Revista de Educação e Pesquisa em Contabilidade
Journal of Education and Research in Accounting

Periódico Trimestral, digital e gratuito publicado pela Academia Brasileira de Ciências Contábeis | Available online at www.repec.org.br

REPeC, Brasília, v. 17, n. 1, art. 2, p. 10-25, Jan./Mar. 2023 | DOI: http://dx.doi.org/10.17524/repec.v17i1.3121 | ISSN 1981-8610

The reduction in the carrying amount of goodwill: an analysis in light of the IASB's Discussion Paper/2020/1

Larissa Castro da Costa
https://orcid.org/0000-0002-5528-1677

Paulo Roberto Barbosa Lustosa
https://orcid.org/0000-0003-4624-197X

Jorge Katsumi Niyama
https://orcid.org/0000-0002-8738-3838

Abstract

Objective: This paper aims to perform a comparative analysis of different ways to reduce the carrying amount of goodwill in light of the IASB's Discussion Paper/2020/1.
Method: This research is a theoretical essay that highlights the view of the literature and accounting standards on the subject.
Results and contributions: Based on the stakeholders' claims towards the IASB, the impairment test, the current goodwill reduction method, has several limitations, such as high cost, late recognition, and shielding effect. The reflection presented here proposes that the permanence of this test as the only form of subsequent goodwill accounting implies a reduction in the quality of accounting information. Therefore, other reduction forms are recommended to represent the figures in the financial statements more faithfully. Thus, given the current opportunity provided by the IASB to discuss the subject, this paper's relevance lies in timely addressing the discussion alluding to Discussion Paper/2020/1 of what are the potential and most appropriate ways to reduce the carrying amount of goodwill in order to represent the equity of companies in a more relevant and reliable manner.
Keywords: Goodwill. Subsequent Accounting. Impairment. IASB.

Published in Portuguese and English. Original Version in Portuguese.

Received in 6/5/2022. Ask to Revise on 10/25/2022. Resubmitted on 12/8/2022. Ask to Revise on 12/26/2022. Resubmitted on 1/20/2023.
Accepted on 1/25/2023 by Dr. Vinícius Gomes Martins (Assistant Editor) and by Dr. Gerlando Augusto Sampaio Franco de Lima (Editor).
Published on 3/31/2023. Organization responsible for the journal: Abracicon.

Copyright © 2023 REPEC. All rights, even translation, are reserved. It is allowed to quote part of articles without prior permission if the source is identified.
(cc) BY

1. Introduction

Accounting information is one of the most relevant inputs for organizational decision-making. Foster (2003) relates it to a lower cost of capital, while other authors highlight its importance in the organizational field and the economy as a whole. For example, Bushman et al. (2001) associate it with the effective allocation and use of resources in an economy when it is used to regulate concentrated sectors, fiscal and tax policies, and identify investment opportunities, among others.

The International Accounting Standards Board (IASB) is the international organization responsible for developing high-quality global accounting standards. Thus, it issues the International Financial Reporting Standards (IFRS), which are currently adopted in 166 jurisdictions (IASB, 2020). Its international relevance is apparent and given its mission to develop standards that confer transparency, accountability, and efficiency to financial markets, a higher quality of accounting information is expected.

The accounting treatment of assets is an object of study and constant development. Although many assets in the measurement process are subjective, the case of goodwill is a "controversial matter in accounting because of its vague nature and difficulty in arriving at a value that is verifiable" (Glautier and Underdown, 2001, as cited in Martins, 2010, p. 167). This difficulty extends to its forms of value reduction (or subsequent accounting) and originates in in-depth discussions concerning its nature.

One of the topics currently discussed concerning goodwill is how the reduction of its book value is configured. Although an indefinite useful life is attributed to it, this does not mean that it is infinite, but rather that there is no predictable limit to the period during which the asset should generate economic benefits for a company.

Currently, IASB determines that the value of goodwill is reduced through an impairment test. Under the previous standard, amortization was required over a maximum period of 20 years. Throughout history, the accounting rules related to it have changed several times (Guillaume et al., 2014). According to a historical survey (Hughes, 1982; Garcia, 2007), the pre-regulatory period was a turning point in the subject, with many researchers in favor of its instant write-off. However, as standards were issued in the early 20th century, the current treatment (recognition as an asset, with reduction based on impairment test), though controversial (Hayn & Hughes, 2006; Li & Sloan, 2017), remains predominant in the literature (Chalmers et al., 2011; Hirschey & Richardson, 2002). Thus, the ways of reducing the value of goodwill is a matter still disputed in Accounting Theory.

Due to a lack of consensus, in addition to the dimension and importance this component – goodwill – has assumed in the global economy, IASB performed a post-implementation review (PIR) of IFRS 3 – Business Combinations, so that stakeholders could express their opinions on the current reduction in accounting goodwill, among other matters. As a result, Discussion Paper/2020/1 was published, and suggestions provided through comment letters may support the IASB's decision on a possible change in the current standard. If the decision is to implement changes (or even in the case of new standards), IASB will publish an Exposure Draft in advance to get feedback from professionals and people working in the field.

Because IASB opened the opportunity to discuss and challenge the current subsequent accounting of goodwill, this study's objective is to answer the following question: what are the alternatives to reducing the value of goodwill?

In this context, this study's general objective is to compare the possibilities for subsequent accounting for goodwill. The specific objectives include (1) presenting the changes proposed in the IASB's Discussion Paper (DP/2020/1) on IFRS 3 – Business Combination; (2) analyzing the current subsequent accounting for goodwill (impairment test); and (3) analyzing alternatives for the subsequent accounting for goodwill. Therefore, this is a theoretical essay presenting the main controversial points in the literature of Accounting Theory about the possibilities of reducing the value of accounting goodwill.

This study shows that the preliminary positioning of the IASB contained in the Discussion Paper 1/2020 (i.e., remaining with the impairment test) does not eradicate the inconsistencies listed in the standard's post-implementation review contested by stakeholders regarding the subsequent accounting of goodwill. Thus, it presents a new theoretical approach to goodwill, whose value reduction (i.e., proportional write-off) may represent a potential future replacement for the impairment test, as it is consistent with the nature of goodwill introduced in this approach, configured as a state of potential wealth, rather than an asset (Lustosa, 2017).

Considering the discussion fostered by the IASB and the imminent change in IFRS 3 (Business Combinations), this study's relevance lies in its timeliness and innovation since it is expected to promote a greater understanding of the reduction in the goodwill's book value and, therefore, assist in a controversial subject, the consequences of which may vary, e.g., from the reasons for sending suggestions (comment letters), in case IASB launches the Exposure Draft, to changes in the course of research and the standardization of this controversial subject, to contribute to the quality of accounting information and enrichment of Accounting Theory.

The remainder of this paper is organized as follows: chapter 2 presents the theoretical framework, such as the history of goodwill and its potential subsequent accounting strategies; chapter 3 addresses the IASB's preliminary positioning presented in Discussion Paper/1/2020; chapter 4 presents a reflection upon the subsequent accounting for goodwill; and finally, chapter 5 concerns the final considerations.

2. Theoretical Framework

2.1 Goodwill history

Business combinations (detailed as mergers and acquisitions in IFRS) play a relevant role in the global economy. In its DP/2020/1, IASB presents data that support the impact and relevance of goodwill accounting. In 2019, business combinations totaling more than \$4 trillion were announced. Furthermore, goodwill reached \$8 trillion for all listed companies worldwide, representing about 18% of their net worth and 3% of their total assets.

The accounting treatment of equity items is an object of study and constant development. The difficulty and subjectivity in measuring goodwill extend to how its value is reduced and originates from in-depth discussions addressing its nature.

The discussion about the nature of goodwill is old. Falk and Gordon (1977) highlighted that, although much has been written on the subject, there are still uncertainties and disagreements. Johnson and Petrone already questioned the subject in 1998, noting that some believed in its recognition as an asset while others disagreed. Hopkins and Ma (1988) referred to goodwill as an example of an accounting puzzle. They highlighted that its nature continues to be misunderstood, which generates inconsistency in the measurement and disclosure of this accounting component. Davis (1992) suggests that goodwill is probably the most intangible of intangibles.

Jahmani et al. (2010) alert for the possibility of earnings management when using estimates and managerial judgments of fair value, cash flow, and discount rates, estimates used in the impairment test. Other authors reinforced the idea that the impairment test can open the door to the manipulation of results (Massoud and Raiborn, 2003; Sevin and Schroeder, 2005; Jordan and Clark, 2004; Han and Tang, 2020; Masters-Stout et al., 2008; and Hamberg et al., 2011).

2.2 Goodwill subsequent accounting

The reduction in the carrying amount of goodwill is directly linked to its predecessor recognition and measurement processes. When goodwill is recognized as an asset, it may have its value reduced through a linear and periodic write-off (amortization), or an occasional write-off for the recoverable value, the need for which is identified through an impairment test. It can also maintain its initial value recorded in the asset without subsequent changes (in this case, there is no reduction in the accounted value).

If goodwill is not recognized as an asset, its subsequent treatment can occur either by instant write-off (full write-off of its value) or by periodical write-off (sporadic write-down of its value). The conversion rate (i.e., reduction) is something to be studied in greater depth in the literature, but its starting point is the theory developed by Lustosa (2017) and Oliveira and Lustosa (2022). This section will present discussions on potential subsequent accounting alternatives of this equity instrument, as shown in Table 1.

Table 1
Alternatives to reduce the book value of intangible assets

Recognition as an asset				Non-recognition as an asset		
With amortization		No amortization		Instant write-off		Regular write-off
Defined useful life	Without defined useful life	Initial measurement unchanged	Subject to an impairment test	Reserves (equity)	Results (expense)	As goodwill is converted into real wealth

Source: adapted from Carvalho et al. (2010).

2.2.1 Impairment test (IFRS 03)

The impairment test consists of assessing the inequality between the accounted and actual cash-generating power to verify potential loss due to the devaluation of the asset.

The recoverable amount is defined as the higher value between the fair value and the value in use. Thus, based on estimates of future cash flows, the impairment test compares the accounting amount with the recoverable amount of cash-generating units (CGU). The entity shall recognize the difference as an impairment loss when the recoverable amount is lower than the carrying amount. Its purpose is to ensure that a company's assets are accounted for at values no higher than recoverable ones (IASB, 2013).

Currently, according to the international standard that provides for the impairment test is IAS 36 – Impairment of Assets (IASB, 2013), together with IFRS 3 (Business Combinations), companies with goodwill are required to test their cash-generating units for impairment at least annually, even if there is no indication of loss.

As goodwill does not independently generate cash flows, but rather through the synergy of its components that are not individually identified and these with other assets, it is tested for impairment losses within the cash-generating units to which their generated economic benefits flow. Thus, the impairment test assesses whether the combined recoverable value of the assets of these cash-generating units, including goodwill, is greater than the recorded carrying amount.

If the recoverable amount of a cash-generating unit (which goodwill comprises) exceeds its carrying amount, no adjustment is made, and no loss is recognized. However, if the recoverable amount is lower than the carrying amount, the CGU is adjusted, reducing the recoverable amount, and the company recognizes the impairment loss. Hence, it is clear that goodwill is not directly tested, which may have consequences.

Because the impairment test verifies the recoverability of the combined book value of assets within cash-generating units - instead of testing the recoverability of directly acquired goodwill -, the so-called shielding may occur, the effect of which incurs the risk of overstating the carrying amount of goodwill.

Shielding occurs when the acquirer's margin (headroom) protects goodwill against impairment loss. In more detail, when the impairment test is carried out jointly (acquired business included in the acquirer's business), the margin produced by the acquirer's business can shield the impairment loss that would exist if goodwill (and its integral components, whose synergy generates economic benefits) was tested separately, as shown in Figure 1:

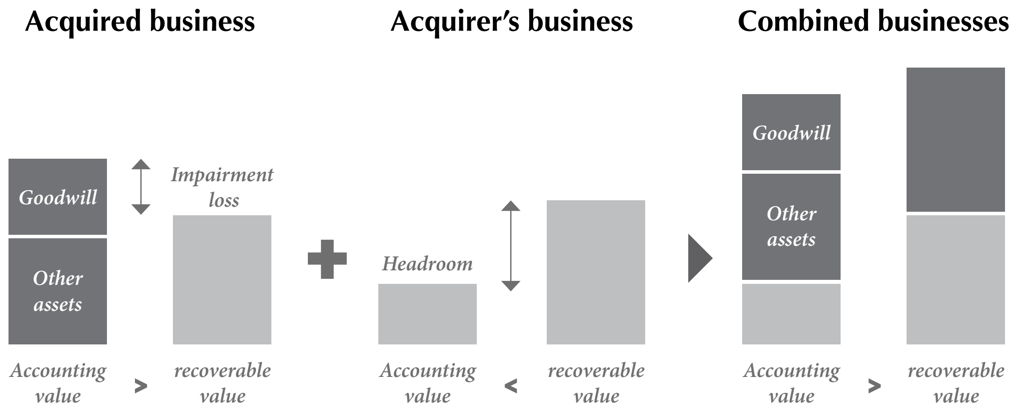

Figure 1. Demonstration of the shielding effect

Source: adapted from IASB (2020).

An acquisition could therefore underperform management's expectations, but the company would not recognize any impairment of acquired goodwill if it had enough headroom to absorb a decrease in value.

Another point noted in the impairment test listed by DP/2020/1 is that impairment losses are sometimes recognized too late, long after the events that caused these losses, both due to the shielding mentioned above and when the future cash flow estimates are very optimistic. The last aspect refers to the fact that the estimates of both the value in use and the fair value minus disposal costs will always be subject to measurement uncertainty. Therefore, managers may be incentivized to make optimistic assumptions and judgments to be financially benefited.

Failure to recognize an impairment loss when an acquisition does not meet its objectives (i.e., if it does not meet the initial expectations of generating future benefits) may induce investors to be more confident in the acquisition than they should. Thus, DP/2020/1 presented the view of some stakeholders that the impairment test is ineffective in holding management accountable for the goodwill recognized on acquisitions. They argue that constant amortization through expenses would represent a more effective accounting and management accountability, as the company would need to generate profits to recoup this expense.

Another critical issue to be highlighted is that impairment losses are recognized infrequently, despite evidence that a significant percentage of acquisitions fail (IASB, 2020). Consequently, there are arguments that the book value of goodwill does not faithfully represent the future benefits expected from the acquisition.

Massoud and Raiborn (2003) believe that the impairment test allows management to make judgments, as companies can choose when to recognize impairment losses in a manner consistent with their operating results. Thus, given its potential for manipulation, the authors believe that reducing the value of goodwill was a "declaration of commitment in which the costs outweigh the benefits."

Some studies associate the impairment test with the quality of accounting information. For example, regarding the Brazilian context, Silva et al. (2017) stated that it is possible that the test is used opportunistically or even not used when it should, decreasing the quality of information presented in financial reports. Furthermore, Chang and Yen (2015) found that given its subjective judgment, the impairment test gives an earnings management opportunity – particularly, big bath accounting and income smoothing on earnings.

On the other hand, those who advocate that impairment testing is the most appropriate way to reduce the carrying amount of goodwill claim that this model provides more helpful information than amortization, considering the arbitrariness in determining the useful life of goodwill (IASB, 2020).

Many stakeholders consider the information provided by the impairment test helpful, even though it mainly provides confirmatory value. That is, even if the impairment loss often delays market assessments of the performance of an acquisition, recognizing such losses confirms the assessments made by investors before the occurrence. Moreover, in some cases, the impairment test may even reveal impairment losses that investors had not previously identified (IASB, 2020).

2.2.2 Alternative subsequent accounting

As noted in Table 1, the impairment test is just one way to reduce the book value of goodwill. The first choice that drives subsequent accounting is whether to recognize goodwill as an asset.

This discussion has not yet been appeased in accounting. Even though the recognition of goodwill as an asset is the predominant understanding in Accounting Theory, even adopted by regulatory bodies (e.g., IASB and FASB), many researchers claim the opposite; there are even some empirical studies on the subject (Lustosa, 2017; Canning, 1929, as cited in Bloom, 2013; Tearney, 1973; Johnson and Petrone, 1998).

Amortization is the most commonly accepted option for reducing the carrying amount of goodwill, other than the impairment test. It was the form adopted by the international standard before IFRS 3 – Business Combinations (IAS 22 – Business Combinations), which required companies to amortize goodwill over its useful life – in theory, no longer than 20 years.

Amortization consists of a linear reduction over an asset's useful life, which may or may not be defined. In the first case, the book value reduction takes place to represent, or at least approximate, the decreased potential for generating economic benefits since the book value of an asset will be zero at the end of its useful life.

However, the same does not occur when an asset's useful life is indefinite. In this case, the useful life of goodwill cannot be estimated; therefore, any rate used for amortization would be somewhat arbitrary. Johnson and Tearney (1993) reinforce the idea that the low period is the focus when it comes to amortization as a way to reduce the value of goodwill. Given that goodwill represents a probable future economic benefit due to a past transaction, the authors believe it has a limited, although "impossible to measure," life.

When amortization was compulsory to reduce the book value of goodwill, Hall (1993) outlined a survey to verify whether company managers are influenced by external aspects when choosing the number of years over which goodwill is amortized. The results indicated that such a choice is affected by the size of the company and the restrictions of debt agreements. In this sense, Henning and Shaw (2003) showed that the choice of the amortization period for the acquired goodwill predicts the company's post-acquisition earnings levels since shorter lives can lead to a dilution of earnings. Therefore, the possibility of external factors influencing the amortization period is perceived to exceed an attempt to estimate the approximate period of the asset's generation of economic benefits.

Jennings et al. (2001) found that earnings before goodwill amortization explained stock prices significantly better than earnings after goodwill amortization and concluded that this component – amortization – is interpreted as a noise source. Therefore, they suggested that excluding amortization from the income statement would not reduce the utility of earnings but might instead eliminate such noise.

Hendriksen (1965, as cited in Gynther, 1969) states that amortization in arbitrary periods can lead to an undervaluation of assets in subsequent periods and does not promote responsible accounting.

Spacek (1968) argues that amortization for acquired goodwill should occur only when there are signs of limited existence, and write-offs due to impairment should only be made when there is evidence of loss in value. The opposite result consists of an understatement of net income during the amortization period and a perpetual understatement of assets in subsequent periods.

The author also stated that the most appropriate treatment would be the total write-off of the goodwill value as soon as it is acquired against equity reserves. However, due to practical difficulties, the periodic revaluation of goodwill could be performed using methods involving capitalizing the entity's profits, the present net values of some assets, knowledge of business conditions, etc., with sophisticated quantitative techniques.

Spacek's (1968) line of reasoning, in which the periodic reassessment of goodwill would have to use a method involving capitalizing the entity's profits, is based on the idea of super profit, which had Leake (1921) as its precursor. The author defended the idea of residual profits; that is, he conceptualized goodwill as the present value of the right to receive future super profits. In this context, the term "super profit" means the amount by which the future income, increase, or advantage to be received must exceed all expenses incidental to its production.

Proponents of reintroducing amortization claim that, with impairment testing, the carrying amounts of goodwill may be overstated. As a result, the company's management is not held accountable for its acquisition decisions. Furthermore, despite goodwill having an indefinite useful life, it is finite. Amortization would reflect the consumption of goodwill more adequately, in addition to reducing the cost inherent to the impairment test. Johnson and Tearney (1993) reinforce that the low period becomes the focus when it comes to amortization as a way to reduce the value of goodwill. The authors believe goodwill represents a probable future economic benefit due to a past transaction and has a limited life, although "impossible to measure."

Lustosa (2017) proposes an alternative theory about goodwill and its subsequent reduction. The author suggests that a company's economic value is formed by an intangible and a physical asset (Lustosa, 2009). Physical assets result from implemented decisions and completed transactions, while intangible assets refer to ideas and strategies whose decisions have not yet been implemented. Creating economic value involves transforming ideas – intangible heritage – into physical (actual) heritage, even though they remain intertwined (Oliveira & Lustosa, 2022).

According to current regulations, goodwill is classified as a separate item in a company's assets list due to the requirement to individualize balance sheet items (Oliveira & Lustosa, 2022). However, the authors state that potential (and not guaranteed) wealth represents the present value of future residual profits. That is, goodwill may or may not "become" physical assets (in addition to being renewed as new ideas, plans, and strategies emerge to feed the decision-making process), which mischaracterizes its intrinsic and unique capacity to generate future economic benefits as assets.

While not converted into physical assets, goodwill is a potential state of intangible wealth. According to Lustosa (2017), its synergistic effects with other assets are beneficial and have economic value for a company. However, while this intangible asset is not materialized in a physical asset, as ideas and strategies are materialized in actual transactions, these intangibles are not supposed to be individualized in the balance sheet as assets.

In the same line of reasoning, Oliveira et al. (2021) propose that physical and intangible wealth are entangled, i.e., they cannot be analyzed separately. Future managerial decisions (intangible wealth) are in the present, just as what happens in the present (implemented managerial decisions – physical wealth) affects future wealth. There is a constant feedback transformation of these riches, characterizing dynamism. For this reason, it is not recommended that the value of goodwill remain for too long in the financial statements, given that the realization of physical assets depends on the conversion of intangibles (i.e., the materialization of ideas, strategies, etc.).

Pereira and Lustosa (2020) deepened this suggestion of conversion – intangible heritage becomes physical. When analyzing the recovery of goodwill acquired in a specific business combination (Hypera S.A.), the authors found that it was recovered within two years. However, it continued to be recorded in the acquirer's balance sheet. This fact confirms the notion that goodwill represents a state of wealth converted into a physical asset. Consequently, keeping it on the balance sheet after its recovery may lead to the risk of recognizing internal goodwill, which is currently prohibited by accounting regulations.

Thus, Lustosa (2017) proposed that if goodwill continues to be recorded as an asset, mainly due to the practical difficulties suggested by Spacek (1968), replacing the impairment test (current requirement) with a write-off proportional to the increase in fixed assets in use, whose rate is a proxy for the conversion of intangible assets into physical assets. However, considering that the classification as an asset is seen as inappropriate in this new theoretical approach proposed by Lustosa (2017) and Oliveira and Lustosa (2022), an alternative, even in this view of a proportional write-off, would be to classify it in shareholders' equity. The rate (an attempt to represent its conversion into physical assets) is still something to be improved in future research since this is a recent approach and different from the prevailing view in Accounting Theory.

Finally, some researchers also advocate the instant write-off approach to goodwill. Seetharaman et al. (2004) highlight some justifications defended in this subsequent accounting method, such as the measurable difficulties – since, unlike other assets, these cannot be sold separately –, and the fact that goodwill related to the business is expected to disappear with time. Gray (1988) and Ma and Hopkins (1988) favor instant write-off because they believe that, since internally generated and acquired goodwill represents benefits with similar risk characteristics, it should be accounted for in the same way so that the balance sheet is not distorted.

On the other hand, the instant write-off has limitations, including the substantial impact on the acquirer's result at the time of acquisition and the distortion in the companies' leverage position (Seetharaman et al., 2004).

3. Discussion on changes proposed by Discussion Paper/2020/1

In 2013 and 2014, the IASB performed a post-implementation review (PIR) of IFRS 3 – Business Combinations to verify whether the standard's operation corresponded to expectations or implementation problems were identified. Stakeholders expressed concerns about some accounting aspects of business combinations, such as the current reduction in accounting goodwill. Some stakeholders described the impairment test as complex, time-consuming, and expensive, requiring companies to make complex judgments. Furthermore, they alleged a time lag between the occurrence of a loss and its recognition in a company's financial statements. Thus, they suggested amortization should be introduced.

As a result of the PIR, IASB published Discussion Paper/2020/1 on potential improvements in business acquisition reporting to help investors assess the success – or failure – of such acquisitions. This document examines the topics under discussion and expresses the IASB's preliminary views. The final objective is to verify if there is convincing evidence that changes in IFRS standards are necessary and justify their cost.

Suggestions are made to the Discussion Paper through comment letters. After considering the feedback, the Board will decide how to move forward with the project and whether to amend any of its previously released draft opinions. If it decides to make changes, the Council will publish an exposure draft, initiating a potential official change to the current standard.

3.1 Preliminary IASB positions in DP/2020/1 and Comment Letters

According to the IASB (2020), its preliminary positions aimed to provide investors with more helpful information about acquisitions and consider the expected benefits and costs. It should be noted that only the positions related to this study's theme (reduction in the book value of goodwill) will be addressed here.

The first preliminary view is that the IASB should maintain the impairment-only model and not reintroduce amortization. This view is based on the impairment test providing essential, if not timely, confirmatory information and ratifying the investors' past assessments that such losses occurred, helping to hold management accountable.

The second preliminary view is that it is not feasible to significantly improve the effectiveness of the goodwill impairment test at a reasonable cost. Such a position concerns the allegations about the shielding effect. Hence, additional information about the subsequent performance of acquisitions would be provided by implementing new requirements on companies, which would provide investors with more direct information about the success or failure of acquisitions.

Finally, the third preliminary view is that the need for an annual impairment test should be removed. That is, companies would only be required to perform such a test if an assessment indicated a reduction in the recoverable amount, which would be done at the end of each year. Such a stance considers that this periodicity cannot eliminate the shielding effect, besides the manifestations of the test's high cost. It is worth highlighting the view of some members that removing this requirement could make impairment tests less robust (IASB, 2020).

An analysis of the 193 comment letters indicated that 30% (58 letters) supported the IASB's decision to maintain only the impairment test to reduce the book value of goodwill. Among other justifications is that amortization has several limitations, such as not being able to estimate the useful life of the goodwill and, consequently, using an arbitrary rate. On the other hand, 28% (54 letters) supported the reintroduction of amortization; most due to the subjectivity of the impairment test, which ends up being subject to management's judgment and, therefore, in practice, the auditors cannot sufficiently contest the value in use. There were also 38 letters (20%) that advocated a hybrid method to reduce the value of goodwill. Apart from these, 43 letters (22%) did not take a stand on any of the methods and/or dealt with different subjects addressed by the DP/2020/1.

4. A reflection upon the subsequent accounting of goodwill

All post-goodwill accounting models have limitations. However, even if there are limitations, the model adopted for reducing the carrying amount of goodwill is expected to represent the economic essence of this component more closely.

Even though the impairment test is the model adopted by the international accounting standard-setting body (IASB) and provides important information that can confirm losses due to the reduction in the recoverable value, some problems cannot be ignored. The fact that the test cannot directly capture the reduction in the value of goodwill (shielding) means that this loss may become arbitrary.

However, it is necessary to verify impairments so that the company's assets in general, including goodwill, are accounted for at amounts not exceeding their recoverable amounts. Given the limitations of this goodwill subsequent accounting model, it is necessary to reduce its value more directly and reliably.

Regarding the DP/2020/1, some stakeholders defend that goodwill has an indefinite but finite helpful life. Therefore, the reintroduction of amortization is the only way to show that goodwill is being consumed. An amortization expense does not provide investors with helpful information if it is arbitrarily determined though. Therefore, a more appropriate way would be to reduce the book value of goodwill in a non-random manner but involving a coherent counterpart, with a rate that, despite not being the direct delimitation of useful life, enables visualizing the conversion of goodwill into the expected benefits (profits).

Spacek (1968) states that this reduction should be performed using a method involving capitalizing the entity's profits. In the same sense, Lustosa (2017) argues that the surplus paid concerning the fair value of the acquirer's net assets is not an acquisition of non-individualizable intangible assets, grouped in the form of goodwill, but rather a partial waiver by the acquirer to the future physical wealth s/he hopes to obtain (with future decisions s/he will make). Therefore, goodwill, as an intangible asset, only potentially exists. According to the author, its value should be reduced along with converting intangible wealth into actual wealth, through proportional write-off, up to the limit of the surplus paid.

Subsequent accounting that manages, even if approximately, captures its economic essence – stock of intangible wealth equivalent to the present value of future residual profits expected from decisions yet to be implemented (Leake, 1921; Lustosa, 2017) – prevents that internally generated goodwill is implicitly recognized, replacing what was purchased and consumed, as noted by Pereira and Lustosa (2020). It needs to be prevented since, in addition to international standards prohibiting the recognition of internally generated goodwill, such recognition, although legitimate (i.e., although internally generated goodwill does exist in companies), would lead to problems in the qualitative characteristic of information comparability, given that only companies that undergo a business combination with the presence of goodwill would have this value explained in the financial statements.

5. Final Considerations

Acquiring a business is a common strategy for companies to grow. However, in subsequent years, acquisitions do not always perform as well as management initially expected. Thus, investors benefit from learning more and comparing acquisitions' performance to their expectations so that the management can be held accountable for their decision to combine business (IASB, 2020).

Reducing the carrying amount of goodwill has always been controversial and subject to wildly divergent views. Goodwill values have increased significantly around the world. According to some members of the IASB (2020), this may be evidence that it is not adequately reduced and that management is not being properly held accountable for its acquisition decisions.

With the post-implementation review (PIR) of IFRS 3, debates have returned to the standard-setters agenda, in which stakeholders expressed concerns regarding some aspects of the current reduction in accounting goodwill (i.e., impairment test), such as a time lag between the occurrence of a loss, high costs, high degree of judgment (and the possibility of earnings management), and shielding effect, among others.

To carry out a comparative analysis of the potential ways of subsequently accounting for goodwill, this study presents a theoretical overview, including the recent changes proposed in the IASB's Discussion Paper/2020/1.

Observing the IASB's preliminary stance, it is clear that maintaining the impairment test, as the only way to reduce the book value of goodwill does not solve the problems listed in DP/2020/1. This test is expected to reduce the book value of acquired goodwill when the margin produced by the acquirer's business (due to the shielding effect) does not mask the loss that would exist if it were possible for goodwill to be tested separately. However, it can also result in relatively inflated balances. Additionally, the use of fair value may be subject to managerial opportunism, which also makes it difficult for auditors and regulators to assess impairment.

Furthermore, the impairment test can only capture the difference between the accounted and actual cash-generating power when goodwill (or its CGU) has its book value below the recoverable amount. Even though this loss has valuable information, it says much more about the cash-generating unit than the goodwill itself. Therefore, it should not be the only criterion considered for reducing its value.

According to Lustosa (2017), while not converted into physical assets, goodwill is a potential state of intangible wealth equivalent to the present value of expected future residual profits from decisions yet to be implemented. As this implementation occurs (e.g., the materialization of ideas and implementation of plans and strategies, among others), this intangible heritage is converted into a physical asset. Note that this conversion cannot occur linearly, much less be captured only annually, as it is a dynamic and constant process. Therefore, the way to reduce its carrying amount that most closely demonstrates that the goodwill is being consumed (i.e., transformed) is the proportional write-off.

The challenge lies in linking this reduction (or conversion) of goodwill to the generation of physical assets and future wealth, as Lustosa (2017) advocates. Thus, the primary and challenging issue to be debated is structuring a rate that can approximately translate the conversion of goodwill into expected future earnings, which remains a suggestion for future research.

References

Bloom, M. (2013). *Double accounting for goodwill: A problem redefined.* Routledge.

Bushman, R. M., & Smith, A. J. (2001). Financial accounting information and corporate governance. *Journal of Accounting and Economics*, 32(1-3), 237-333. https://doi.org/10.1016/S0165-4101(01)00027-1. Recuperado de: https://www.sciencedirect.com/science/article/abs/pii/S0165410101000271.

Carvalho, C., Rodrigues, A. M., & Ferreira, C. (2010). A Mensuração Subsequente do Goodwill e a sua Contribuição para a Manipulação dos Resultados: uma Revisão da Literatura. *XIV Encuentro AECA, Coimbra, Portugal, setembro*. Recuperado de: http://www.aeca1.org/pub/on_line/comunicaciones_xivencuentroaeca/cd/106a.pdf.

Chalmers, K.G., Godfrey, J.M. & Webster, J.C. (2011), Does a goodwill impairment regime better reflect the underlying economic attributes of goodwill? *Accounting & Finance*, 51: 634-660. https://doi.org/10.1111/j.1467-629X.2010.00364.x. Recuperado de: https://onlinelibrary.wiley.com/doi/abs/10.1111/j.1467-629X.2010.00364.x.

Chang, M. L., & Yen, T. Y. (2015). Does Reversal of Asset Impairment Loss Matter? Evidence from China. International Research Journal of Applied Finance, 6(4), 197-222. Recuperado de: https://search.proquest.com/openview/28ebde297135bbe557ea0e49f07a1f34/1?pq-origsite=gscholar&cbl=2046325.

Davis, M. (1992). Goodwill accounting: Time for an overhaul. Journal of Accountancy, 173(6), 75. Recuperado de: https://www.thefreelibrary.com/Goodwill+accounting%3A+time+for+an+overhaul-a012237698.

Foster, N. The FASB and the Capital Markets. *The FASB Report.* Norwalk, CT: FASB, 2003. Recuperado de: https://www.fasb.org/jsp/FASB/Page/Foster_FASBReport.pdf.

Falk, H., & Gordon, L. A. (1977). Imperfect markets and the nature of goodwill. *Journal of Business Finance & Accounting*, 4(4), 443-462. https://doi.org/10.1111/j.1468-5957.1977.tb00727.x. Recuperado de: https://onlinelibrary.wiley.com/doi/abs/10.1111/j.1468-5957.1977.tb00727.x.

Garcia, C. (2007). How Accounting for Goodwill relies on Underlying Assumptions: Historical Approach. *30th Annual Congress of European Accounting Association*, 1–2. https://basepub.dauphine.fr/bitstream/handle/123456789/2638/fulltextEAA2007.pdf?sequence=2.

Guillaume, O., Andrea, B., & Pierre, D. (2014). The Accounting Treatment of Goodwill: When will FASB Stop Changing the Rules? *International Journal of Management, IT and Engineering*. 4(October), 520–534. https://www.researchgate.net/publication/262862969_The_Accounting_Treatment_of_Goodwill_When_will_FASB_Stop_Changing_the_Rules.

Gynther, R. S. (1969). Some" conceptualizing" on Goodwill. The accounting review, 44(2), 247-255. Recuperado de: https://www.jstor.org/stable/243799.

Gray, S. (1988). Accounting for acquisitions and mergers: A unified approach. *The Accountants Magazine*.

Hamberg, M., Paananen, M., & Novak, J. (2011). The adoption of IFRS 3: The effects of managerial discretion and stock market reactions. European Accounting Review, 20(2), 263-288. https://doi.org/10.1080/09638181003687877. Recuperado de: https://www.tandfonline.com/doi/abs/10.1080/09638181003687877.

Han, H., Tang, J. J., & Tang, Q. (2020). Goodwill Impairment, Securities Analysts, and Information Transparency. European Accounting Review, 1-33. https://doi.org/10.1080/09638180.2020.1791725. Recuperado de: https://www.tandfonline.com/doi/abs/10.1080/09638180.2020.1791725.

Hayn, C., & Hughes, P. J. (2006). Leading Indicators of Goodwill Impairment. *Journal of Accounting, Auditing & Finance*, 21(3), 223–265. https://doi.org/10.1177/0148558X0602100303. Recuperado de: https://journals.sagepub.com/doi/abs/10.1177/0148558x0602100303.

Henning, S. L., & Shaw, W. H. (2003). Is the selection of the amortization period for goodwill a strategic choice? *Review of Quantitative Finance and Accounting*, 20(4), 315-333. https://doi.org/10.1023/A:1024043316292. Recuperado de: https://link.springer.com/article/10.1023/A:1024043316292.

Hirschey, M. & Richardson, V. J. (2002). Information content of accounting goodwill numbers. *Journal of Accounting and Public Policy*. Volume 21, Issue 3, Pages 173-191, ISSN 0278-4254. https://doi.org/10.1016/S0278-4254(02)00048-0. Recuperado de: https://www.sciencedirect.com/science/article/pii/S0278425402000480.

Hopkins, R., & Ma, R. (1988). Goodwill - An Example of Puzzle-Solving in Accounting. Abacus, 24(1), 75-85. https://doi.org/10.1111/j.1467-6281.1988.tb00204.x. Recuperado de: https://onlinelibrary.wiley.com/doi/abs/10.1111/j.1467-6281.1988.tb00204.x.

Hughes, H. P. (1982). *Goodwill in accounting: A history of the issues and problems* (Georgia State University Press (ed.); Vol. 80).

Iasb - *International Accounting Standard Board*. (2020). Discussion Paper DP/2020/1 - Business Combinations - Disclosures, Goodwill and Impairment. Recuperado de: https://cdn.ifrs.org/-/media/project/goodwill-and-impairment/goodwill-and-impairment-dp-march-2020.pdf.

Iasb - *International Accounting Standard Board*. (2020). IAS 36 - Impairment of Assets. Recuperado de: https://www.ifrs.org/issued-standards/list-of-standards/ias-36-impairment-of-assets/.

Iasb - *International Accounting Standard Board*. (2020). IFRS 3 - Business Combinations. Recuperado de: https://www.ifrs.org/issued-standards/list-of-standards/ifrs-3-business-combinations/.

Iasb - *International Accounting Standard Board*. (2020). Who uses IFRS Standards? Recuperado de: https://www.ifrs.org/use-around-theworld/use-of-ifrs-standards-by-jurisdiction/.

Jahmani, Y., Dowling, W. A., & Torres, P. D. (2010). Goodwill impairment: A new window for earnings management? *Journal of Business & Economics Research* (JBER), 8(2). https://doi.org/10.19030/jber.v8i2.669, Recuperado de: https://www.clutejournals.com/index.php/JBER/article/view/669.

Jennings, R., LeClere, M., & Thompson, R. B. (2001). Goodwill amortization and the usefulness of earnings. *Financial Analysts Journal*, 57(5), 20-28. https://doi.org/10.2469/faj.v57.n5.2478. Recuperado de: https://www.tandfonline.com/doi/abs/10.2469/faj.v57.n5.2478.

Johnson, J. D., & Tearney, M. G. (1993). Goodwill - An eternal controversy. *The CPA Journal*, 63(4), 58. Recuperado de: https://search.proquest.com/openview/bfe874ff302f59fb6174876339d5e415/1?pq-origsite=gscholar&cbl=41798.

Johnson, L. T., & Petrone, K. R. (1998). Is goodwill an asset? *Accounting Horizons*, Sarasota, v. 12, n. 3, p. 293-303, set. 1998.

Jordan, C. E., & Clark, S. J. (2004). Big bath earnings management: the case of goodwill impairment under SFAS No. 142. *Journal of Applied Business Research* (JABR), 20(2). https://doi.org/10.19030/jabr.v20i2.2206. Recuperado de: https://www.clutejournals.com/index.php/JABR/article/view/2206.

Leake, P. D. (1921). *Commercial goodwill: its history, value, and treatment in accounts*. Sir J. Pitman & sons, Limited.

Li, K.K., & Sloan, R.G. (2017). Has goodwill accounting gone bad? *Review of Accounting Studies* 22, 964–1003. https://doi.org/10.1007/s11142-017-9401-7. Recuperado de: https://link.springer.com/article/10.1007/s11142-017-9401-7#citeas.

Lustosa, P. R. B. (2017). A New Approach to Accounting Goodwill (and other identified intangibles with indefinite useful lives): Theory and Empirical Evidence. *Available at SSRN 3023311*. http://dx.doi.org/10.2139/ssrn.3023311. Recuperado de: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3023311.

Lustosa, P. R. B. (2009). Ativo e sua avaliação. In: Ribeiro Filho, A. F.; Pederneiras, J. L. M. (Orgs.). *Estudando Teoria da Contabilidade*. 1. ed. São Paulo: Atlas, 2009.

Martins, E., Almeida, D. L. D., Martins, E. A., & Costa, P. D. S. (2010). Goodwill: uma análise dos conceitos utilizados em trabalhos científicos. *Revista Contabilidade & Finanças*, 21(52), 0-0. Recuperado de: https://www.scielo.br/j/rcf/a/YRYyWmKRrXbDJbyK8JQmdwN/?format=pdf&lang=pt.

Massoud, M. F., & Raiborn, C. A. (2003). Accounting for goodwill: are we better off? *Review of business*, 24(2), 26. Recuperado de: https://search.proquest.com/openview/24e11579d7d17d92b28118e3196ac225/1?pq-origsite=gscholar&cbl=36534.

Masters-Stout, B., Costigan, M. L., & Lovata, L. M. (2008). Goodwill impairments and chief executive officer tenure. Critical Perspectives on Accounting, 19(8), 1370-1383. https://doi.org/10.1016/j.cpa.2007.04.002. Recuperado de: https://www.sciencedirect.com/science/article/abs/pii/S1045235407000640.

Oliveira, K. V., Lustosa, P. R. B., & de Oliveira Gonçalves, A. (2021). Goodwill from the appreciative inquiry (AI) perspective: innovation transforming intangible capital. *Revista Contemporânea de Contabilidade*, 18(47), 03-17. https://doi.org/10.5007/2175-8069.2021.e75538. Recuperado de: https://periodicos.ufsc.br/index.php/contabilidade/article/view/75538.

Oliveira, K. V., & Lustosa, P. R. B. (2022) The entanglement of accounting goodwill: Einstein's "spooky action at a distance", *Accounting Forum*, DOI: 10.1080/01559982.2022.2089319. Recuperado de: https://www.tandfonline.com/doi/full/10.1080/01559982.2022.2089319.

Pereira, J. A. S., & Lustosa, P. R. B. (2020). Goodwill Adquirido como Proxy de Estado de Riqueza Intangível: Estudo de Caso de sua Recuperação. *In XX USP International Conference In Accounting.* Recuperado de: https://congressousp.fipecafi.org/anais/20UspInternational/ArtigosDownload/2577.pdf.

Spacek, L. (1968). *In* Catlett, G. R., & Olson, N. O. (1968). Accounting for goodwill; Accounting research study no. 10. Recuperado de: https://egrove.olemiss.edu/cgi/viewcontent.cgi?article=1141&context=aicpa_guides.

Seetharaman, A., Balachandran, M., & Saravanan, A. S. (2004). Accounting treatment of goodwill: yesterday, today and tomorrow: Problems and prospects in the international perspective. Journal of intellectual capital. https://doi.org/10.1108/14691930410512969. Recuperado de: https://www.emerald.com/insight/content/doi/10.1108/14691930410512969/full/html.

Sevin, S., & Schroeder, R. (2005). Earnings management: evidence from SFAS No. 142 reporting. *Managerial Auditing Journal*. https://doi.org/10.1108/02686900510570696. Recuperado de: https://www.emerald.com/insight/content/doi/10.1108/02686900510570696/full/html.

Silva, J. D., Bonfim, M. P., Niyama, J. K., & Silva, C. A. T. (2017). Impairment test e qualidade da informação contábil: a utilização do teste de recuperabilidade de ativos nas empresas Brasileiras de capital aberto. *In XVI CICA - Congresso Internacional de Contabilidade e Auditoria*, 12 e 13 Outubro, Aveiro. Recuperado de: https://www.occ.pt/dtrab/trabalhos/xviicica/finais_site/104.pdf.

Tearney, M. G. (1973). Accounting for goodwill: a realistic approach. *Journal of Accountancy* (pre-1986), 136(000001), 41. Recuperado de: https://search.proquest.com/openview/f08cef3d6644b4d069250adbb70ce6fb/1.pdf?pq-origsite=gscholar&cbl=41064.