Volume **IX**/2019 ISSN 2344-102X
Issue (XIX) / **February** 2019 ISSN-L 2344-102X

THEORETICAL BASES ON THE NATURE OF GOODWILL

Professor PhD. Veronica GROSU
Stefan cel Mare University of Suceava, 720229, Romania
doruveronica@yahoo.it
Ec. Mihaela – Ionela SOCOLIUC
stanciuc_mihaela@yahoo.com

Abstract
Over time, the concept of goodwill has changed significantly: if initially goodwill is considered to be the result of a good and valuable relationship between the business owner and his clients, the current concept is broader because it encompasses more intangible economic factors from company. Thus, using the specialized literature, the purpose of the paper is to provide an overview of the accounting treatment of the goodwill and the relationship between its value and the company's notoriety as well as the effects of the negative goodwill on the financial position of the company.

Key words: *goodwill; value intangible assets; IFRS; the reputation of the company.*

JEL Classification: *M41.*

I. INTRODUCTION

In recent years, especially in the context of the development of the global market and the intensification of the entities consolidation operations, the goodwill has acquired a significant advantage which gives it a greater importance and materiality in the total assets of an entity (Cosmulese, 2018). So, the problem of recognizing and evaluating intangible assets, for which we have tried to point out some defining elements, continues to provoke controversy all the more since, in a society marked by competition and change, the estimation of the future benefits generated by investments depends less on their material or immaterial nature and more than the characteristics of the market within which they operate (degree of competition, speed of technological changes) (Grosu, Bostan, Socoliuc, Mates, Hlaciuc & Mihalciuc, 2011).

Over time, goodwill has been considered a factor associated with the business synergy phenomenon (Bedford, 1997); from the accounting point of view it has been described as an unidentifiable resource, a generic term that includes several attributes that cannot be directly attributable to an asset, such as: notoriety, customer relationship, strategic location, etc. (Tollington, 1997) and which can be characterized as "an impalpable, intangible, immaterial, abstract, and invisible good" and categorized in vague terms as "advantages, benefits, rights, sources and privileges of a successful business" (Ratiu, 2013: 20).

Nowadays, companies communicate that they are customer oriented (Mulder, 2006), their main assets are employees, the most important thing is innovation and that corporate social responsibility is almost as important as making profit. Indeed, corporate responsibility can also be used as a strategic marketing tool capable of capturing a market niche or ensuring a very good reputation, which will later be rewarded (see http://www.aeca1.org/). Maintaining the reputation is an asset and the risk of losing it, which can be instantaneous and for unexpected reasons, is the main threat to any company and its shareholders.

II. THE EVOLUTION OF THE GOODWILL CONCEPT

Goodwill is the economic value of capital in producing long-term profit, that is, to capitalize on the income that will be generated over time (Zannoni, 2005). The amplitudes of the period, used for evaluation purposes, are extracted from the connection of the annual financial years and are projected throughout the period of complete implementation of a project to create the benefits. The progress of long-term economic profit leads to a more complex notion, represented in fact by the economic value of capital and goodwill.

The economic capital can be obtained from the capitalization of the revenues that will be generated in the future, the goodwill being the result of the same capitalization, but only in relation to the economic profit.

Finally, it can be seen that the way in which the goodwill is rooted and present in the realities of the company, it is widespread in the elements that make up the capital and assets of the company and is realized in the capacity of the production unit, to realize revenues that, nevertheless, are different for each market and for every business or entrepreneurial reality that operates on the market (Mironiuc, 2012: 19).

An entity may be characterized differently, as the algebraic sum of the assets or elements that make up the capital, or understood as an efficient and adequate union to achieve the purpose for which it was formed, that is,

Volume IX/2019 ISSN 2344-102X
Issue (XIX) / February 2019 ISSN-L 2344-102X

the ability to obtain an economic benefit (Horomnea, 2013: 344). In its definition, there is a goodwill when, due to its set of operations and the optimization of management in time, the company established under the conditions of trading on the same market and taking into account the invested capital, can manage to obtain a relatively higher income than the one obtained by other entities that are apparently identical (Bănacu, 2012). That is why there are a lot of factors such as: patents, trademarks, location of the factory or commercial spaces, good relations with customers and staff and many more, which can be attributed to goodwill.

The first British and North American publications contribute to the clarification of the concept of goodwill. Thus the first accounting article regarding the commercial fund quoted in the analyzed literature was published in 1884 (- although the term itself has a much older use, dating from the beginning of the seventeenth century (Harris, 1884). Thus, Leake (1921) makes attempts to explore the nature of goodwill, defining it as "the right that grows out of all kinds of previous efforts in the pursuit of profit, value growth or other benefits."

Each company is therefore the synthesis of a combination of productive factors that are organized by the entrepreneur, in the most efficient way, with his activity and intuition (Socea & Ciubotariu, 2012).

When we refer to the commercial fund, we all think about the clientele and the prestige of the company it has, but this concept can be synthesized as the difference between the value of a company and the value of the individual goods that constitute it. Put more simply, goodwill is a notion that generates income based on a set of assets (Civil Code, Article 2555).

The dictionary textually refers to the word goodwill, as: "the recognized value of an economic company, based on elements such as reputation, turnover and clientele". From this simple definition we can distinguish two basic concepts: goodwill is a recognized value; goodwill depends on the elements that make up an enterprise. Goodwill, simply called an "impetus", is characterized as the ability of a company to make more revenue, financial benefits or profits compared to another company, also to give more value to the complex of assets that make up the company (Encyclopedic Dictionary 98,000 Definitions, 2012: 115, 201).

The term commercial fund is used when evaluating entities that are subject to "merger, divestment, consolidation and even for taxation" operations (Petrescu, 2009: 113). Therefore, goodwill can be defined as an intangible asset that generates future economic benefits resulting from the synergy between identifiable assets, or from intangible assets that do not meet the definition of an identifiable intangible asset (Hoegh-Krohn & Knivsfla, 2000: 245).

Grosu and Socoliuc (2016: 71), define the goodwill as the entity's ability to make a profit, which derives either from specific factors, capable of contributing positively to income, or by increasing the value for the entire set of assets on which the entity holds, in relation to the value related to each individual asset.

In defining and explaining the concept of goodwill, the International Valuation Standards (IVSC, 2018, par. C11-146), which define goodwill as any future economic benefit resulting from an activity of an asset group, are of real help, which is not separable from the entire activity or group of assets.

The goodwill therefore consists of a number of factors that contribute to determining the profitability of the enterprise. For example, reputation, long-term relationships with suppliers, credits in money and financial markets, accumulated experience, tradition of production are the factors that contribute to the formation of capital owned by the company.

In short, goodwill is an abstract, intangible concept, which includes best practices and is included in the company, it is the invisible part that is able to group the individual assets and ensure that they are not producers of any income, but of a higher income, an extraordinary profit, so as to increase the commercial value of the company as a whole.

Some authors consider that the problem of defining and conceptualizing this asset is underestimated, which is why it is not at all surprising that, for an entity, the evaluation, recognition and reporting of information on this subject are chaotic, lacking in importance and credibility (Mates, Anisie & Cosmulese, 2016: 70).

III. The Accounting Treatment Of Goodwill As Stipulated By IAS/IFRS International Accounting Rules And National Accounting Regulations

In accordance with the provisions contained in the regulations of our country, the goodwill indicates that part of the goodwill that does not exist within other patrimony elements, but which participates in maintaining and developing the potential of the company, such as: retail market, clientele, reputation and notoriety and other intangible items, which will be separately disclosed in an intangible assets account.

According to the international accounting regulations IAS 38 - Intangible Assets, only in certain cases a category of expenses are incurred in order to obtain favorable effects in the future. There are many cases where the expenses presented as a contribution to the internally generated goodwill are not recognized as assets, because they cannot be considered as identifiable resources that are controlled by the company so that they can be reliably evaluated (IAS / IFRS , 2015, IAS 38, par. 2). Therefore, in accordance with IFRS (IAS 38 and IFRS 3 - Business

Volume IX/2019 ISSN 2344-102X
Issue (XIX) / February 2019 ISSN-L 2344-102X

combinations), the goodwill will be recognized as an intangible asset only at the date of purchase, provided that a business combination will take place (IAS / IFRS, 2015, IAS 38, par. 3).

In accordance with the categories of intangible assets, regulated by the accounting norms compliant with the European directives in Romania and by the international standard, it follows that the goodwill represents the public opinion on the company located in a certain area, by the company's reputation, by the manufacturing brand, by services or trade, the commercial relations that the company maintains in a certain geographical area, but also the clientele of the respective company. Within an acquisition or combination of undertakings, it is the element that adds value to the goodwill that may exercise a beneficial or less beneficial action on the acquisition cost of the entity.

The identifiable nature of an intangible asset implies that it is "distinguished from goodwill" (IFRS, 2005: 1676). The condition of identifiability is fulfilled if the intangible assets are separable (that is, they can be sold, transferred, authorized, rented or exchanged and the future economic benefits attributable to the respective asset can be distributed, without missing the future economic benefits generated by other assets used within the same activities). At the same time, intangible assets must derive from contractual rights or legal rights of another nature, regardless of whether those rights are transferable or separable from the entity or other rights and obligations. Identifiable intangible assets include patents, copyrights, licenses, customer lists, brand names, software, marketing rights and specialized know-how. The characteristic that these elements have in common is the non-existence of the material, physical substance and the fact that they have a useful life of more than one year (determined or indeterminate).

From an accounting perspective, goodwill appears in the reporting of an entity only when it is acquired through acquisition, being considered an economic resource, of an intangible nature. On the other hand, the values resulting from the application of favorable government regulations, favorable rates related to loans, senior management and good working relationships are examples of non-identifiable intangible assets (Cosmulese, 2018).

Thus, the goodwill not only includes those immaterial and indivisible conditions of the company that allow it to compete in the market, guaranteeing higher profits, but also all the practices implemented to maintain this condition. If the goodwill is present, in almost every company, the opportunity to represent it from an accounting point of view is very different.

The value of goodwill that can be represented in the balance sheet is the difference between the price paid to acquire a business, or a part of it, and the net value of the assets acquired. The difference paid in addition derives from the desire to have higher profits in the future, being represented by a goodwill in the acquired company or in a part of it.

The way in which goodwill generates revenue for the current year, and how it influences future income, is also different. It should not be forgotten, that in order to represent the best values of the company, we must take into account certain accounting rules by keeping the discretionary margins reduced to the body that prepares the accounting in order to avoid the significant distortion of the financial statements. Higher confidence in budgetary values can lead to more efficient market prices, lower capital costs for publicly traded companies or greater opportunities for value creation.

Therefore, goodwill contains in itself a series of practices that allow the company to obtain higher profits, however, when there is a company acquisition and it has a certain value in the balance sheet, it is not easy to quantify how much of the fund commercially acquired contributed to the higher income created. We must recognize that assigning a financial value to each of the intangible value generators can be difficult, but this does not necessarily need to be an argument for abandoning the search to provide meaningful measures for these assets (Cosmulese & Alexandru, 2017: 225).

Depending on the results of the valuation of the assets that support the entity, some questions will arise, for example, whether these assets will have a certain value or can they have a value greater than all the existing assets? What is this difference and to whom is it due? To be brief and objective, we can say that the value of the individual goods that make it up may be less than the value of the company, this result is called goodwill. But not every time the value of the goods can be lower, it is possible that there are situations where it is the opposite, that is the totality of the goods is worth more than the value of the company, this result will be called negative goodwill.

IV. Negative Goodwill And The Effects On The Financial Position Of The Company

In the previous subchapter we presented the positive significance of goodwill, which is a higher income, an extraordinary profit due to the company as a whole compared to other capitals of other similar entities, practically obtaining a profit above the normal one. But there may still be situations in which the company fails to earn a higher income, identical to what happens in times of crisis.

As a result, an enterprise may record a positive goodwill, or a negative goodwill. Negative goodwill occurs when the company is less productive so that its value is less than the current value of the sum of the individual assets that compose it (Zanda, 1974: 222). In these cases, the value of the economic capital seems to be lower than the current value of the equity of the entity (Angiola, 1997). The inability to manage existing resources within

Volume **IX**/2019 ISSN 2344-102X
Issue (XIX) / **February** 2019 ISSN-L 2344-102X

companies repeatedly leads to the recording of losses, expenses higher than the value of incomes that have no compensation in the factors of production and meeting the needs.

When identifying and quantifying the goodwill, whether it is an asset (goodwill) or a liability (negative goodwill), the legal provisions in the field should be taken into account. Thus, the entities that organize and run the accounting according to the accounting regulations in accordance with the European directives, when recognizing the goodwill, they shall apply the requirements of the Order of the Minister of Public Finance no. 1802/2014, with subsequent modifications and completions. In this respect, in order to recognize the negative goodwill, an entity must ensure that the identifiable assets acquired have not been overvalued and the debts have not been omitted or undervalued (Iornache, 2013: 12).

Going back to the term of goodwill mentioned above, it can be stated that the negative goodwill of a company appears when, through the pre-entrepreneurship and relations with internal and external operators (relations with employees, customers, suppliers, relations with funders, etc.), the company fails to make an adequate profit in time, or unfortunately only achieves expenses, i.e. only losses. In this situation, negative goodwill or badwill is precisely the difference that would affect the assets of the entity. It can be considered a profitable business to buy a company with a negative goodwill because the value of the goods is lower than their real value (Yang, 1927). According to IFRS 3 in par. 57, such situations are not really a positive business because they can indicate in some cases the following possible errors:

- over-appreciation of the activity;
- minimizing or omitting certain or even potential obligations;
- incorrect determination of the cost of the company complex.

However, the society as a whole, even if it is on the downside, thanks to the fact that it already works, could have positive intangible values, this being the theory of the value of continuity (Zanda & Lacchini, 1994).

V. CONCLUSION

I believe that the claims that the goodwill is influenced by the economic evolution of the company is closely related to its profit and to the evolution in the market in which it operates, or in other words the higher profits of the entity increase directly in proportion to the value of the goodwill. Basically, it can be noticed that when the economic entities have goodwill, its evaluation depends, essentially, on the possibility of making forecasts as accurate as possible regarding the future revenues, with the help of the data and analysis to which the company has access in the assessment of the economic environment in which it operates, thus managing to rationally predict its evolution. Under these conditions, accounting standards become a normative framework, but also a guide in terms of defining and recognizing goodwill. However, they only prescribe how they should be recorded in accounting, without referring to the empirical result. Goodwill continues to be a problem for accounting, both in terms of identifying and attributing it to the source that generates it.

VI. REFERENCES

1. Angiola, N. (1997). *L'avviamento negative.* Giappichelli, Torino, Italy.
2. Bănacu, C. S. (2012). *Evaluation of intangible assets.* Tribuna Economică, Bucharest, Romania.
3. Bedford, N. M. (1997). *Goodwill in Davidson.* Handbook of Modern Accounting (McGraw-Hill Book Company), New York.
4. Cosmulese, C. G., Alexandru, C. D. (2017). *Accounting policies specific to intangible assets.* Paradigme financiar-contabile în viziunea tinerilor cercetători, 15 December, Chişinău, 220-227.
5. Cosmulese, C.G. (2018). *Correlations and implications for the valuation of intangible assets - for example of listed entities (abstract thesis).* Universitatii Ştefan cel Mare, Suceava, Romania.
6. De Mulder, E. (2006). *La era de los intangibles y la paradoja del valor*. Journal APD: Asociación para el Progreso de la Dirección, (207), 19-20.
7. Grosu, V., Bostan, I., Socoliuc, M., Mates, D., Hlaciuc, E., Mihalciuc, C.C. (November ,2011). *The Valuation of Intangible Assets.Where To?* The International Business Information Management Conference (17th IBIMA) – Creating Global Competitive Economies A 360-degree Approach - in Milan, Italy,774-794. Retrieved December 10, 2018 from: http://www.ibima.org/italy2011/papers.html.
8. Grosu, V., Socoliuc, M. (2016). *Accounting discriminations regarding the treatment of goodwill, Accounting and auditing paradigm: national realities, regional and international trends*. Chișinău, Moldova.
9. Harris, W. (1884). *Goodwil*l. The Accountant, March 29, 9-13.
10. Horomnea, E. (2013). *Social and spiritual scientific dimensions in accounting.* Tipo Moldova, Iași, Romania.
11. Iordache, E. (2013). *Recognition of negative goodwill in financial statements*. Auditing practices, Year 2- 4/2013, 11-12.
12. Leake, P.D. (1921). *Commercial Goodwill. Its History, Value and Treatment in Accounts*. Sir Isaac Pitman and Sons, Ltd, Bath, England.
13. Mateș, D., Cosmulese, C.G., Anisie, L. (2016). *Approaches and methods of valuing intangible assets, Accounting and auditing paradigm: national realities, regional and international trends*. Accounting and auditing paradigm: national realities, regional and international trends, the V Edition, 1 April, Rep. Moldova, 59-71. Retrieved December 08, 2018 from: ase.md/files/catedre/cae/conf/conf_aprilie_2016.pdf.
14. Mihai, I., Socea, A. D., Ciubotariu, M. (2012). *The assets of the company–a theoretical and practical aproach relating particularly to intellectual capital.* The USV Annals of Economics and Public Administration, 11(2), 201-207.
15. Mironiuc, M. (2012). *Fundamentele științifice ale gestiunii financiar-contabile a întreprinderii.* Revised edition II, Universității Alexandru Ioan Cuza, Iași, Romania.

Volume **IX**/2019 ISSN 2344-102X
Issue (XIX) / **February** 2019 ISSN-L 2344-102X

16. Petrescu, S. (2009). *Concepte şi teorii privind evaluarea părţii invizibile a întreprinderii*. Articol publicat in cadrul Simpozionului ştiinţific, Analiza economico-financiară şi evaluarea proprietăţilor. Provocări în actualul context global, Bucharest 29-31 May, 107-112. Retrieved December 10, 2018 from: http://store.ectap.ro/suplimente/Simpozion-29-31.05.2009_ro.pdf.
17. Rațiu, R., V. (2013). *Implicații, tratament contabil și studii avansate privind fondul commercial*. PhD Thesis, Universitatea Babeş-Bolyai, Cluj-Napoca, Romania.
18. Ruz, A.M. (n.d.). *El fondo de comercio procedente de valores intangibles*. 1-16. Retrieved December 10, 2018 from: http://www.aeca1.org/pub/on_line/comunicaciones_xvicongresoaeca/cd/19d.pdf.
19. Tollington, T. (1997). *When is an asset not an asset?* Management Accounting, 75(6), 53-54.
20. Yang, J., M. (1927). *Goodwill and Other Intangibles*. Ronald Press, New York, USA.
21. Zanda, G. (1974). *La grande impresa. Caratteristi chesttrutturali e di compartamneto.* Giuffre, Milano, Italy.
22. Zanda, G., Lacchini, M. (1994). *La valutazione delle aziende*. G. Giappichelli, Torino, Italy.
23. Zannoni, A., B. (2005). *Il valore delle risorse immateriali*. Il Mulino, Bologna, Italy.
24. CECCAR. (2015). *Standardele Internaționale de Raportare Financiara.* Partea A, Bucharest, Romania.
25. ***Codul Civil, Art. 2555 - Termenul stabilit pe ore. Retrieved December 10, 2018 from: https://legeaz.net/noul-cod-civil/art-2555-termenul-stabilit-pe-ore-implinirea-prescriptiei.
26. *** Goodwill. Dicționar enciclopedic 98.000 de definiții, ediția a VI-a. Cartier, 2012.
27. ***OMFP 1802/2014 for the approval of the Accounting Regulations regarding the individual annual financial statements and the consolidated annual financial statements, published in M.O. no. 963 / 30.12.2014, as subsequently amended and supplemented.