MUCH ADO ABOUT NOTHING

Many directors and their advisers believe that goodwill amortisation discourages takeovers because of its adverse effect on the offeror's share price due to lower reported earnings per share. The implication of this view is that the basic concept of valuations – that value is the present value of all future cashflows – is somehow lost on investors when it comes to pricing shares.

Clearly, this is not the case. The Securities Institute of Australia's 1995 survey of 200 analysts and fund managers shows that goodwill amortisation does not have a significant effect on pricing in either the primary or secondary markets. The survey had a 56 per cent response rate and represented $134 billion of funds under management in Australia.

The SIA survey shows that the widely held perception that investors incorrectly price securities because of goodwill amortisation is misconceived. Professional investors generally adjust the profit and loss for the effects of goodwill amortisation. This adjustment occurs regardless of the method of goodwill amortisation adopted.

By adjusting for the effects of goodwill amortisation, investors are saying that provided takeover decisions are made on rational financial grounds, share prices of offerors should not be adversely affected.

It is to be hoped that the survey results will put to rest the longstanding and often heated debate in Australia about the amortisation of goodwill. In reality, the question of which, if any, goodwill amortisation method should be used is a non-issue. Since, according to the survey, 86 per cent of professional investors generally add back goodwill amortisation when making investment decisions, there is little point in arguing over the method of amortisation.

From an accounting-standard perspective, it is incorrect to say that Australia has "the toughest goodwill standard in the world". Goodwill has to be amortised under accounting standards prevailing in all the major capital markets. While some countries, such as the US, allow more generous amortisation periods for goodwill, the reality is that other relevant accounting standards in those countries (eg, the requirement to amortise all intangible assets such as brand names, licences, mastheads, prohibitions on revaluations, etc) are much tougher than Australia's.

THE SIA SURVEY SHOWS THAT THE WIDELY HELD PERCEPTION THAT INVESTORS INCORRECTLY PRICE SECURITIES BECAUSE OF GOODWILL AMORTISATION IS MISCONCEIVED.

On balance, the Australian standard on goodwill is not significantly different from its international counterparts. Indeed, the most recent International Accounting Standard requires a five-year amortisation period with longer periods in appropriate circumstances, capped at a maximum of 20 years.

The SIA survey also showed that:

- 82 per cent of institutions and analysts believe Australian companies use the goodwill standard to manipulate reported results; and
- 66 per cent of institutions and analysts believe that company reporting practices reduce the value of reported results.

There is a clear message in these statistics that companies which adopt "aggressive" accounting policies risk engendering a degree of market scepticism (with its inevitable adverse impact on the company's share price) which may outweigh the benefit, if any, of those policies.

Accounting requirements should not override rational economic decision-making. If a takeover makes good economic sense, directors should not avoid making an offer because of an accounting standard requirement that has no effect on corporate cashflows.

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JASSA welcomes readers' views on matters of importance to the securities industry.