

Goodwill Estimation and Value Relevance of Accounting Information

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ABSTRACT

This study investigated goodwill and value relevance of accounting information. The study is motivated by the extraordinary worry of stakeholders since mid-1990s that the shortfall of portion of intangibles on the asset reports has prompted the decay of the nature of accounting information. The study adopted cross sectional time series data from 2012-2019 across eight manufacturing firms. The secondary data gathered were analyzed using multiple regression analysis. The result shows that there is a negative relationship between goodwill recognition and value relevance of accounting information and therefore the goodwill recognition does not increase the value relevance of accounting information. It was also revealed that there is a negative relationship between goodwill amortization and value relevance of accounting information and goodwill amortization has an insignificant effect on value relevance of accounting information, therefore goodwill amortization does not increase the value relevance of accounting information. The result further showed that there is a positive relationship between impairment of goodwill and value relevance of accounting information and impairment of goodwill has an insignificant effect on value relevance of accounting information, therefore the impairment of goodwill increases the value relevance of accounting information but not significantly. It was concluded that recognizing goodwill in financial reports can either increase or decrease share prices thereby increasing the value relevance of accounting information. It was recommended that the firms should place much emphasis on information regarding goodwill recognition and amortization but focused more on impairment as an asset in the financial statements.

1. Introduction

Reporting of intangible assets has been an age long issue and a complex hitch largely due to difficulties in obtaining reliable estimates of value for these assets, despite their increasingly significant role in strengthening firm value. As a result, the complexities in their underlying economics, most intangible investments fail to meet the asset recognition criteria outlined in traditional financial reporting systems (Lev, 2001; Wyatt, 2001; Hartini, 2001; Hellman 2021). Goodwill forms paramount part of business combination and is therefore reported in the account statement of an organization. Goodwill according to IFRS 3 (Business Combination) is referred to as intangible asset with an indefinite life annual impairment review.

Maldani (2012) affirmed goodwill to be surplus of the value of acquisition above the acquirer's motive in the fair value of identifiable assets and liabilities. Goodwill as a future

economic benefit also arises from the assets that are not proficient of being individually identified or separately recognized Muteanu *et al* (2012). The accounting and recognition of goodwill has been a contentious issue over time but its usefulness in financial reporting cannot be over emphasized (He *et al* 2016).

Goodwill is a resource which addresses the future monetary advantages that emerges from different resources gained in a business mix that are not independently distinguished and perceived independently. Goodwill is estimated as the sum paid to procure a business in overabundance of the reasonable worth of its net recognizable resources (Anderson *et al* 2011). While some accounting scholars characterize goodwill as buildup of a bigger resource, which insinuates speculation, subsequent to being separated into its recognizable parts (Colley & Volkan, 1988; Johnson & Petrone, 2015). Other accounting scholars, be that as it may, consider goodwill as its fundamental part which incorporates things, for example, a buy premium for things not perceived in the assertion of monetary position (Giuliani & Brännström, 2011; Henning *et al* 2000; Higson, 1998; O'Sullivan 2019). The distinction as respects the feelings on the idea of goodwill has additionally made the distinction in assessment in regards to the acknowledgment and estimation of goodwill.

Albeit the acknowledgment and divulgence of goodwill in budget reports have been significant for clients (Ji & Lu 2014; Oliveira *et al.* 2010; Sahut *et al.* 2011), the interest is reasonable given that in 2008, the IFRS 3 presented unmistakable prerequisites for stating goodwill estimation, just as its estimation therefore, which varies substantially from past revealing guidelines on goodwill (Eloff & De Villiers, 2015; Shahwan, 2004; Wines *et al* 2007). Specifically, the ensuing treatment of goodwill in understanding to as per IFRS 3 no longer necessitates that goodwill be efficiently amortized over a recommended period. The standard just recommends resulting hindrance testing. The ensuing accounting medicines for goodwill notwithstanding, are set apart with immense intricacies, both from a specialized and critical viewpoint (Bepari *et al* 2014). This structures part of the long-standing discussion on a suitable resulting estimation of goodwill (Bepari & Mollik 2017; Hamberg & Beisland 2014; Oliveira *et al.* 2010).

Therefore, the essence of financial statements is to communicate to users of accounting information the true and fair operating performance, during a specified period and the financial position at the end of the period. In any case, the discounting of a portion of the intangibles as expected by the required standard in the pay articulation twists reality and reasonableness of the working exhibition and the monetary situation also which becomes deluding in that capacity. Moreover, this might bring about shortcomings in the portion of assets in the capital market and significant expense of funding to the organizations. There is in any case, an extraordinary worry since mid-1990s by the Regulators, Practitioners, Academia and different Stakeholders, that the shortfall of a portion of these intangibles on the asset reports has prompted the decay of the nature of accounting information as clear in the wide expanding hole between the book values and market upsides of the organizations in this new economy period. One more proof of the deficiency of nature of accounting information is the decrease in the goodwill significance of the accounting information. Likewise, the ensuing accounting information for goodwill are, in any case, set apart with immense intricacies, both from a specialized and critical viewpoint (Fatima & Robert 2017). This normally prompts the appraisals being dependent upon the executive inclination, vagueness and prudence, which are available to manhandle and have prompted various corporate embarrassments (Wines *et al.* 2007). Consequent upon this, the specific objectives of the study aspire to investigate recognition, amortization and impairment of goodwill on the value relevance of accounting information. Questions and hypothetical statement were

developed to address the stated objectives.

2. Literature Review

2.1 Recognition and Accounting for Goodwill

Paradigm shift from focusing on tangible assets to intangible assets not recognized in financial statements has challenged the decision relevance of information provided by financial reporting systems. The not too long corporate failures in numerous advanced countries have highlighted the necessities to review provisions of relevant information to investors (Bontis, 2000; Richard *et al* 2021). Assets that are generally defined as non-cash assets without tangible actuality. These are frequently classified either as identifiable or unidentifiable. It includes patents; trade-marks; license; brand names; mastheads; and copy rights. Although they are valuable to the business, they cannot be individually measured with acceptable levels of reliability. As such, this composite asset is titled goodwill (Deegan, 2008).

From an accounting perspective, goodwill is thus part of the cost of a business combination and consists of the premium an entity pays on top of the book value of the entity at the moment it is acquired. Whether goodwill is perceived to be an asset can be measured through the research of the relation between a firm's value and its capitalized goodwill. In case investors use goodwill in their valuations, tested by performing a regression analysis on firm value and capitalized goodwill, they perceive goodwill to be an asset useful for the determination of a firm's value (Bepari & Mollik, 2017). A positive relation between equity worth and goodwill is found by Jennings *et al.* (1996), indicating investors perceive goodwill as a valuable economic resource which creates impending economic benefits and thus represents economic value (Van Hulzen *et al.*, 2011, Luis 2019).

More evidence on a relation between goodwill and equity value is provided by Chen *et al.* (2004) and Churyk and Chewning (2003). Evidence of increased value relevance as the result of adopting SFAS 142 in 2002 is provided by Chen *et al.* (2004). It revealed that more value-relevant information is furnished by reported goodwill after adjusting for impairments. Churyk and Chewning (2003) also found favorable relations amid equity values and recognized goodwill (Van Hulzen *et al.*, 2011). According to Spacek (1964), capitalization and subsequent amortization are arbitrary and understate net income. Therefore, a better treatment would be to write off goodwill immediately against retained earnings. More arguments are being brought forward for this treatment, such arguments emphasize the difficulty of measuring goodwill and thus suggest to expense goodwill immediately at a subcomponent of the assets of new firms; they include knowledge and employee's development (Richard *et al.*, 2021). Goodwill would be inappropriately measured if as future economic benefits if its measurement is not reliable. However, goodwill is perceived to be an asset which needs to be observed on the statement of financial position by most accounting regulation bodies and investors.

2.1.1 Goodwill Amortization

Numerous academic articles have been written on the accounting for goodwill. However, said literature is predominantly on research with respect to the standard issued by the FASB, SFAS 142. It appears that research on IFRS 3 is much less present. The differences in these standards seem to be minimal and are not specifically relevant for the research questions addressed in this study. Margaret (2021) affirmed that goodwill amortization is a technique that is adopted to diminish the intangible assets (goodwill) over a set period of time. Most

academic literatures on goodwill amortization largely dwell on IFRS 3; however, the value relevance of amortization of goodwill is however still in doubt to several scholars. Goodwill amortization is gradual decline of value of intangible assets in a conventional manner over a given certain period in a consistent manner (Ross *et al* 2019). It thus being refer to as expensing off goodwill within a specified period of time.

2.1.2 Impairment of Goodwill

The method of accounting for goodwill impairment is only effective for a limited number of years. Margaret (2021) examined perceptions of financial analysts of the accounting for goodwill under IFRS and more specifically the concept of goodwill impairment testing. During late 2012 and early 2013. Impairment is an expense charge when the carrying amount of goodwill is greater than its fair value (Ellof & De Viller 2015).

2.1.3 Quality of accounting information

The process for the Preparation and Presentation of Financial Statements was introduced by the International Accounting Standards Board (IASB) during 1989. It was eventually adopted in April of 2001 (IASB, 1989). The framework's intent was to provide guidance for the devising of accounting standards. The four principal qualitative characteristics are understandability, relevance, reliability and comparability. The IASB states that useful financial information must be relevant and a faithful representation what it purports to represent. In order for the information to be useful; its relevance must be for decision making. Information possesses relevance when it aids the economic decisions of users.

2.1.4 Goodwill and Value Relevance of Accounting Information

Prior studies show that purchased goodwill at acquisition is relevant for the market. McCarthy and Schneider (1995) report a significant coefficient on goodwill regardless of what ever measurements the income change variable possesses. Bugeja and Gallery (2006) examined the value relevance of goodwill over time and found out that, even though goodwill is associated with equity values, such association diminishes in two years after the business combination.

2.2 Positive Accounting Theory

This theory was hypothesized by Watts and Zimmerman (1986). The theory clarifies and give motivations to why accounting takes the structure it does and anticipate how accounting changes across general setting. For the most part, firm usefulness and monetary development are factors that are normally thought to be in settling on accounting decision both from sharp and productivity grounds. According to conventional perspective, firm efficiency and financial development is viewed as a result of development in labor and capital (Solow, 1956).

This study is pinned on the positive accounting theory. As indicated by Gaffikin (2005) positive bookkeeping explores center around the thought processes of administrations and controllers in settling on bookkeeping decisions as for business sectors. This is educated by the way that innovation as indicated by Schumpeter (1942) imply diffusing item into the market for essential job of brand value. Hence, they are appropriate for clarifying the connection between theoretical resources and the monetary presentation and position of an association as well as the upper hand and firm worth.

2.3 Empirical Review

Istrate (2013) investigated the value relevance of goodwill and intangible assets in the pre- and postadoption times of IFRS, utilizing 350 UK organizations more than 2002 to 2007. The outcomes showed that goodwill and other intangible assets are value relevant, yet their worth importance didn't increment in the post-reception time frame. He & Stephen (2016) interested in the study Accounting for goodwill: An academic literature review and analysis to inform the debate. The study analyzed academic literature on goodwill reporting based on historical perspective and analysis of literature. Fatima & Robert (2017) carried out a study on the value relevance of goodwill under IFRS 3: A south African context. They used Ohlson model to confirm the recognition of goodwill as an asset. The model revealed carrying amount of goodwill to be value relevance.

Ross *et al* (2019) in their study Goodwill amortization and usefulness of earnings used share earnings value of public companies during a period of 1993 -1998. The study arrived at earnings prior to amortization and distribution of share prices. Hellman (2020) investigated Discussion of accounting for intangible assets: suggested solutions. The study was based on the approach of BLPT and it explained core issues in accounting especially measurement after recognition.

Benjamin (2020) studied audit quality indicators and the timeliness of goodwill impairments: evidence from German setting. Listed firms in Germany from 2006-2013 were used in the study and results indicated that goodwill impairments are not recognized in timely manner. Jose (2020) empirically study Economic effect of goodwill accounting practices. 90 Spanish listed firms between 2004-2011 were used in the study. The study revealed that impairment test in the firms confirmed higher amount of goodwill that didn't recognize impairment loss, thereby increasing ROA and ROE. Richard *et al* (2021) studied accounting for intangible assets: suggested solutions. It revealed in their study that asset recognition must consider effect of measurement in income statement. Tami & Wolfgang (2022) in their study Accounting for R&D on the income statement? Evidence on non-discretionary Vs discretionary R&D capitalization under IFRS in Germany found that reported capitalized R&D is not linked with lower information asymmetry but positively associated with forecast errors.

3. Methodology

Ex-post facto research design was adopted. The study utilized only the secondary source of data; sourced from the annual reports of the sampled manufacturing firms for the years reviewed in the study (2012-2019). 2012 was selected as base year because of the adoption of IFRS that took place in Nigeria in 2012. The population of the study comprises of all 64 manufacturing firms listed on the Nigeria Exchange Group (NXG) as at December, 2020. A non-probabilistic method in the form of judgmental sampling technique was used to select six (6) manufacturing firms. Judgmental sampling technique was used to select manufacturing firms that have available and adequate data for the purpose of this study. The Ohlson valuation model of Enggar (2013) to examine the book value of equity per share and earnings per share-on-share prices which reflects the value relevance of accounting information stated thus:

$$P_{it} = b_0 + b_1BVPS_{it} + b_2EPS_{it} + e_{it} \dots \dots \dots eqn 1$$

BVPS = Book Value of Equity per Shares; P_{it} = Share price at the end of the period; EPS = Earnings per share; b = Regression coefficients; e = Error term.

Modifications were made to the model.

Modification:

$$P_{it} = b_0 + b_1BVPS_{it} + b_2EPS_{it} + b_3GR + b_4GA + b_5GI + e_{it} \dots\dots\dots eqn\ 2$$

By definition:

BVPS = Book Value of Equity per Shares

Pit = Share price

EPS = Earnings per share

GR = Goodwill Recognition

GI = Goodwill Impairment

GA = Goodwill Amortization

b = Regression coefficients

e = Error term.

A priori expectation is that these variables will have positive effects on share price

4. Data Analysis and Discussion of findings

4.1 Descriptive Statistics

The evaluated variables include goodwill recognition (GR), goodwill impairment (GI), goodwill amortization (GA) while value relevance was represented by share price (Pit). From the table 1, it was observed that most variables are significantly dispersed, except Pit with wide dispersion. The significant dispersion of the variable is obviously as a result of the heterogeneity of the cross-section i.e., a significant fraction of the total distribution is within a confidence level of 99.9% while less is within 68% confidence level.

For this purpose of this study, the probability of skewness and kurtosis suffice to adjudge if the variables are normally distributed or not. The probabilities of the two statistics for the selected variables are not normally distributed as the P-values are significantly lower than 5% level of significance, owing to the heterogeneity of the distribution. Therefore, the null hypothesis that the variables are not normally distributed is rejected in favour of the alternate.

Table 1: Descriptive Statistics

	GR	GI	GA	PIT
Mean	0.666667	0.145833	0.083333	37.93575
Median	1.000000	0.000000	0.000000	6.000000
Maxiumum	1.000000	1.000000	1.000000	230.0000
Minimum	0.000000	0.000000	0.000000	0.900000
Std.Dev.	0.476393	0.356674	0.279310	67.17690
Skewness	-0.707107	2.006957	3.015113	1.857037
Kurtosis	1.500000	5.027875	10.09091	4.83249
Jarque-Bera	8.500000	40.44755	40.44755	173.2893
Probability	0.014264	0.000000	0.000000	0.00000
Sum	32.00000	7.000000	4.000000	1820.916
Sum Sq. Dev.	10.66667	5.979167	3.666667	212098.6
Observations	48	48	48	48

Source: Author's Computation, 2021

4.2 Correlation Matrix

The pairwise correlations among the selected variables are presented in Table 2. This helps

to assess individual relationship, and serves a preliminary test of multi-collinearity. Empirically, no two variables are totally devoid of a degree of correlation (no zero correlation regardless the variables are substantially unrelated). It, however, becomes problematic if the coefficient is significantly higher than 0.50 or 50%. The correlation coefficients of the variables are lower than 0.5 or 50%. Hence, the distortionary effect of multi-collinearity to the structural model through an understated or overstated standard error is less likely.

Table 2: Correlation matrix

	GR	GI	GA	PIT
GR	1.000000			
GI	0.292174	1.000000		
GA	0.053300	-0.124584	1.000000	0.000000
PIT	-0.709475	-0.214797	0.020487	1.000000

Source: Author's computation, 2021

4.3 Goodwill Estimation and Value Relevance of Accounting Information

Data analysis and estimation were obtained employing the panel data regression model over the investigated period of 2012 to 2019. Goodwill recognition, goodwill impairment and goodwill amortization were used as explanatory variables for the study. Value relevance represented by share price was used as dependent variable for this study. The empirical result of the model is shown in the Table 3.

The F-statistics probability value of 0.0000 for both random and fixed effect models shows that both models are valid for drawing inference since they are both statistically significant at 5%. It disclosed that R^2 for which the coefficient of determination is 0.655738. It explains that the variation occupied in share price is 65.5738%. That is, the explanatory variables could only explain 65.5738% of change that occurred in share price.

In testing for the cause-effect relationship between the dependent and independent variables in the table stated above, the two widely used panel data regression estimation techniques (random effect and fixed effect) were adopted, it presents the two panel data estimation techniques results (fixed effect and random effect). The results revealed the difference in coefficients, signs and the number of insignificant variables. The estimation of the random effect considers that the error term and explanatory variables are correlated while estimation of the fixed effect panel regression was based on the assumption of no correlation between the error term and explanatory variables. In selecting from the two panel regression results, the Hausman test was conducted and the test revealed that random effect is more preferred to fixed effect. A look at the p-value of the Hausman test (0.0000), implies that we should accept random effect relationship at 5% level of significance.

Table 3: Regression Results of Goodwill Estimation and Value Relevance of Accounting Information

Variable	Coefficient	Random Effect	Fixed Effect
GR	-57.12607 (0.0013)	-47.07329(0.0000)	-4.047961(0.7552)
GI	1.872285 (0.9168)	2.448639 (0.7342)	-1.334398 (0.8605)
GA	2.945734 (0.8938)	-9.834540 (0.2515)	-10.67197 (0.2653)
Hausman Test	0.0000		
F statistics	-	14.91326 (0.000000)	78.70380 (0.000000)
R squared	0.655738	0.639690	0.955099

Source: Author's Computation, 2021

4.4 Discussion of Findings

The result provided in Table 3, with the p-value of 0.0000 and t-statistics value of -7.937362, the coefficient of - 47.07329GR showed a negative effect of goodwill recognition on the value relevance of accounting information of the selected firm while its p-value 0.0000 showed a significant effect of goodwill recognition on the value relevance of accounting information. The value of the R^2 stood at about 63.9 percent; this implies that the explanatory variables explained approximately 63.9 percent variation in value relevance of accounting information. Therefore, the null hypothesis was rejected and the alternate hypothesis was accepted based on 5% significance.

For the second hypothesis, with the p-value of 0.2515 and t-statistics value of -1.162855, the coefficient of -9.834540GA showed a negative effect of goodwill recognition on the value relevance of accounting information of the selected firm while its p-value 0.2515 showed an insignificant effect of goodwill recognition on the value relevance of accounting information. The value of the R^2 stood at about 63.9 percent; this implies that the explanatory variables explained approximately 63.9 percent variation in value relevance of accounting information. Therefore, the null hypothesis that amortization of goodwill has no effect on the value relevance of accounting information of listed Nigerian firms. was accepted and the alternate hypothesis was rejected based on 5% significance.

Regarding the third hypothesis, with the p-value of 0.7342 and t-statistics value of 0.341874, the coefficient 2.448639GI showed a positive effect of goodwill recognition on the value relevance of accounting information of the selected firm while its p-value 0.7342 showed an insignificant effect of leverage on audit report lag. The value of the R^2 stood at about 63.9 percent; this implies that the explanatory variables explained approximately 63.9 percent variation in value relevance of accounting information. Therefore, null hypothesis was accepted and the alternate hypothesis that the impairment of goodwill has no effect on the value relevance of accounting information of listed Nigerian firms. was rejected based on 5% significance.

5. Conclusion and Recommendations

The findings from this study show that goodwill does not significantly affect share prices and it's less likely to increase the value relevance of accounting information in listed manufacturing firms in Nigeria. The findings from this study are based on the positive accounting theory. The positive accounting theory suggest that the report of accounting information in financial reports can either increase or decrease share prices thereby increasing the value relevance of accounting information. Based on the findings of these research, goodwill information released in financial reports does not bring about increase in the value relevance of accounting information except where there is impairment of such

goodwill. It was recommended that the firms should place too much emphasis on information regarding goodwill recognition and amortization but focused more on impairment as an asset in the financial statements. However, information regarding impairment of goodwill should be provided as investors place attention as to whether there is reduction in the goodwill of the firm and as it increases the value relevance of their accounting information, although, not significantly.

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