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Reviewing IFRS Goodwill Accounting Research: Implementation Effects and Cross-Country Differences

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ABSTRACT

We review 42 studies from 2008 to early 2017 about IFRS goodwill accounting choices for recognition, impairment, and disclosure of goodwill, focusing on cross-country evidence of implementation effects. We develop a model of application of goodwill accounting based on IFRS 3, IAS 36, and country- and firm-level influences to analyze the research and to summarize existing evidence about goodwill accounting choices. We report evidence in support of IFRS accounting for goodwill recognition, impairment, and disclosure from many countries. However, evidence regarding value relevance is mixed. Overall, there is a lack of cross-country evidence regarding factors affecting goodwill accounting. Many studies show goodwill recognition, impairment, and disclosure are associated with economic and firm factors, and there is some evidence about the impact of managerial incentives and a lack of timeliness in impairment recognition. There is scope for more cross-country studies showing how institutional factors affect the application of IFRS 3 and IAS 36.

1. Introduction

The aim of our paper is to provide a synthesis of existing literature to identify where research provides strong evidence on the topic of accounting for goodwill after implementation of International Financial Reporting Standards (IFRS) in various countries. We develop and use a framework of accounting choice to analyze recent research on the effects of application of IFRS 3 Business Combinations and IAS 36 Impairment to find evidence as well as research opportunities for the following questions: Are goodwill accounting choices value relevant? This is a necessary condition for the next set of questions: What determinants influence goodwill accounting choices? What are the consequences of different goodwill accounting choices? To what extent are those determinants and consequences explained by country differences? We propose that strong evidence is provided when studies which are based on appropriate samples and methods provide consistent results across countries and over time. The focus of our paper is, initially, cross-country studies because we seek evidence about the application of IFRS in a range of countries. To supplement this analysis (and because there are few cross-country studies) we also consider evidence from single-country studies.

Accounting for goodwill is important and controversial. Recognized goodwill often represents the single largest item on a firm's balance sheet (Boennen & Glaum, 2014). Accounting for business combinations has changed dramatically with the release by the US

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Financial Accounting Standards Board (FASB) of Statement of Financial Accounting Standards (SFAS) 141 Business Combinations and SFAS 142 Goodwill and Other Intangible Assets in June 2001 (FASB, 2001a, 2001b).[1] Similar requirements were introduced in IFRS 3, which applied beginning in January 2005 for European Union listed companies' consolidated accounts and in other countries that subsequently adopted IFRS, including Australia, Canada, and Malaysia (IASB, 2015). Notable aspects of IFRS 3 were abolishing the pooling of interests method and goodwill amortization as well as adopting an impairment-onlyapproach for goodwill and some other intangible assets. IAS 36, adopted from 2005, applies to impairment recognition, measurement and disclosure.

There are many concerns about goodwill accounting under IFRS 3 and IAS 36. Some research states that accounting for goodwill and impairment involves judgements and estimates, and is therefore very challenging and time consuming (e.g., Bloom, 2009; Masters-Stout, Costigan, & Lovata, 2008). Regulators have expressed concerns about the rigor of application of IAS 36 and the adequacy of disclosures (ESMA, 2013). EFRAG (2017) listed a number of issues of concern including the possible late recognition of impairment and thus the overstatement of goodwill; the cost and complexity of impairment testing and the judgements and estimates involved; the requirement to allocate (and re-allocate) goodwill to cash generating units; and the requirements to apply two methods to determine recoverable amount and to use a pre-tax rate.

Managers may use the discretion in the accounting standards to opportunistically manage earnings or to provide incomplete information (Boennen & Glaum, 2014), for example at the first-time recognition of goodwill, in the decision to impair goodwill, and regarding disclosure about goodwill and impairment. Managers' opportunism or incomplete disclosures could lead to lower-quality accounting information and value relevance, thus reducing the positive outcomes from adoption of IFRS. This effect may vary due to different country-level and firm-level influences. Thus, we expect these influences will affect goodwill accounting policy choices for recognition, measurement and disclosure, and the quality of the resulting accounting outputs.

The IASB completed a post implementation review (PIR) of IFRS, including a review of the relevant academic literature by Piombino and Tarca (2014). The authors presented evidence generally showing the usefulness of reported goodwill, other intangible assets, and goodwill impairment for IFRS firms. Some studies pointed to the possible impact of managerial incentives on impairment recognition. Three other academic literature reviews focus on studies of both US GAAP and IFRS firms (Boennen & Glaum, 2014; Wen & Moehrle, 2016; Wersborg, Teuteberg, & Zülch, 2014). In contrast to these reviews, we focus on the IFRS literature. We posit that there are notable variations in the institutional settings for financial reporting in the US and in IFRS adopting countries, thus raising questions about the comparability and generalizability of the US evidence. Schatt, Doukakis, Bessieux-Ollier, and Walliser (2016) provide a review of the usefulness of goodwill impairments by European firms. We add to this work by examining studies about the full range of goodwill accounting choices and searching for evidence of country effects among IFRS adopting jurisdictions.

An extensive review of IFRS studies (ICAEW, 2015:11–18) described various challenges for researchers who want to explore the impact of IFRS relating to sample selection, methods of analysis, and interpretation of the evidence. The study highlighted the difficulties of comparing the evidence across countries, which we also address in our paper. We review papers published in the 2008–2016 period and early 2017 period. We investigate the impact of time period and country of origin on the evidence presented. We focus on studies that are published in highly ranked academic journals to base our analysis on studies that demonstrate academic rigor.[2] We structure our review by presenting a model that captures the country- and firm-level factors that could influence firms' policy choices under IFRS 3 and IAS 36 and then using the model to explore the possible consequences of goodwill accounting choices. We review studies in two groups: Studies (1) exploring the value relevance of goodwill, goodwill impairment, and related disclosure and (2) analyzing possible country- or firm-level determinants influencing managers' accounting choices on goodwill, goodwill impairment, and related disclosure.

We find there is evidence in support of IFRS requirements for goodwill recognition, impairment, and disclosure from many countries. However, evidence in support of present accounting practices for other intangible assets is less strong. Many studies show goodwill recognition, impairment, and disclosure are associated with economic and firm factors. There is also some evidence of the impact of managerial incentives and indications of a lack of timeliness in impairment recognition. Many authors of studies in single-country settings call for better compliance with IAS 36 disclosure requirements. Overall, we find only a small number of studies that focus on multiple countries; thus, the evidence of the impact of institutional factors on accounting practices for intangible assets is not yet well developed.

Our paper contributes to the literature in three ways. First, we add to knowledge about the implementation of IFRS goodwill accounting by reviewing the latest research. With longer time series of data, in the twelve years since the widespread adoption of IFRS in 2005, this research may provide new insights and evidence of stronger relationships, which can be distinguished from the effects observed in studies of first time adoption in 2005. Second, we develop and apply a model of goodwill accounting choice to systematically review and group studies, thus identifying future research opportunities for academics. Our review also focuses on the research designs used. This enables us to differentiate findings and provide new insights regarding possible reasons for the differences identified. In addition, we are able to explore differences in findings based on time periods and countries of analysis, which should be relevant to the design of future studies. Third, our review aims to assist standard setters, regulators, and other practitioners to better understand the implications of research findings about accounting for goodwill and related country effects. Regulators in many jurisdictions have queried the application of the goodwill standards, particularly in relation to impairment (e.g., ESMA, 2014; FRC,

[1] Under codification, ASC 805 Business Combinations and ASC 350 Intangibles – Goodwill and Other.

[2] In the Appendix, we provide a list of papers published in other journals and a list of working papers that were publicly available at March 2017. We refer to individual working papers when they are relevant to our statements about future research opportunities, but generally, we do not include the evidence of the working papers because it may change prior to publication.