practical treatment of goodwill, regulating both the issue of transparency in so far as enterprise mergers are concerned towards their shareholders and creditors as well as the subsequent incidence of expenses triggered by this intangible asset on the result.

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