Australian Accounting Standard **AAS 18**

June 1996

Accounting for Goodwill

Prepared by the
Public Sector Accounting Standards Board of the
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Australian Accounting Research Foundation
on behalf of the **Australian Society of Certified Practising Accountants and The Institute of Chartered Accountants in Australia**

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211 Hawthorn Road
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Email: standard@aarf.asn.au

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Defined words appear in *italics* the first time they appear in a section. The definitions are in Section 14. Standards are printed in **bold** type and commentary in light type.

MAIN FEATURES OF THE STANDARD

The Standard prescribes the accounting treatment for goodwill and discount on acquisition arising on acquisition of a business entity, or part thereof, through acquisition of the assets, or in the case of an investment in a subsidiary or in an associated company, through the acquisition of some or all of the shares in another entity. The Standard also prescribes the accounting treatment for internally generated goodwill.

The main revision to the superseded Australian Accounting Standard AAS 18 "Accounting for Goodwill" is that the straight-line method of amortisation has been prescribed.

The Standard has been presented in plain English format, consistent with the approach adopted in recent standards and exposure drafts issued by the Boards. However, aside from amendments to effect the revision outlined above, the requirements of the Standard remain the same as those of the superseded Standard.

AUSTRALIAN ACCOUNTING STANDARD

AAS 18 "ACCOUNTING FOR GOODWILL"

1 Application

1.1 This Standard applies to *general purpose financial reports* of:

(a) each private sector *reporting entity*; and

(b) each public sector reporting entity;

to which Accounting Standards operative under the Corporations Law do not apply.

1.2 This Standard applies to financial reports that are held out to be general purpose financial reports by an entity which is not a reporting entity and to which Accounting Standards operative under the Corporations Law do not apply.

1.2.1 Accounting Standards operative under the Corporations Law apply to companies and to other entities required by legislation, ministerial directive or other government authority to apply such Standards. Reporting entities which are not required to apply Accounting Standards operative under the Corporations Law are required to apply this Standard.

1.2.2 The standards specified in this Standard apply to the financial report where information resulting from their application is material, in accordance with Australian Accounting Standard AAS 5 "Materiality".

2 Operative Date

2.1 This Standard applies to reporting periods ending on or after 30 June 1996.

2.2 This Standard may be applied to reporting periods ending before 30 June 1996.

2.2.1 AAS 18 "Accounting for Goodwill", as issued in March 1984, continues to apply for reporting periods that end before 30 June 1996. However, where an entity elects to apply this Standard early in accordance with paragraph 2.2 it will not also be obliged to comply with AAS 18, as issued in March 1984, for the reporting periods to which the election applies.

2.3 When operative, this Standard supersedes Australian Accounting Standard AAS 18 as issued in March 1984.

3 Purpose of Standard

3.1 The purpose of this Standard is to:

(a) specify the manner of accounting for *goodwill* and *discount on acquisition* on the acquisition of an *entity*, or part thereof; and

(b) require disclosure of information relating to goodwill so that users of *general purpose financial reports* are provided with information about the financial position and performance of the *reporting entity*.

4 Internally Generated Goodwill

4.1 *Goodwill* which is internally generated by the *entity* must not be *recognised* by that entity.

4.1.1 Goodwill which is internally generated by an entity is not permitted by this Standard to be recognised as an asset by that entity. 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 would not usually be capable of being measured reliably. If internally generated goodwill is not recognised as an asset, it will either go completely unrecognised or will be recognised as an expense.

5 Purchased Goodwill

Accounting Treatment for Purchased Goodwill

5.1 *Goodwill* which is purchased by the *entity* must be *recognised* as a non-current asset at acquisition, except in the case of an investment in an *associated company*.

5.1.1 When goodwill is purchased in a business acquisition the exchange transaction enables the value of goodwill to be measured reliably. A number of methods of accounting for such purchased goodwill exists. Principally these methods include either recognising the expenditure as:

(a) an asset; or

(b) an expense at the time when the acquisition is made.

5.1.2 The view adopted in this Standard is that purchased goodwill represents future benefits acquired in an exchange transaction which need to be recognised as an asset.

5.1.3 The alternative accounting treatment, whereby purchased goodwill is recognised as an expense at the time of acquisition, is not supported because it fails to recognise the future benefits (including synergistic benefits) arising from the *unidentifiable assets* acquired.

5.1.4 Another alternative accounting treatment for purchased goodwill is to write-off goodwill against reserves at the time of acquisition. This treatment is unacceptable since it too fails to recognise the future benefits acquired, contravenes the requirements of Australian Accounting Standard AAS 1 "Profit and Loss or Other Operating Statements" and is contrary to the spirit of Australian Accounting Standard AAS 4 "Depreciation of Non-Current Assets".

5.1.5 In this Standard the view adopted is that goodwill comprises the future benefits from unidentifiable assets which, because of their nature, are not normally individually recognised. Unidentifiable assets would usually include market penetration, effective advertising, good labour relations and a superior operating team.

This would exclude assets of an intangible nature which are capable of being both individually identified and specifically recorded, as may be the case with patents, licences, rights and copyrights.

5.1.6 A distinction is frequently drawn between goodwill which is purchased and goodwill which is internally generated. The view taken in this Standard is that the concept of goodwill is the same regardless of whether it has been purchased in an exchange transaction or generated internally. The only distinction is that purchased goodwill can be measured reliably on the basis of the amount paid for it, while internally generated goodwill is not usually capable of being measured reliably. Consequently, the accounting treatment specified in this Standard for purchased goodwill differs from that specified for internally generated goodwill.

5.1.7 Goodwill is normally only recognised by a purchaser in connection with the acquisition of a business entity, or part thereof, through acquisition of the assets therein or, in the case of an investment in a *subsidiary* or in an associated company, the acquisition of some or all of the shares in another entity. Such purchased goodwill reflects future benefits from two sources: those which have been internally generated by the vendor prior to the *date of acquisition* and which are expected to flow to the purchaser, and those which arise from the combination or inter-relationship of entities or groups of assets (synergistic benefits).

5.2 Purchased goodwill must be amortised so that it is recognised as an expense in the profit and loss or other operating statement on a straight-line basis, over the period from the date of acquisition to the end of the period of time during which the benefits are expected to arise. This period must not exceed twenty years from the date of acquisition.

5.2.1 In accordance with paragraph 5.6, the unamortised balance of goodwill must be reviewed as at each *reporting date* and recognised as an expense to the extent that it is no longer supported by probable future benefits.

5.2.2 In order to amortise goodwill over the period during which the associated benefits are expected to arise, separate assessments may need to be made in respect of different goodwill components (such as those relating to the purchase of different businesses) to the extent that such components can be separately identified.

5.2.3 Factors which ought to be considered in estimating the useful lives of the assets comprising goodwill include:

(a) effects of obsolescence, demand and other economic factors; and

(b) the service life expectancies of individual employees or groups of employees; and

(c) expected actions by competitors or potential competitors; and

(d) relevant legal, regulatory or contractual provisions; and

(e) foreseeable life of the entity or industry.

5.2.4 Because the period of anticipated benefits will in many circumstances be difficult to identify, decisions concerning the period of amortisation may be arbitrary. For this reason, in no circumstance does this Standard permit the amortisation period to exceed twenty years. However, it is anticipated that in many circumstances the period will be considerably shorter than twenty years from the date of acquisition.

5.3 Subject to paragraph 5.2, the period over which goodwill is to be amortised must be reviewed as at each reporting date and, if necessary, adjusted to reflect the amount and timing of expected future benefits. The period must not extend beyond twenty years from the date of acquisition.

5.3.1 The period over which goodwill is to be amortised needs to be reviewed as at each reporting date and, if necessary, adjustments made in a manner consistent with the provisions of Australian Accounting Standard AAS 4 "Depreciation of Non-Current Assets".

Measurement of Purchased Goodwill

5.4 On acquisition of some, or all, of the assets of another entity, or in the case of an investment in a subsidiary or associated company, on acquisition of some, or all, of the shares of another entity, the identifiable net assets acquired must be measured at their *fair values*.

5.4.1 Fair value is a measure of the worth of an asset at a specified time, and is utilised in this Standard as the amount which the purchaser attributes to the assets acquired. When making an assessment of the fair values to be attributed to individual assets, the purchaser may sometimes find that a number of such assets are combined into a related or composite group (such as the units of plant in a steel mill). In these circumstances, it may be more appropriate to consider the fair value of the composite group rather than the aggregate of the fair values of the individual assets.

5.5 Purchased goodwill must be measured as the excess of the *purchase consideration* plus incidental expenses over the fair value of the identifiable net assets acquired.

5.5.1 The purchase consideration may take the form of any one, or combination, of the following:

(a) cash; and/or

(b) other monetary assets; and/or

(c) non-monetary assets; and/or

(d) securities issued; and/or

(e) liabilities undertaken.

5.5.2 Where the purchase consideration is in the form of cash and/or other monetary assets, its value is usually readily determinable. However, where the purchase consideration comprises (either partially or totally) non-monetary assets, its value will need to be ascertained by reference to the fair values of the non-monetary assets given.

5.5.3 Where the purchase consideration comprises shares or other securities of the investor and these securities are listed publicly on an Australian Stock Exchange, the price at which they could be placed in the market will usually be an indication of their fair value. Where the securities issued are those of an unlisted entity, it may be necessary to make a valuation of those securities. It should not be assumed that the par value of securities reflects their fair value, as this is rarely the case.

5.6 To the extent that the purchase consideration plus incidental expenses exceeds the fair value of the identifiable net assets acquired but the difference does not constitute goodwill, it must be recognised immediately as an expense in the profit and loss or other operating statement. Similarly, the unamortised balance of goodwill must be reviewed as at each reporting date and written down to the extent that it is no longer supported by probable future benefits. Any loss must be recognised immediately as an expense in the profit and loss or other operating statement.

6 Subsequent Changes in Cost of Acquisition

6.1.1 The *purchase consideration* may vary, contingent on one or more future events. When a variation is probable and the amount of the variation can be estimated reliably at the date of the acquisition, it needs to be included in the calculation of the purchase consideration. If any additional payment cannot be estimated reliably at the date of the acquisition, an accrual for the additional payment needs to be made as soon as the amount can be estimated reliably.

6.1.2 The accounting treatment of any variation of the purchase consideration depends upon the nature of the contingency. Where the contingency affects the determination of the *fair value* of net assets (such as the valuation of receivables or inventory, or the identification of liabilities) of the acquired *entity*, an adjustment to the individual assets or liabilities and to the purchase consideration needs to be made. On the other hand, where the contingency does not affect the value of the net assets of the acquired entity, for example, where it relates to the level of earnings of the acquired entity, the acquiring entity treats the variation as an adjustment to the purchase consideration. The adjustment in this instance has the effect of increasing (decreasing) the amount of *goodwill* or *discount on acquisition*.

7 Subsequent Identification of Assets and Liabilities

7.1.1 Where it becomes known, subsequent to acquisition, that assets or liabilities existed at the *date of acquisition* but were not accounted for, this would necessitate an adjustment in respect of those assets and liabilities. This may also necessitate an adjustment to the amount of *goodwill* or discount on acquisition. The same accounting treatment would also apply when assets or liabilities which were unidentifiable at acquisition subsequently become identifiable. Tax losses carried forward are an example of this and the accounting treatment is covered in paragraph 7.1.2.

7.1.2 The carrying amount of goodwill may include an element which relates to the expected value of the benefits of tax losses carried forward at the time of acquisition. Where the benefits of tax losses carried forward are subsequently recognised under Australian Accounting Standard AAS 3 "Accounting for Income Tax (Tax-Effect Accounting)", the carrying amount of goodwill needs to be reassessed and written down, to the extent that the benefits of the tax losses carried forward included therein are now separately recognised.

8 Discount on Acquisition

8.1 Where the *fair value*s of the identifiable net assets acquired exceed the *purchase consideration* plus incidental expenses, the difference represents a *discount on acquisition* and must be accounted for by reducing proportionately the fair values of the non-monetary assets until the discount is eliminated. Where, after reducing to zero the recorded amounts of the non-monetary assets acquired, a discount balance remains it must be *recognised* as a revenue in the profit and loss or other operating statement.

8.1.1 The fair values assigned to the identifiable net assets acquired may, on occasions, exceed the purchase consideration plus incidental expenses. A number of views are held as to the nature of the resultant difference. They include the following:

(a) the difference represents a discount on acquisition, because the purchase consideration paid for the identifiable net assets acquired is less than the fair value of those assets; and

(b) the difference is a liability for future costs which must be incurred by a business enterprise in order to justify the values attributed to the identifiable net assets.

8.1.2 The view adopted in this Standard is that the difference represents a discount on acquisition. This discount may reflect a bargain purchase and/or compensation in anticipation of temporary future losses or inadequate future profits. The discount on acquisition is to be accounted for by reducing proportionately the fair values of the non-monetary assets acquired until the discount is eliminated. In the rare circumstance that, after reducing to zero the recorded amounts of the non-monetary assets acquired, some of the discount remains, this discount balance must be recognised as revenue in the profit and loss or other operating statement.

8.1.3 This accounting treatment is generally consistent with the cost method because the assets acquired are recorded at their discounted amounts which aggregate to the cost of the acquisition.

8.1.4 The view contained in paragraph 8.1.1(b) is rejected because, in the absence at acquisition of a presently existing obligation to undertake future costs, a liability cannot be recognised. If there were any unrecorded liabilities at acquisition, they would need to be recorded prior to the measurement of *goodwill* or a discount on acquisition.

9 Treatment on Consolidation of Goodwill/Discount on Acquisition

9.1 On acquisition of a *subsidiary*, the accounting treatment for purchased *goodwill* (including any amortisation thereof) and *discount on acquisition* must be effected as a consolidation adjustment and not in the subsidiary's or holding company's books of account.

9.1.1 On acquisition of a subsidiary, goodwill/discount on acquisition must be determined and accounted for in accordance with the accounting treatment outlined for purchased goodwill/discount on acquisition. The accounting treatment for purchased goodwill (including any amortisation thereof) and discount on acquisition would be effected as a consolidation adjustment and not in the subsidiary's or holding company's books of account.

10 Acquisition of an Associated Company

10.1.1 On acquisition of an interest in an *associated company*, *goodwill*/*discount on acquisition* must be determined in accordance with the accounting treatments outlined in this Standard. Under the equity method an interest in an associated company is presented in a one-line summary, which means that goodwill will not be separately identified. However, for profit determination purposes, goodwill would need to be amortised in accordance with the requirements of this Standard.

11 Disclosures

11.1 In respect of the amount of *goodwill recognised* in the financial statements, the following must be disclosed:

(a) the unamortised balance of goodwill; and

(b) the amount of goodwill amortised during the period; and

(c) the policy adopted in amortising goodwill.

12 Comparative Information

12.1 Subject to 12.2, the financial report must disclose information for the preceding corresponding reporting period which corresponds to the disclosures specified for the current reporting period.

12.2 If the disclosure requirements in paragraph 11.1 have not previously applied to the *entity*, the information required by paragraph 12.1 need not be disclosed.

13 Transitional Provisions

Application of the Straight-Line Method

13.1 Whether or not the superseded Standard applied to the *entity*, where the straight-line method of amortisation of *goodwill* is not already being applied as at the beginning of the reporting period to which this Standard is first applied, the straight-line method must be applied prospectively to the unamortised balance of goodwill as from the beginning of that reporting period.

13.1.1 Where an entity was applying a method of amortisation not permitted by this Standard to allocate the cost of purchased goodwill, paragraph 13.1 prescribes prospective application of the straight-line method to the unamortised balance. The period over which the unamortised balance is amortised shall not exceed twenty years from the *date of acquisition*. Prospective application of the straight-line method of amortisation would result in the unamortised balance of purchased goodwill being amortised in equal amounts over the remaining useful life, unless an additional write-down is required in accordance with paragraph 5.6.

Superseded Standard Applied to Entity

13.2 If the superseded Standard applied to the entity, an amount of goodwill arising in relation to the acquisition of an entity, or part thereof, included in the financial statements as at the beginning of the reporting period to which the superseded Standard was first applied is deemed to have been determined in accordance with this Standard.

13.2.1 Any credit balance arising in relation to the acquisition of an entity, or part thereof, included in the financial statements as at the beginning of the reporting period to which the superseded Standard was first applied, would already have been adjusted against the carrying amounts of non-monetary assets acquired or against retained profits or accumulated losses, in accordance with the superseded Standard.

Superseded Standard Did Not Apply to Entity

13.3 If the superseded Standard did not apply to the entity, where there is included in the financial statements as at the beginning of the reporting period to which this Standard is first applied an amount of goodwill or a credit balance arising in relation to the acquisition of an entity, or part thereof, that amount must be deemed to have been determined in accordance with this Standard. Where the amount is a credit balance, it must be accounted for by reducing proportionately the carrying amounts of those non-monetary assets acquired which continue to be held. Where a credit balance remains after the carrying amounts of such non-monetary assets have been reduced to zero, the remaining balance must be adjusted against retained profits or accumulated losses as at the beginning of the reporting period to which this Standard is first applied.

13.3.1 The transitional provision set out in paragraph 13.3 acknowledges that there will be companies which have either goodwill or *discount on acquisition* balances existing at the beginning of the reporting period to which this Standard is first applied and that such balances need to be accounted for subsequently in the reporting period to which this Standard applies. The accounting treatment applied to such existing balances is to be consistent with the broad principles required by this Standard.

14 Definitions

14.1 In this Standard:

associated company **means an investee, not being a** ***subsidiary*** **of the investor, over which the investor has significant influence. This is the same meaning as in the Australian Accounting Standard AAS 14 "Equity Method of Accounting"**

date of acquisition **means the date on which the risks and rights to future benefits, as would be conferred with ownership, pass to the acquiring** ***entity***

discount on acquisition **means the saving or allowance in the** ***purchase consideration*** **that flows to the purchaser on acquiring identifiable net assets or shares at less than** ***fair value***

economic entity **means a group of entities comprising the** ***parent entity*** **and each of its subsidiaries**

entity **means any legal, administrative, or fiduciary arrangement, organisational structure or other party (including a person) having the capacity to deploy scarce resources in order to achieve objectives**

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**

general purpose financial report **means a financial report intended to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs**

goodwill **means the future benefits from** ***unidentifiable assets***

***identifiable assets* means those assets which are capable of being both individually identified and specifically recorded in the books of account**

***identifiable net assets* means *identifiable assets* less liabilities**

***parent entity* means an entity which controls another entity**

purchase consideration* means the fair value of assets given or share capital issued, liabilities undertaken, and/or other securities given, in exchange for assets (net, where applicable) or shares of another *entity

***recognised* means reported on, or incorporated in amounts reported on, the face of the profit and loss or other operating statement or of the statement of financial position (whether or not further disclosure of the item is made in the notes thereto)**

***reporting date* means the end of the reporting period to which the financial report relates**

***reporting entity* means an entity (including an *economic entity*) in respect of which it is reasonable to expect the existence of users dependent on *general purpose financial reports* for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources**

***subsidiary* means an entity which is controlled by a parent entity**

***unidentifiable assets* means those assets which are not capable of being both individually identified and specifically *recognised*.**

CONFORMITY WITH INTERNATIONAL AND NEW ZEALAND ACCOUNTING STANDARDS

Conformity with International Accounting Standards

As at the date of issue of this Standard, compliance with this Standard will ensure conformity with International Accounting Standard IAS 22 "Accounting for Business Combinations", issued by the International Accounting Standards Committee to the extent that IAS 22 addresses accounting for goodwill except for the following:

(a) Where an entity applies a period of amortisation exceeding five years, it would be required to disclose a justification of the period adopted in order to comply with IAS 22.

(b) This Standard requires that a discount on acquisition be eliminated proportionately against the fair values of non-monetary assets and where the values of such non-monetary assets are reduced to zero, any remaining discount must be recognised as revenue. Under IAS 22, any remaining discount should be treated as deferred income and amortised to the profit and loss account over a period not exceeding five years unless a longer period, not exceeding twenty years from the date of acquisition, can be justified.

(c) Under this Standard, assets and liabilities acquired as part of a business acquisition which are identified and recognised subsequent to acquisition are accounted for by adjusting goodwill or discount on acquisition. Under IAS 22, any adjustments made after the end of the first financial year subsequent to acquisition are recognised as revenue or expense rather than as adjustments to goodwill or discount on acquisition.

(d) In addition to the disclosure requirements of this Standard, IAS 22 requires a reconciliation of movements in balances of goodwill, discount on acquisition and related amortisation during the financial year.

Conformity with New Zealand Accounting Standards

As at the date of issue of this Standard, compliance with this Standard will ensure conformity with Statement of Standard Accounting Practice SSAP 8 "Accounting for Business Combinations" issued by the New Zealand Society of Accountants to the extent that SSAP 8 addresses accounting for goodwill.