

Double Accounting for Goodwill
- A Problem Redefined

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THE UNIVERSITY OF SYDNEY

Faculty of Economics and Business

CANDIDATE'S DECLARATION

I hereby declare that this thesis, entitled "Double Accounting for Goodwill – a Problem Redefined" and submitted for the degree of Doctor of Philosophy, contains no material that has been accepted for a degree or diploma at any other university or tertiary institution. This work, to the best of my knowledge and belief contains no material previously published or written by another person, except where due reference has been made in the text and bibliography.

Signed:

Date:

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Abstract

The function of accounting is to provide users with useful information in making economic decisions. Information regarding goodwill, a major constituent of the value of many listed companies, is likely to be useful in making decisions relating to those companies.

A historical review of accounting literature, including professional standards, relating to methods of accounting for purchased goodwill showed that none of them has stood the test of time. The current trend towards an impairment paradigm will not resolve the issue satisfactorily because it produces, at best, a partial solution. The difficulty in accounting meaningfully for goodwill is compounded because, given its foundation in historical cost principles, accounting has been unable to present any information at all with regard to internally generated goodwill within the confines of the traditional Balance Sheet. This, in turn, has led to the evasion of the reality that the two forms of goodwill are inextricably merged.

Trying to account satisfactorily for goodwill has been a prime example of R.R. Sterling's 'issues conceived in a way that they are in principle unresolvable'. The problem was accordingly redefined as being to find a method by which the current level of information relating to goodwill in the financial statements contained in a company's Annual Report could be improved. This thesis seeks to identify a logically defensible method of accounting for goodwill which addresses the redefined problem. It builds upon the historical research undertaken, combined with a priori reasoning, to propose an additional financial statement which is a modification of nineteenth century 'double accounting' in a modern context. This statement, which goes far to solve the redefined problem, also furnishes information regarding the company's market capitalization at balance date and is termed the Market Capitalization Statement ("**MCS**"). While the idea of furnishing market capitalization data to readers of the Annual Report is not new, it is believed that this is the first time such data has been systematically linked with the Balance Sheet to provide an objective, integrated and meaningful view of goodwill in the financial statements.

The practical application and simplicity of the MCS are illustrated by a range of examples drawn from Australian 'dot-com' companies over a period of time which saw considerable fluctuation in both goodwill and market capitalization, supplemented by examining data relating to some of Australia's largest listed companies over the same period. These examples demonstrate that the MCS has the potential to provide significant

information not available in conventional financial statements, while freeing the traditional Balance Sheet and Profit and Loss Account to present information in a more meaningful and less distorted way.

Finally, the MCS is noted as still being subject to certain problems and distortions in the context of the historical cost basis of the remaining financial statements. It is shown that, if used in the context of an exit price based system, Chambers' CoCoA, many of these distortions are removed. The MCS also complements the information provided by CoCoA as originally formulated.