"TO BE OR NOT TO BE": IMPAIRMENT PRACTICES AMONG INDIAN LISTED COMPANIES

Jenny Wang, Keith Hooper***

Abstract

India is converging its practices to be consistent with IFRS, but in the case of goodwill impairment how much consistency is there among Indian companies and auditors, and how much impairment has been disclosed. The paper investigates these questions. Arguably, the issue of how India writes-down goodwill is important as Indian companies and the Indian share market are influential throughout the world. It is a question of recognition, measurement and disclosure.
The findings are that different methods of writing down goodwill are recognised implying different methods of measurement. There is even more inconsistency around disclosure as nearly half of the top 50 companies analysed on the Bombay exchange failed to mention any write down of goodwill. Some companies claimed that they were testing for impairment but no case of actual impairment was reported. This, in spite of some compaines reporting declining earnings and share price.

Keywords: India, Bombay, Goodwill, Impairment, Write-downs

* *Department of Accounting & Finance, Unitec, Auckland, New Zealand*
** *Department of Accounting & Finance, Unitec, Auckland, New Zealand*

1. Introduction

In late 2013, The Economist journal published an article entitled "Goodwill Hunting" which reported a conspicuous lack of impairment among public Indian companies and identified as a possible explanation "arm twisting" of auditors by powerful company executives. To find out what is the case, this paper sets out to examine the write-down practices of the top 50 public companies listed on the Bombay exchange.

International Financial Reporting Standards (IFRS) is fast becoming the global accounting language. Over 100 countries have now adopted IFRS and many more have committed to make the transition in the next few years. The benefits of global standards are widely acknowledged. For companies, however, the conversion to IFRS is a major change both for the finance function and for the wider business. India is one of the largest jurisdictions that are currently going through the process of convergence with IFRS. Considering the diversity and complexity amongst Indian Companies that will undertake IFRS reporting, the Ministry of Corporate Affairs (MCA) has announced a roadmap which requires Indian Companies to adopt the converged standards in a phased manner from 1 April, 2011 onwards.

The purpose of this study is to investigate goodwill treatment among the 50 top listed Indian Companies, on the Bombay exchange during the three year period 2010-12, with regard to either impairment, amortization or if there is a total disregard for providing information about goodwill. Also, the study considers the role of auditors and their treatment or not of impairment in the accounts especially in the light of declining share values and price-earnings ratio.

In terms of the International Financial Reporting Standards, goodwill acquired in a business combination is an asset and must initially be measured at cost (IFRS 3 par.51). After initial recognition, the acquirer must measure this goodwill at cost, less any accumulated impairment losses (IFRS 3 par.54). The acquirer must test goodwill for impairment annually, or more frequently, if events or changes in circumstances indicate that it might be impaired, in accordance with IAS 36, Impairment of Assets (IFRS 3 par. 55). Because The Economist in 2013 reports, in respect of Tata Steel, on how "executives twist the arms" of auditors pressurising then to delay impairments. Thus, the aim of this study is to review and analysis the accounting treatment of goodwill in Indian companies.

It may be argued that the new treatment of goodwill has created potential auditing challenges for auditors. Auditors will not only have to deal with the unexpected complexities and ambiguities but also regarding the assignment of fair value. To examine causes and consequences, and in the case typical case of Tata Steel, the Economist finds that excess payment in acquisition should be related to higher subsequent impairment loss. But testing for impairment by auditors is one thing and actual impairment is another.

The literature (Bloom, 2009; Brunovs & Kirsch, 1991; Boyle & Carpenter, 2011; Ding et al., 2008; Jennings, LeClere & Thompson, 2001; Moehrle, Reynolds & Wallace, 2001) on goodwill behaviour claims that the managerial acquiescence is the most important determinant of write-down decisions. The calculation of impairment is therefore subject to manipulation and may be unreliable due to management's estimation. This study conducted on the top 50 listed companies in India may provide evidence of the extent of convergence with IFRS practice. Another question to investigate is how the Big 4, Second tier and Indian auditors are treating goodwill in terms of reporting and how much they have moved to IFRS impairment testing.

The study covers the top 50 companies only listed in Bombay Stock Exchange (BSE). The enterprises are chosen on the basis of market capitalization. We have collected data from the annual reports of the companies, available on their websites. The aim is to investigate if there is a consensus on the method treatment of goodwill among Indian auditors.

The paper is organized as follows. The next section discusses goodwill, the standards requiring impairment and the problems associated with impairment. Further discussion considers the arguments for and against amortization, the advantages and disadvantages of impairment, implications of impairment and the problems that arise for auditors. With regard to the empirical section, the method employed is explained followed by the presentation of the findings from the analysis. A final discussion concludes the paper.

2. Discussion and Review

Goodwill

In 2001, the Financial Accounting Standards Board ("FASB") expressed its opinion that it is virtually impossible to predict accurately the useful life of goodwill and amortisation of goodwill is not a faithful representation of the true pattern of declining goodwill (FASB 2001b). Subsequently, FASB published the Statement of Financial Accounting Standards ("SFAS") 142, "Goodwill and other intangible assets", which prohibits amortisation of goodwill.

SFAS 42 requires instead annual impairment tests to reflect the true and fair view of the assets values.The purpose of this accounting rule is to encourage management to communicate privately held information about goodwill and provide stakeholders with better quality information to assess the performance and future cash flows of the company (Li et al., 2011; Ding et al, 2008; AbuGhazalehet al., 2012). In order to seek international convergence and global harmonisation, the International Accounting Standards Board ("IASB") followed the FASB's approach in 2004 by replacing IAS 22 with IFRS 3, and converging with US GAAP. IFRS 3 declares that from the beginning of the first annual period beginning on or after 31 March 2004, all entities must discontinue amortising goodwill and must test the goodwill for impairment.

In the same year, IASB issued IAS 36 Impairment of Assets, which provided a two-step approach for goodwill impairment testing as follows:

- Step 1: Compare the carrying amount of the unit, including the goodwill, with its recoverable amount. The recoverable amount of such a unit should be measured, consistent with the requirements in IAS 36, as the higher of value in use and net selling price. If the recoverable amount of the unit exceeds its carrying amount, goodwill is not impaired. If not, then follow Step 2.

- Step 2: Compare the implied value of goodwill with its carrying amount. Implied goodwill

is the excess of the recoverable amount of the unit to which the goodwill has been allocated over the fair value of the net identifiable assets that the entity would recognise if it acquired that unit in a business combination on the date of the impairment test. Any excess of the carrying amount of goodwill over its implied value is recognised immediately, in profit or loss, as an impairment loss. Any remaining excess of the carrying amount of the unit over its recoverable amount is recognised as an impairment loss and allocated to the other assets of the unit on a pro rata basis, based on the carrying amount of each asset in the unit.

Prior theoretical and empirical research suggests that acquirers often overpay for the target. These studies argue that overpayment may result from agency conflicts in mergers and tender offers (The Economist, 2013). Managers may act in their own self-interest at the expense of shareholders in order to remain entrenched or to decrease the risk associated with their managerial human capital. It has found that higher payments of excess (acquisition price as a percentage of target's book value) and premium (acquisition price as a percentage of target's price) are related to higher subsequent impairment loss. Acquirers often overpay, when the purchase consideration includes a high stock component, which has a significant positive relation between the interaction variable and impairment loss (Bloom, 2009; Brunovs & Kirsch, 1991).

Goodwill impairment loss is estimated in most cases from management's projections of future cash flows. Thus, it is plausible that the impairment loss conveys some private information of managers to investors. Also, the subjectivity inherent in estimating the impairment loss using unverifiable fair values could reduce the information content of the impairment loss (Skinner, 2008). Thus, it may be debatable whether the announcement of a goodwill impairment loss reveals new information to market participants.

There are a number of questions that may be raised around the concept of impairment. First, whether the announcement of a goodwill impairment loss provides new information to market participants. Second, whether the impairment loss is related to subsequent performance and thereby shed light on the nature of the information conveyed by the impairment. Third, whether the magnitude of goodwill impairment can be predicted by proxies of overpayment for the target at the time of the acquisition (Boyle & Carpenter, 2011; Petersen & Plenberg, 2010).

The difference in the measurement of goodwill impairment and the timing of loss recognition under SFAS 121 and SFAS 142 has implications for testing impairment. The specific focus of SFAS 142 is on goodwill as anasset, the guidelines for its fair value measurement, and the periodic impairment testing requirement suggest that recognition of goodwill impairment under SFAS 142 may (arguably) be more precise and timely relative to that under SFAS 121 and therefore may have a stronger market reaction.

The literature shows that on average the market revises its expectations downward on the announcement of a goodwill impairment loss and the downward revision is related to the magnitude of the impairment loss.. Overall, the evidence suggests that the announcement of goodwill impairment reveals negative information about the firm to the market (Li et al, 2011; Laghi et al, 2013; AbuGhazaleh et al, 2012).

There is discussion on the nature of the information conveyed by the impairment loss. First, if the impairment loss conveys managers' private information about the firm's adverse future earnings prospects, they expect financial analysts to revise their earnings forecasts downward subsequent to the loss announcement. The impairment loss thus appears to be a leading indicator of a decline in future profitability, likely because the company failed to realize the expected benefits of prior acquisitions. Further, they find that the announcement market reaction can be largely attributed to investors revising their expectations of future sales and operating profits downward based on the information conveyed by the impairment (Petersen & Plenberg, 2010).

Market participants respond to the unexpected impairment loss negatively. Moreover, an expected impairment of goodwill in fact significantly predicts a decline in future performance. Taken together, these results lead us to conjecture that the market perceives that some firms with potentially impaired goodwill have used their managerial discretion to avoid taking the impairment loss in the post acquisition period. This interpretation is consistent with the implications of Ramanna and Watts (2010) that firms that avoided taking an impairment loss may have acted opportunistically.

The suggestion is that overpayment for acquired targets could be a potential contributing factor to the subsequent goodwill impairment. Thus, it appears that the value of goodwill of these firms may have been partly impaired at the outset due to overpayment for targets and may have been further depleted by subsequent negative events. Generally, investors and financial analysts revise their expectations downward on the announcement of an impairment loss. Further analysis shows that the impairment loss is negatively correlated with the average growth in sales and operating profits of subsequent years. Moreover, the market reaction can be attributed mainly to news about the decline in subsequent sales and operating profits that is conveyed by the impairment loss (Li et al, 2011; Laghi et al, 2013; AbuGhazaleh et al, 2012).

Wang (2011) found that the change from amortisation to impairment promotes and improves the investors' understanding of the components of companies' earnings and also clears up their confusions on goodwill amortisation information. Subsequently, the accounting treatment on goodwill in most listed companies in Anglo-Saxon countries are no longer amortised, instead there is testing for impairment annually or whenever there is an indication that the goodwill may be impaired, in accordance with IFRS 3. Public companies have to recognise an impairment loss when the carrying amount exceeds the recoverable amount. Goodwill impairment loss may show some correlations with operations, performance and investors' confidence (Li et al., 2011). First, goodwill impairment was found to be a leading indicator of a decline in prospective sales and operating profits, and of a failure to realise the expected benefits from prior acquisitions. Second, overpayment for the prior acquisition could be another potential contributing factor as companies recognise the overpayment in terms of goodwill impairment by subsequent negative events. Third, the announcement of a goodwill impairment loss would influence investors' confidence and cause financial analysts to revise their expectations of prospective cash flows downwards.

Although the impairment test is costly, time consuming and susceptible to manipulation, it is arguably a better approach for reflecting future prospects of investments and gives a true and fair view of the business. It is worth noting that the IASB has recently decided to conduct a post implementation review (the "PIR") on IFRS 3 which introduces some possible solutions to address the existing issues encountered. This includes improving the existing impairment test rules and disclosure requirements by IAS 36 and reintroducing goodwill amortisation in addition to the impairment test (Laghi et al., 2013). Intangible assets are the most difficult to value in acquisition accounting, and one of the most complex and controversial of the intangible assets is goodwill. At its most basic goodwill is an acquisition premium. Goodwill is the cost above the fair value of a firm

once all the assets of the firm have been stated at fair value (Skinner, 2008).

Amortisation

The literature (Nobes & Parker, 2012) reveals the goodwill reflects the ability of a company to earn an excess return on investment. Systematic amortisation with additional impairment testing assumes that the factors that constitute acquired goodwill generally diminish in value over time, and that the related costs are systematically charged to income over the useful life of the goodwill.

Some debate (Bloom, 2009; Brunovs & Kirsch, 1991; Boyle & Carpenter, 2011; Ding et al., 2008; Jennings, LeClere & Thompson, 2001; Moehrle, Reynolds & Wallace, 2001) regarding the most appropriate method of accounting for goodwill that arises from an acquisition raged during the early 1990s and again during the early 2000s. The debate in the early 1990's resulted in the general amortisation of goodwill. Conceptually, amortisation is a method to allocate the cost of goodwill over the period it is consumed. This is consistent with the approach taken with regard to other fixed assets that do not have indefinite useful lives (IASB 2004d). Overpayment for the assets of an acquired company generally reflects an expectation of high future earnings. Amortisation of this overpayment ensures that the overpayment is matched with the expected future earnings (Boyle & Carpenter 2011; Fontanot 2003). Although the useful life of goodwill cannot be predicted, an amortization period of between 20 to 40 years was often applied, with a satisfactory level of reliability; systematic amortisation provides an appropriate balance between conceptual soundness and operationality at an acceptable cost.

Impairment versus amortisation: advantages of impairment

One of the main arguments of the FASB in proposing the impairment approach was that it would lead to improved financial reporting, because the financial statements of entities that acquire goodwill would reflect the underlying economics of those assets better. As a result, financial statement users would be better able to understand the investments made in those assets and the subsequent performance of those investments (FASB 2001b).

According to Moehrle (2001), a good impairment test promotes transparency, because the trigger is a change in underlying economic or business conditions, not an arbitrary period. As a result, reporting is based on current events that affect the business. If it is properly managed, goodwill is an appreciating asset, and if it is not properly managed, the impairment test will recognise any reduction in value (Petersen & Plenberg, 2010).

Another argument against amortisation of goodwill is based on the assumption that goodwill is a wasting asset (that is, finite), and thus ignores the fact that some kinds of goodwill can have an indefinite useful life. The value of a business, and consequently of its goodwill, does not necessarily wear out. It can be maintained or even improved by careful management and by cash expenditure charged against the income stream.

The underlying logic for removing the traditional amortisation method is that amortisation on a straight-line basis over a set number of years contains no information value for those using financial reports (Ravlic, 2003). In a review of capital markets research, Clinch (1995) concludes that there is no clear evidence of any association between goodwill amortisation and share values. That is, there is little, if any, firm evidence that goodwill amortisation expense included in the calculation of periodic profit reflects information that is used by investors in setting share prices and returns. A problem of the amortisation method relates to time period estimation. An estimate of the useful life of goodwill becomes less reliable as the length of the useful life increases (Waxman, 2001). By being based on an actual valuation of goodwill, the IFRS-based standard's impairment testing policy moves away from an arbitrary assessment of useful life. The overall advantage, from a balance sheet perspective, is that the valuation of goodwill will be more closely aligned to a real assessment of asset value, rather than reflecting an arbitrary "cost less accumulated amortisation" calculation. Also, from an income statement perspective, any recognition of a loss as a result of a write-down in the valuation of goodwill will be more closely aligned to a real economic decline in value rather than an arbitrary amortisation calculation. The new treatment should therefore be more aligned with the decision- making needs of financial report users (Ding et al, 2008).

Disadvantages of impairment

With regard to the capitalisation of internally generated goodwill, one of the main arguments of the respondents to *ED 3* in support of amortisation was that it prohibits the recognition of internally generated goodwill, which is consistent with the general prohibition in *IAS 38* on the recognition of internally generated goodwill (IASB 2004d). The impairment test does not distinguish between acquired goodwill and this pre-existing goodwill of the company that is being acquired, nor between acquired goodwill and the goodwill internally generated after the combination

Goodwill impairment is not without its problems. First, the impairment test may impose significant cost on companies (Wiese, 2005). The valuation of goodwill is complex and unlikely to be verifiable, thus specialised experts and specific

valuation techniques are often required for impairment test. According to a survey conducted by the American Business Conference, Grant Thornton, LLP, and the NASDAQ Stock Market, Inc. (Lewis et al., 2001), 71% of selected CFOs in the survey would use "outside assistance" to perform the impairment test. Second, the impairment test may be liable to manipulation. The impairment criteria provided by the standard are drafted in such a way as to leave significant room for managerial discretion, interpretation, judgement and bias (Massoud & Raiborn, 2003). Companies may act opportunistically by using their greater managerial reporting discretion to avoid reporting an impairment loss (Li et al., 2011). Management may act for their self-interest at the expense of shareholders as considerations of vanity arise after an overpayment for an acquisition becomes apparent. Third, the uncertainty and subjective judgements involved in impairment tests may affect the reliability of the information provided by the disclosures demanded by users of financial statements to assess future cash flow generated from goodwill (Wang, 2011). Such subjectivity may make it no less arbitrary than amortisation (Wiese, 2005).

There are possibilities for companies to enhance their earnings per share at a satisfactory level without taking any impairment on goodwill. This could deceive investors into considering that such companies are doing better than anticipated, thus increasing and overvaluing their stock prices (Basi & Penning, 2002). The accounting treatment of goodwill has been a long standing issue of concern to accountants and accounting standards committees for more than a decade. Both amortisation and impairment tests involve a certain degree of subjectivity, and have different drawbacks either in implementation difficulties or theoretical support (Boyle & Carpenter, 2011; Petersen & Plenberg, 2010). There is no perfect solution to satisfy everyone on the options of how to recognise the decline in the value of goodwill.

Impairment can have an arbitrary effect on earnings as annual systematic charges to goodwill are more objective than periodic reviews for impairment. The latter would allow firms greater opportunities to manage their earnings (Schoderbek & Slaubaugh 2001). There is also the issue of complexity: IFRS 3 puts its faith in a potentially unreliable and very complex impairment test. The projection of future cash flows is difficult, especially in developing and volatile industries (such as the "high tech" and telecommunications industries).

Cost is another factor. The cost of the impairment tests is likely to be high and the benefits may be diminished by their potential unreliability. For smaller companies, both quoted and unquoted, the costs may outweigh any possible benefit. To ensure compliance with *SFAS 142* and to avoid unexpected charges, many companies in the USA are paying more for professional valuation services to value goodwill and other intangibles (Boyle & Carpenter, 2011).

Perhaps the most salient issue is that of subjectivity. The impairment test is subject to a high degree of subjectivity and uncertainty, which may make it no less arbitrary than amortisation. The determination of the fair value of a unit and the detailed measurement of the implied fair value of goodwill may be so subjective that the timing and amount of write-downs may not always be independently verifiable (Skinner, 2008; Waxman 2001).

Another argument against impairment is that there are different accounting treatments for other assets. IFRS 3 does not differentiate goodwill in the same manner as *IAS 38* differentiates other intangible assets. Goodwill and other intangible assets that are similar in nature will thus be subject to different accounting treatments, which will diminish comparability and reliability.

The new IFRS treatment introduces considerable scope for uncertainty and therefore creative accounting (Holt, 2013). The first potential difficulty relates to identifying cash-generating units. The identification of a cash-generating unit could be difficult in cases where a company has acquired another entity and the latter consists of a number of separate subsidiaries, divisions and/or branches. Should the cash-generating unit be identified as the complete initial entity purchased or should a number of sub-units be identified? Further, potential difficulties arise with the overlap between the identification of cash-generating units and the assessment of the recoverable amount of the unit. Determining recoverable amount involves calculating fair value less costs to sell and value in use of the unit.

However, the identification of the initial cash-generating unit/units could have a strong bearing on those calculations. As recoverable amount is calculated as the higher of a cash-generating unit's fair value less cost to sell and value in use, the many assumptions adopted in the various calculations required become critical. Just as management could bias the estimated recoverable amount of a cash-generating unit in an upward direction to avoid impairment loss recognition, valuations in the transition period to the new IFRS treatment could be biased in a downward direction. In this way, the company could deliberately recognise possibly excessive impairment losses in the transition period. An associated concern relates to cost and time issues. Conducting a detailed impairment test on every applicable asset and associated goodwill at the end of each reporting period will, in many cases, be time consuming and costly (McGreachin, 1997; Rockness et al., 2001). For this reason, company management will have incentives to recognise cash-generating units at as high a level of aggregation as possible.

In summary, there is scope for creative accounting. It may well be that goodwill will remain

on balance sheets and that reported profits will not be significantly affected by impairment losses over time. Management will certainly have financial reporting incentives to avoid recording impairment losses if possible.

Imlications of impairment

First, the rules provide too much flexibility in the measurement of goodwill and give firms too much discretion in timing the write-off. This can lead to pressure on auditors as The Economist (2013) found. Second, there is an effect on earnings. Basi and Penning (2002) note that the one-time charge-offs that may be made after a change to impairment could further depress already weak earnings in the financial records of some companies. They estimate that in the USA in 2001 nearly two -thirds of major companies would have to record some impairment of goodwill on adoption of SFAS 142 (Investor Relations Business 2001). Third, there is the effect of the change from amortisation to impairment. Amortisation results in a very small effect on the profitability of the acquiring company, especially where it is written off over a long period (Basi & Penning 2002). This was confirmed by the significant effect of the changeover to an impairment test in 2002 on companies in the USA where goodwill had been amortised over long periods before (Basi and Penning, 2002).

Impairment may be avoided because of the subjectivity it involves for financial report preparers and auditors, and for its potentially serious impact on financial results. For example, the introduction of the requirement for more explicit estimates of fair values subsequent to initial acquisition may introduce increased uncertainty and a lessening of transparency, as the new reporting regime will rely on increased professional judgment by preparers and auditors (Skinner, 2008). Specifically, company management, in collaboration with the accounting profession, will need to use their valuation and measurement expertise and skills to estimate fair values rather than refer to verifiable transaction amounts. By replacing the amortisation of goodwill with impairment testing and relying on fair value estimates, further opportunity for creative earnings management at the individual company level may have been established (Gowthorpe and Amat, 2005).

Fair value is defined in International Financial Reporting Standards as "the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction" (see, for example, AASB 3, Appendix). Unfortunately, determination of the fair value of an asset in individual situations is not always straightforward. When capital markets are not perfect or are incomplete and the fair value concept is ambiguous with respect to measurement and valuation, it is possible in individual situations that several fair values could exist (Barth and Landsman, 1995; Bradbury, 2000). In incomplete market settings, the alternative fair value constructs of entry value (replacement cost), exit value (market/liquidation value) and value-in-use (earnings capitalisation/present value of future cash flows) are likely to differ (Beaver, 1981; Barth and Landsman, 1995). Consequently, measurement error in fair value estimates can exist, affecting their relevance and reliability. The application of fair value concepts to the determination of goodwill can result in wide variations in valuation depending on the assumptions inherent in the various calculations required.

Auditing

Potential problems for auditors will commence with the initial entries recording a business combination. The assignment of fair values to the identifiable net assets acquired determines the amount of goodwill or discount on acquisition, given that goodwill/discount on acquisition is the difference between the fair value of the identifiable net assets acquired and the cost of the business combination (Skinner, 2008). A second potential problem relates to the revised treatment for discount on acquisition. Discount on acquisition (negative goodwill) arises when the cost of acquisition is less than the fair value of the net identifiable assets acquired, effectively representing a "bargain purchase" (Boyle & Carpenter, 2011).

Auditors will not only have to deal with the unexpected complexities and ambiguities but also regarding the assignment of fair value. Auditors will also have to verify the identification of cash-generating units, calculations of the estimated selling price of the unit, and calculations of the value in use of the cash-generating unit based on estimates of discounted cash flows. Hence, all the complexities involved in confirming the level at which cash-generating units should be recognised, in estimating a "hypothetical" market transaction and in estimating net cash inflows, residual values and discount rates will result in great scope for disagreement and tension between auditors and financial report preparers. A company may engage a professional valuation services firm to value its cash-generating units and goodwill, and this practice is occurring with greater frequency (Wiese, 2005).

In such consulting engagements, the valuation firm is not restricted by applicable accounting standards, and is not required to specifically consider the needs of individual financial report users and qualitative characteristics such as relevance and reliability. The company may choose a compliant valuer to supply a valuation consistent with management's wishes. This then potentially places the auditor in a difficult position when faced with such an "expert" valuation. Because of the many required assumptions implicit in valuation that are often not capable of audit by reference to objective evidence, it

is the auditor who is put on the "back foot" and in a defensive position to disprove any valuation procured by the company's management (Holt, 2013).

Auditors are not unanimous in their views about the appropriateness of goodwill accounting rules in IFRS. This may result from a lack of experience on the long-term effects of the current practice. Auditors have a difficult role in balancing between the interests of those who pay their fees and those who require accurate information about fair values (Ronen, 2008).

In 2001, the USA introduced a similar impairment testing system. The American Institute of Certified Public Accountants (AICPA, 2003) suggests that the audit of business combinations and associated goodwill and other intangible assets is complex, costly and time-consuming, as many of the audit objectives require considerable substantive testing to substantiate the valuation of goodwill. Moreover, if a company's reported earnings are to be reduced significantly, perhaps even resulting in a reported loss as a result of goodwill write downs, the new accounting treatment is vulnerable to manipulation and creative accounting, particularly by management who might desire a more favourable outcome for compensation and/or market considerations as suggested by agency theory (Gowthorpe and Amat, 2005). In summary, the major auditing challenges arise from the following:

(1) Company directors may bias initial valuations of assets, liabilities and contingent liabilities in business combination to: maximise the valuation of goodwill, which is now not subject to periodic amortisation; and to maximise the excess of the fair value of net assets acquired over purchase consideration to enable the immediate recognition of this excess (discount on acquisition) as a gain in profit and loss.

(2) There is the potential for disagreement between company directors and auditors on the identification of cash-generating units and in the valuations of those units by reference to recoverable amount (higher of fair value less cost to sell and value in use, both of which may require a large number of arbitrary assumptions to be made in calculation).

(3) The auditor does not have reference, in many cases, to wholly objective evidence pertaining to the valuation assumptions adopted by management, especially in situations where the relevant cash-generating unit and the assets it comprises are not subject to active capital markets (and especially where the unit comprises unique facilities).

(4) A compliant valuer could well provide a valuation for a cash-generating unit, and related goodwill, that suggests that no impairment loss needs to be recognised.

This puts the auditor in an unenviable position of having to disprove company valuations, especially in situations where there is a lack of objective evidence to support any valuation (Rees & Jones, 2012).

Method

The present study covers the only listed companies in Bombay Stock Exchange (BSE). It includes both government and private sector companies. The enterprises are chosen on the basis of market capitalization. The top fifty corporate enterprises are considered for the sample. Two criteria are used for the selection of the companies in the final sample. First, the enterprises are listed only in BSE. Second, their accounting and market data, both were available for the study

The period covered is three years, ranging from 2010 - 12 as it was considered a reasonably good period to analyse goodwill treatments due to number of acquisition by Indian companies. We have picked data of goodwill, minority interest, profit, auditors, earning per share and notes on account of goodwill from annual reports of the companies.

Findings

In the analysis, we have find out that 10 companies of the top 50 companies (see table 1) are following goodwill amortization approach as disclosed in their notes on the accounts in their consolidated financial statement. However, these 10 companies are not following any standard approach for number of years of amortization, this is because the amortization period allowed may vary between 5 to 15 years. Out of these 10 companies, two are audited by the Big 4 and the remainder by others.

By contrast, 14 companies show in their notes to accounts that their goodwill is tested for impairment. However the financial statements reveal that there is no impairment done by them during this period. Surprisingly 8 of the 14 companies are audited by "Big 4" auditors and although they mention in the financial statements that they are testing goodwill for impairment, there is no evidence of actual impairment. More serious is the finding that 24 companies do not disclose any note on goodwill so no public information on how goodwill is treated is available.

Table 1. Analysis of the companies

Treatment of Goodwill	Big 4	Tier II	Indian	Total
Goodwill amortized	2	1	7	**10**
Goodwill Tested for Impairment	8		6	**14**
No Note on Goodwill	4	1	19	**24**
Not amortized but no note on impairment	1		1	**2**
Total	**15**	**2**	**33**	**50**

Of the almost 50% (24) of companies that do not disclose any notes regarding goodwill treatment in accounts, and most of these (19) are audited by Indian firms. Rather ambiguously, two companies (audited by Tier II auditors) have mentioned that they are not amortizing but have not mentioned whether they are impairing or not. Overall fifteen companies are audited by big 4 auditors, two by tier II and the remaining (33) by Indian auditors.

Table 2. Analysis of the companies

Relationship - EPS+MPS	Big 4	Tier II	Indian	Total
EPS Increased but MPS decreased	1		3	**4**
EPS decreased but MPS increased	3		3	**6**
Both EPS and MPS Increased	4	1	11	**16**
Both EPS and MPS decreased	3		9	**12**
Both EPS and MPS fluctuate	4	1	7	**12**
Total	**15**	**2**	**33**	**50**

To check whether earnings per share and market price per share influenced the impairment of goodwill as market worth of company due to decreases in EPS and MPS, the relation between earnings per share, market price of share and price earnings ratio. The analysis shows that EPS and MPS have gone up for 16 companies but on the other hand 12 companies have shown both earnings and price going down (see table 2). For these latter 12 companies some impairment may be warranted. However, nine companies (out of 28) have mentioned in their notes to the accounts that they are testing goodwill for impairment but still there is no sign of impairment of goodwill in their accounts.

Conclusion

Goodwill is a complex and controversial intangible asset. Accounting for goodwill is one of the more subjective aspects of financial reporting. It is therefore also very difficult to find an accurate method for measuring goodwill in terms of whether it has been consumed or not (Rees & Jones, 2012). In 2001, Financial Accounting Standard Board (FASB) prohibited systematic amortization of goodwill. But, it seems in India amortisation is still practised by public companies. The findings of this analysis reveal a situation where Indian public companies seem to follow their own or their auditors preferences. Why is their in India and possibly in many other countries to what are Western standards requiring impairment? There are many possibilities to explain such resistance. First, it seems auditors and particularly Indian audit firms may be reluctant to change their practices because of the costs involved and Indian management may prefer the opportunites for earnings management that non-disclosure of practice offers. Second, the lack of effective oversight by the Bombay exchange allows a variety of practices to continue. After all, why change if there is no compulsion? Third, those companies that disclose they are testing for impairment would seem to meet international standards but without any actual impairment following such tests, the true situation remians ambiguous.

The study conducted on the top 50 listed companies in India provides some evidence that impairment is being avoided as the data reveals no actual case of an impairment among the 50 companies during the period. Yet some of the companies have in the period expereienced a decline in earnings and share price. With many of the 50 companies not disclosing any information around goodwill there is a lack of transparency inherent that could, at worst imply some earnings management, at best, a reluctance to disclose what they are doing or not doing. The lack of information revealed in this study indicates that auditors have a difficult role in balancing the interests of those who pay their fees and those who require accurate information about fair values. As the Economist (2013) suggest "arms are being twisted" by powerful executives. Whether all Indian public companies will follow international practices and recognise measure and disclose impairment unambiguously remains – "to be or not to be".

References

1. AbuGhazaleh, N. M., Al-Hares, O., & Haddad, A. E. (2012). The value relevance of goodwill
2. impairments: UK evidence. *International Journal of Economics and Finance*, *4*(4), 206-216.
3. AICPA (2003) Consulting Services Division. *AICPA Consulting Services Special Report 03-1 —Litigation Services and Applicable Professional Standards*. 2003. New York: AICPA. Product No. 055297
4. Basi, B.A. & Penning, S.M. 2002. Let the investor beware. *Supply House Times, May*:70-74.
5. Barth, M.E., Landsman, W.R. (1995) Fundamental issues related to using fair value accounting for financial Reporting. *Accounting Horizons* (9): 97-108.
6. Bradbury, M. E. (2000). "Issues in the drive to measure liabilities at fair value", *Australian Accounting Review*, Vol. 10 No.2, pp. 19-25.
7. Bradbury, M.E., Godfrey, J.M., & Koh, P.S. (2003). Investment opportunity set influence on goodwill amortisation. *Asia-Paific Journal of Accounting and Economics*, 10(1), 57-79.
8. Beaver, W. H. (1981), Financial Reporting: an accounting revolution, Prentice- Hall, USA

9. Bloom, M. 2009. Accounting for goodwill. *Abacus* 45(3): 379-389.
10. Boyle, D. M. and B. W. Carpenter. 2011. Testing goodwill for impairment: An optional consideration of qualitative factors. *The CPA Journal* (November): 36-39.
11. Boyle, D. M., B. W. Carpenter and D. Mahoney. 2012. Goodwill accounting: A closer examination of the matter of non-impairments. *Management Accounting Quarterly* (Summer): 10-19.
12. Brunovs, R. and R. J. Kirsch. 1991. Goodwill accounting in selected countries and the harmonization of international accounting standards. *Abacus* 27(2): 135-161.
13. Burton Malkiel. *Investment Opportunities in China*. July 16, 2007. (34:15 mark)
14. Clinch, G. (1995). Capital markets research and the goodwill debate. *Australian Accounting Review*, 5(1), 22-30.
15. Ding, Y., J. Richard and H. Stolowy. 2008. Towards an understanding of the phases of goodwill accounting in four Western capitalist countries: From stakeholder model to shareholder model. *Accounting, Organizations and Society* 33(7-8): 718-755.
16. Findlay, M. C., & Williams, E. E. (2001). A fresh look at the efficient market hypothesis: How the intellectual history of finance encouraged a real "fraud-on-the-market". *Journal of Post Keynesian Economics, 23*(2), 181-199.
17. Financial Accounting Standards Board (FASB). (2001) *Goodwill and other intangible assets- Statement No 142*. June. Norwalk, Connecticut: FASB.
18. Financial Accounting Standards Board (FASB). (2001). *Summary of Statement No 142*. http://www.fasb.org/st/summary/stsum142. Shtml. Accessed: 20 August 2004.
19. Fontanot, P. (2003). How good is goodwill- you decide. *Accountancy SA*, May: 9-11.
20. Graham, Holt (2013, October). Are you complying? *Accounting and Business, 16*(9), 49-51.24
21. Gowthorpe, C., Amat, O. (2005). " Creative accounting: some ethical issues of macro- and micro- manipulation", *Journal of Business Ethics*, Vol. 57 pp. 55-64.
22. International Accounting Standards Board (IASB). 2002. *Business Combinations*, ED 3,December. London: IASB.
23. International Accounting Standards Board (IASB). 2004d. *Basis for conclusions on IFRS 3 Business Combinations*, IFRS 3 BC.March. London: IASB.
24. Jennings, R., LeClere, M., & Thompson, R. (2001). Goodwill Amortisation and the usefulness of earnings. *Financial Analysts Journal.57* (5).20 28.
25. Laghi, E., Mattei, M., & di Marcantonio, M. (2013). Assessing the value relevance of goodwill impairment considering country-specific factors: Evidence from EU listed companies. *International Journal of Economics and Finance, 5*(7), 32-49.
26. Li, Z., Shroff, P. K., Venkataraman, R., & Zhang, I. X. (2011). Causes and consequences of goodwill impairment losses. *Review of Accounting Studies, 16*(4), 745-778.
27. Lewis, E., J. W. Lippitt, and N. J. Mastracchio. (2001). Users' Commentson SFAS 141 and 142 on Business Combinations and Goodwill, *The CPA Journal*, 71, 76.
28. Massoud, M. F., & Raiborn, C. A. (2003). Accounting for Goodwill: Are we better off?.*Review of Business.24* (2).26- 32.
29. Moehrle, S. R., J. A. Reynolds-Moehrle and J. S. Wallace. 2001. How informative are earnings numbers that exclude goodwill amortization? *Accounting Horizons* (September): 243-255.
30. Rees, D. A. and T. D. Jones. 2012. The continuing evolution of accounting for goodwill. *The CPA Journal* (January): 30-33.
31. Ramanna, K., and Watts, R. (2010). Evidence on the Use of Unverifiable Estimates in Required Goodwill Impairment. Working paper. Harvard Business School.
32. Ravlic, T. (2003). "Goodwill hunting", *Australian CPA*, Vol. 73 No. 3, pp. 69-70.
33. Rockness, J.W., Rockness, H. O., Ivancevich, S. H. (2001). "The M and A game changes", *Financial Executive*, Vol. 1 No. 7, pp. 22-5.
34. Skinner, D. J. 2008. Discussion of "The implications of unverifiable fair-value accounting: Evidence from the political economy of goodwill accounting". *Journal of Accounting and Economics* (August): 282-288.
35. McGreachin, A. (1997). "Bringing impairment under one umbrella", *Accountancy*, Vol. 120 No. 1247, pp. 66-9.
36. Nobes, C., Parker, R.H. (2000), *Comparative International Accounting*, 6th ed., Financial Times/Prentice-Hall, London/ England.
37. Petersen, C. and T. Plenborg. 2010. How do firms implement impairment test of goodwill? *Abacus* 46(4): 419-446.
38. Schoderbek, M. P. & Slaubaugh, M. D. (2001). The FASB exposure draft on accounting for business combinations and intangible assets: an instructional assignment. *Journal of Accounting Education*, 19: 265-281.
39. The Economist (14 May 2013). Goodwill Hunting, The Economist: London.
40. Wang, V. S. (2011). Is amortisation good enough? evidence from the U.K. goodwill accounting. *Journal of International Management Studies, 6*(1), 1-7.
41. Waxman, R. N. (2001). Goodwill convergence. *CPA Journal*, 71, October:18-25.
42. Wiese, A. (2005). Accounting for goodwill: The transition from amortisation to impairment - an impact assessment. *Meditari Accountancy Research, 13*(1), 105-120.