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ACCOUNTING REGULATIONS FOR GOODWILL IN AN EMERGING COUNTRY- THE CASE OF ROMANIA

Theoretical article

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Abstract

The International Accounting Standards Board (IASB) has been promoting a worldwide accounting harmonization and convergence project for more than a decade now with the declared purpose to increase comparability of financial information worldwide. We conduct a historical and chronological analysis of the evolution of the Romanian accounting and audit regulations and their comparability to the international standards, following a period of more than two decades, post-communism until today. Romanian regulators have adopted many changes of the accounting regulations in a short period of time, moving from the International Accounting Standards (IAS) partial adoption, to the European Union (EU) directives, to International Financial Reporting Standards (IFRS). These changes have had an impact on the listed companies which have applied them.

Introduction

The IASB has been promoting a worldwide accounting harmonization and convergence project for more than a decade now. The major declared purpose of this project is the need to increase global comparability of financial information. In recognition of this need, the Financial Accounting Standards Board (FASB), the EU and many other countries around the world have joined the IASB to adopt convergent standards of accounting. Albu et al. (2011) note that the implementation of the IFRS by so many emerging countries may be seen as means to gain a sign of legitimacy from the developed countries, as is the case for ex-communist countries, which are on the way to modernization.

This paper we will focuses on the particular case of Romania, which is an emerging country that emancipated from a 42 year communist regime in December 1989. We will discuss the particular case of accounting for goodwill evolution in the context of the entire accounting system evolution of Romania. There are two main reasons why we chose to discuss the case of Romania: the objective reason, also addressed by Ionascu et al. (2007) and Albu et al. (2011), is that Romania offers a unique setting of accounting evolution, which transitions several influences over a relative short period of time; the subjective reason is that we are personally interested to acknowledge how our country has managed, via accounting, to move forward from a closed economy to international exposure, and how the topic of our interest- goodwill- has been dealt with in a chronological order.

The Evolution of Romanian Accounting Regulations for Goodwill

The first accounting law in Romania was passed in 1991, Legea contabilităţii Nr. 82/ Accounting Law No. 82. The regulations for its implementation were released in 1993, under the Regulament Nr. 704 de aplicare a Legii contabilitatii Nr. 82/1991/ Government decision No. 704 for the implementation of the Accounting Law No.82/1991. The rules and regulations promoted by these laws were inspired by the French accounting legislation, which is first justified by the need to move away from Russian and communist influences and second, by a strong historical bond which Romania shared with France prior to the communist regime. More reasons why Romania would choose the French model of accounting are given by Feleaga (1992) and they are related to a significant relationship Romania shared with France at an economic, political and social level. The French model had a powerful influence in the period in between the two World Wars and continued to be a model of reference after the communist regime had fallen. Adopting the French model was an attempt to reflect that Romania would detach from communist rules and regulations.

Government decision No. 704 defines goodwill as:

> ”an asset which is not recognizable anywhere among other asset, but sustains maintenance and development of a company’s potential such as: customers, prime commercial location, market share, reputation and other intangible elements and is recorded in the books under a separate account.”

This definition is given from a bottom-up perspective, it considers what elements may be included in goodwill and stresses that it is a separate asset and it will be booked under its own separate account.

Next, the abovementioned law provisions that the value of goodwill is determined as the difference between the consideration given and the total value of assets which are acquired. No mention is given whether the result of the difference is positive or negative. The law does not provide any indications of the possibility of negative goodwill arising.

An interesting observation made in the law is that goodwill is not usually amortized, even if this accounting treatment is provisioned for other assets. Should any irreversible depreciation happen, then amortization can be a solution to write-off that goodwill. No other indication of an accounting treatment is provided.

A detailed attention is directed to the bookkeeping of goodwill, which is usual in Romanian regulations, as an increased importance is given to bookkeeping. The goodwill account is debited with the value of acquired goodwill or, given the case, with the value of capitalized goodwill. The account is credited with the value of sold goodwill and with the value of amortized goodwill.

A next phase in the Romanian accounting evolution, as Ionascu et al. (2007) identify, happens between 1996 and 2001 when the Romanian government modernizes the law for compliance with the World Bank and International Monetary Fund (IMF) requirements. With regard to the large companies, the Romanian government issued Ordinul Ministrului Finantelor Publice (OMFP) Nr. 94/2001 pentru aprobarea Reglementarilor contabile armonizate cu Directiva a IV-a a Comunitatilor Economice Europene si cu Standardele Internationale de Contabilitate/ Order of the Minister of Public Finance (OMPF) No. 94/2001 for the approval of accounting regulations harmonized with the Fourth European Directive and the International Accounting Standards. The paradox of the OMPF 94 is obvious from the title for two reasons. First, the law attempts to harmonize the Romanian standards with the EU Fourth Directive (Romania was accepted as a member of the EU in 2007, and for years before was negotiating acceptance, which is why the government specifically mentioned the phrase "harmonized with the Fourth European Union Directive" (the Romanian Government had contracted several loans from the World Bank which conditioned Romania to adapt accounting regulations to international standards), even though they had been initially adopted from the French, which already complied with EU requirements. Second the law attempts to also harmonize Romanian accounting standards with IAS (The Romanian Government had contracted several loans from the World Bank which conditioned Romania to adapt accounting regulations to international standards), at a time before 2005, when the EU hadn't decided on adopting the international standards. The IASs were on Anglo-Saxon influence, Ionascu et al. (2007), and they were different than the EU directives. But the government was actually trying to achieve two objectives using the same tool: to be accepted as a EU member and to follow through the World Bank and IMF's conditions for the contracted loans. The actual provisions in the OMPF 94 with regard to goodwill were more harmonized with the IAS rather than the Fourth Directive. Goodwill is defined in the context of a business combination in the same way as cited above in the Government Decision No. 704.

The differences arise where valuation of goodwill is concerned. OMPF 94 provisions that goodwill is an intangible asset and that it represents the excess of the acquisition cost over the fair value of the net total identifiable assets and liabilities purchased, at the date of the acquisition. Clearly this method of valuation is copied from the IAS 22, because there is no mention in the Forth Directive of any of the elements included in this valuation: fair value, acquisition date, net total identifiable assets and liabilities in the definition.

Another fortunate development of the OMPF 94 was the introduction of the negative goodwill concept. Negative goodwill is defined as any excess, at the acquisition date, of the total fair value of the assets and liabilities acquired over the cost of the acquisition. Negative goodwill was to be recorded as profit. Naturally, a new account was introduced for the book keeping of negative goodwill. The other accounts for keeping positive purchased goodwill were kept unchanged.

Further, the OMPF 94 also introduced the concept of internally generated goodwill. The standard denies the possibility to record internally generated goodwill because of precarious means of correct valuation, but it admits that companies generate their own goodwill, without it being accounted for.

The specified accounting treatment for goodwill was again matching the IAS 22. Goodwill was systematically amortized over its useful life, but for no longer than 20 years. Disclosure of acquired goodwill and the choice for amortization period are required in the Notes to the financial statements, for the first time.

We find it interesting and remarkable that in 2001 Romania managed to have such a coherent standard for goodwill, regardless that it was introduced under the pressure of the World Bank to stimulate the favorable conditions of the economy. Ionascu et al. (2007) mention that an experiment was conducted which included 13 volunteer companies, which were audited by a Big Five company, and that their financial statements had positively changed when they switched from the old Government decision No. 704 to OMPF 94.

In 2002, the Romanian regulator issues Ordinul Ministrului de Finante Publice (OMFP) Nr. 306/2002 pentru aprobarea Reglementarilor contabile simplificate armonizate cu directivele europene/ Order of the Minister of Public Finance (OMPF) No. 306/2002 for the approval of simplified accounting regulations harmonized with European Directives. Companies that did not meet the quantitative criteria of OMPF 94 applied OMPF 306. With regard to goodwill, this regulation requires that goodwill be amortized for the entire period of its useful life, without establishing any margins for the period.

The last phase in the development of the Romanian accounting regulations, identified by Ionascu et al. (2007), begins in 2005 and we believe is ambiguously ongoing. The OMPF 94 was replaced by the Romanian regulator in 2005 with Ordinul Ministrului Finantelor Publice Nr. 1752/2005 pentru aprobarea Reglementarilor contabile conforme cu Directivele Europene/ Order of the Minister of Public Finance No. 1752/2005 for the approval of accounting regulations according to the European Directives. The OMPF 1752 was deliberately adopted to bring Romanian accounting principles closer to the EU directives than to the IAS, at a time when the major political, strategic and economic priority in Romania was the adherence to the EU. The new regulation, with concern to goodwill, was a step back from the previous standard.

Purchased goodwill is an intangible asset, which is expected to arise upon consolidation and it is measured as the difference between the cost of acquisition and the net assets acquired. Amortization remains the required accounting treatment for goodwill. The time period allowed for amortization changes, from a maximum of 20 years to a maximum of five years, according to the Fourth Directive, moving away from IAS provisions.

There is no significant change in the book keeping required, the negative goodwill account is kept active, even though the standard does not makes any reference to how negative goodwill may arise.

There is no mention of internally generated goodwill.
Disclosure is required, in the Notes to the financial statements, for choice of the amortization period and the reasoning attached to the choice. The valuation process for goodwill and minority interests has to be disclosed in the Notes as well.
The OMPF 1752 was released in 2005, the year when the EU joined the IASB and FASB in their project for the harmonization and convergence of the accounting standards. In 2005 the EU required member states to apply the IFRS provisions for all publicly traded companies. Consequently, this meant that the Romanian listed companies would have to prepare a double set of financial statements, in order to comply with the national and the EU regulations at the same time. A study conducted by Tiron and Ratiu (2010) on all companies listed on the Bucharest Stock Exchange between 2006 and 2008 reveals small percentage of companies reporting according to IFRS regulations by Romanian listed companies.
In 2009, the OMPF 1752 was replaced with Ordinul Ministrului Finantelor Publice Nr. 3055/2009 pentru aprobarea Reglementarilor contabile conforme cu Directivele Europene/ Order of the Minister of Public Finance No. 3055/2009, which was mostly issued to regulate accounting provision for individual accounts, Albu et al. (2011). Although the new requirements do not significantly change from OMPF 1752, for goodwill they are a mid-ground between OMPF 1752 and OMPF 94.
Goodwill was similarly defined, but using the concept of fair value, which had been excluded by the OMPF 1752. For the first time a rule for the recognition of goodwill is presented in the OMPF 3055. According to the new regulations goodwill is recognized into accounts upon complete or partial transfer of the assets and liabilities, measured at fair value, regardless if the transfer is a consequence of an acquisition or a merger. The opinion of a professional certified evaluator is required to establish the fair value of the assets and liabilities transferred.
Negative goodwill is given a lengthy consideration in OMPF 3055. According to the new regulations, negative goodwill can be recorded in the profit and loss account under two circumstances: one, the difference between the acquisition price and the fair value of the assets acquired is negative due to an unfavorable situation of the acquiree or because of future costs which the acquiree may addition to the business combination or if it corresponds to bargain purchase. Before negative goodwill is recognized into accounts a careful evaluation of the acquired identifiable assets must be made, so that overvaluation of the assets or undervaluation or the liabilities does not occur.
OMPF 3055 reintroduces internally generated goodwill concept, which remains unaccounted for, again, justified by a missing proper instrument for its valuation.
The accounting treatment for goodwill according to OMPF 3055 was kept unchanged from the OMPF 1752, at a five year amortization period. Disclosure requirements asked companies to justify the selected period for amortization, which could be extended across the five years to a maximum of the useful life of goodwill, on condition that valid justifications are provided in the Notes to the financial statements. Disclosure also required detailed information on the valuation of goodwill and non-controlling interests.
The bookkeeping for goodwill did not stand for any modifications in OMPF 3055.

Conclusion

Romanian regulators have adopted many changes of the accounting regulations in a short period of time. An early adoption of the IAS, before EU had even considered making the transition from EU Directives to IAS/IFRS has proven to have increased the association between market returns and earnings and the reforms and definitely increased the timeliness of earnings up until 2001, (Filip, 2010). Another empirical study conducted on Romanian companies around the same change of regulation in 2001, documents a decrease in the cost of capital, derived from other benefits: increased transparency, lower information asymmetry, lower risk, (Mihai et al., 2011). A study conducted by Baltariu and Cirstea (2012) reveals, based on a sample of companies listed on the Romanian main stock exchange market, that even though legislation is harmonized with the IFRS to a high degree, de facto companies do not apply IFRS provisions with regard to goodwill in their financial statements. Surely the impact of such studies' findings would be appealing to regulators and other financial information users.
In conclusion, accounting for goodwill in particular, the changes have simply followed one international trend or another, as mainly dictated by politics and derived interests. We believe it is reasonable to assert that isolated, the changes in accounting for goodwill have not had a major impact on the market to the day, as the merger and acquisitions activities in Romania, which are the primary generators of goodwill, are not yet extremely influential.

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