Accounting Regulations for Goodwill at a National, European and International Level

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Abstract
The main objective of this article is to evaluate the degree of formal harmonization of the Romanian accounting regulations with the International Financial Reporting Standards with regard to goodwill, as it appears in the consolidated financial situations. This study measures the degree of harmonization using the Jaccard Coefficient. The results show that the Romanian regulations are partially compliant with the international regulations.

Key words: harmonization, Jaccard coefficient, goodwill

JEL Classification: M41

Introduction
Accounting is shaped by economic and political forces. Every day we observe the globalization of both economy and politics which inevitably leads to a higher degree of integration of the financial reporting standards both in theory and in practice. “Most market and political forces will remain local for the foreseeable future, so it is unclear how much convergence in actual financial reporting practice will (or should) occur” (Ball, 2006).

The globalization process brings huge changes and challenges to accounting. One of them, mentioned in the last period by international accounting researchers as being the most important and interesting at the same time, is the accounting harmonization process with all implications, contingencies, barriers and advantages involved.

The accounting harmonization following the adoption of the IFRS regulations seems to be one of the most controversial topics in recent literature, thus we consider that researchers have come across a generous subject to debate upon.

Romania is a country with a transition economy and as Albu et all (2010) mention, Romania is a “particularly interesting case study of the process of accounting change, in our particular interest the harmonization with international accounting standards. Like other countries from East and Central part of Europe, Romania, has been confronted with significant changes and challenges regarding the political, social and economic framework when they changed from a centralized national system to a decentralized one”.

Harmonization and convergence became some of the most debated topics by the researchers in the past years. Our study evaluates Romanian and international accounting regulations which concern the topic of goodwill. Thus, we measure the degree of harmonization between Romanian and international regulations, using Jaccard coefficients.

To meet our objective we consider it necessary to make a comparison between commonalities and differences of regulations regarding goodwill, by analysing IFRS 3 „Business Combinations”, FAS 142 „Goodwill and other intangible assets”, the 4th and 7th ECC Directives, and OMFP 3055/2009.
The reminder of the paper is structured as follows: next we will review the literature regarding our subject of study, the third part comprises of the research methodology used, the fourth part consists of analytical incursion of regulations, the fifth part is the actual harmonization measurement, and last we focus on conclusions and future developments.

1. Literature review

Ball (2006) observes “that extraordinary success has been achieved in developing a comprehensive set of ‘high quality’ IFRS standards, in persuading almost 100 countries to adopt them, and in obtaining convergence in standards with important non-adopters (notably, the US). “On the ‘con’ side”, he envisages “problems with the current fascination of the IASB (and the FASB) with ‘fair value accounting’”.

In 2001 Saudagaraz and Shahrokh M created a comprehensive study regarding the advantages and the threats regarding the harmonization of the accounting system. Taking into consideration primary that IFRS became mandatory in European Union countries for listed companies and secondly that listed companies are usually multinationals, the concept of transferability across cultures becomes a research subject for accounting harmonization researchers.

Reazaee et all (2010) discuss the convergence in accounting standards from the “perspectives of academicians and practitioners regarding convergence to a set of global accounting standards”. They conclude that “effective convergence to a set of globally accepted accounting standards would be beneficial to preparers, users, auditors, analysts, and standard setters. Convergence in accounting standards can require extensive and possibly costly changes to the standard-setting infrastructure and enforcement process in the US and other countries, and will also require proper training for management, auditors, and investors”.

How are IFRSs applied in different countries? This is a question to which many researches tried to find answers.

“The compulsory use of IFRS for the consolidated statements of listed companies in the EU and elsewhere, and the convergence of IFRS with US GAAP, might imply the end of ‘international accounting’ as an important field of study. However, there are motives and opportunities for international differences of practice to exist within IFRS usage. Some of the original motives for international accounting differences may still be effective in an IFRS context, though in different ways. The opportunities for different IFRS practices are divided into eight types” under Nobes and for each type he proposes hypotheses related, and some ways of testing them. Nobes (2006) notes “some implications of the existence of different national versions of the IFRSs”.

Ball (2006) considers that there will inevitably “be substantial differences among countries in implementation of the IFRSs, which now risk being concealed by a veneer of uniformity. The notion that uniform standards alone will produce uniform financial reporting seems naive”.

Other authors as well conducted national research about accounting harmonization with IFRS: in Turkey (Yalkin et al., 2008 and Alp and Ustundag, 2009) in Greece (Ballas et al., 2010) in Romania (Feleaga et al., 2009, Filip A, 2010 Albu et al., 2010, Mustata, 2008).

The measurement systems for accounting harmonization include four steps, as highlighted by Mustăță R., 2008:

- The need of harmonization
- Formal harmonization
• Material harmonization
• Spontaneous harmonization.

Our study focuses on aspects regarding formal harmonization.

2. Methodology

The hypothesis we test in this study is the following: H1 Romanian accounting regulations are highly harmonized to the IFRS regulations, with regard to the formal aspect of harmonization.

To verify our hypothesis we chose to use Jaccard coefficients in order to make an accurate measurement.

The degree of formal or de jure accounting harmonization, can be quantified using two systems as presented by Mustăţă R., 2008:

• Distance measurement based systems and
• Correlation and association measurement based systems.

The second category, correlation and association measurement based systems, uses three types of coefficients: Spearman, Pearson and Jaccard coefficients (Mustăţă R., 2008).

In order to measure the similarity between two sample sets, we can use the Jaccard coefficient. This coefficient is defined as the size of the intersection of the two sets divided by the size of the union of the same sets.

\[ J(A, B) = \frac{|A \cap B|}{|A \cup B|}. \]

If we have two objects that we call A and B and each of these objects has n binary attributes, than the Jaccard coefficient is a very useful tool to measure how much A and B overlap with their attributes. Because A and B have binary attributes, their values can either be 0 or 1. So the total number of combinations of attributes can be represented as follows: M11 specifies the number of attributes where both A and B have the value 1. In a similar fashion M01 represents the number of attributes in which the attributes of A is 0 and the attributes of B is 1, M10 is the total number of attributes in which the attributes of A is 1 and the attributes of B is 0 and last M00 is the total number where both the attributes of A and B have the value 0. Since these are all the possible combinations it means that M11 + M01 + M10 + M00 = n. In this scenarios the Jaccard coefficient is defined as:

\[ J = \frac{M_{11}}{M_{01} + M_{10} + M_{11}}. \]

We can also define the Jaccard distance as a complementary to the Jaccard coefficient, so we subtract the Jaccard coefficient from 1. This distance is useful to measure the differences between sample sets. Since 1 can be defined as the size of the union divided by the size of the union, then the Jaccard distance will become the difference of the size of the union and the size of the intersection and all this divided by the size of the union.

\[ J_d(A, B) = 1 - J(A, B) = \frac{|A \cup B| - |A \cap B|}{|A \cup B|}. \]

In the case of binary attributes the Jaccard distance becomes:

\[ J' = \frac{M_{01} + M_{10}}{M_{01} + M_{10} + M_{11}}. \]
One limit of using the Jaccard coefficients is that it does not consider situations such as a method or accounting treatment is absent from both regulations tested or if their implementation is practical and possible (Mustata et al., 2011). In the case we study, none of these limitations affect our measurement, therefore we consider our result to be accurate.

In our study we chose to measure the degree of formal harmonization of the Romanian accounting regulations to the International Financial Reporting Standards, for 2008 to 2011, regarding the subject of goodwill, as it appears in consolidated financial statements. The reason why we chose this subject is that goodwill represents the topic of research for our doctoral dissertation. For the choice of timeline, 2008-2011, we wanted to continue a study made by Mustata (2008) who made a similar analysis for the timeline of 1973-2007.

3. Accounting treatment for goodwill at an international, european and national level

In order for our study to be complete, before making the measurements we consider it necessary to analyse how the compared terms are viewed by each of the referentials mentioned above.

3.1. International Financial Reporting Standards (IFRS)

3.1.1. Goodwill from a business combination

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(2004) compares for the calculation of goodwill two numbers, “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”.

3.1.2. Negative goodwill or a gain from a bargain

“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”, under paragraph 35 of IFRS 3R.

3.1.3. Accounting for goodwill

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”.

At the beginning of each reporting year, and also at the end, the company which acquired another company has the obligation of disclosing the amount of carrying goodwill for the next period. Deloitte specialists have shown separately 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”.

3.1.4. Reporting for goodwill

“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.

Moreover, the same regulation, 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. Under IFRS, there is no separate test for goodwill, which is a relief for Canadian companies to some extent. However a company must identify 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.

3.2. The United States General Accepted Accounting Principles (US GAAP)

As a consequence of the US’s strong economic position on the market and the continuous development of business combinations on the international markets we observe how the US GAAP influences the IFRS, especially since the American regulatory body has a consulting position in the IASB meetings (Ristea et al., 2006).

Under the US GAAP there is a two-step approach to goodwill: “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 substantially from the IFRS. Next, we will make a comparison between the two standards.

3.3. Comparing the IFRS to USGAAP

In 2001, the FASB issued SFAS 141. Following that, after three years, the IASB issued their own standard entitled the same, “Business Combinations”. The FASB and IASB planned a convergence program since 2004 and for years later, in 2008 both regulating bodies announced revised versions of their standards regarding the matter of business combinations. Therefore, the SFAS 141R becomes effective from December the 15th 2008, and the IASB’s IFRS 3R becomes effective from the 1st of July 2009.

According to Deloitte (2006) 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”.

3.3.1. Similarities between the IFRS and the USGAAP

The US GAAP and the IFRS contain indicators which assess the impairment of long-lived assets, that are defined similarly. These internationally approved standards require that revision of goodwill and other intangibles with indefinite lives be performed at least once a year or even more frequently if any impairment indicators are present. Other long-lived assets will be tested when indicators of possible impairment are present, and not yearly. Impairment indicators under the US GAAP and the IFRS are similar. The standards FAS 142 Goodwill and Other Intangible Assets, FAS 144 Accounting for the Impairment or Disposal of Long-Lived Assets, and IAS 36 Impairment of Assets all apply to long-lived and other intangible assets, although each standard underlines certain exceptions. With regard to similarities and differences between the two standards, we can conclude that differences are present in the way impairment is reviewed, recognized and measured.
3.4. European accounting regulations: the EEC 4th and 7th Directives

The EU accounting consolidation policy is laid down in the Seventh Council Directive, issued in 1983. This Regulation has been the main harmonization instrument in the field of consolidation policy on EU level.

The project of convergence between international accounting regulations and the American ones, is strongly supported by the European Commission. The president of the IASB, Sir David Tweedie, and the Commission of American Exchange Security, SEC, both consider that on a medium term, the following elements are in view: “a technical support to facilitate the use of the concept of true and fair value; the obligation to book, report and issue a comprehensive income statement; an adhesion to the American model of a report on segments. A detailed application on short term of the concept of true and fair value is less probable”. The president of the IASB supplied to the Committee of Accounting Regulations (part of the organism that work for the adoption of the IFRS standards at the European level) details referring to the subjects for the convergence project. In this regard, several projects are undertaken: “company combination (development and revision of the standard IFRS 3); the distinction liabilities/ equities; financial instruments; the process of identifying; information regarding the performance; income accountancy; the measurement of a fair value”. For Romanian companies, the way to reach the convergence project is to adopt of the two accounting referential. Companies that are quoted on the market, as well as insurance companies have to implement IFRS regulations.


In 2009 the Romanian accounting law was improved by the issue of the OMFP 3055/2009. With regard to the subject of goodwill, the main difference compared to the former regulation is analyzed below. The main change consisted in evaluating assets at the fair value, not at the accountable value as before.

According to OMFP 3055/2009, companies must use fair value evaluation for recognizing any asset or liability arising from a business combination, in order to establish their individual value. This action should be performed by professionals in the field of evaluation, members of a worldwide recognized professional body.

Goodwill is usually recognized at the time of the consolidation, and it represents the difference 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 Romanian law, because it is considered to be an unidentifiable resource, meaning it can not be evaluated at a credible cost.

Goodwill is usually amortised during a period of five years, but companies are still allowed to prolong this beyond the specified time, on condition that the lifetime of the asset does not expire before the amortization is complete.

4. Case study: Measurement of formal harmonization of Romanian accounting regulations to the International Financial Reporting Standards, with regard to goodwill, using Jaccard coefficients

In this section of our paper we will visualise the results of the Jaccard coefficients which led to the results we later on interpreted.
4.1. Comparability of the accounting treatment for goodwill and calculus of Jaccard coefficients

*Table 1. Accounting rules and the calculation of the coefficients*

<table>
<thead>
<tr>
<th>IFRS and NAR 8 elements</th>
<th>Year 2008</th>
<th>Year 2009</th>
<th>Year 2010</th>
<th>Year 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Goodwill from a business combination</td>
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<td>2. Negative goodwill</td>
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<tr>
<td>3. Internally generated goodwill</td>
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<td>4. Fair value in relation to goodwill</td>
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<tr>
<td>5. Calculus of goodwill</td>
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<tr>
<td>6. Amortization of goodwill</td>
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<tr>
<td>7. Impairment of goodwill</td>
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<td>8. Explanatory notes</td>
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*Source*: The projections and calculations of the author

The results obtained after the measurements of the similarity and discrepancy coefficients are the following:

\[ J_{S2008} = 0.5, \quad \text{and} \quad J_{D2008} = 1 - J_{S2008} = 0.5 \]
\[ J_{S2009} = 0.625, \quad \text{and} \quad J_{D2009} = 1 - J_{S2009} = 0.375 \]
\[ J_{S2010} = 0.625, \quad \text{and} \quad J_{D2010} = 1 - J_{S2010} = 0.375 \]
\[ J_{S2011} = 0.625, \quad \text{and} \quad J_{D2011} = 1 - J_{S2011} = 0.375 \]

Where \( J_S \) represents the Jaccard similarity coefficient calculated for each separate year between 2008 and 2011 and \( J_D \) represents the Jaccard discrepancy coefficient calculated for each separate year between 2008 and 2011.

4.2. Interpretation of the results

With regard to goodwill, we see that there are different degrees of harmonization. For 2008, the degree of similarity is 0.5 which means that the Romanian legislation is 50% harmonized with international referential. For the coming years, the degree of similarity increases to 0.625. This increase happened because in 2009 the Romanian Minister of Public Finance Order no. 3055/2009 was introduced for the approval of Accounting Regulations in accordance with European directives.

The main modification of this order is the valuation of assets at fair value, first introduced in the Romanian legislation. Because the valuation of assets at fair value is the...
amount used in calculating goodwill, its presence in the Romanian legislation increases the Jaccard coefficients.

Therefore we conclude that the degree of formal harmonization is high, confirming our initial hypothesis H1 from which we started our research.

5. Conclusions and future developments

The main purpose of our research was to analyze the accounting regulations regarding goodwill and to measure the degree of formal harmonization of the Romanian regulations to the IFRSs. To achieve our goal, we first made a thorough analysis of all international, european and national regulations, followed by the actual measurement of the degree of formal harmonization using Jaccard coefficients.

We have, in our paper, demonstrated through mathematical calculus that the degree of formal harmonization of the Romanian regulations to the IFRSs has reached a level above fifty percent, but we could also find aspects where the regulations can still be improved.

Given that at an international level there are specific regulations, such as IFRS 3 Business Combinations, which only regard the subject of business combinations and that Romanian legislature holds only one regulatory act, OMFP 3055/2009 for all accounting treatments according to international standards, we consider that our comparison may be detrimental to Romanian law, at least partially. Our solution to this matter would propose adopting the whole version of the IFRS at a national level, or the adaptation of them according to the national needs, by creating National Accounting Regulations. This is not an innovative proposal, since it follows the model of The Check Republic or Hungary, both of which have their national standards. Of course, debates should be organized between the academic and professional bodies, in order for the best solution to be reached.

We consider we have achieved our initial objective and managed to confirm our presumed hypothesis.

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