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Abstract

The purpose of the present paper is to examine the concept of goodwill in the context of national accounting. Goodwill, being originally business accounting concept, was incorporated into the SNA in its 1993 version as a category of intangible non-produced assets, though Japanese national accounts have never included it. The SNA 2008 introduced a composite category called goodwill and marketing assets and included it in the list of non-produced non-financial assets. By recognising that goodwill is just essentially net worth (as a national accounting concept) with the sign reversed, it may be very natural to ask whether it is necessary or not for national accounts. This paper gives an answer to the question negatively and seeks to show that national accountants can deal with business acquisition fully reasonably without the concept. Some facts from business accounting history about the concept may bring insight into problems involved.

(146 words)

Note: Among his many debts, the author is grateful to Dr Aki Yamauchi, an ex-colleague of the author and a business accounting specialist. Discussion with her on the business accounting treatment of goodwill was of great help for him to improve the paper.

1. Introduction

Goodwill is a business accounting concept that is used in national accounts as well, though this concept has never been included in Japanese national accounts.

Business accountants would understand that the concept of goodwill is defined in national accounting in the same way as in business accounting by reading the following citation from the SNA¹:

Potential purchasers of an enterprise are often prepared to pay a premium above the net value of its individually identified and valued assets and liabilities. This excess is described as “goodwill” ... (2008 SNA paragraph 10.196).

In the current SNA, a composite category called *Goodwill and marketing assets* is introduced, which includes marketing assets such as brand names, mastheads, trademarks, logos and so on as well as goodwill. The description of this composite item is as follows:

The value of goodwill and marketing assets is defined as the difference between the value paid for an enterprise as a going concern and the sum of its assets less the sum of its liabilities, each item of which has been separately identified and valued. Although goodwill is likely to be present in most corporations, for reasons of reliability of measurement it is only recorded when its value is evidenced by a market transaction, usually the sale of the whole corporation. Exceptionally, identified marketing assets may be sold individually and separately from the whole corporation in which case their sale should also be recorded under this item (2008 SNA paragraph 10.199).

Here, special attention should be paid to the meaning of the term “liabilities.” In the citations above, as business accountants understand the term, it is defined excluding shares and other equity issued by the enterprise to be acquired. However, when national accountants define net worth as the value of all the assets owned by an institutional unit or sector less the value of all its outstanding liabilities, they regard shares and other equity as liabilities. ²

¹ Three versions of the SNA will be referred to in this paper. They are United Nations (1968), Commission of the European Communities et al. (1993), and European Commission (2009), which are often referred to as 1968 SNA, 1993 SNA and 2008 SNA, respectively.

² It may be easily understood by taking a glance at Table 13.1 in the 2008 SNA, for example.

Thus, the term “liabilities” is given two different meanings in the current, 2008 version of SNA. In defining goodwill (and marketing assets) as described above, shares and other equity are excluded from the list of liabilities (say, business accounting concept of liabilities). On the other hand, when net worth is defined in the context of national accounting, shares and other equity are included in the list of liabilities (say, national accounting concept of liabilities).³

By comparing the two concepts, goodwill and net worth (in the context of national accounting)⁴, you can find a close relationship between the two. That is, in the case of a corporation just purchased and merged by another corporation acquiring the whole equity.

$$\begin{aligned} & \text{Net Worth (national accounting)} \\ & = \text{Assets-Liabilities (business accounting)-Equity (issued)}^5, \\ & \text{and} \\ & \text{Goodwill} = \text{Equity (issued)-[Assets-Liabilities (business accounting)]}, \\ & \text{therefore,} \\ & \text{Goodwill} = -\text{Net Worth (national accounting)}. \end{aligned}$$

Then, a natural question may be whether the concept of goodwill is necessary or not in the SNA as it is just *net worth with the sign reversed*.

The purpose of the present paper is to examine the concept of goodwill in some detail. The above question will be answered negatively. It will be shown that national accountants can deal with business acquisition fully reasonably without this concept.

The present paper is organised as follows. The next section is devoted to business accounting history concerning the concept of goodwill as some facts from the history may bring insight into challenges we face. Four theories of, or views on, goodwill in business accounting context will be surveyed, on the basis of which, for example, it will be examined whether the introduction of the newly arrived category “goodwill and marketing assets” may be considered to be reasonable or not.

In the third section, the treatment of goodwill in the SNA will be described more fully. In doing so, several important considerations will be made clear. It will be shown that “internally generated goodwill” another business accounting concept

³ Note that in United Nations (1977), the balance sheet version of the 1968 SNA, liabilities except shares and other equity are called “third-party liabilities” while equity including shares is called “second-party liabilities.”

⁴ The term “net worth” is used in business accounting as well, though in the context of business accounting, the list of liabilities excludes shares and other equity. The net worth formulated this way may be called business accounting concept of net worth.

⁵ Equity owned is included in the list of assets in both accounting systems.

is not adopted in the SNA (as well as in any business accounting standard) and goodwill is recorded only when a business (or part of it, as in the case of Sony Corporation's selling its VAIO-PC business) is traded, so it is called "purchased goodwill." In addition, we will go through topics such as amortisation/impairment issues, problems related to the treatment of transfer costs involved with the business acquisition, etc. It should be noted that in this stage, the rationale for the concept of goodwill itself will not be challenged.

In the fourth section, the focus will be the rationale of the business accounting concept of goodwill in the national accounting framework. It will be shown that business acquisition may be fully reasonably and more naturally described by regarding it as the purchase of equity rather than the acquisition of goodwill. It may be noted that a business or part of it to be acquired may be regarded as a quasi-corporation if not a fully incorporated business. (Purchased) goodwill is, after all, just a *token* of the fact that the business experienced a business acquisition in the past. Finally in this section, a very interesting relationship between the concept of net worth and Tobin's Q, a macroeconomic concept, will be examined.

Finally, conclusions will be drawn and proposals will be put forth.

2. Four theories of goodwill: An historical perspective

According to Yamauchi (2010), historically, there have been four views on "goodwill" as a business accounting concept. They are: 1) intangibles theory of goodwill; 2) super-profit theory of goodwill; 3) residuals theory of goodwill; and 4) synergy theory of goodwill. They will be taken up in turn. For the sake of convenience, in what follows, historical cost valuation often found in business accounting will be totally ignored. Instead, the valuation at current prices including valuation at current replacement cost will be presupposed.

1) Intangibles theory of goodwill

When an economic entity acquires a business (incorporated or unincorporated), it may pay a sum of money that exceeds the amount of the tangible and intangible assets it owns net of related liabilities, if any. This excess amount of money was, according to this theory, deemed to be the sum of the value of "intangibles" unidentified including, among others, customer loyalty in the current business terminology. This type of payments was legally recognised and established at latest late 19th century and called "goodwill." A

well-known remark “(the goodwill is) nothing more than the probability that old customer will resort to the old place” was made by Lord Eldon in 1810.⁶ More (1891: 282) writes:

We all know – in a general way at least – what Goodwill is. It is, I take it, just another name to designate the patronage of the public.

Thus, the continued patronage of customers including the factor of location was considered to be the essential elements of goodwill in the 19th century. However, by the early 20th century, various items such as good business management (if the old management is retained), excellent reputation, monopolistic privileges, trademarks (if not separately traded), knowhow unidentified, and favourable attitudes toward the firm on the part of employees as well as bankers and investors⁷ came to be recognised to be intangibles involved in goodwill.

That is, the value of goodwill G may be expressed as the sum of the values of intangibles $I_j (j = 1, 2, \dots, n)$;

$$G = I_1 + I_2 + \dots + I_n .$$

It should be stressed that in the 19th century, enterprises were seldom acquired by purchasing their shares in the organised stock exchange. So, it was necessary to evaluate the business itself without resort to market evaluation of it. However, for valuation purposes, it may not be so helpful to assume that the value of goodwill must be the total value of intangibles involved. Moreover, it should be noted that part of the value of goodwill recorded could be allocated to one or more than one item (tangible or intangible asset item) in the balance sheet. For example, as stated in Hendriksen (1977: 438), a favourable location means that the land and buildings are worth more than similar property elsewhere.

2) Super-profit theory of goodwill

Dealing with the question “How the goodwill attaching to a business may be valued as between a willing seller and a willing buyer?” ⁸some accountants purported to find another seemingly better definition of goodwill by the early 20th century. Thus, among others, Grendlinger (1925:166) writes as follows:

Good-will has been defined as that intangible quality of patronage which attaches to an established business and is presumed to continue, irrespective of

⁶ As cited in Yang (1927: 28).

⁷ Concerning the three categories of goodwill, consumer’s goodwill, industrial goodwill, and financial goodwill, see Yang (1927: 41-56) for example.

⁸ This question can be found in More (1891: 284).

any change of ownership. Perhaps, a better definition would be that good-will represents the present worth or capitalised value of the estimated future earnings of an established enterprise in excess of the normal results that it might be reasonably assumed would be realized by a similar undertaking established anew.”

The term “super-profit” is due to Leake (1914: 82). In fact, he defines goodwill as follows:

Goodwill, in its commercial sense, is the present value of the right to receive expected future super-profits, the term ‘super-profits’ meaning the amount by which future revenue, increase, or advantage, to be received, is expected to exceed any and all expenditure incidental to its production.”⁹

A pioneering contribution by More (1891:285)¹⁰ gives a very simple numerical example:

A trading company with tangible assets, the full going value of which is ascertained to be £100,000, and suppose it is earning, and is likely to earn, eight per cent., or £8,000 a year, I would say that the total price should not exceed the value of the tangible assets, viz., £100,000, because no more than an ordinary return is being got.

But suppose the concern is earning, and is like to earn, thirteen per cent., or £13,000 a year, then I think a fair price might be seven annual payments of the extra £5,000, or a present payment of £26,030, being the amount of seven annual payments of £5,000, less eight per cent. discount. In this case, the price would be the above £100,000 plus £26,030, or together, £126,030.

Why thirteen percent? The P&L statement of the firm may provide some information needed. Why seven years? While this may be a matter of negotiation between the buyer and the seller, it may be understood that it was taken for granted that goodwill should be depreciated (or amortised). For, the superior earning power was considered to decline over time, say, due to competition.

Note that this definition is not contradictory to the older, intangibles theory of goodwill. In fact, Yang (1927: iii), maintaining basically the older theory, sought to show

⁹ It should be understood that such expenditure includes a normal return to capital invested. See Bloom (2008: 28).

¹⁰ More’s paper was revised and published as More(1900-01) as well and the latter was reprinted and included in Lee (1984). According to the introductory note in the reprinted version(p.65), “More’s contribution represents a scholarly paper, well ahead of its time- the usual practice for valuing goodwill being a multiple of total profits minus the valuation of tangible assets (a practice which More did not favour).”

that the value of intangibles is essentially an expression of the superior earning power of the specific concern. However, it may be stressed that the two theories are logically independent though some argue that goodwill in the super-profit theory is just a measurement concept.

3) Residuals theory of goodwill

The residuals theory of goodwill appeared in the early 20th century and came to be established in the second half of the century. According to this theory, goodwill may be defined as the excess of the value of the business as a whole over the valuations attaching to its individual tangible and intangible net assets. ¹¹

The residuals theory is considered to be originally due to Canning (1929:42-43). He preferred to regard goodwill as “a master valuation account.” He wrote: “Goodwill, when it appears in the balance sheet at all, is but a master valuation account.” That is, goodwill is the balancing item for the sub-account which appears in the balance sheet when a business combination occurs. So, naturally, goodwill becomes a “catch-all” item. More importantly, he also wrote: “It cannot under any circumstances be called an ‘asset.’”

This definition of goodwill is considered to be important in that it is adopted by international and national business accounting standard setters including Accounting Standards Board or ASB, the predecessor of which is Accounting Standards Committee or ASC, in the United Kingdom among others. In fact, ASB (1997: para.2) defines (purchased) goodwill as “difference between the cost of an acquired entity and the aggregate of the fair values¹² of the entity’s identifiable assets and liabilities.”

At the same time, it may be noteworthy that this definition is quite generally accepted when the concept of goodwill was first introduced in the System of National Accounts in its 1993 version. Until then, the SNA lacked the concept of goodwill. No less important is the fact that by the second half of the 20th century the number of incorporated businesses had increased drastically and acquiring businesses by purchasing the outstanding shares in the stock exchange came to be quite a usual way of doing so. In fact, MacNeal (1939: 233) wrote: “The total value of a business as a whole is best expressed by the price of its equities in the market place.”

¹¹ This definition is found in Hendriksen (1977: 43-59).

¹² According to the 1982 version of IAS 16(IASC (1982)), “Fair value” in the context of business accounting may be defined as the amount for which an asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm’s length transaction. Here, IAS is an abbreviation for International Accounting Standards and IAS 16 is for Property, Plant and Equipment.

However, as to the above three views on goodwill, Hendriksen (1977: 435-369) remarks as follows:

The attempts (...) to provide goodwill with semantic interpretation have basically failed. Furthermore, little or no evidence has been found to indicate that the reporting of goodwill provides relevant information for investors or creditors in their decision making. Because goodwill lacks real-world interpretation and cannot be measured independently, it should be omitted from financial statements. This does not mean, however, that aggregations of resources should not be reported separately from measurement of individual assets. Aggregations of resources may have valuations greater or less than the summation of identifiable parts because of synergism among the resources acquired or with resources already owned.”

4) Synergy theory of goodwill

According to *Oxford Dictionary of English*, “synergy” means the interaction or cooperation of two or more organisations, substances, or other agents to produce a combined effect greater than the sum of their separate effects.

By noticing that (purchased) goodwill is recorded when an event of merger and acquisition occurs, it is not difficult to find that there may be some synergistic effects involved. As Hendriksen suggested, there may also be synergistic effects among a number of asset items in the balance sheet of the acquired enterprise as well as the acquiring firm. Because of this, as Schmalenbach¹³ correctly argued at latest as early as 1910’s, that if resources are tied up in a business, they do not possess individual values. Instead, a collection of resources has only a collective value. The following somewhat long citation is from Schmalenbach (1959: 26).

If a landlord owns ten houses, he can list their values on the assets side of his balance sheet, the liabilities, including mortgages, on the liabilities side, and the result is a balance sheet which shows the value of his capital. The accuracy of this value depends upon accuracy of the individual valuations. This apart, there is nothing wrong with the procedure.

However, if a man owns a business which is made up of buildings, machines, tools, office equipment, stocks, debtors, creditors and more, he cannot arrive at a true value for his capital by means of the above accounting

¹³ Eugen Schmalenbach (1873-1955) is a versatile German academic whose fields include economics, sociology as well as business accounting. Schmalenbach (1959) is an English translation of his famous book *Dynamische Bilanz (Dynamic Accounting)*, which first appeared in 1919 and went through several impressions.

procedure, no matter how the individual values are arrived at; for the value of a business does not equal the total of the values of its individual parts.

The value of business depends upon its suitability for the manufacture or sale of useful things. If a collection of buildings, machines and stocks are needed for this, then there is a collective value. As long as they are tied up in the business they do not possess individual values.

The machines had individual values once, before they were installed, when they still in the hands of a dealer. They can have individual values again, if they are dismantled and sold as used machines. But as long as they are tied up in the factory there can be no talk about individual values.

The synergy theory of goodwill emerged as the newest theory of goodwill in the late 20th century. Thus, Miller (1973: 281) wrote:

The essential characteristics of a system is collection of functioning elements, such as the parts of an automobile engine, that work together as a unified whole because of relationships among the elements of the system. (...) Systems may be most complex. Some are almost incomprehensible as aggregates of elements because interaction of the parts results in synergy.

In recent decades, this new theory made a big step toward winning general acceptance among wider accounting circles. Many authors, including Ma and Hopkins (1988), Johnson and Petrone (19989), and Yamauchi (2010) among others, have contributed to the development of the theory. At present, no one can deny that the measure of goodwill includes synergies in its core component. In fact, Johnson and Petrone (1998: 295-296) proposes the term “core goodwill” that excludes intangibles elements as well as overpayment (or underpayment) due to any valuation error or fire sale and so on but just includes “going concern goodwill” and “combination goodwill.” The former refers to the synergies which may be generated from tying up the assets in the balance sheet of the acquired enterprise and the latter refers to the synergies from combining the two businesses.

Yamauchi (2010:146-157) clarifies that the measure of goodwill actually brought into accounts may include the values of unidentifiable intangibles that are not deemed to be assets in the business accounting standard (human capital, for example) as well as the values of unrecognised intangible assets (certain R&D assets that were recorded as costs incurred as corresponding R&D expenditures were made). Thus, by excluding these values, the purification of the concept of goodwill is possible at least theoretically.

This may be the right place to consider the newly coined composite item “goodwill and marketing assets.” Here, a full description of the term “marketing assets”

is given in paragraph 10.198:

Marketing assets consist of items such as brand names, mastheads, trademarks, logos and domain names. A brand can be interpreted as far more than just a corporate name or logo. It is the overall impression a customer or potential customer gains from their experience with the company and its products. Interpreted in that wider sense it can also be seen to encompass some of the characteristics of goodwill such as customer loyalty.

From the historical point of view we gained, the author is dubious about this treatment even on the presumption that we would accept the concept of goodwill. For, synergies involved in the measure of goodwill and marketing assets such as logos, etc. are so different to be wrapped up in an item.

Understanding goodwill as synergy is not contradictory with the residuals view on goodwill as the latter could be seen as a measurement concept. However, as noted earlier, the central claim in Canning (1929) is that goodwill is not an asset, which does not seem to be shared with advocates of synergism.

3. Treatment of goodwill in the SNA revisited

1) The introduction of the concept of goodwill in the 1993 SNA and challenges confronted

As noted earlier, 1968 version of the SNA (the 1968SNA as well as United Nations (1977) as the balance sheet version of the 1968SNA) lacks the concept of goodwill. It was its 1993 version that introduced the concept for the first time though it is somewhat different from that in the 2008 SNA. What follows is from paragraph 12.22 in the 1993 SNA:

When an enterprise is sold at a price that exceeds its net worth, this excess of purchase price over net worth is the asset “purchased goodwill.”

However, this definition cannot be applied to the purchase/sale of a corporation if the definitions of liabilities and net worth are to be retained through the system. In fact, in the 1993 SNA, purchased goodwill was necessarily calculated differently depending on whether the business to be acquired was an unincorporated enterprise or a corporation. The followings are also from the same paragraph:

Two cases must be distinguished. For the sale/purchase of an unincorporated enterprise not treated as a quasi-corporation, the purchased goodwill represents the excess of the purchase price of this enterprise over its net worth (derived from its separately identified and

valued assets and liabilities). ... For the sale/purchase of a corporation or quasi-corporation, the purchased goodwill represents the excess of the purchase price of its shares and other equity over their value just prior to the sale/purchase.

Accounting procedures for the purchase/sale of incorporated businesses were described in the same paragraph as follows:

This excess enters the balance sheet of the seller of shares and other equity prior to the sale as a revaluation of a financial asset so that the shares and other equity can be sold at their purchase price. At the same time, the purchased goodwill enters the other changes in the volume of assets account as an economic appearance of an intangible non-produced asset and is recorded as such in the closing balance sheet of this corporation or quasi-corporation. The sales and purchases of the shares and other equity are recorded in the financial accounts of the seller and the purchaser.

It seems, quite interestingly, that the 1993 SNA's measure described above could be interpreted as a measure of "combination goodwill," one of the two components of goodwill (synergy) by assuming that the market evaluation of the business just prior to the acquisition is made when information about the acquisition is not yet available to the market players. So, although the measure does not exclude various "errors and omissions" type elements, this measure of goodwill may not be meaningless.

2) The exclusion of internally generated goodwill

With regard to the definition of goodwill in the 2008 SNA cited earlier in the present paper, it may be noted that goodwill is recorded only when a business (or part of it) is actually traded. This type of goodwill is called "purchased goodwill."¹⁴ It is the case with the 1993 SNA version of the concept as well. In fact, according to paragraph 12.22,

Goodwill that is not evidenced by a sale/purchase is not considered an economic asset: the only way that goodwill enters the System is for such a purchase to occur.¹⁵

However, goodwill as defined as the excess of the sale/purchase price of the business over its net worth (business accounting concept) may be conceivable even when

¹⁴ The term "purchased goodwill" may be used in another context in which the amount does not include the minority owners' equity. The 2008 SNA is not so clear about how you can deal with it.

¹⁵ The first half of this sentence may be found in paragraph 12.26 in the 2008 SNA as well.

an actual sale/purchase does not occur, by estimating the sale/purchase value of the enterprise. It may be particularly the case when the incorporated enterprise is listed and its shares are traded in the stock exchange. Goodwill in this case may be called “internally generated goodwill.” Business accounting standards uniformly rule out the concept. In fact, for example, Ma and Hopkins (1988: 84) described the concept as “Alice-in-Wonderland” type accounting concept. The SNA in its 2008 version exclude the concept as well.

The third chapter of Bloom (2008) gives an excellent account of how goodwill write-up was temporarily condoned and brought anomaly into the accounts in the early 20th century before the Depression era and how non-recognition of internally generated goodwill was established in the United States after the period.

3) Negative goodwill

According to the definition of goodwill in the 2008 SNA, it may be understood that goodwill may well be negative. And in fact, the 2008 SNA accepts that the measure of goodwill can be negative. What follows is from paragraph 12.33:

The value (of goodwill) may be positive or negative (or zero). By its calculation and designation as an asset of the enterprise, the net worth of the enterprise at the moment it is bought is exactly zero, whatever the legal status of the enterprise.

The treatment of negative goodwill in business accounting standards varies. Regarding it as profits seems to be a typical response to the situation by business accountants. From what is cited, again, it may be known that goodwill + net worth (in the sense of national accounting) = zero.

4) Appearance of goodwill in the accounts and amortisation/impairment:

According to paragraph 12.34 in the 2008 SNA, the recording of the appearance of goodwill (and marketing assets) will be made as follows:

The value of purchased goodwill and marketing assets is calculated at the time of the sale, entered in the books of the seller in the other changes in the volume of assets account and then exchanged as a transaction with the purchaser in the capital account.

The entries are as follows. Goodwill and marketing assets first appear in the balance sheet of the seller via the other changes in the volume of assets account. The entry is an economic appearance of a non-produced non-financial asset. Then the disposals (acquisitions) of the item are recorded in the capital account of the seller (the purchaser)

as “disposals (acquisitions) of non-produced non-financial assets.” And then, goodwill and marketing assets are recorded in the closing balance sheet of the purchaser.

Next step is to record the amortisation of the asset in question. What follows is from the same paragraph:

Thereafter the value of the purchased goodwill and marketing asset must be written down in the books of the purchaser via entries in the other changes in the volume of assets account. The rate at which it is written down should be in accordance with commercial accounting standards. These are typically conservative in the amount that may appear on the balance sheet of an enterprise and should be subject to an “impairment test” whereby an accountant can satisfy himself that the remaining value is likely to be realizable in case of a further sale of the enterprise.

Business accounting rules concerning amortisation (and impairment tests) varies over time, as well as from country to country. Thus, while IFRS (International Financial Reporting Standard) prohibits the amortisation and requires the implementation of a impairment test at least once a year, a regular amortisation of goodwill over its economic life (20 years at longest) is mandatory in the Japanese business accounting standard. However, to enhance international comparability of business accounting records, voluntary application of the IFRS rules started from the consolidated fiscal years ending on or after March 31, 2010 in Japan. It may be worth mentioning that business circles in Japan claimed that the application of the IFRS rules to financial reporting would further M&A by Japanese companies.

Nevertheless, some business accounting specialists in Japan now argue that the application of the IFRS rules will make some accounting figures including profits in addition to goodwill itself rather unstable over time. Thus, if national accountants have no choice but to depend on business accounting records to estimate goodwill figures in national accounts, it should be understood that the figures will be highly volatile and country-to-country comparability may be quite doubtful.

In any case, the 2008 SNA stipulates the use of an amortisation rule together with an impairment test approach. While the scope of asset items over which the impairment test should be applied is not clear in the above paragraph, a possible criticism against the treatment may be that some elements of internally generated goodwill could be mixed up in the measure because the further sale value may include them.

5) Costs of ownership transfer involved

This point is related to costs associated with the acquisition (disposal) of goodwill. Of course, in the SNA, goodwill is one of the categories of non-financial non-produced assets so that the costs of ownership transfer incurred with regard to the acquisition (disposal) of goodwill are treated as fixed capital formation. However, the acquisition (disposal) of goodwill can be done only through the acquisition (disposal) of a business, while the purchase of the business can be done by acquiring the controlling equity of it.

Because equity is in the list of liabilities in the SNA, the costs of ownership transfer involved with the acquisition (disposal) of equity are treated as intermediate consumption. For example, research costs (including fees paid to financial advisers) about the enterprise to be acquired may be incurred by the acquirer. Are they intermediate or final?

Japanese business accounting standard recently changed its position concerning FA costs. Previously, they were considered part of goodwill, but now they are regarded as current outgoings.

4. How you can do without the concept of goodwill

1) How to record business acquisitions

Regardless of whether the business is incorporated or not, the fact that it is sold tells us that it can be deemed to be at least a quasi-corporate if not a fully incorporated entity.

It is perfectly possible that the business (to be sold) is just part of a household previously. In such cases, it is necessary for the business in question to be reclassified to the corporate sector (from the household sector) prior to the sale/purchase. It is assumed that the household sector has now equity to the quasi-corporate. The equity in question must be introduced into the system via the other changes in the volume of assets account, as an economic appearance of financial assets/liabilities (assets of the household, liabilities of the quasi-corporate). Then, when a business acquisition occurs, sale/purchase of the equity of the business is recorded. The value of the equity in question depends on purchase price of the business that is formerly part of a household.

After the acquisition, the business is merged into the acquiring corporation; therefore the equity will disappear because the issuer of the particular liabilities is merged with the holder of it. The share price of the acquiring entity and hence net worth (national accounting concept) of the corporation may increase or decrease depending on the market evaluation of the acquisition. It seems that there is no room for the entry of goodwill.

2) Purchased goodwill, internally generated goodwill and net worth: T-form presentations

The T-form below shows the B/S account of the business just to be acquired. Suppose that the transaction value of equity is the purchase price of the business to be acquired,

16

Purchased goodwill to be recorded in the account of acquiring business
 = -Net worth (national accounting concept) of the business to be acquired,
 as previously noted.

Assets	Liabilities other than equity Equity Net worth
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The same situation is shown differently in the second T-form.

(-) Net worth=Goodwill	Equity (-) Net worth*
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Let us suppose that an enterprise experienced acquisition once in the past. Goodwill was recorded then and has been written down at a certain previously-determined rate until now. The T-forms below shows the balance sheet of the enterprise in four different ways. The first T-form is a national accounting presentation of the situation, though the tangible-intangible distinction that you may find appearing on the debit side of the accounts¹⁷ ceased to be exist in the 2008 SNA actually. Note that close relationship between (purchased) goodwill and net worth that existed at the time of the acquisition is not retained. In the second T-form, net worth is defined in the fashion of business accounting. It may be understood that the lack of equity data in the account makes business accounts less informative. In the third T-form, the situation involves the write-up of internally generated goodwill. In the fourth T-form, the same situation as the third T-form is presented in somewhat different way.

¹⁶ In the T-forms in this section, asterisk (*) denotes that the item is business accounting concept.

¹⁷ Computer software should be deemed to be tangible except for certain development costs. See Sakuma(2013:564-565).

Tangible assets	Liabilities other than equity
Intangible assets other than goodwill	Equity
Purchased goodwill	Net worth

Tangible assets	Liabilities other than equity
Intangible assets other than goodwill	Net worth*
Purchased goodwill	

Tangible assets	Liabilities other than equity
Intangible assets other than goodwill	Net worth*
Purchased goodwill	
Internally generated goodwill	

Tangible assets	Liabilities other than equity
Intangible assets other than goodwill	Equity
(-) Net worth	
(Purchased goodwill)	
(Internally generated goodwill)	

In the fourth T-form above, net worth that appears with the reversed sign on the left-hand side of the account is defined in a national accounting fashion, but the list of assets excludes purchased goodwill as well as internally generated goodwill. This

form of presentation is somewhat similar to “market capitalisation statement” in Bloom (2008).

From the presentations above, it may be confirmed that it is quite difficult to measure purchased goodwill over time separately from internally generated goodwill. A particular business acquisition brings about a particular synergism which is subject to change over time. This cannot be estimated independently from synergy newly created after the acquisition. Thus, goodwill evidenced by a business combination will be inevitably mixed up with internally generated goodwill. It is net worth (as a national accounting concept) not purchased goodwill that is meaningful.

As already shown, business acquisition may be accounted for more naturally by regarding business acquisition as the purchase of equity rather than the acquisition of goodwill. An interpretation may be that purchased goodwill is, after all, just a token that shows the entity experienced business acquisition in the past. And this token is oblique in a way. For, business acquisition does not necessarily bring about recording of goodwill.

By considering in addition practical difficulties about using business accounting data to estimate comparable figures for goodwill (and marketing assets), the author would like to propose to quit the use of the concept.

3) Tobin’s Q from the viewpoint of synergy

James Tobin, Nobel laureate in economics, devised a ratio called Tobin’s Q, which may be defined as:

$$\frac{\textit{the market value of the firm}}{\textit{the replacement value of the firm's assets}} .$$

Here, the market value of the firm means the total market value of its shares and other equity and the firm’s assets should be understood to be its net worth as a business accounting concept. The original formulation of Tobin’s Q’ may be found in Tobin (1969). Although a prevalent adjustment-cost type of interpretations of the Q theory may be found in Yoshikawa (1980) and Hayashi (1982) among others, his own account of Tobin’s Q may be found in an interview with *The Region*, a periodical issued by the Federal Reserve Bank of Minneapolis:¹⁸

The idea is to think about the productive, physical assets of a company—maybe people think of it as book value of a company—but convert that into the replacement cost of the assets, not the original cost. How much would it cost to buy the assets again, new, off the production line? So, that's one valuation of the

¹⁸ Tobin (1996).

firm.

Looking at it that way, then, there's the market valuation, and one way of having a market valuation would be to have used capital goods markets—used car markets or used house markets. But for many things that's not a practical matter, so we have a used business market implicit in securities markets, stock and bond markets. And that's the ratio. The replacement costs are the denominator, the securities market valuations are the numerator.

Now, you might think that the value of this should be 1, that arbitrage would keep the two valuations the same. If people have a choice, they either buy new, build a new plant or buy another firm that already has a plant, in the securities market. That's one arbitrage. Now, of course, there are going to be deviations from 1, obviously, even if the measurements were precise, which they're not—there would be deviations from 1 because of goodwill or monopoly value or things like that. But at any rate, it is possible to estimate this number on an aggregated basis as well as on a disaggregated basis.

Tobin's Q, as a theory of investment behaviour of a firm, may be most easily understandable by reading the paragraphs cited from Schmalenbach (1959) again. According to the citation, tying up the assets makes synergism. If a positive synergy is generated, investment in these assets may bring gains to investors. Thus, the fact that Tobin's Q >1 may be regarded as a stimulus to investment.¹⁹ In fact, *by deleting goodwill from the asset list if necessary,*

$$\text{Tobin's } Q = \frac{\text{Equity}}{\text{Assets} - \text{Liabilities other than equity}} >1 \text{ or } <1$$

is equivalent to

(-) Net worth >0 or <0.

Noteworthy may be the fact that Tobin suggested goodwill and intangibles may be regarded as disturbing factors to the functioning mechanism of Tobin's Q. In fact, in following the cited paragraphs above, he wrote:

Now, it is true that there may be a change in the ratio between goodwill, human capital, things that are not in the commodity market, that are the basis for the valuation of firms—like Microsoft. Microsoft is not being valued at what it is now because of bricks and mortar and even chips—microprocessors. It is being valued as it is now because it has a kind of monopoly lead based on its

¹⁹ About the Q-theory of mergers, see Jovanovic and Rousseau(2002), for example.

ability to keep innovating and to have its hands on human capital of a superior kind—an organization of a superior kind. So, if that's the case, then the 'q' ratio, which requires a replacement cost calculation in the denominator, is not going to be very informative for telling you about Microsoft. If more of the economy is like that, it's going to be different from what it used to be.

Because intangibles including intangible assets (human capital, copy rights and so on) and tangible assets (machines, farm land, factories, computer software) have different positions in the production process of the firm that ties up these assets, they should be differently treated in the calculation of Tobin's Q. For example, deducting the value of intangibles as well as goodwill from the numerator and denominator may be one possibility.

By deducting the values of other intangibles from the numerator and denominator of the above equation, the measure of Tobin's Q may be improved. That is,

$$\text{Modified Tobin's } Q = \frac{\text{Equity} - \text{the value of intangibles}}{\text{Assets less intangibles} - \text{Liabilities other than equity}}.$$

5. Conclusions and proposals

Conclusions are as follows:

- 1) While there have been different views on goodwill, the synergism viewpoint may be most persuasive.
- 2) The concept of goodwill is not necessary for national accountants and goodwill should be excluded from the list of assets.
- 3) Business acquisition can be dealt with and analysed not by using the concept of goodwill but by using equity (market capitalisation) and net worth as a national accounting concept.

In addition, the present paper showed:

- 4) There is a very interesting relationship between net worth as a national accounting concept and Tobin's Q.

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