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Abstract

As we know, Australia is going to harmonize its standards with International Accounting Standards (IASB); as a result the Australian standards will automatically comply with IASB Standards. Harmonizing would not lead to a lessening in quality of Australian standards, but rather formulate Australian standards more internationally recognized. At present the International Accounting Standard Board is planning to change nearly half of its standards and these changes are coming into force in Australia on 1st of January 2005. The changes, enclosed in the IASB enhancement project and in its amendments to standards on financial instruments, which will definitely have a leading effect on Australian companies. As a result the companies need to take necessary measures.

Goodwill in business has long been the subject of debate in accounting. The main issue raised in this paper regarding the treatment of goodwill under both the standards AASB1013 (Australian standard) and IAS 38 (International standard) and both the standards have different approaches in the treatment of goodwill. As the harmonization process is in progress and hence the Australian standard has to be in compliance with the International Standard therefore it is a burning topic for companies and in the corporate world in Australia.

At present under AASB 1013 the companies amortize goodwill over a maximum of 20 years but under the International standard IAS36 the treatment of goodwill is quite different. Under IAS36 there is no need to amortize such goodwill because we cannot judge the life of Goodwill and it may go further 20 years time frame hence IAS36 has quite a different approach to the treatment of goodwill. The international accounting standard will not require goodwill to be written off in equal chunks over a period. I therefore tried to find major differences in the Accounting treatment of Goodwill under the related Australian and the International Accounting Standards and also to argue how the adoption of the International Standards serve the Australian corporate world in the present business environment.

Introduction

Accountants all over the world have displayed an agreement in clamoring for uniform accounting standards to promote, evaluation and easy consolidation. Further, uniform accounting standards is also desirable to make accounting a universal language of communication and to deny any scope for manipulation. In earlier seventies accounting practice from around the world joined forces and established a global body whose function is to minimize variations in international accounting reporting practices through the dissemination of international accounting standards. The process of harmonization is a step-by-step and as well as a progressive step hence the environments in which the harmonized standards must work are constantly sprouting. Therefore it (harmonization) cannot be consider as isolated. The advantage of Harmonization is very clear because it reduce the diversity of accounting reports from one corner to other corner of the world. Harmonization will make the comparison of international reporting easier and less expensive. In Australia, Australian Accounting Standards Board a Public Sector body issues standard that all companies have to follow by virtue of the corporation law. The body (AASB) has completed a substantial process to re-issue some of the standards that are incompatible with International standards, which is “an attempt to ensure that compliance with Australian accounting standards result in compliance with International standards”. [1]

In Australia the companies will implement International Accounting Standards by 1 January 2005, hence all entities from Ist January 2005, reporting under the corporation act have to apply International accounting standard Boards standards. Therefore we can say that the process is under conversion, hence companies in Australia have to start thinking about how to implement these changes and what measures have to be taken, say for e.g. training of staff members and how to make the internal management report system parallel with new system etc. and so on.

The Treatment of goodwill is always been a controversial issue in Australia, The Australian Accounting Standard for the Treatment of Goodwill Is discussed in AASB 1013 which also discuss about the Discount on acquisition that arise from acquisition of a business. In general when the purchase consideration of a business after paying the identifiable assets and liability for that business, which is based on fair value may give accounting difference and if this difference is excess amount of the net asset will give rise to Goodwill. On the other hand if the

¹ AASB policy statement

purchase consideration is less than the net asset will be treated as discount. I will discuss later in detail the treatment of goodwill according to AASB 1013. & IAS38.

In late 90s IASB (International Accounting standard revised its standard IAS 22 and issued IAS 38 which deals with treatment of goodwill (more specific intangible assets). This new or revised standard IAS 38 applies to all the Intangible assets but this standard does not deal with Financial assets like Ordinary and Preference shares, Debentures, Bills and notes which represent claims for future payment on other economic units. According to this revised IAS 22 “both goodwill and most identifiable intangible assets are to be accounted for in the same manner”.^[2] Hence if Australian Companies going to adopt this IAS38 and the time frame is already set will definitely impact Australian companies’ because the current AASB1013 practice for treatment of goodwill is quite different from IAS38 as the current practices in Australia regarding the identification and measurement of intangible assets, which comprises amortization.

Proposed Structure by 2005

The International Accounting standards committee (IASB) is an independent private sector body, which shaped with the objective to achieve uniformity in accounting principle, which is used, by businesses and other organizations for financial reporting around the world. International Accounting standard have done immense effort to improve, harmonize and encourage convergence in financial reporting standards around the world: The advantage of international harmonization is enormous because of following reasons:

1. The financial report of different companies in different part of the world can easily be compared due to International harmonization.
2. Again harmonization removes barriers in international capital flows by removing differences in financial reporting.
3. Harmonization also reduces the cost, where Multinational companies operating in different part of the world and it also facilitate better comparisons between two financial reports of different countries.

It can be seen that International standards will be adopted in many parts of the world and Australia is one of the country, which recently decided to adopt International Financial Reporting standards by 2005. Which means Australian companies will adopt International accounting standard by January 1, 2005, all entities reporting under the Corporations Act will apply standards, which are issued by the International Accounting Standards Board (IASB). Adopting

² [http://www.ey.com/global/download.nsf/Australia/International_Harmonisation_-_Intangibles_-_August_1999/\\$file/Intangibles_Aug99.pdf](http://www.ey.com/global/download.nsf/Australia/International_Harmonisation_-_Intangibles_-_August_1999/$file/Intangibles_Aug99.pdf)

IAS is only a starting point whereas a great deal of work will have to be done over the next few years time. The timeframe is incredibly short, whereas the disparities are huge between International Accounting Standard and Australian GAAP, which is a major challenge for Australian companies.

Treatment of Goodwill under AASB

The standard applies to Treatment of goodwill is discussed in Australian Accounting Standard, AASB 1013 which become operative since 30th June 1996. The Main Purpose of the standard, which is specified in AASB1013 basically divided in two parts.

1. Part (1) tells if there is goodwill arise or if there is any discount arises on acquisition then how will this be accounted and
2. Part (2) tells about the financial disclosure (financial report) that relates to goodwill.

In accounting the term Goodwill generally used by businesses and it is an unidentifiable Intangible assets of the firm. These unidentifiable assets, which include as efficiency of the firm, the reputation of the firm or business in the market, the name of the business say brand name **Ex.** When someone says Colgate we recognize it as a brand, we trust the product because its reputation in market for so many years and therefore we never hesitate to buy the product or we have no second thought for the product. But when we look at the balance sheet of a firm, these assets are not reported, as separately, this is a simple example of Goodwill. Goodwill is measured for accounting purposes as the difference between the prices we paid to acquire of identifiable assets at fair value and if that price is more then those of identifiable assets are called “goodwill”.

For example

Net Identifiable Assets (Mkt Value)	\$5,00,000
Price paid to Acquire the Above Assets	\$5,75,000
The price paid to acquire the unidentifiable assets (Goodwill) also acquire at the cost of:	\$75,000

The Exposure draft on Accounting for goodwill In Australia was issued in early 80s i.e. May 1983 which was consequently improved and issued as Australian Accounting standard as AAS18. This AAS18 was issued on March 1984 but before this standard there is very modest regulation or guidance for the treatment of goodwill in Australia and at that time goodwill is treated as fixed assets. In the past goodwill was treated in many ways: goodwill is written off completely against reserve or profit immediately or it is separately deducted from shareholders

equity. [³] According to AASB 1013 goodwill is treated as asset only if it satisfies the following criteria of assets. i.e.

(a) It is probable that the future benefits embodied in the Unidentifiable assets will eventuate; and

(b) It possesses a cost or other value that can be measured Reliably. [⁴]

AAS18 also states that goodwill that comprises the future benefits from unidentifiable assets because of its nature and it is not usually recorded separately in the accounts. The Accounting standard AASB1013 also classify between the internally generated and purchased goodwill and how these goodwill are treated. As both purchased and internally generated goodwill give rise to economic benefits, which is the one of the criteria of recognizing the asset but only purchase goodwill is recognized as an asset.

'This is principally because of the difficulty, or impossibility, of identifying the events or transactions, which contribute to the overall goodwill of the entity. Even if these were identifiable, the extent to which they generate future benefits and the value of such benefits are not usually capable of being measured reliably. Internally generated goodwill, which is not recognized as an asset will either go completely unrecognized or will be recognized as an expense.' [⁵]

And another reason is a management can manipulate the internally generated goodwill because it is in the control of the management of the entity. The purchased goodwill, which also give rise to economic future benefit and recognized as an asset of the firm. Therefore this asset (Goodwill) is to be amortized over a maximum of twenty years on straight line method and recognized as an expense in P&L a/c it is assumed that the benefits are likely to be received maximum unto 20 years and every year the unamortized value of goodwill should be reviewed on each reporting date and treated as an expense in profit and loss account and the purchase goodwill must not be revalued.

Purchased goodwill can be measured more reliably, on the basis of the amount paid for it, than can internally generated goodwill which is not usually capable of being measured reliably. Consequently, the accounting treatment for purchased goodwill differs from that specified for internally generated goodwill. [⁶]

³ Henderson ,S & Peirson, G. (1994).

⁴ <http://www.aasb.com.au/aasb1013>

⁵ <http://www.aasb.com.au/aasb1013>

⁶ <http://www.aasb.com.au/aasb1013>

Even with clearly specified rule mentioned in AASB1013 it is truly mentioned “despite clear restriction, the accounting standards give management considerable discretion as to the rate by which purchased goodwill is amortized, and the actual rate used is largely at the whim of directors.”^[7]

The standard also clearly specify how the Discount that arises from purchase consideration which is less then or below the fair value will be treated under AASB1013. In case of discount the value of non-monetary assets are to be reduced.

For Example

Net Identifiable Assets (Mkt Value)	\$5,00,000
Price paid to Acquire the Above Assets	\$4,75,000
The price paid to acquire the unidentifiable assets (Discount)	(\$25,000)

The accounting standard AASB1013 clearly specify the accounting treatment of such discount as:

‘Must be accounted for by proportionately the fair value of the non-monetary assets acquired, until the discount is eliminated. Where, after reducing to zero the recorded amount of the non-monetary assets acquired, a discount balance remains it must be recognized as revenue in the profit and loss account.’ ^[8]

Treatment of Goodwill under IAS

The relevant standard for Treatment of goodwill under ISAC is IAS 38. The International Accounting Standards Committee based in UK and in July 1998 approved the IAS38, regarding Intangible Assets and became operative for financial statement that’s starts from July 1, 1999. The IAS 38 basically applies to all intangible assets except the financial assets (already mentioned before) and the intangible assets that fulfill the criteria of asset, must be recognized at cost. The current standard IAS38 replace the previous Standards IAS 4 & IAS 9, which states about the amortization of intangible assets and R&D Costs. Some of the key issues of IAS 38 are as below:

1. The International accounting standard IAS 38 state that internally generated goodwill and other assets such as brands, publishing titles, customer lists are not to be accepted as assets.

⁷ Jubb,P.,Haswell,S& Langfield-Smith,I

⁸ Jubb,P.,Haswell,S& Langfield-Smith,I

2. The IAS38 also states that the majority of acquired intangibles cannot be revalued upwards. The reason is as there is no active market (buyers and sellers are readily available) for such assets.
3. Both The standards IAS 38 and IAS 22 require that intangible assets are to be amortized on a systematic basis over the best estimate of their useful lives
4. The standard also states that amortization period and method should be reviewed annually and as well as the impairment test applies to intangible assets. The standard IAS36 relates to impairment. If the amortization period exceeds the period of 20 years or the intangible is not ready for use then there is compulsory Impairment test applies and also there is need of special disclosures. As Goodwill has no definite life hence under the standard it should not Amortized, and require a further thorough and complex impairment testing. (Detail for this impairment test is under IAS36)
5. The IAS38.63 states that Intangible assets should be carried at cost less any amortization and impairment losses.

Comparison of treatment of Goodwill under the Australian and International Accounting Standards.

Under the Australian Accounting standard Amortization is based on straight- line basis and the time frame is required between 5 and 20 years. The requirement to adopt straight- line amortization was introduced in 1996. According to Australian standard Goodwill is amortized with over its useful life unto a maximum of twenty years. With the adoption /harmonization process the impact on Goodwill treatment has to be reviewed hence there is no need to amortize the goodwill. Whereas the current IFRS recommendation, under the IAS 22 Accounting for Business Combinations which clearly indicate a contradict belief that goodwill has a maximum useful life of 20 years as we can not judge or clearly specify the life of goodwill the logic is there is no physical substance of the goodwill and basically the goodwill measured with no of other factors. On the other hand, contrary to the Australian treatment that the maximum period of amortization of goodwill is 20 years, if there is convincing evidence that the useful life of goodwill will exceed 20 years, the International standard states that an enterprise should amortize the goodwill over its estimated useful life. This is consistent with the amortization requirements for intangible assets in IAS38 Intangible Assets. But on the other hand if the goodwill expected useful life of goodwill exceeds 20 years, then the enterprise needs to go for the impairment test, which is:

“(a) Test goodwill for impairment at least annually in accordance with IAS36

Impairment of Assets;

(b) Disclose the reasons why the presumption that the useful life of goodwill will not exceed 20 years from initial recognition is rebutted and also disclose the factor(s) that play a significant role in determining the useful life of goodwill.” [9]

Goodwill impairment test is under current Australian standard is done on reporting date but there is no specific rule or guideline regarding that but normally done on entity basis whereas the proposed impairment test is more comprehensive and also need thorough calculation.

Generally, testing of impairment of goodwill can only be performed in conjunction with the cash-generating unit (CGU) to which the goodwill relates. The exposure draft proposes that an entity determine the recoverable amount for the cash-generating unit to which the asset belongs and allocate the impairment loss (if any) to, first, any goodwill allocated to that cash-generating unit, and then on a pro-rata basis to the other assets included in the cash-generating unit. [10]

Treatment best for Australian Companies

There is lot of controversy between corporate worlds in Australia in adopting IAS38, some strongly support the IAS38 standard (like AISC) and some are totally against the standard. Apparently if the IAS38 standard adopted its impact on Australian corporate world seems to be awful. It is too early to say that IAS38 will help Australian companies in every sense. We have to wait and *it would be inappropriate for the Board to adopt an approach that harmonizes with IAS38 "Intangible Assets" until the position in respect of US GAAP is known or IAS 38 is adopted for cross-border purposes. [11]* The (ASIC) Australian Securities and Investment Commission is a keen follower of IAS 38. After analysis of 181 Australian public companies financial statement it can be noted that there is nothing-positive consequence that IAS38 brings to Australian businesses (See appendix 1). There is quite a no of difference in Australian environment and the practices in treating and reporting of Goodwill from internationally environment in respect of Valuation of asset, Test of recoverable amount and historical cost framework. It seems incompatibility of IAS 38 in regards to Australian practice because of following reason:

⁹ www.iasc.org.uk/

¹⁰ <http://www.cpaaustralia.com.au>

¹¹ <http://www.group100.com.au/>

If we look at taxation point of view Amortization of goodwill is tax deductible in the in many European countries and as well as in US, where as amortization is not tax deductible in Australia. Therefore its economic impact on companies is enormous. The fundamental problem in accounting for intangible assets is the conflict of opinion between the historical cost and the mark-to-market approach. The Standard setting is presently leaning towards mark-to-market approach, whereas IAS 38 is clearly subjective towards the historical cost approach hence if Australian Corporate world adopt market-to-market approach mean there is need of independent valuations on each reporting date and recording increases and decreases in value directly into the results for the period as a result there is no requirement of amortization. Therefore it can be said that current Australian practice AASB1013 is better for Australian companies in the treatment of goodwill after looking at different point of views and after the review of both AASB1013&IAS38 but at the same time I can say in long term, as globalization is going around the world and hence it is compulsory for Australian companies to formulate there account which is widely acceptable and brings many benefits like (fund raising, listing of share, and world wide accepted) accounting practice.

“Picker says the firm is undertaking a study to determine whether the contents of IAS 38, if implemented in Australia, would be contrary to the national interest.”^[12]

“Paul Phenix, says: "This latest standard is difficult, and it has always been realised that it is difficult. Australia is further down the road on intangibles than other countries.”^[13]

“The technical director of the Australian Society of CPAs, Colin Parker, says the argument that the international accounting standard is "un-Australian”^[14]

¹² brw.com.au/stories/19990521/2238.htm - 18k

¹³ brw.com.au/stories/19990521/2238.htm - 18k

¹⁴ brw.com.au/stories/19990521/2238.htm - 18k

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KPMG, in Australia, has produced a publication which compares IAS GAAP

And Aust GAAP. Refer to

<http://www.kpmg.com.au/content.asp?cid=21215&s=21166>.

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An extract of the publication can be found at

http://www.kpmg.com.au/content/Services/Services/Assurance_and_Advisory/International_Financial_Reporting_Standards/docs/aaa_ifrs_gaap_extract.pdf

[Accessed on 16th October 2003]

To order the full publication refer

http://www.kpmg.com.au/content/Services/Services/Assurance_and_Advisory/International_Financial_Reporting_Standards/docs/aaa_ifrs_gaap_order.pdf

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[IASB - International Accounting Standards Board](#)

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Abbreviation

AARF	Australian Accounting Research Foundation
AASB	Australian Accounting Standards Board
AASC	Australian Accounting Standards Committee
ASB	UK Accounting Standards Board
ASC	Australian Securities Commission
ASCPA	Australian Society of Certified Practising Accountants
ASRB	Accounting Standards Review Board
ASX	Australian Stock Exchange
AuSB	Auditing Standards Board
FASB	US Financial Accounting Standards Board
FRC	Financial Reporting Council
GAAP US	Generally accepted accounting principles
IASC	International Accounting Standards Committee
ICAA	The Institute of Chartered Accountants in Australia
IOSCO	International Organization of Securities Commissions
LRB	Legislation Review Board
PSASB	Public Sector Accounting Standards Board
SEC	Securities and Exchange Commission
UIG	Urgent Issues Group

Fair value

Means the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's length transaction

Goodwill

Means the future benefits from unidentifiable assets

Identifiable assets

Means those assets which are capable of being both individually identified and specifically recognized

Purchase consideration

Means the fair value of assets given or share capital issued, liabilities undertaken, and other securities given by the purchaser, in exchange for assets (net, where applicable) or shares of another entity

Unidentifiable assets

Means those assets, which are not capable of being both individually identified and specifically recognized.

Appendix

One

- Items that may be covered by the scope of IAS 22 and IAS 38, excluding research and development costs but including goodwill totalled approximately \$59.9 billion, representing about 5% of total assets of the companies surveyed.
- These intangible assets generally included items such as goodwill, trade names, brand names, trademarks, patents, management or distribution type rights, mastheads, deferred expenses (excluding items described as deferred research and/or development), rent rolls, royalty agreements, etc. It is very difficult to estimate how much of the total intangibles value may not even meet the recognition criteria contained in IAS 38 as many companies do not separately disclose their internally generated brand names and similar type items from other intangible assets such as patents and trademarks. However, of the total value of intangibles, approximately \$43.5 billion or 73% represented other intangibles, excluding goodwill.
- A whopping \$39.7 billion or 91% of these other intangible assets were not being amortized.
- If these unamortized intangible assets were to be amortized over 20 years on a straight-line basis, the result would be close to a \$2 billion annual charge against net profits, thereby reducing total net profits by an average of 39% for those companies currently not amortizing some or all of their intangible assets. The effect on profit is magnified when you consider that amortization is not tax-deductible in Australia. This is in contrast to the United States where amortization is usually tax-deductible.
- The companies that would be hardest hit are the media corporations involved in the publishing and broadcasting industries. The statistics are even more disastrous when you consider that some companies would be forced out of a net profit position and into a net loss position, thereby severely limiting or erasing all together their ability to pay dividends. This does not even take into account those companies, which are amortizing their intangibles over periods in excess of 20 years and may need to reduce their amortization periods to 20 years if they cannot justify the longer amortization periods.

(Source: [http://www.ey.com/global/download.nsf/Australia/IAS_Intangible_Assets_Jan03/\\$file/IntangibleAssetsJan03.pdf](http://www.ey.com/global/download.nsf/Australia/IAS_Intangible_Assets_Jan03/$file/IntangibleAssetsJan03.pdf))