



Measurement of Goodwill as an Intangible Asset in Accounting

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Abstract

This study aims to analyze the method of measuring goodwill as an intangible asset in accounting. Goodwill is an important element in the total value of a company resulting from an acquisition or business combination and is recognized as an intangible asset. Determining the value of goodwill often faces challenges due to factors that are difficult to measure, such as reputation, customer loyalty, and management quality. This research examines intangible asset measurement theory, relevant accounting standards, as well as methods commonly used in practice, such as the cost method, fair value, and future net income analysis. The research method used is an in-depth literature study on the concept and measurement of goodwill as an intangible asset in accounting. The results show that the choice of goodwill measurement method has a significant effect on the company's financial reporting, especially on the value of assets and equity. This research emphasizes the need to develop more accurate and consistent accounting standard guidelines in the measurement of goodwill.

Keywords: Intangible Assets, Goodwill Measurement, Accounting.

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INTRODUCTION

Intangible assets arising from business combination activities through acquisitions are called goodwill (Kieso, 2014). Goodwill has been an issue in accounting for many years (Gynther, 1969; Johnson and Tearney, 1993; Comiskey et al, 2010; Kusuma, 2017). Risky, incomprehensible, unreliable, undesirable, and unpredictable are properties attributed to goodwill in some literature (More, 1891; Dicksee, 1897; Densham, 1898; Guthrie, 1898). The controversy over the recognition of goodwill led the International Accounting Standards Board (IASB) in 2004 to issue the International Financial Reporting Standard (IFRS) - Business Combinations. The IASB revised International Accounting Standard (IAS) 36 - Impairment of Assets and IAS 38 Intangible Assets which made major changes to the accounting treatment of goodwill. The new Accounting Standards make changes to business combinations, intangible assets and goodwill. The new accounting standards imply that business combinations are accounted for using the purchased method and goodwill is no longer amortized, but the value of goodwill must be evaluated for possible impairment and write off the value of goodwill to the extent of the impairment (Jerman, and Manzin, 2008).

Goodwill in accounting refers to intangible assets that represent the reputation, customer loyalty and brand value of a company. Goodwill is an important concept in financial reporting, especially in situations involving business acquisitions. When a company acquires another business, its purchase price often exceeds the fair value of its identifiable net assets. The excess amount is referred to as goodwill. Goodwill arises from intangible factors such as the target company's customer relationships, brand recognition, and employees, to name a few. Goodwill is classified as an intangible asset because it has no physical substance and cannot be measured or sold separately from the company as a whole. Unlike tangible assets such as buildings or equipment, goodwill is an intangible value that the company owns and contributes to its overall value.

A good understanding of goodwill and how to calculate it is essential for investors, financial managers and analysts to assess the financial health and intrinsic value of a company. By calculating and understanding the value of goodwill, companies can better manage their intangible assets, while investors can make more informed and strategic investment decisions. Goodwill is not just a number on the balance sheet, but also a representation of a company's strength and future potential.

METHOD

This research uses the literature study method to analyze the concept and measurement approach of goodwill as an intangible asset in accounting. The literature study was conducted by collecting and reviewing various academic sources, such as journals, books, and relevant international accounting standards, including IFRS and PSAK. This approach aims to understand the prevailing theories and practices related to goodwill measurement, the challenges faced in its application, and the variation of methods used in different countries. By focusing on theoretical sources, this research not only provides an overview of the concept of goodwill, but also identifies key issues that arise in the measurement of this intangible asset.

RESULTS AND DISCUSSION

Accounting Standards for Goodwill in Different Countries

Goodwill is an intangible asset that is recognized when a company purchases another business at a price higher than the fair value of its net assets. The difference between the purchase price and the fair value of these net assets becomes goodwill. Accounting standards for goodwill differ between countries and depend on the accounting framework adopted, such as IFRS, US GAAP, or country-specific standards. Under IFRS, goodwill is recognized when a

business combination occurs and is not amortized. Instead, goodwill is tested annually for impairment using IAS 36 (Impairment of Assets). The objective is to ensure that the goodwill recorded in the balance sheet remains relevant and does not exceed the recoverable value of the related cash-generating unit. If the value of goodwill decreases, the company must recognize the impairment loss in the income statement. This approach emphasizes annual impairment tests in lieu of amortization and is applicable in many countries that adopted IFRS.

Under US GAAP, goodwill is not amortized but tested for impairment annually or more frequently if there are indications of impairment. Goodwill will be recorded as a loss if the carrying amount is greater than the recoverable amount. Standards related to goodwill are contained in Financial Accounting Standards Board (FASB) ASC 350. EU - International Financial Reporting Standards (IFRS), mainly IFRS 3 and IAS 36. Goodwill under IFRS is recognized as part of an acquisition and tested for impairment annually, similar to US GAAP. The difference is in the recognition of goodwill and the calculation of impairment value may vary depending on the member country. In Indonesia, goodwill is governed by PSAK 22 and PSAK 48, which refer to IFRS. Goodwill is recognized in the statement of financial position, not amortized but tested for impairment annually. Under J-GAAP, goodwill can be amortized over 20 years or shorter, and an impairment test is performed if there is any indication of impairment. This practice is more conservative compared to IFRS or US GAAP. Under Ind AS 103, goodwill is recognized in accordance with IFRS, i.e. not amortized but tested for impairment annually or more frequently if there is an indication of impairment.

Overall, the main differences between different countries' accounting standards regarding goodwill lie in the treatment of amortization and the frequency of impairment tests. IFRS, US GAAP, China, India and Canada do not amortize goodwill, but strictly apply annual impairment tests. On the other hand, Japan and UK GAAP allow amortization under certain conditions, but still require impairment tests if indicated. This suggests a more flexible approach that adapts to the specific needs of each country while maintaining the quality and relevance of financial statements.

Goodwill as an Example of an Intangible Asset

Trademarks, organization costs, and goodwill are examples of non-identifiable intangible assets. They are classified as non-identifiable intangible assets because the company continues to incur costs to maintain or replace these intangible assets (replacement cost). This makes it impossible to determine when the original value ends and is replaced by its replacement cost. Therefore, the original value must continue to be reflected in the books, while the replacement cost must be expensed immediately. There is no need for amortization because the original value is considered to be maintained by the replacement cost. Since replacement in intangible assets is a continuous process, the replacement cost results in relatively equal expenses over the life of the intangible asset. The advantage that companies get when using this method is that income for a year is charged current.

There are four criteria that must be met for something to be recognized as an intangible asset, namely:

1. The asset is identifiable, which causes the asset to have economic benefits that can be sold, leased, or exchanged separately.
2. The company has control over the asset, for example through legal rights.
3. The company will derive future benefits from the asset.
4. The acquisition cost of the intangible asset can be measured reliably.

Goodwill Impairment

Goodwill impairment is an impairment of goodwill that occurs when its carrying value in the balance sheet exceeds its recoverable value. Goodwill arises when a company acquires another business at a price higher than the fair value of its net assets, and is not amortized and therefore requires periodic impairment testing, primarily annually or when there are indications of impairment. The process begins by allocating goodwill to the cash-generating units (CGUs) that benefit from the acquisition. Subsequently, the recoverable value is calculated based on fair value less costs of sale or value in use. If the carrying value of the CGU is higher than its recoverable value, impairment occurs, and this loss is recorded in the income statement. Under IFRS, impairment is performed on CGUs that benefit from goodwill with flexibility in the method of determining recoverable value. While under US GAAP, a Simplified Test option is available to simplify impairment testing. Impairment of goodwill has a direct impact on reducing net income and may affect investor perception as it suggests that the asset no longer provides the expected economic benefits.

Internal Goodwill

Internal goodwill is goodwill created from within the company through the process of business growth, reputation enhancement, customer satisfaction, innovation, or good working relationships, without involving the acquisition of other businesses. This goodwill reflects the added value arising from intangible assets such as brands, customer loyalty, or competitive advantages organically developed by the company. In accounting practice, internal goodwill is not recognized in the financial statements as it has no objectively measurable cost. Accounting standards, both IFRS and US GAAP, only allow the recognition of goodwill resulting from external transactions, such as acquisitions. Internal goodwill will only be recognized as goodwill on the balance sheet when there is a business transaction that explicitly establishes the value of these assets, for example through a third-party purchase.

According to PSAK No.19 Intangible Assets paragraph 31, "internal goodwill is an expenditure made by the company to generate future economic benefits but the expenditure is not an identifiable resource controlled by the company and can be measured reliably at cost."

Negative Goodwill

Negative goodwill occurs when the purchase price made for an asset is lower than its market value. Negative goodwill is an indicator of unfavorable circumstances, however the presence of goodwill (or "positive" goodwill) implies that the value of the intangible asset is high, and the company is under relatively low pressure to sell - this situation favors the seller. Why does negative goodwill arise?

Negative goodwill usually arises due to one of the following:

1. Forced sale of the company or due to financial difficulties A company that is in financial distress and under pressure to sell may be willing to sell the company at a discount in the form of negative goodwill because the value of intangible assets for a struggling company is likely to be lower.
2. Incorrect asset valuation Asset valuations, especially long-term fixed assets, may be inappropriate - given that macroeconomic factors are constantly changing - and result in inaccurate market values. Similarly, an inaccurate valuation of intangible assets may also result in a lower market value and negative goodwill.

Goodwill Measurement

Goodwill is considered an intangible asset that has the largest value of all company assets and is a difficult item to measure. The difficulty is because goodwill does not have characteristics

associated with assets such as identifiable and separable. There are three main approaches in valuing goodwill as follows:

1. Valuation of favorable attitudes towards the company this assessment considers that goodwill is derived from beneficial business relationships, good employee relations, and the favorable nature of customers. These advantages may be derived from the company's good location, reputation or good name, monopoly market advantage, and good business management.
2. Present value of abnormal excess earnings, this approach most widely used in accounting textbooks assumes that goodwill represents the discounted present value of expected future earnings in excess of what is considered a normal return.
3. Goodwill as a valuation account some experts question whether goodwill is the same as an asset in the usual sense. They prefer to view goodwill as a valuation account. This approach is because all assets have value to the company because they have a specific contribution to the future cash flow stream. The value of the company should therefore be attributed to all assets that give rise to an increase in cash flows.

Following the development of the concept of goodwill which has changed over time, the accounting treatment for goodwill has also changed. Some of the methods that have been applied to recognize and record the value of goodwill are.

1. Write off method under this method, goodwill is written off immediately against an account in shareholders' equity, usually retained earnings. Proponents of this method argue that capitalizing and amortizing goodwill is arbitrary and under-presents net income. Therefore, the better treatment in their opinion is to write off goodwill immediately against the retained earnings account. Goodwill has no separability from the company so the value of goodwill should not appear on the statement of financial position.
2. Capitalization-amortization method the rationale used in the capitalization-amortization approach is the matching concept related to costs and benefits. The problem then faced is about how long the useful life of goodwill to amortize. APB Opinion No.17 states that all intangible assets with determinable useful lives should be amortized using the straight-line method over the useful life of the asset. Meanwhile, if the useful life of the asset cannot be determined (usually the case with goodwill), the asset may be amortized for a maximum of 40 years. The long amortization period is intended to have a small effect on net income.
3. Non-amortization capitalization method the basis of the non-amortization capitalization method is that the value in goodwill does not decrease. High managerial ability, reputation and good name, and superior company staff generally do not decrease in value, and may even increase. A better treatment would be a periodic reassessment of goodwill, i.e. if there is an impairment, it would be removed through profit or shareholders' equity.

Goodwill can be referred to as an investment that does not require amortization. According to the viewpoint of this approach, amortizing goodwill will reduce the reliability and relevance of income statement information because goodwill has an indefinite useful life and goodwill is not used or consumed in the process of earning profits.

CONCLUSION

Conclusion

The conclusion of this study highlights that goodwill as an intangible asset is very important in accounting, especially in the context of business acquisitions. Goodwill, which reflects the value of reputation, customer loyalty, and management quality, plays a significant role in enterprise value but is difficult to measure objectively. Various methods have been applied in the measurement of goodwill, such as fair value and net income analysis, but each method faces challenges due to the intangible nature of goodwill and the complexity in its valuation.

Accounting standards for goodwill vary across countries, with IFRS and US GAAP not amortizing goodwill, in contrast to some other countries that still allow amortization under certain conditions.

Internal goodwill, which is organically generated within the company, is not recognized in the financial statements due to the difficulty of establishing an objective cost, while external goodwill from acquisitions is recognized following the applicable standards. Impairment testing is an important method to ensure that the reported value of goodwill remains realistic, especially in situations where the carrying value may exceed the recoverable value. Negative goodwill, although rare, can occur when the purchase price is lower than the market value of the assets, indicating an unfavorable financial condition for the seller.

Limitations

The study is limited by its reliance on a literature review methodology, without including empirical data or case studies to validate its findings. The study does not explore the practical challenges faced by companies in applying goodwill measurement methods, nor does it address sectoral or regional variations in depth. In addition, its theoretical focus may not fully capture the complexities and nuances of real-world applications.

Research Implications

This research underscores the importance of harmonizing international accounting standards, such as IFRS and US GAAP, to improve global comparability in goodwill reporting. The study advocates the development of more precise and consistent guidelines for goodwill measurement, addressing challenges in valuation and reporting. In addition, the study also highlights the need for regular impairment testing to maintain the reliability of financial statements. Increased transparency in reporting, including detailed disclosure of assumptions and methods, can strengthen stakeholder confidence and support better investment and strategic decision-making. The findings also suggest that companies should prioritize training for accountants and decision-makers to improve understanding and application of goodwill-related standards.

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