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Goodwill and Negative Goodwill: The Real Vision for the Future of a Company—Greek Accounting Standards View

Gkinoglou Emmanouil

Department of International and European Economic Studies, University of Western Macedonia, Koila Kozani,
Kozani Greece

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ABSTRACT

During the last decades, more and more the role of the intangible assets of a company, becomes the main advantage. Especially the goodwill, that the company held from previous years, maybe a significant factor for the establishment of a competitive advantage. But sometimes, this asset, trapped the company and mainly the holders of the company, in a false estimation of high valuation of the company. When a company, undoubtedly change the main purpose of his activity, then the goodwill, must be written-off, or must appear as a negative goodwill, giving to the stakeholders the real vision for the future of the company, and the real value for not false prospects.

Keywords: *Goodwill, Intangible Assets, IFRS, Negative Goodwill, Greek Accounting Standards*

Introduction: Inability to support from traditional accounting systems

In the contrary of past years, the future in the growth and stability for business after '00 is undoubtedly their intellectual property. This type of asset is not as easy to be explained, but is still there, not necessary in financial statements, but is depicted in the market value of the company.

Corresponding author's email address: egkinoglou@uowm.gr

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According to Gkinoglou and Ginoglou (2017), the main difference between two similar products, made from the same raw material, is the Intellectual Capital of Producer of enterprise. The main comparative advantage of each company provides the intangible property to which shareholders and investors should obtain full knowledge (Gkinoglou, 2014). This type of asset for the company, is very difficult to be measured, or estimated accurately, due to the plurality of the differential types of this asset.

Intangibles are the main factor underlying business growth. The total transformation of economy from a completely industrialized to computerized, where the human resources and the new technologies combine to give an exceptional value to the companies (Lev & Zambon, 2003).

Intangible assets: The case of goodwill – separating from brand asset

The term of intangible assets means the non-physical substance assets, exploitable by the company, as part of the total asset or as part of a transaction in case of mergers and acquisitions, or alternatively contribute to the company's activities.

Causing the complexity of the definition for the Intellectual Capital, or the intangible assets, for a company, still there is no universal definition (El Tawy & Tollington, 2012). The measurement or the valuation of this asset for a company, is undoubtedly critical but although the methods of measuring Intellectual Capital are increasing in number still there is no universally accepted measure.

The value of Goodwill is based on abstract and often unreliable concepts such as people and ideas, under the condition that they will not remain in the jurisdiction of a company forever. That's why it's considered an intangible asset.

The intangible assets or intellectual capital is a broad term, that includes the goodwill, the brand asset of a company, the Research and Development and other assets, that their evaluation is difficult to be represented in financial statements.

It includes all factors, above and above book value, which makes investors interested in buying a business.

Johnson and Tearney (1993) propose that goodwill can appear as the difference between Book Value and acquisition cost. Brown (1996), support that the term good reputation should not be confused with other intangibles to be recognized separately in the financial statements. In the case of brand and publishing rights, they should be considered more carefully, because they are not as clear as agricultural frameworks.

The goodwill is not the same thing as intangible brand asset, and this distinction must be highlighted. While the brand asset is the management result for their successful practices, the goodwill asset is the accountant's tool for dealing with the different kinds of intangible assets of a company. Tollington (1998), has noticed that distinction and propose to set a boundary among the brand asset and purchased goodwill that the purchased goodwill is not an asset and so, brand asset is a process of distinctive recognition completely different than goodwill.

For the brand assets, Barwise et al. (1990), don't find evidence that brand names have an economic value, but find that attaching precise numbers to these valuations can be fraught with

difficulties. Enforcing the distinction and the opinion that the brand asset is not the same as goodwill, Keller et al. (1998), examining the effects of the meaningfulness of brand names on recall of advertising, found that a brand name explicitly conveying a product benefit, leads to higher recall of an advertised benefit claim consistent in meaning with the brand name compared with a nonsuggestive brand name, while, a suggestive brand name leads to lower recall of a subsequently advertised benefit claim unrelated in product meaning (e.g., superior sound) compared with a nonsuggestive brand name.

From, all the above, the distinction between brand asset and goodwill for a business must be clear.

According to Seetharaman et al. (2000), the buyer of a business can reasonably expect a return (instead of the unspecified interest rate) of his invested capital. This return must be high enough to offset the risk it took. Consequently, it proposed that a value should be attributed to Goodwill only if a company made a profit.

Abratt and Bick (2003), noticed that the measurement of brand asset is easy to be manipulated to deliver the aims of the management and for that reason the valuation must be adequate and derive a fair value.

Gkinoglou (2009) support that in case that the total purchase price is less than the current selling price of the individual items there is no negative goodwill, because the current selling price of each item individually may not be the same as what would be achieved if all the items were sold as a whole, with a single transaction.

Negative goodwill

According to SFAS No 141, in case of acquisition, the full recognition of purchased amount must be written. But when a negative goodwill occurs, this amount should be recognized. Ketz (2005), propose to realize and recognize the economics of the transaction, for both the managers and accountants. After this recognition the final financial statements reveal the substance of transaction, providing a much better picture for the investors. FASB requires that all negative goodwill is to be recognized as a gain. Under that proposal, Comiskey and Mulford (2008), found for a sample of companies, increases in assets, stakeholders' equity, and net income, as they reported in higher amounts. In a next study, Comiskey et al. (2010), based upon a sample of acquisition transactions, they don't provide evidence that markets value negative goodwill. Also, for bargain purchase amount discuss Comiskey and Mulford (2011). Under new rules, acquisition-related gains, asset valuations and shareholders' equity will be higher in transactions yielding negative goodwill, a financial statement element referred to henceforth as a bargain purchase amount. For a sample of 71 acquisitions, Comiskey and Mulford (2011) found several reasons for the existence of such bargain purchase gains, ranging from financial distress of the target to special characteristics of the acquiring firm, to flaws in the bidding process.

Examining the impairment of goodwill and the relationship with the managerial ability Sun (2016) reveals a significant and negative relationship between managerial ability and goodwill impairment. The goodwill impairment is measured as the possibility of depreciation and

amortization of goodwill and the economic damage of this depreciation. That means that the impairment of goodwill is very possible and thus, the final amount of the goodwill that appears in financial statements, could be negative. The empirical research of Šapkauskienė & Leitonienė, (2014), pointed out, that the performance of monitoring due to a possible decline in goodwill provides company executives with an opportunity to manipulate this type of information, therefore, users of financial statements cannot always be sure whether the value of goodwill was properly adjusted and on what grounds this correction was made.

Similar findings on Avallone and Quagli (2015) study. Avallone and Quagli (2015) examine a sample of listed companies in the greater European stock markets such as Germany and UK, for a 5-year period with goodwill written in their financial statements. To specify the variables that the managers use, they found manipulation of growth rate in order to not reduce the value of goodwill.

The managers' use of discretion in determining goodwill impairment losses with evidence from UK market, and whether this discretion reflects opportunistic reporting by managers, or the provision of their private information is the main theme of study for AbuGhazaleh et al. (2011). Specifically, goodwill impairments are more likely to be associated with recent CEO changes, income smoothing and "big bath" reporting behaviors. However, the results also indicate that goodwill impairments are strongly associated with effective governance mechanisms suggesting that managers are more likely to be exercising their accounting discretion to convey their private information about the underlying performance of the firm rather than acting opportunistically.

This possibility of manipulation seems to be a threat also for the fair value, that IFRS and nowadays, most national standards, provide as the only and secure method for objective financial statements.

From the above, we can assume that the term of negative goodwill, in these cases, is not in a wrong direction. The new proposal of fair value contains the total amount of the goodwill that occurs in a company.

How possible is the case of Negative Goodwill – Some examples from the recent past

A possible case that a negative goodwill, will arise, is when a company, redefines the main activity and it is different from the previous.

This could happen in a case of acquirement, and a company write down in the financial statements the acquired goodwill. In the next year, decides to change the main activity, or decides, to disinvest from the specific sector, or decides to invest in a different activity.

According to the new situation, the amount of goodwill that appears in the financial sector, is not the real and must be underestimated in a new amount, furthermore less than the previous.

Or the company, must reveal the fair value for this asset in the financial statements. This value will be less than the previous year.

Comparing the two consecutive financial statements, the result will be negative amount for the goodwill, or else a negative goodwill.

Undoubtedly, the previous case, is not a common situation that could happen to every company, because there is no common to invest in a new activity and suddenly the next year change strategic, but there is a lot of external factors, for a company (as the pandemic crisis of COVID-19, or the oil crisis caused by the Russian-Ukrainian war), that may lead a company to redefine the main purpose or change the main activity, in order to save from bankruptcy

Alternatively, a company may acquire another company, and write down the measured goodwill. But next year, the real value for this asset of the company, could be reduced to a smaller amount.

Same paradoxes can be found in almost every period of economic crisis (the international economic crisis of 2008-2012 starting from the United States spread in Europe and all over the world, the capital control crisis and GREXIT in 2015-2018 in Greece and in South Europe etc.). When a crisis period occurs in a country, most companies face economics and especially liquidity problems, that many times leads to merges, acquisitions and sometimes in bankruptcy. In those cases, the market value of a company seems to be very low, and there is bargain purchase gains, similar these that Comiskey and Mulford (2011) found.

The company must appear in fair value these assets and comparing the two financial statements, the last amount could be lower, or negative, depends on the real situation of the acquired company.

Accounting treatment of goodwill

The goodwill for an entity, could either be acquired as part of another entity in a merge or an acquisition or be produced by the entity.

Davis (1992) defines the goodwill as the result occurred of a transaction that two entities can exchange part or all their assets, like the acquisition. Thus, the goodwill is the extra value over the purchased price of the total tangible asset and well-defined intangible asset of the entity.

Venkatesan (1995) propose four different goodwill methods The three quality features for goodwill are reliability, foresight and consistency. The final solution and reliable proposal for the goodwill is not as obvious. During the years the term of «goodwill» and finally what exactly contains is not so clear. There is approach method instead of definition method. The four different goodwill methods are: a) the write-off method, not written the goodwill into the account, b) the Capitalization method, according to, the goodwill should be written on the balance sheet, c) the non-Amortization method, that support that the value of the goodwill, does not decrease and d) the Amortization method, according to which companies are allowed to combine the cost of intangible assets during their acquisition.

Treatment of business combination and Goodwill

A business combination (business association) is an event or transaction in which two or more businesses come under common administration, or common holding. As an example, is the combination that occur after merge and acquisition. Two of the main reasons that the entities choose the method of merge and acquisition is the product differentiation and the integration.

The product differentiation for the entity is to achieve to dispose many and different products to their clients. Integration is the procedure that one entity joins another entity either horizontally or vertically. Horizontal integration is when two entities competitors' producers of same or pretty similar products combined in one while vertical integration is that one entity combined with the next or previous in the production chain. The differentiation and the integration could be produced either internal from the entity or could be acquired, which is the faster way.

There are two different approaches, according to Davis (1992), for business combinations and goodwill the Pooling of Interested Method and the Purchased Method.

According to Purchased Method the entity that make a transaction such as the business association, acquires the net assets from the acquired business that are recorded at net value on the date of combination.

According to the Pooling of Interested Method, the entity that states the consolidated financial statements, add together the balance sheet of the affiliated companies. According to this method, everything with economic substance appears separately. The assets remain as before the acquisition. The shareholders remain as before and the same for the asset of every company.

Davis (1992), propose two conditions before this method that must be met. The first condition is that the transaction must be approved by the vote of the shares. That means that the transaction is finalized. The second condition that must be met, is that there must not be identified separately one of the firms that take part in the transaction.

According to Davis (1992), the excess of cost over the net value must be treated as a goodwill and amortized in a maximum 40-year period.

Johnson and Petrone (1999), with data from United States, examining if the goodwill must be treated as an asset or an expense, found that the largest combinations are recorded as pooling, although that treatment is much less common in other parts of the world.

Comparing the two methods above, when the business interest of two businesses is combined under this method, there is no recording of goodwill. Under the purchase method, goodwill is recorded because of the purchase if the purchase cost is greater or less than the net value of the net tangible and identifiable intangible assets acquired. Goodwill must be amortized over the years and is a non- tax-deductible expense. As a result, the new entity's earnings are reduced and lower per share.

Goodwill under IFRS

The accounting treatment of purchased goodwill under IFRS has been severely criticized due to the extensive use of fair value accounting. Baboukardos and Rimmel (2014), found that in the case of purchased goodwill, fair value accounting generates relevant accounting numbers but only in companies that comply highly with IFRS disclosure requirements.

The goodwill accounting is influenced by Fair Value Accounting, that is promoted by IFRS for more true and fair financial statements. IFRS 3 provides the rules at goodwill's initial recognition and measurement and subsequent annual impairment test under IAS 36. For that

reason, the purchased goodwill (either from bargain or from merge and acquisition) has been criticized.

For SFAS 142, Beatty and Weber (2006), point out that requires managers to make unverifiable estimates of the values of firm segments, and subjective allocation of joint benefits associated with goodwill to the firm's segments. These choices are likely to allow the manager to make biased decisions in their determination of whether goodwill is or is not impaired. They investigate the outcome of the manager's goodwill allocation and reporting unit decisions by examining the determinants of the SFAS 142 write-off decisions. They found that the managers' consideration affects their preferences for accounting treatment above-the line instead below-the line for some of accounting choices like the recognition of expenses at the present or to the future. This distinction between the two accounting treatments is very important for the administrator of the entity.

Wines et al. (2007) compare the accounting treatment of goodwill under IFRS with the former Australian Standards and find that the identification and valuation of cash-generating units and goodwill require numerous assumptions to be made in estimating fair value, value in use and recoverable amount. Ramanna (2008), consistent with the FASB issuing SFAS 142 in response to political pressure over its proposal to abolish pooling accounting, found evidence that firms' lobbying support for SFAS 142 impairment tests increases in their discretion potential under the tests. While agency theory suggests such discretion potential can be used opportunistically.

Goodwill according to the Greek accounting standards

Greek Accounting Standards changed in the Greek economy recently, with the Greek Law 4308/2014, starts from 01.01.2015. The previous law for accounting standards in Greece, was too confused, too extended and instead of explaining the accounting principles and the international generally accepted accounting principles, trapped in efforts to explain the imprinting and the treatment in specific occasions in the daily transactions of companies, in order preventing the tax evasion. According to the law, the Greek Accounting Standards defines the goodwill, as the difference between the purchase price for the total or a part of an entity, and the total amount of fair value for the net assets of balance sheet. Positive goodwill means that the entity will have future benefits from the assets that can be managed separately during an acquisition, while negative goodwill means purchase in a low price, below the fair value.

If the development costs, are available for use from the entity, have future financial benefits from their use and measured in a reliable way, can be managed as an asset, otherwise must be managed as expenses

Besides these development costs, no other internal developed intangible assets are recognized as intangible assets.

The following categories managed as expenses for the entity:

a) The costs of setting up and starting an entity, including legal and secretarial support costs incurred when setting up an entity, costs of opening a new establishment (pre-commencement

costs), costs of starting new operations or launching new products or processes (cost before operation).

- b) Training expenses for the staff,
- c) Advertisement expenses
- d) The costs of relocating or reorganizing part or all an entity.

Also, the goodwill as well as the intangible assets, considered that have not limited useful economic life (according to Directive 34/2013 or indefinite useful life according IFRS 38). More specifically, seems to be very difficult to predict the exactly future financial benefits for the company that holds the goodwill as an intangible asset. Equally difficult is to be predicted the period that expect for the asset to give benefits. Otherwise, it is considered that the period of the economic value of the item is limited.

When the goodwill arises as benefit from an acquisition, when the acquired company seems to be in a good financial condition without stabilization problems, then the goodwill assumed that have not limited economic life. The same treatment is also suitable for a trademark that is part of acquisition. For the company that acquired this trademark and expects higher cash flow this asset treated as an intangible asset without limited useful economic life. Like all the intangible assets without limited economic life, goodwill is not depreciated and amortized. The only correction is retesting every year for impairment.

On the other hand, when the company cannot in a reliable objective way determinate the useful economic life of the intangible assets, like goodwill, development costs and other similar assets, then is obliged to depreciate this asset in a ten-year period. This maybe cause a real problem for the company, when cannot prove the usefulness of an intangible asset due to different factors like high cost. An intangible asset, that in real has not limited useful life but the company refuse (for their reason) to prove it, must depreciated it in a ten-year period. This leads to non-real visualization and untrue value of financial statements.

Intangible assets with a specific most definite by objective reason, economic life, —which can be determined by legal, technical, economic, etc. factors, such as for example an intangible asset with a contractual useful life of 8 years— are depreciated in the specific period (in the example at 8 years).

Conclusions

The intangible assets, the most significant and strategic factor for the future development of the company, is the key for sustainable financial statements. The Greek Legislation, according to the International Standards, gives main directions to the companies to use, develop or acquire intangible assets in their financial statements. Some of the intangible assets, will not play only a strategic role to the market value of the company but sometimes the entire “life” of company, depends on them. The fair value, means that every balance sheet item, will objectively written in the financial statements, also the goodwill that occurs either internally for the company, or through an acquisition. But if the total amount of written goodwill in a company’s financial statements do not meet the requirements and due to external factors, the fair value is lower, then

the term of “negative goodwill” must be used, to inform the external users of financial statements, about true and fair value of financial statements. In that case the result that point out is that the term “fair value” cannot include the term of “negative goodwill” and that must point out separately. The reason is that with the fair value, users of financial statements, cannot understand the full disclosure of the entity’s transactions happened in the past year and appear in the balance sheet concerning the goodwill.

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