

Efficiency Improvements for Goodwill Accounting in Business Combinations

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I. Introduction

Goodwill is an important item for reporting for companies in the digital economies around the world. Indeed, as innovation in the digital space takes over the classical model of economic transactions, a company acquiring an innovative digital company with latest technology products and offerings in a new market, is well expected. Where opportunities previously did not exist, or were not identified or available for the existing business, an innovation that further expands its market, makes the products or services updated or simply improves the profitability from its operations, is encouraged by the shareholders as well as most regulative environments with which the company operates.

So, when an company is innovative and makes an appeal for acquisition by another, the acquiring company certainly has an extent of expectation, from which it will profit further, upon completing the acquisition. This extent of expectation, is often referred to as the 'Goodwill' that is acquired by the company upon acquisition. Hence, 'Goodwill' in a business combination is a monetary representation of the expected gains that the acquiring company inherits, upon taking over the acquired company.

Such a defined and expected Goodwill, is indeed an asset upon acquisition. However, post-acquisition, when the acquired Goodwill is already resident and under the control of the acquiring company, it should be expected that the monetary allocation towards this Goodwill, would have some further representations, as opposed to the point-in-time representation that it had at the time of acquisition.

II. Characteristics of Goodwill

Goodwill, necessarily, is applicable for an acquiring company when taking over another company that produces such Goodwill valuations upon takeover. Hence, Goodwill is not an internally generated value, as internally, such efficiency improvements are already inherent in the current operations, and adequately reflected in the current statement of accounts.

However, when a company intersects with another, who offer an efficiency improvement that is currently not available, such opportunity is the considerable Goodwill value for acquisition. This important derivation for Goodwill is fundamental to its accounting in a business combination. The key characteristics of Goodwill accounting are:

1. Goodwill is generated in a business combination, when a company acquires another, who provide this added value.
2. Goodwill is not an internally generated value, rather an externally acquired value.
3. Goodwill is initially resident as the acquiring company's asset.
4. The acquired company, did not have any such associated value of Goodwill in its statement of accounts previously.

III. Issues with Current Methods of Goodwill Accounting

Whilst an acquired value in a business combination, the value of Goodwill is usually resident in the acquiring company's books as :

Consolidated Statement of Financial Position

Non-current Assets

<i>Goodwill</i>	xxxx
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This increases the value of assets for the acquiring company, by a value attributed to Goodwill (xxxx), that is above and beyond the value of the total individual assets of the acquired company.

So, when the value of assets of acquiring company (A) and acquired company (B) are:

1. Pre-Acquisition

Company A:

Consolidated Statement of Financial Position

Non-Current Assets

<i>Other tangible assets</i>	xxxx
<i>Property, Plant and Equipment</i>	xxxx

Current Assets

<i>Inventories</i>	xxxx
<i>Investments</i>	xxxx
<i>Cash and Bank Balances</i>	xxxx

Company B:

Consolidated Statement of Financial Position

Non-Current Assets

<i>Other tangible assets</i>	yyyy
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Property, Plant and Equipment yyyy

Current Assets

Inventories yyyy
Investments yyyy
Cash and Bank Balances yyyy

2. Post-Acquisition

Company A:

Consolidated Statement of Financial Position

Non-Current Assets

Goodwill zzzz
Other tangible assets zzzz
Property, Plant and Equipment zzzz
Investment Assets zzzz
Investment in Associates zzzz

Current Assets

Inventories zzzz
Investments zzzz
Cash and Bank Balances zzzz

Fundamentally, upon acquisition, the total assets of the company A is increased by an amount (zzzz) allocated to the new item line of Goodwill, that is introduced by virtue of this acquisition.

Hence, the balance sheet value of assets, is increased by at least a value of Goodwill (zzzz), for the combined set of companies A and B, completely reflected by A.

However, whilst current accounting standards hold the value of Goodwill as a Non-current Asset, whether such a classification of Goodwill is appropriate, is to be decided.

III-a. Goodwill as a Non-current Asset

Since Goodwill is a current expectation of business improvements upon acquisition, its classification as a non-current asset may not be appropriate. The acquiring company uses Goodwill to generate further business in its current operating environment, and to classify it as Non-current, could be a core issue of further complications.

Compared to other parked assets, such as *Investments* items, where company A, only derives the financial gain from such investments, and is not using such investments in its actual business

operations, Goodwill is inappropriately placed, as Goodwill is expected to be applied and utilized by the acquiring company, immediately upon acquisition.

In principle, the application of Goodwill can be represented as :

$$\begin{array}{l} \text{Company A Assets generates profits (P1)} \\ + \\ \text{Company B Assets generates profits (P2)} \\ = [\text{Company (A+B) Assets + Goodwill}] \text{ generates profits (P3)} \end{array}$$

It is expected at acquisition that the future value of P3 would be more than the value of P1, when company A uses the assets of company B, including the currency of the thus immediately created Goodwill.

So at no stage, there is any element of deferring the use of the created new asset of Goodwill, rather that any acquiring company would always expect to use the created value of Goodwill, immediately to use for improving its business operations and profits, as opposed to having any intentions to 'park' the created goodwill, as it would mostly reduce efficiency for the combined business to not use this acquired, available and valuable asset.

This created value of Goodwill, should therefore firstly be an item listed as a Current Asset, that is being used for its operations, as otherwise it should not be an asset upon acquisition, rather a liability, if it is in a non-current or non-performing state for the acquiring company. Indeed, the created Goodwill, cannot be a Non-Current and therefore, non-applied or un-utilized for the company, as well as be classified as an Asset. If this created Goodwill at the time of acquisition is an asset at all, it would certainly be current as opposed to any future expectations or derivations.

Post-Acquisition, if the Goodwill is Non-current, it should fairly be in the Liability Section, as opposed to the Asset Section. However, as the company A, expects that the acquisition itself, creates the additional Asset of Goodwill, this certainly has to be a current expectation with current applications, as opposed to having a deferred value by this combination – and should therefore be most appropriately placed as a Current Asset for the acquiring company.

III-c. Affecting Goodwill

Since itemizing Goodwill as an Asset for the acquiring company, a further complication arises regarding the appropriate reflection of this newly created asset in the accounting books, such that users of the accounting statement, can reliably make assessments about the company post acquisition.

Current methods of Affecting Goodwill consists of :

III-c-1. Goodwill Impairment

In this method, the acquired Goodwill is allocated to each of the cash generating units of the company. Annually, if there is an increase in the recoverable amount of the unit, the value of Goodwill remains unaltered, however, if the recoverable amount is reduced, then a corresponding

value of Goodwill that has been allocated to the unit, is also proportionately reduced to reflect this performance.

Hence, the value of Goodwill is not affected or reduced as long as the unit to which it has been allocated does not reduce its recoverable amount. However, this may cause an issue in consolidating the accounts, as Goodwill that has been defined as an Asset, would seem to be unapplied or unutilized, in cases where the recoverable amount for the unit is increasing. However, that the existing and allocated Goodwill is consumed whilst increasing the recoverable amount, is almost misinformed or even overlooked, in cases when the unit is increasing in recoverable amount.

Goodwill that is allocated and used by an unit can be represented as:

Current Impairment Method

$$\text{Operating Unit Assets (A) + Allocated Goodwill (G) = Operating Unit Performance (P)}$$

where,

$P > P_x$; G is constant

$P < P_x$: G is reduced

P_x is Previous Annual Performance

Like most Assets, Goodwill should be expected to have a lifespan during which the asset is consumed by the company. Indeed, if any Asset is not consumed, it would not be an asset, that can be appropriately accounted for by the company. The current configuration of a pseudo-concept of a 'Parked' asset in the form of Goodwill, seems inappropriate when all other assets for the company has an accounting allocation, consumption and re-evaluation.

To then, discount the re-evaluation of a consumed asset, such as Goodwill, for which the company had acquired, in cases when the operating unit is increasing in recoverable amount, is high risk and may introduce erroneous readings of the company statements.

As with all Assets, it is to be consumed by the company, and the value added to the company from its uses or consumption, is carried over to other forms of gains for the company, be it in cash, increased revenue, increase in products etc.

Expected Impairment Method

$$\text{Operating Unit Assets (A) + Allocated Goodwill (G) = Operating Unit Performance (P)}$$

where,

$P > P_x$; G is reduced

$P < P_x$: G is reduced

P_x is Previous Annual Performance

Goodwill is consumed, prior to reporting and during operation of the unit, and is therefore reduced irrespective of the annual performance of the unit.

Hence, the method of Goodwill Impairment for all assets, is currently inconsistent with principles of asset allocations and may introduce erroneous reporting of financial statements.

III-c-2. Goodwill Amortization

Goodwill, as with all other assets, can be amortized over its specific lifetime. Further, most assets are classified as having a finite life, the time in which the asset is consumed and used by the company. Goodwill, being a new asset item for the company that is created by the combination, would be expected to have a finite life, as the novelty value of the acquisition, would not be indefinite or infinite, when the business starts operating as a combined operation. To define the novelty of Goodwill, indefinitely and over an infinite timeline would actually incur an associated liability, as the novelty is 'parked' as opposed to operational - the expectations with which the acquiring company had acquired the business combination. A company would not acquire any Goodwill, should it not expect its immediate consumption, making it an asset with a reducing novelty and thus reducing lifespan.

i. Infinite Lifespan of Goodwill

Year 1

$$\text{Company Assets (A)} + \text{Added Goodwill (G)} = \text{Company Performance (P)}$$

where,

G remains constant
A changes to A1

Year 2

$$\text{Company Assets (A1)} + \text{Added Goodwill (G)} = \text{Company Performance (P1)}$$

where,

G remains constant
A1 changes to A2

However, as the company uses the acquired Goodwill, there would be implications for its existing Assets, that are influenced by the added Goodwill, and change from its current state from A to A1.

Post acquisition, it would be erroneous for a reader of the company statement to assume that the stated item of Goodwill on the company balance sheet is infact 'parked' or unused, as opposed to other current and non-current assets of the company that have a tangible operational use to the company, for such readers who read the statements with equal valuations of such line items of company assets.

As Goodwill exists in the company accounts, the reader of this information fairly expects that this is applied to the existing assets of the company to improve its operations, and to define a constant and unaffected set of assets, and an infinite lifespan of the novelty of Goodwill, would reduce the value of information that is provided from such accounting reports.

To provide that the company assets have changed in value, whilst there is an item of Goodwill, however, that the value of Goodwill is infinite, therefore reduces the value of such reported information, as the efficiency of reported asset items becomes ambiguous to the reader of such statements.

ii. Finite Lifespan of Goodwill

Year 1

$$\text{Company Assets (A)} + \text{Added Goodwill (G)} = \text{Company Performance (P)}$$

where,

G reduces to G1
A alters to A1

Year 2

$$\text{Company Assets (A1)} + \text{Added Goodwill (G1)} = \text{Company Performance (P1)}$$

where,

G1 reduces to G2
A1 alters to A2

In this form of amortization, the company allocates a defined lifespan for the acquired novelty of Goodwill. It is expected that this defined lifespan is due to the Goodwill being appropriately and adequately utilized by the company for its operations. Hence, Goodwill reduces with its lifespan, as its economic uses is gradually taken up by the business combination. However, that there is an allocation of the Goodwill to the current assets and operations of the company is not definite, however, this method of amortization, reduces the carrying value of the allocated Goodwill, irrespective of its economic uses by the company, as is in current defined practices.

Whilst the dynamic nature of the novelty of acquired Goodwill is appropriately captured in a reducing value with defined lifespan, that such combination of Goodwill into the existing business, does affect certain values of existing assets, is not clearly defined by such current provisions, and thereby reduces the value of the provided information. A reader of the information, when observing that the value of acquired Goodwill is reduced, however, unsure of how it has been applied or utilized, would become uncertain about such reported information.

To provide that the value of Goodwill, as an asset has reduced, however, that the current assets and operations had not been affected, would reduce the value of such information, as inexplicably, an item of Goodwill inherits and implies an utilization to other existing assets and operations of the company upon acquisition, to the reader of this information.

IV. Legal Implications

The current identified issues in Accounting for Goodwill raises several aspects of compliance and regulatory requirements for reporting of companies. Particularly, the worldwide accounting standard of a 'True and Fair' view of company accounts, are inadequately addressed. Also, a mis-statement about the future matter of a company arising from a takeover, could also be incurred.

IV-a. True and Fair View

For most countries that are in conjunction with the IFRS, reporting financial performance through company accounts, have a mandatory and core criterion of providing a True and Fair view of company performance. Here, a True and Fair view can be defined as the complete and efficient representation of the financial operations of the company, as undertaken in the previous financial year, including how it had managed its tangible and intangible assets, incurred liabilities, paid its dues and collected revenue from its operations.

The issue of a True and Fair view regarding Goodwill, therefore cannot be overlooked simply because it is an acquired asset upon a business combination, and is therefore in no one party's responsibility to report with such True and Fair view. Indeed, the acquiring company, whilst inheriting this Goodwill upon acquisition, should also be responsible for reporting on this acquired asset with equal fairness for its appropriate and adequate representation in company accounts. Any reason such as that of acquiring an external asset upon acquisition, that maybe fundamental to any overlooking for accurate reporting for such assets, should not be acceptable, as the responsibility of the acquiring company is not legally or ethically surpassed, by virtue of such assets being inherited, and yet itemized as company asset.

IV-a-1. True and Fair View Regards for Asset Currency

To the reader of the financial statements, an item of Goodwill introduced in a business combination, is mostly considerable as a current asset as opposed to a non-current asset. As current assets such as *Inventories* and *Cash* are a direct utility for business operations, and without which a business will not be able to operate, with Goodwill, the company does not have a choice but to use it fundamentally without any option for non-engagement with such Goodwill after acquisition and during its ongoing business operations thereafter.

Conversely, a company could not state that the Goodwill created after acquisition and in a combined business operation, is stopped, stalled or inapplicable, when such Goodwill is reflected in the statements.

Indeed, it would not be natural to the reader of the financial statement to assume that the item of Goodwill is not applied in the current operations of the company, post acquisition. Whether the company was able to make a success of such applied and available Goodwill, is a separate matter, and that such Goodwill was available and applied inherently post acquisition, should be fairly reflected by stating such a Goodwill as a current asset for the company. Meeting the extent of expectations, that the acquiring company had during acquisition, is not determining of the fact that it actually fundamentally and unreservedly applies such Goodwill in its business post acquisition, and to not do so would not be a True and Fair view of the company statements, concurrently, the reported information being of reduced value to the reader.

IV-a-2. True and Fair View Regards for Asset Utilization

The current methods of reporting utilization of Goodwill in company assets, is inadequate for a True and Fair view of the full and partial company statements, as the reader is uncertain of the impacts of such asset consumption by the company. To the reader, it would certainly seem erratic, that at times, Goodwill is amortized irrespective of the performance or profits with other assets of the company, and yet, at other, that the asset of Goodwill remains a constant value, when all other assets seem to have an altered valuation from the ongoing operations of the company. Indeed, Goodwill is a more fundamental asset of the company than it is current defined, as the company is almost never without such Goodwill in its current operations – and should therefore be reported with a better standard that reflects such constant engagements directly for the company.

Further that at times, when the value of a company unit increases with respect to the market, it does so without any effect of reducing or consuming the Goodwill, and when at others, that the Goodwill was indeed consumed for such reduction of market value, certainly seems to be an unfair and ambiguous relationship for the reader of such statements. By such differentiation of reporting standards, the reader of the financial statements, is not certain in developing a consistent perspective for Goodwill, that is essential for the reader and the market to have a constant valuation for such companies. Indeed, for the same company, the consumption value of Goodwill is inherently undetermined when the performance of a particular allocated unit, varies over time, and to expect a consolidated view for an itemized Goodwill, almost becomes humanly impossible.

Certainly, there maybe common scenarios when a company unit performs better in a subsequent year, attributed to better trade facilitation through Free Trade Agreements, or reduction in barriers or duties, that directly is not related to any such inherited Goodwill, however that the improvement of performance is allocated to a validated Goodwill, that is opposed when the unit does not improve performances, is certainly not consistent for a reader of the statements. That the current standards for reporting Goodwill, allows for such developments inconsistent for the reader, should certainly require to be improved. When a unit performs better, is always attributed to existing Goodwill, is not providing adequately for such a consistent reporting environment, when alternatively, it necessitates that Goodwill is consumed when the unit under-performs.

IV-a. Material Mis-statements

A material mis-statement in company financial statements may occur when a stated item in company accounts, is mis-informing for the reader of the statement. This may happen when a particular item is allocated a figure more than it materially affects the company. Goodwill, as an item in the company balance sheet, is certainly subjected to such analysis for mis-statements, and by virtue of it being categorized as a non-current asset or as an intangible item, still does not discount any further elements for analysing the accuracy of the reported numbers.

In the current format, the acceptable standard being that the acquired Goodwill is an item as a non-current asset, and also that the value initially allocated to it does not have to necessarily change over the financial years, makes the reading of such Goodwill in the company accounts, an ambiguous and unresolvable value for readers of the company statement. When Goodwill exists as an asset, and that the company had specifically gained this financially valuable asset upon acquisition, it certainly makes an item of Goodwill a ‘high value’ item to most readers of the company statement. Here, having such existing ambiguity in accounting for Goodwill, introduces the added risk of a Material Mis-Statement in company accounts.

Current Reporting Standards

Consolidated Statement of Financial Position

	<u>31/12/2020</u>	<u>31/12/2019</u>	<u>31/12/2018</u>
<i>Non-current Asset</i>			
<i>Goodwill</i>	100	100	100
<i>Other Tangible Assets</i>	500	300	400
<i>Property, Plant Equip</i>	1000	1200	1500
<i>Current Assets</i>			
<i>Inventories</i>	1000	2000	1500
<i>Investments</i>	1500	1200	2000

To a reader of the financial statement, whilst all other values of Current and Non-current Assets are dynamic and keeps changing over time, this dynamism to have a void or null effect in conjunction with a representatively affected value of Goodwill, seems to become ambiguous. Further, whether and how much of the changes values of assets, should be allocated due to Goodwill and what measures of discounts should be applied to the represented items, is certainly unclear.

That Goodwill exists and affects current business operations, is the acceptable fact by both the preparer and reader of the financial statement, however, a figurative representation of Goodwill, that clearly states that it does affect the existing operations, remains unresolved by such standards.

Indeed, to the reader of the statements, the implication of such Goodwill representation may suggest several interpretations including:

- a. Goodwill value could have varied over the year, but was recovered to the current value due to subsequent improved performance.*
- b. Goodwill value is a fixed and parked asset for the company, that is never accessed.*
- c. Goodwill value had changed to a higher or lower value, but was re-allocated from some other unit, or through some other financial adjustments.*

To the reader of the statement, the current standard does not clarify and inform adequately, which one of a,b or c conditions that the company had used to represent this value of Goodwill in the company statements.

Therefore, a Material Mis-Statement would occur as such conditions are un-confirmed or doubly represented in the company statements. That the stated value of Goodwill could represent any of the above conditions, without any further information, would cause such a condition of a Material Mis-Statement to the readers of the statement.

V. Suggested Improvements

The core issues of the deficiencies in the current standards of reporting for Goodwill, can be defined as :

1. Inconsistent application of Goodwill for company operations
2. Appropriate representation of Goodwill consumption

Accordingly, efficiency for the reported Goodwill can be improved for better understanding of the reader of such statements by :

- a. Introducing consistency in Goodwill as an Asset
- b. Conditions by which Goodwill is consumed as a resource

For a company to acquire Goodwill and to be able to park it as a non-current asset is a general reason why such further complications may arise from such accounting methods.

It can be observed that when a company acquires any asset, it does either of the two options for the company :

Option 1

Induct the Asset into existing Assets of the company

Option 2

Apply the Asset for company operations

For Goodwill as an acquired asset, it should also be expected that either of the two outcomes as is with all other assets, is its true and full eventuality. Currently, Goodwill not having any standard or requirement to meet with such characteristics of other assets of the company, causes a deficiency in the presentation of financial statements.

It is therefore suggested that the standard for accounting Goodwill in company statements, are qualified further to be accounted for, using either of the above two methods.

V-1. Asset Induction - Inducting Goodwill with existing Assets

Post acquisition and in the operations of the combined business, the acquired Goodwill is present universally for the business. From standard business activities such as purchasing, production, selling and accounting activities, the business is already operating with this Goodwill that is applicable irrespective of any other instance, such a point-in-time, particular engagements or any specific defined operation for the company. Hence, such Goodwill is like an addition to the 'Brand Value' of the acquiring company, that operates in conjunction and simultaneously with the previous Brand Value pre-acquisition.

$$\text{PreAcquisition Brand Value} + \text{Goodwill} = \text{PostAcquisition Brand Value}$$

However, the Pre-Acquisition Brand Value was built upon the existing operations of the company that is operationalized using the existing assets for the company. Indeed, a failure in the operations,

allocated to the deterioration or subjective failure of an operating asset of the company, would conceivably reduce the existing Brand Value, or the equivalent existing Goodwill of the company in its market. If the company sells such a reduced value or faulty goods or services in the market, its corresponding Brand Value or Goodwill will be reduced as customers would gradually stop purchasing such faulty goods and services. Hence, the existing Brand Value of the company is a predecessor to its acquired Goodwill, that it further actuates upon a business combination. Also, as such Brand Value is clearly and almost completely dependent on existing Assets of the company, it is almost pre-configured that any further actuation of such a Brand Value would consist of further application of existing assets of the company.

So, on the basis of a pre-existing Brand Value of the company, the acquired Goodwill can be allocated as:

		Existing Asset 1
Existing Brand Value	<i>Uses</i>	Existing Asset 2
		Existing Asset 3
Goodwill	<i>Increases</i>	Existing Brand Value
		Existing Asset 1
Goodwill	<i>Improves</i>	Existing Asset 2
		Existing Asset 3

Hence on the application of Goodwill, the existing asset values would increase by a factor of the Goodwill that is used by the particular asset.

Existing Value of Assets (including Brand Value) - Pre-Acquisition

	<u>31/12/2020</u>	<u>31/12/2019</u>	<u>31/12/2018</u>
Non-current Assets			
<i>Property, Plant and Equip</i>	1000	1200	1500
Current Assets			
<i>Inventories</i>	1200	1500	1800

Existing Value of Assets (including Brand Value) – Year of Acquisition

	<u>31/12/2020</u>	<u>31/12/2019</u>	<u>31/12/2018</u>
Non-current Assets			
<i>Property, Plant and Equip</i>	1000	1200	1500
<i>Goodwill</i>	500		
Current Assets			
<i>Inventories</i>	1200	1500	1800

Updated Value of Assets (Actuated Goodwill) – Post Acquisition

	<u>31/12/2022</u>	<u>31/12/2021</u>	<u>31/12/2020</u>
Non-current Assets			
<i>Property, Plant and Equip</i>	1400	1500	1000
<i>Actuated Goodwill</i>	50	50	
<i>Total Property, Plant and Equip</i>	<u>1450</u>	<u>1550</u>	<u>1000</u>
Current Assets			
<i>Inventories</i>	1200	1500	1800
<i>Actuated Goodwill</i>	50	50	
<i>Total Inventories</i>	<u>1250</u>	<u>1550</u>	<u>1800</u>
<i>Goodwill</i>	300	400	500

As Goodwill improves the value of Assets for the company, it is fairly expected that the appropriate allocation of such Goodwill is actuated and implemented in the accounting for such affected assets of the company in the following years, and whilst it would be reasonable to have a lifespan for this acquired Goodwill.

For this :

- a. In the Year following acquisition, the Goodwill value is actuated by a certain amount.

- b. This actuated value is allocated to the existing assets of the company, to reflect its improved valuations post-acquisition.
- c. The maximum number of years that the Goodwill can exist is taken to be 10 years.

V-1-a. Actuation of Goodwill

In the year of acquisition, the Goodwill value would be a non-current asset, as the acquired Goodwill is newly introduced into the company operations.

However, in the subsequent years, this acquired Goodwill is assumed to be of some value to the existing operations of the company.

In this automatic actuation of Goodwill by the company, it should be accounted for by allocating such actuations appropriately to its existing assets for operations. So, if the company uses the actuated Goodwill, in a certain ratio as per the assets, this ratio should be used to calculate the actuated Goodwill for this asset in the process of accounting for the Goodwill in subsequent years.

$$\text{Goodwill used in Subsequent Year 1} = 10\% \text{ of Acquired Goodwill ... (x)}$$

So, this value of 'x' is then re-distributed amongst the Assets that would have been affected by such acquired Goodwill, and which corresponds to the already existing Brand Value of the company pre-acquisition.

V-1-b. Allocation of Goodwill

The actuated value of Goodwill is then allocated per ratio to the list of assets that are affected by Brand Value.

Pre-Existing Brand Value Allocations

Brand Value is dependent on Asset 1 by 50%

Brand Value is dependent on Asset 2 by 50%

Hence,

Post-Acquisition Goodwill Allocation

Goodwill Allocation to Asset 1 = 50% of x

Goodwill Allocation to Asset 2 = 50% of x

It is important to note that the sum total of Assets of the company post acquisition, including the value of acquired Goodwill, remains the same, as effectively amortized or impaired, however, that this acquired Goodwill is being used by the company, as per the expectations of the reader of the

statement, is adequately and appropriately reflected by its allocation to the affected list of Assets. This adds to the value of the information that is provided in the financial statements, to the reader of such statements.

i. Existing Standard – Amortized or Impaired

	<u>31/12/2022</u>	<u>31/12/2021</u>	<u>31/12/2020</u>
Non-current Assets			
<i>Property, Plant and Equip</i>	1000	1200	1500
<i>Goodwill</i>	300	400	500
Current Assets			
<i>Inventories</i>	1200	1500	1800
Total Assets	2500	3100	3800

ii. Suggested Standard

	<u>31/12/2022</u>	<u>31/12/2021</u>	<u>31/12/2020</u>
Non-current Assets			
<i>Property, Plant and Equip</i>	1000	1200	1500
<i>Actuated Goodwill</i>	50	50	
<u><i>Total Property, Plant and Equip</i></u>	<u>1050</u>	<u>1250</u>	<u>1500</u>
Current Assets			
<i>Inventories</i>	1200	1500	1800
<i>Actuated Goodwill</i>	50	50	
<u><i>Total Inventories</i></u>	<u>1250</u>	<u>1550</u>	<u>1800</u>
<i>Acquired Goodwill</i>	300	400	500
<i>Actuated Goodwill</i>	100	100	0
<u><i>Residual Goodwill</i></u>	<u>200</u>	<u>300</u>	<u>500</u>
Total Assets	2500	3100	3800

It can be noted that for consistency, the year of acquisition (2020 in the above example), the acquired Goodwill is completely residual and is un-actuated. However, in the subsequent year (2021), the total value of Goodwill is the sum of the residual and actuated value, which is taken to be the amortized or impaired value of the acquired Goodwill. The sum of the acquired and actuated Goodwill for the subsequent years, is the same as the acquired value of the previous year. This is consistent with any method of amortization or impairment, where the allocation of the reduction can be observed by the reader of such statements.

V-1-c. Lifespan of Goodwill

As with all assets of a company, the value of Goodwill should reasonably be allocated a lifespan that can be applied for the benefit of the company. As Goodwill is a novelty that is acquired by the business combination, it cannot be reasonably assumed by the reader of such statements, that this Goodwill will have an infinite lifespan. Realistically, when a company is acquired due to better technology, product or market, this novelty is gradually absorbed into the company, and can be expected that at a future point in time, that the company has completely absorbed and actuated such novelty and advantages, and has no further benefits that can be derived from this business combination. To assume otherwise, that the company has inherited any infinite lifespan Goodwill, would suggest that the company is unable to absorb such advantages as an existing benefit, and should therefore not be of any informational value for the benefit of the company, to readers of such a statement.

In the digital age, and with the developing digital economies globally, a realistic lifespan of an acquired Goodwill should be 10 years. Within this 10 year maximum lifespan, the company has to actuate this acquired Goodwill, or risk losing it at the end of such term.

V-2. Asset Application - Applying Goodwill with existing Operations

A second method for actuating the acquired Goodwill is by applying it to current operations of the company. It can be inferred that due to any added ability in the form of this acquired Goodwill, may fairly be expected to have an impact on its existing operations, where the company maybe able to perform its operational activities more efficiently than previously, hence appreciating its existing operations by this value of acquired Goodwill.

As a result, the company should be able to reflect this in its current reports of operational performances.

V-2-a. Allocation of Goodwill

Similar to the method of Asset Induction, the acquired Goodwill is identified to be affecting certain operational activities of the company, due to which there would be an allocation in operational value.

Goodwill used in Subsequent Year 1 = 10% of Acquired Goodwill ... (x)

This allocated value of 'x' is at the discretion of the company, as per how much of such acquired Goodwill, it would have successfully applied in its operations.

Also, this value of 'x' is again allocated per ratio to the existing operations of the company that are affected by such acquired Goodwill.

Post-Acquisition Goodwill Allocation

Goodwill Allocation to Operational Activity 1 = 50% of x

Goodwill Allocation to Operational Activity 2 = 50% of x

V-2-b. Actuation of Goodwill

A company would report this actuated Goodwill in its operations, in the reports that provide a statement on such operational activities.

i. Existing Standard

31/12/2021 31/12/2020

Operating cash flows before movements in working capital

<i>Decrease/(increase) in inventories</i>	1000	1200
<i>Decrease/(increase) in trade and other receivables</i>	1200	1500

ii. Suggested Standard

31/12/2021 31/12/2020

Operating cash flows before movements in working capital

<i>Decrease/(increase) in inventories</i>	950	1200
<i>Actuated Goodwill</i>	50	
<u><i>Net Change in Inventories</i></u>	<u>1000</u>	<u>1200</u>
<i>Decrease/(increase) in trade and other receivables</i>	1150	1500
<i>Actuated Goodwill</i>	50	
<u><i>Net Change in Trade and Receivables</i></u>	<u>1200</u>	<u>1500</u>

Accordingly, in the Balance Sheet Statement :

	<u>31/12/2021</u>	<u>31/12/2020</u>
Non-current Assets		
<i>Property, Plant and Equip</i>	1200	1500
Current Assets		
<i>Inventories</i>	1500	1800
<i>Acquired Goodwill</i>	400	500
<i>Actuated Goodwill</i>	100	0
<u><i>Residual Goodwill</i></u>	<u>300</u>	<u>500</u>
<u>Total Assets</u>	<u>3000</u>	<u>3800</u>

Using this method, the company transfers the acquired Goodwill to operational purposes, and whilst the value of Current Asset reduces, it is however, accounted for by an allocation towards the operational Cash Flow that is generated due to this acquired Goodwill, that would not have occurred had this Goodwill not be applied to the existing operations of the company.

Hence, with this method, a company can clearly state to the readers of the financial statement, that indeed, the acquired Goodwill is operational and is contributing towards the added cash flow for the company, an assessment that would be highly regarded by the readers of such statements, as opposed to such Goodwill being a parked Non-Current Asset, as is per current standards.

V-2-c. Lifespan of Goodwill

The lifespan of acquired Goodwill should be set to 10 years, as is consistent with the method of Inducting Goodwill, and as per the market expectations in the digital economy.

VI. Summary

The current deficiencies in accounting for Goodwill are identified to be:

Key Issues:

- a. Itemizing Goodwill as a Parked Non-Current Asset
- b. Indefinite and inconsistent Lifespan of Goodwill as an Asset
- c. Insufficient allocation and actuation of Goodwill

Suggested Resolutions:

It is suggested that Goodwill be allocated and actuated using either:

i. Asset Induction Method

Characteristics:

- i.a. Brand Value is identified and allocated to existing Assets
- i.b. Goodwill is consumed at a rate per year
- i.c. Consumed Goodwill per year is realized to existing Assets per Brand Value allocations
- i.d. Maximum Lifespan of acquired Goodwill is taken to be 10 years

ii. Asset Application Method

Characteristics:

- ii.a. Operational Activities affected by Goodwill are identified
- ii.b. Goodwill is consumed at a rate per year
- ii.c. Consumed Goodwill per year is allocated to realization in the identified Operational Activities
- ii.d. Maximum Lifespan of acquired Goodwill is taken to be 10 years

Using such methods, the reader of financial statements would derive better value from the information provided, when Goodwill exists as an acquired Asset for the company in a business combination.