Accounting for goodwill under IFRS: a critical analysis
Sven-Erik Johansson, Tomas Hjelström, Niclas Hellman
Stockholm School of Economics, Stockholm - Sweden

The revised model for accounting for goodwill under International Financial Reporting Standards (IFRS) has now been in force for a number of years. There is a growing body of empirical research related to the application of the relevant standards in connection with purchase price allocation and impairment tests (IFRS 3 and IAS 36, respectively), which indicates extensive use of management opportunism. We perform a critical analysis with the aim to clarify the theoretical logic of IFRS accounting for goodwill, notwithstanding the room for management opportunism. We explore how the difficulty in distinguishing between the elements of goodwill, in conjunction with features of accounting recognition and measurement, can allow financial statements to be uninformative with regard to the success or failure of acquisitions. We find that in the presence of conservative accounting and growth, the accounting goodwill will remain on the balance sheet during the post-acquisition period by subsuming the value of other assets, even though the core goodwill recognised at the acquisition date has disappeared (i.e., the expected excess returns and synergies have been realised). A buffer related to conservative recognition and measurement practices is created that protects goodwill from being impaired. This occurs even in the absence of any management discretion since the effect is built into the design of IFRS 3/IAS 36. Our research is based on the design of IFRS (the combination of IFRS 3 and IAS 36), but since the US standard setter applies the same underlying theoretical model for accounting for goodwill, the general results pertain also to US GAAP.

Keywords: goodwill, impairment, intangible assets, acquisitions, IFRS 3, IAS 36, business combinations, accounting conservatism, financial statement users