HONG KONG SOCIETY OF ACCOUNTANTS

Financial Accounting Standards Committee

Urgent Issues & Interpretations Sub-Committee

Interpretation
13
Goodwill - continuing requirements for goodwill and negative goodwill previously eliminated against/credited to reserves

Interpretations are authoritative guidance on the application of Statements of Standard Accounting Practice with which enterprises should comply if their financial statements purport to give a true and fair view. Unless indicated otherwise, Interpretations have the same status as the background material and implementation guidance contained in Statements of Standard Accounting Practice. Interpretations are not intended to apply to immaterial items.

References: *Framework for the preparation and presentation of financial statements*

SSAP 2 *Net profit or loss for the period, fundamental errors and changes in accounting policies*

SSAP 9 *Intangible assets*

SSAP 30 *Business combinations*

SSAP 31 *Impairment of assets*

SSAP 32 *Consolidated financial statements and accounting for investments in subsidiaries*

ISSUES

1. SSAP 30 paragraph 88 sets out the transitional provisions relating to the first time application of the SSAP in respect of:

   (a) the restatement of goodwill and negative goodwill; and

   (b) the amortisation of goodwill and recognition of negative goodwill as income; and

   (c) the treatment of impairment losses on goodwill.

2. Guidance in the former Accounting Guideline 2.204-"Accounting for Goodwill" permitted goodwill to be eliminated* against reserves at the time of acquisition as a matter of accounting policy and recommended that negative goodwill should be credited directly to reserves. The transitional provisions in SSAP 30 encourage reporting enterprises to restate such goodwill and negative goodwill and to account for it retrospectively in accordance with the provisions of SSAP 30. However, this treatment is not mandatory, and an enterprise may elect not to restate goodwill (negative goodwill).

3. Where a reporting enterprise, as a matter of accounting policy, has previously eliminated goodwill on acquisition against reserves (or credited negative goodwill directly to reserves), and now elects not to restate goodwill and/or negative goodwill in accordance with the transitional provisions of SSAP 30, the issues are:

   (a) How should that enterprise account for any impairment of that goodwill subsequent to the adoption of SSAP 30?

   (b) How should that enterprise account for such non-restated goodwill (or negative goodwill) in the event of a subsequent disposal of part or all of the subsidiary whose acquisition gave rise to such goodwill (or negative goodwill)?

CONCLUSIONS

Impairment

4. In applying the impairment provisions of SSAP 31, goodwill that was eliminated against reserves on acquisition should be considered and accounted for in accordance with the requirements of SSAP 31. Accordingly:

   (a) any impairment loss identified in respect of goodwill previously eliminated against reserves should be recognised as an expense in the income statement immediately; and

   (b) any previously recognised impairment loss should be reversed only in the circumstances set out in SSAP 31 paragraph 109.

Disposals

5. On disposal of an interest in a subsidiary, associate or joint venture, the gain or loss included in the consolidated income statement in respect of the disposal of that interest should be determined taking into account the attributable amount of either:

   (a) any purchased goodwill which, as a matter of accounting policy, has previously been eliminated against reserves and which has not previously been charged to the income statement; or

   (b) any negative goodwill previously credited directly to reserves.

6. Companies should maintain records that will enable an appropriate estimate or apportionment of the attributable purchased goodwill (negative goodwill) to be made when the subsidiary, associate or joint venture is sold. In the rare circumstances in which the purchased goodwill attributable to a disposal cannot be determined or estimated on a reasonable basis, (for example, where a disposal relates to a business that was part of a group acquired many years ago and subsequently restructured), the following should be explained:

   (a) the fact that goodwill is not reasonably determinable;

   (b) the reasons therefor; and

   (c) the date of acquisition.

Disclosure

7. The requirements of SSAP 30 paragraphs 77(e) and 80(d) apply equally to goodwill (negative goodwill) that is carried in reserves.

BASIS FOR CONCLUSIONS

Impairment

8. The acquisition of a subsidiary, associate or joint venture results in expenditure which is normally expected to result in future economic benefits to the acquirer. The amount of such expenditure is the total consideration incurred, and not solely that element relating to the identifiable assets and liabilities acquired and accounted for at fair value as part of the recording of the acquisition. The adoption of an accounting policy under previous standards of eliminating residual goodwill on acquisition against reserves (crediting negative goodwill to reserves) did not write off the balance of goodwill. It merely transferred the balance to reserves. The goodwill therefore continues to be carried in the balance sheet: either as a specific deduction from a particular reserve or in a separate reserve. Therefore, until such goodwill (negative goodwill) is recognised in the income statement, its carrying amount recognised in the balance sheet remains at its original value less any accumulated impairment losses already written off through the income statement.

Disposal

9. The failure to account, in a disposal calculation, for any goodwill or negative goodwill neither previously recognised as an asset, nor charged or credited to the income statement, would result in the misleading and incorrect reporting of a gain or loss on disposal. That goodwill represents part of the total cost of the acquired enterprise. For example, if a subsidiary which had been acquired for $100 (of which goodwill, directly eliminated against reserves, was deemed to have been $40) were to have broken even for a number of years and were then to be sold for $70, a gain on disposal of $10 would be reported were the goodwill on acquisition not to be taken into account. In fact, the proper economic loss that should be reported would be $30 ($70 minus $60 minus $40). This loss reflects the true economic loss to the enterprise as a result of its decisions to buy, hold and sell the subsidiary at the amounts and within the timeframes reported. To disregard goodwill and report a gain on disposal would be inconsistent with paragraph 31 of the Framework which states:

   "To be reliable, information must represent faithfully the transactions and other events it either purports to represent or could reasonably be expected to represent."

10. Moreover, not to take goodwill on acquisition through the income statement would also be contrary to SSAP 2 paragraph 6 which states:

   "All items of income and expense recognised in a period should be included in the determination of the net profit or loss for that period unless an Accounting Standard or, in the absence of a relevant Accounting Standard, the law requires or permits otherwise."

11. The Committee notes that the conclusions contained in paragraph 5 of this Interpretation are consistent with the guidance set out in SSAP 32 paragraph 37. It also notes that they are consistent with the previous requirements of SSAP 7 "Group accounts", which was in force prior to the introduction of SSAP 30 on business combinations, as well as former Accounting Guideline 2.204.

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**Although the former Accounting Guideline referred to the "elimination" of goodwill, some reporting enterprises used expressions such as "writing off" goodwill. The principles in this Interpretation apply to all situations where goodwill arising on acquisition has been debited to reserves, or negative goodwill has been credited to reserves, at the time of acquisition as a matter of accounting policy, regardless of the terminology used in the reporting enterprise's accounting policy to describe such treatment.*