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The four phases of accounting regulation on goodwill: An illustration of the varying influence of social forces

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Abstract

Accounting ceased to be considered as a pure technique a long time ago, and is often viewed as an instrument for social management and change. The objective of this paper is to illustrate the "game" between four social forces in the evolution of accounting regulation for goodwill. Based on a study of four countries, , Great Britain, the United States, Germany and France and over more than a century, starting in 1880, we illustrate the role of four groups of social forces: lawyers, bankers, tax administrations and capital markets. We demonstrate that the four countries studied have a common starting point, a time when the lawyers were dominant, and have made their way to a common destination, due to the current importance of capital markets. The four countries have gone through four identified phases, classified as (1) "static" (immediate or rapid expensing), (2) "weakened static" (write-off against reserves), (3) "dynamic" (amortization over a long period) and (4) "actuarial" (recognition and no amortization). We contribute three new features to the existing literature on goodwill and social forces: (1) our study is international and comparative; (2) it spans more than a century and (3) illustrates the social nature of accounting showing the varying importance of social forces in time and the current "victory" of capital markets with regard to goodwill.

Introduction

It was several decades ago that accounting ceased to be considered as a pure technique and came to be seen as an instrument for social management and change (Hopwood, 1976; Burchell et al., 1980; Puxty, Willmott, Cooper & Lowe, 1987), i.e. a "social rather than a purely technical phenomenon" (Burchell, Clubb & Hopwood, 1985, p. 381). Gilling (1976), as Burchell, Clubb and Hopwood mention (1985, p. 382), not only "notes the fact of and argues the necessity for accounting change under the impact of environmental (social and technical) change", but also attempts to provide "some understanding of the underlying social and institutional forces at work".

This article sets out to show that if there is one issue that perfectly reflects the "game" among the social and institutional forces, goodwill is the one. Based on a study of four countries which played a major role at the time of the industrial revolution, Great Britain, the United States, Germany and France, we illustrate the role of four groups of "social forces" (expression namely used by Burchell, Clubb and Hopwood (1985, p. 382)): lawyers, bankers, tax administrations and capital markets. We demonstrate that the four countries studied have a common starting point, a time when the lawyers were dominant, and have made their way to a common destination, due to the current importance of capital markets. But the routes they took were different, precisely because the social forces' roles were distributed differently in each country.

As Leake (1914, p. 81) pointed out, the "word 'Goodwill' has been in commercial use for centuries, as is shown by the following references to old writers: 1571 Will & Inv. …, I gyve to John Stephen … my whole interest and good will of my Quarrell (i.e. quarry). … having given a hundred pounds for my predecessor's goodwill".

Our study does not reach so far back in time, but still covers a period of more than a century, starting from 1880. This can be considered a key date in Germany, the country with the longest history of goodwill, but also in Great Britain (Bryer, 1995, p. 291). Hughes (1982,

p. 24) tells us that "accounting literature on goodwill appeared in both Great Britain and the United States at about the time the profession was beginning to be formed … and papers read at meetings of these societies were printed for the members and published in periodicals or newspapers, such as *The Accountant* started in 1874".

Nobes and Norton (1996, p. 180) note that there are three types of goodwill: (a) internally generated goodwill, (b) goodwill purchased when buying assets other than by buying the shares in a company (non consolidation goodwill), and (c) goodwill purchased by a group when buying shares in a company (consolidation goodwill). This paper concentrates on the last two types, which we refer to as "acquired goodwill" (individually or in a business combination). Internally generated goodwill is not covered, as it involves specific issues in addition to those relating to acquired goodwill (see Jennings & Thompson, 1996).

Many articles observe a wide diversity in both regulations and treatments applied in practice to goodwill (Catlett & Olson, 1968; Hughes, 1982; Arnold et al., 1994). In the United States, Walker (1938a) provides tables showing prevailing practices in the treatment of goodwill in the balance sheet. The tables illustrate that there is "little uniformity as to the position of goodwill". In the United Kingdom, Holgate (1990, p. 9) considers that "the history of how goodwill has been accounted for … is a classic case study of the difficulties that standard-setters – and legislators – face in the light of varied practice, vested interests and an inadequately developed theoretical framework of accounting".

It is always difficult to divide accounting regulation into clearly dated phases. For this study, we decided to take a time when fundamental change took place as the start of a phase. That time is mainly determined by the change in accounting regulation (the issuance of a new standard or of an exposure draft that would later lead to the final standard). However, for the early stages (the end of the 19th century and the beginning of the 20th century) when the formal accounting regulation on goodwill was still absent, we rely on discussion papers written by leading scholar of the period to determine the phases.

All the countries examined (with the exception of France concerning one phase – see later in section 3) went through an initial phase that can be classified as "static" by reference to idea that the balance sheet should be related to the "end" of the firm and then valued on the basis of liquidative value. This phase is marked by great reluctance to see goodwill as a true asset. In principle, this "embarrassing" asset was to be expensed immediately or at least rapidly. In the second phase (we call "weakened static"), goodwill was made to disappear within a short time of acquisition, but by means of a write-off against reserves. The third phase called "dynamic", as it refers to the going concern (dynamic) assumption, saw widespread amortization of goodwill over a relatively long period. Finally, during the fourth phase called "actuarial", goodwill came to be recognized as an asset, with no systematic reduction of value.

Both individual accounts and consolidated are considered at the same time. A first reason for distinguishing the two kinds of accounting could be that goodwill in individual financial statements is not the result of a purchase of shares. But this argument is a formal one and there is no substantial reason to make a special fate for single companies when they acquire unincorporated businesses (Davies, Paterson & Wilson, 1997, p. 247). The second reason is that the treatment of goodwill in consolidated financial statements could have an effect "more cosmetic than real because distributions are determined by the reserves of individual companies, not groups" (Davies, Paterson & Wilson, 1997, p. 238). But several studies conducted as well in the USA (Lintner, 1956; Abrutyn & Turner, 1990; Baker, Powell & Veit, 2002) as in continental Europe (Pellens, Gassen & Richard, 2003; Busse von Colbe, 2004) seem to show that in fact, in big listed companies, the distribution of dividends is based on consolidated accounts: accounting for goodwill in consolidated financial statements is not merely a "show"!

This study differs from previous literature on goodwill in three ways. Firstly, it takes an international, comparative approach, focusing as it does on four countries. Secondly, it spans

more than a century, starting in 1880. Thirdly, it uses the social nature of accounting to explain the evolution of regulation for goodwill in the four countries studied.

The remainder of this paper is organized as follows. The first section describes the existing literature on accounting regulation and on social nature of accounting which serves as our theoretical framework of analysis. The second section is dedicated to the identification of social forces which are supposed to be interested in the goodwill regulation. We analyze their general interests and directions to which these social forces should push the accounting regulation on goodwill. The third part examines four historical phases of accounting for goodwill in four countries and explains why these evolutions took place. The following section contains a discussion and a final section concludes the article.

1. Accounting regulation and social nature of accounting

1.1. Theories explaining accounting regulation

For decades, accounting regulation has been arousing interests among researchers. Booth and Cocks (1990, p. 511) examine accounting standard-setting and note that its study has been pursued from five general research traditions: professional logic, neo-classical economics, cognitive psychology, the market for excuses and political lobbying. Lobbying has been extensively invoked in explaining standard-setting (Sutton, 1984; Tutticci, Dunstan & Holmes, 1994; Weetman, Davie & Collins, 1996; Van Lent, 1997; McLeay, Ordelheide & Young, 2000; Zeff, 2002). The concept of “interest groups” has also been developed (Walker, 1987). Conflicting agendas (Walker & Robinson, 1994a) or inter-organizational conflict (Walker & Robinson, 1994b) may also explain standard-setting. Booth and Cocks propose a power analysis (1990, p. 524).

Nobes (1992), setting out to explain the history of goodwill in the UK, proposes a cyclical model of standard-setting as a political process influenced by six parties: corporate managers, auditors, users, government, international opinion and upward force. Bryer (1995) develops

another theory to explain standard SSAP 22 (ASC, 1984) on accounting for goodwill: he employs concepts from Marx's political economy.

Many authors have stressed the political aspects of standard-setting: Hope and Gray (1982) emphasize the role of power in the development of an R&D standard; Laughlin and Puxty (1983) analyze the political process of standard-setting in the light of the problem of the conceptual framework and its viability; Power (1992) discusses brand accounting in the United Kingdom; Willmott et al. (1992) theorize the process of accounting regulation and the professes of social and political regulation generally, taking accounting for R&D in four advanced capitalist countries as an example; Fogarty, Hussein and Ketz (1994), in the US, develop an approach based on power, ideology and rhetoric; Klumpes (1994) analyzes the politics of rule development in the case of Australian pension fund accounting rule-making. Walker and Robinson (1993) review this literature. Harrison and McKinnon (1986) use change analysis to reveal the attributes and essential properties of regulation in a specific nation.

The political and economic consequences of accounting also require consideration. Zeff (1978, p. 56) defines the concept of "economic consequences" as the "impact of accounting reports on the decision-making behavior of business, government, unions, investors and creditors" and adds that "the economic consequences argument is a veritable revolution in accounting thought", accounting policy-making being assumed to be neutral. Zeff (1978, p. 60) illustrates his views with an example that directly concerns goodwill: "It would appear that the APB was at least somewhat influenced by economic consequences in its prolonged deliberations leading to the issuance of Opinions no. 16, Business Combinations, and no. 17, Intangible assets".

Solomons (1978; 1983), too, notes that "few if any accounting standards are without some economic impact. The requirement that U.S. companies write off purchased goodwill is said to give an advantage to foreign companies in bidding for American businesses because, not

being subject to the same accounting requirement, they can afford to offer a higher price" (1978, p. 68).

1.2. Social nature of accounting

The social nature in the development of accounting has been emphasized by several authors. Hopwood (1976, p. 1), for example, says "the purposes, processes and techniques of accounting, its human, organizational and social roles, and the way in which the resulting information is used have never been static. The economic distinctions drawn by accountants and the methods which they use are themselves creations of the human intellect and reflect social as well as economic evaluations. They have evolved, and continue to evolve, in relation to changes in the economic, social, technological and political environments of organizations".

Harrison and McKinnon (1986, p. 233) remind that "since the early 1970s, policy formulation has been viewed as a social process; i.e. as the outcome of complex interactions among parties interested in or affected by accounting standards". They refer to Watts and Zimmerman (1978), Holthausen & Leftwich (1983) and Kelly (1983).

In their work on value added in the United Kingdom, Burchell et al. (1985) review some existing theories of the social nature of accounting and conduct a social analysis.

In the same vein, for Burchell et al. (1980), "accounting change increasingly emanates from the interplay between a series of institutions which claim a broader social significance". As Burchell et al. mentioned (1985, p. 381), "although the relationship between accounting and society has been posited frequently, it has been subjected to little systematic analysis". They add (1985, p. 382) that "the social has been brought into contact with accounting but the intermingling of the two has not been explored. As a result, little is known of how the technical practices of accounting are tethered to the social, of how wider social forces can impinge upon and change accounting". We believe that there is still some room for

supplementary contribution in this field. In this study, we try to illustrate how social forces influence accounting regulation by using goodwill as example.

Our analysis will be in line with Gilling (1976)'s framework who believes that accounting "is a product of its environment, and as such it will, and should, change with its environment" (p. 60). While Puxty et al. (1987)'s analysis concentrated on international differences in accounting regulation institutions, we will focus on accounting regulation and one of its outputs on goodwill.

2. Goodwill and social forces

In this article, we believe that the evolution of regulations governing treatment of goodwill can be explained by the influence of social forces, whose importance is variable over time. As mentioned by Puxty et al. (1987), "the institutions and processes of accounting regulation in different nation-states cannot be understood independently of the historical and politico-economic contexts of their emergence and development. For this reason, we view the particular institutional forms and social processes of regulation as an outcome of distinctive constellations of material and ideological forces that are present within different nations."

We identified four groups of forces that have had such influence: lawyers, bankers, tax administrations and capital markets. It should be noted that we are interested in the processes whereby a particular configuration of interest groups, or rather groups with an interest in accounting, comes into existence.

We do not recognize managers as a distinct force, because the role they played has been dramatically changed for more than one hundred years: for the last decades of 1800's and at the beginning of 1900's, most managers were the owners of the companies they were managing. Therefore, their interests were to preserve the company in long-term, which was the same as those of the creditors protected by lawyers. However, nowadays, in most major companies, managers are employees like others. With the grant of stock options and other incentives, they act more like short-term investors.

We also exclude auditors from our list of social forces, since we believe they have been playing the role of facilitators or accompanists during the whole period of our study. Their major mission has been accompanying the dominant forces, so they have been the privileged observer of accounting regulation evolution.

As Puxty et al. (1987), we believe that the reproduction/reform of the prevailing structure of politico-economic relations is seen as an (often unintended) consequence of these parties' efforts to mobilise their stock of material and ideological resources (including institutions) to negotiate policies and practices of regulation that are perceived, within the terms of their own frames of reference, to safeguard or advance their own individualistic career interests as well as the class interests of those on whose behalf they act.

2.1. The lawyers

Lawyers were a driving force at the start of the period under examination. In the 1900s, most authors insisted that acquired goodwill was not a true asset. Balance sheet recognition of this "fictitious" asset might be accepted, but only on condition that the goodwill should be amortized rapidly (generally in less than five years) or a similar solution applied. Most of these authors were lawyers following the theory of the famous French lawyer Thaller (1895, p. 251) who believed that "creditors' interests are decisive".

Many influential lawyers were uncomfortable with rapid expensing of goodwill, and in France for example a less drastic alternative still coherent with the static approach was proposed: establishment of a reserve equivalent to the goodwill value. This "French" solution cannot be considered equivalent to the Anglo-Saxon practice of charging goodwill to equity, as it entails a reduction in distributable dividends for the current year (like expensing). For this reason, we consider it equivalent to expensing soon after acquisition. Several French authors recommend this approach (Decugis, 1906, No. 270; Croizé, 1908; Houpin & Bosvieux, 1927, No. 1384).

2.2. The bankers

The bankers' main concern was protection of the corporate assets. They did not therefore approve of recording goodwill as an asset, preferring to have it eliminated as soon as possible. Walker sums up their position very succinctly (1938a, p. 174): "It might be desirable for credit or other purposes to show the financial condition of an enterprise on the basis of tangible assets alone. If so, goodwill or the intangibles might appear on the balance sheet as deductions from the proprietary equity".

The creditors, particularly banks, were sufficiently influential to impose the write-off against equity solution. The opinion of some actors of the time was expressed by Mc Kinsey and Meech (1923, p. 538): "Depreciation of intangibles should be estimated with care and liberally provided for. Bankers and business men generally prefer a balance sheet presenting only tangible assets to one loaded with goodwill and other intangible values … in general, accumulated surplus should bear its share". This opinion was echoed by one of the period's best goodwill specialists: "It is undeniable that today's balance sheet proceeds on the assumption that it is going to be used to obtain bank loans; and as the banker is presumed to loan only on the security of liquid assets, all the efforts of the statement of the financial status are directed towards the proof of that liquidity" (Esquerré, 1927, p. 41).

The interests of lawyers and bankers have often been convergent throughout the time. They allied in many circumstances (see below) and can form a broader category referred to as the "creditors".

2.3. The tax administrations

Increasing fiscal income was the major motivation of tax administrations, which explains their preference for recognition of goodwill as an asset, to remain unamortized. Emery (1951, p. 562) illustrates this position: "The last point to be mentioned here in support of not writing off valuable goodwill is essentially the reasoning behind the income tax ruling, which disallows any deduction for goodwill amortization. The rule is generally defended on the

grounds that the effective usefulness of intangibles is of indefinite duration. It is claimed, and rightly so, that no one knows exactly when goodwill value ceases to exist. Hence, it is the lesser of evils to allow the only objectively determined valuation available (i.e. original cost) to be shown in the balance sheet".

How can the very specific situation in France be explained? The answer is well-known in international accounting circles. Whereas in countries like Great Britain and the United States, where the stock exchange played a major role, the need to dissociate taxable income from "financial" income soon became clear, this was not the case in France, a country where the capital markets played only a minor role in business financing, at least until the 1960s. This meant there was no great resistance to tax rules affecting accounting, particularly as in most cases they led to lower taxable income than "economic" or "financial" accounting rules. It is true that non-amortization of goodwill was an "anomaly", but this anomaly had come to be accepted as a "negative" component of the deal (at least in tax terms), to be taken together with "positive" components that were beneficial to taxpayers (for instance, the capacity to deduct start-up, research and advertising costs immediately, and depreciate many tangible assets rapidly).

But the growing importance of consolidated financial statements considerably reduced the influence of taxation as far as goodwill was concerned. Nobes and Norton (1996, p. 186-188) rightly point out "it is in the discussion of tax treatments that the confusion between the different types of goodwill becomes serious. The vital initial point is that, in all countries, consolidated financial statements as prepared for financial reporting purposes are irrelevant for tax purposes … In most countries, corporate income tax is calculated company by company … Since the consolidated income statement is not directly relevant for tax purposes, and since amortization charges for consolidation goodwill only appear in such statements, then such charges are not tax deductible …".

2.4. The capital markets and professional shareholders

The patent conflict between creditors (represented by lawyers and bankers) and shareholders is a classic of the accounting literature. As soon as 1882 in the well known Flitcroft's case, Lord Jessel stresses the diverging interests of these categories of actors (Edwards, 1989, p. 178). But more interestingly for us this conflict is basically not between creditors and all shareholders but between creditors and professional shareholders. Professional shareholders or "rentiers investors" (to use an expression of Hannah, 1983, p. 57), at the difference of family-owners shareholders, are generally short-term oriented and expect immediate and maximum profits. This kind of distinction is also a classical one in the accounting literature. A great number of accounting historians has shown how very often the interests of creditors and family-owners for a conservative accounting are common (see notably Edwards, 1989; Lemarchand, 1993, p. 529-581). This is the reason why we are not examining here specifically the role of family-owners which is supposed to be fundamentally to play in the same direction as the creditors. So for us the major conflict is between the creditors - possibly helped by the family owners - and the professional shareholders. Normally speaking the disappearance of the old conservative attitude towards goodwill should be connected with a rise of the influence of professional shareholders.

The total separation between owners and managers tends to work in favor of a non-amortization approach. More prosaically, it could be said that shareholders will not stand for immediate or rapid charging of goodwill against income. Already at the end of the 19th century, a good many authors, including supporters of immediate expensing/amortization, were aware that shareholders could find themselves deprived of dividends due to drastic amortization of goodwill. Explicit allusions to this problem are found in the writings of Matheson (1884), More (1891, p. 287), Guthrie (1898, p. 429), and Linnett (in Guthrie, 1898, p. 430). Guthrie is particularly eloquent on the subject: after demonstrating that in principle goodwill should be amortized over its estimated life, he stresses that in practice this method

(although less drastic than immediate expensing/amortization) would “deprive the capitalist or shareholder of all income for that period” (1898, p. 429). To solve the problem, he suggests that the amortization should be based on “double the number of years at which the purchase was made” (1898, p. 429). The same view is expressed by Leake (1914, p. 88), who first declares that in theory, goodwill should be expensed over a period determined by the company, before conceding that “it is not, however, necessary to set aside each year so large a sum” and that “something between the amount of the annuity which the company has purchased and the amount which would have to be set aside for the purpose of a twenty years’ sinking fund” should be expensed.

More recently, the FASB itself (2001b, p. 3) acknowledged that “analysts and other users of financial statements, as well as company managements, noted that intangible assets are an increasingly important economic resource for many entities … and that financial statement users also indicated that they did not regard goodwill amortization expense as being useful information in analysing investments”. It went on (2001b, p. 5) to reiterate the importance of “financial statements users”, saying they “will be better able to understand the investments made in those [goodwill and intangible] assets and the subsequent *performance of those investments*” (our emphasis). The accent is explicitly on performance measurement, and “ability to assess future profitability and cash flows” (FASB, 2001b, p. 5).

The influence of social forces, particularly the financial markets, is visible in the same FASB Statement (2001b, p. 5), which concludes that “amortization of goodwill was not consistent with the concept of representational faithfulness, as discussed in FASB Concepts Statement No. 2” (FASB, 1980). It may sound surprising that it took the FASB more than 20 years to realize this inconsistency, but the FASB does explicitly link the reform to “the increase in merger and acquisition activity that brought greater attention to the fact that two transactions that are economically similar may be accounted for by different methods that

produce dramatically different financial statement results" [the pooling-of-interests method and purchase method] (FASB, 2001b, Appendix 1, p. 5).

Bryer (1995, p. 304) also mentions the influence of capital markets, stating that "… the motive for wanting to return to amortization [in the beginning of the 1990s] seems clear. When the merger boom of the 1980s subsided, investors began to demand a return to conventional goodwill accounting to allow them to observe the rate of return on capital". In our opinion, the capital markets' influence is also reflected in the notion of international pressure, or the desire for international comparability which is sometimes mentioned (Bryer, 1995, p. 305).

The growing role of the capital markets is also due to the ever increasing significance of goodwill in corporate financial statements, as studied namely by Higson (1998).

Figure 1 below summarizes the results of our analysis on the influence of social forces on accounting regulation for goodwill.

Insert figure 1 about here

3. The four historical phases of accounting for goodwill

The interaction (or "game") between the four groups of social forces named above, which will be discussed in more detail in the present section, resulted in changes in the regulations affecting goodwill over the period examined. But, and this is what gives this article particular relevance, the four countries studied went through the same phases but at different times. Schematically, the history of goodwill since 1880 can be divided into four phases with the recourse to a typology inspired by the traditional continental European theories of accounting (Richard, 2005):

(1) The pure static phase (Richard, 1996, p. 31, 33): The term static (latin "stare": to stop) is used in order to describe an accounting theory which assumes that the balance sheet, for the sake of protection of creditors, is to be valued on the basis of liquidative values

(reselling value in a liquidation process). It implies that goodwill is a fictitious or "embarrassing" asset: immediate or rapid expensing (amortization over 5 years).

(2) The weakened static phase: this is an adjusted form of non-recognition of goodwill with a write-off against reserves.

(3) The dynamic phase (Richard, 1996, p. 51, 61-62). In that case the basic hypothesis is no longer the liquidation of the company but the going concern (dynamic) assumption, however connected with the idea of death of goodwill. It implies the recognition of an asset with amortization over a long period.

(4) The actuarial phase: it corresponds to the going concern assumption but without the idea of death of goodwill and leads to the recognition of an asset with impairment testing based on discounted (actuarial) cash flows.

Figure 2 below summarizes the four phases in the evolution of accounting for goodwill in the four countries studied over the period.

Insert figure 2 about here

3.1. Phase 1: The "embarrassing" asset or non-recognition phase

3.1.1. Great Britain: the static phase (1880 - 1900)

The law and court rulings played a practically non-existent role in the treatment of goodwill in Great Britain, right up until 1990. While one author does point out that "goodwill is legalized as a 'fixed asset', which may remain upon [the] books for an indefinite period" and there is no need "to provide for its extinction" (Gundry, 1902, p. 662), he also believes that "this is not advisable" for accountants, who have an essential role to play and whose duty it is to "draw ... shareholders' attention to such a case" (1902, p. 662). The same opinion had been expressed earlier by Guthrie (1898, p. 430), and was later taken up by Dicksee and Tillyard (1920, p. 70): "The law has not much to say … and … leaves accountants to manage their own business in their own way".

It is thus important to find out what practices most British accountants recommended. Three distinct phases appear: one from 1880 to about 1900, followed by another covering the years to 1990. From 1990, a third period began, one of intervention by the standard setters and a fundamental change of conception.

In the first phase that is the subject here, the dominant doctrine considered that goodwill was not a true asset, and should be immediately, or at least rapidly, expensed. The best proof of the widespread refusal to consider goodwill as an asset is in the writings of Gundry, one of the few authors in favor of seeing it as a "valuable asset" (Gundry, 1902, p. 663). Gundry complains of "the general denouncement and deprecation of the term as an asset" (1902, p. 663). He quotes Pixley (1909), who includes goodwill in "fictitious assets accounts", and Dicksee, who "appears to deprecate the inclusion of goodwill in any accounts where it can possibly be avoided" (Gundry, 1902, p. 662).

The lawyers, as in Germany (see below), appear to be the cause of goodwill's "misfortune". Roby (1892, p. 291), for example, points out that in the event of bankruptcy, what he calls "local goodwill ... will be of little value for any purpose of realization". He even goes so far as to say that "the purchase of a goodwill is like the purchase of a lottery ticket" (1892, p. 293). The argument that goodwill would have no value in a bankruptcy situation was taken up by (many) accountants, including Knox (in Guthrie, 1898, p. 430), Stacey (1888, p. 605) and the author of a leading article in Time in 1905 (quoted by Dicksee & Tillyard, 1920, p. 99).

So it is hardly surprising that a large number of accountants are in favor of immediately or rapidly writing off goodwill against profits. Matheson (1884) is one of these, although he does qualify his statements, only demanding total disappearance for goodwill that is "small". Another author, Bourne (1888, p. 604), is of the opinion that acquired goodwill "should be gradually written off, so that in a few years the account could be closed". The reason he gives is that "it is a prudent course to adopt, not knowing what may happen in the futurity, … to extinguish as early as possible all intangible and fictitious assets", using the "Revenue

Account”. Just a few years later, More (1891, p. 286) preached in favor of the static approach: for this specialist, goodwill “ought to be regarded merely as an advance by capital, which falls to be replaced out of the revenues at the earliest possible date”. More, whose first concern was clearly the creditors (p. 286) was afraid that goodwills would be overstated (p. 287), and “cannot see how Limited Liability Trading Companies are ever to equal in stability our best private trading companies, so long as any considerable portion of their capital is represented by nothing more tangible than Goodwill” (p. 287).

After Roby’s pessimistic lecture, most of the audience considered that goodwill should be depreciated, and very substantially (Roby, 1892, p. 293). And after Guthrie’s lecture (1898), Knox, who “fully agreed”, thought that “the sooner … goodwill ... [can] be deleted … the better it would be for the concern” (in Guthrie, 1898, p. 430). Our final example, the “Time leader writer” (quoted by Dicksee & Tillyard, 1920, p. 99) also wants to eliminate this “undesirable” asset, by charging it to expenses or via a reserve set against profits. Certain authors preferred the reserve method (Roe, in Browne, 1902, p. 1343).

The partial conclusion that can be reached from all this information is in our opinion that the immediate expensing or rapid amortization approach, against current profits, is the standard approach up until 1900-1905. Authors, particularly opponents, certainly position themselves with reference to this approach.

In contrast to the German situation (see below), there was strong opposition to the dominant purely static doctrine in Great Britain, comprising several clearly distinct views. For simplicity’s sake, we identify three main views.

The first and very minor view of opposition came from supporters of the actuarial approach (phase 4), who wanted to make goodwill a real “asset”, amortized only in cases of effective loss of value as assessed by an impairment test. This appears to have been the position taken by Nairne (in Roby, 1892, p. 293).

The second view, rather larger, concerned proponents of the dynamic approach (phase 3). For them, the cost of goodwill should be spread systematically over a certain number of periods reflecting the way it was used or calculated. This group includes Guthrie (1898, p. 429) who recommended the following basis for amortization: "the amount of the years' purchase of the goodwill as originally paid so far as the excess profits".

Finally, the third position, and at the time the only credible alternative to the purely static approach, rallied authors who (also) proposed making goodwill disappear from the accounts immediately, but by charging it to equity (variation of phase 2). This was the position of writers such as Dicksee (1897), whose later influence was to be fundamental (see below).

To conclude for this phase, many who opposed the principle of the static view finally changed their minds in practice once under its pressure. Browne (1902, p. 1342), for example, after declaring his hostility to profit reduction, adds, "I do not go so far to say that it may not be desirable in many cases to strengthen a concern by reducing… the book value of its goodwill, but the application of profits in this direction would be more in the nature of a voluntary appropriation than a necessary charge". Pain (in Browne, 1902, p. 1344), who was not very favorable to writing off goodwill against profits, finally said, "at the same time, the old adage about providing for a rainy day furnishes a stronger argument in favor of arming oneself against *a contingency which is not impossible of realization* in any concern" (our emphasis).

Globally speaking this prudent accounting conception is not a surprise: it is in line with the social and economic context of the period (Parker, 1965, p. 160). As it has clearly been shown by historians at that time, in line with a situation coming from the 18th century, it is no doubt that the "horror of failure" (Hoppit, 1987, p. 16) still caught eye an imagination. For that reason most business man prefer to rely on their own resources or provided by people they know well (Wilson, 1995, p. 46). In that context personal credit could play a central role but was associated with the moral obligation to reimburse and a severe penalty for ignoring

conventional wisdom: bankruptcy (Wilson, 1995, p. 58). At that time power (to offer life or death in case of failure) was in the hands of rich and influent creditors, i.e. gentlemen, widows, merchants supplying country banks. As far as failures were frequent (Wilson, 1995, p. 56) these people imposed overall a cautious attitude (Wilson, 1995, p. 61).

3.1.2. United States: the static phase (1880 - 1900)

Throughout the period, goodwill was not considered as a true asset in the United States, and was theoretically to be deducted against revenues. Changes in the treatment of goodwill in the United States illustrate that the static approach was becoming increasingly problematic for American social forces.

There was no regulation during this phase, but British writings and practices were very influential. As one American goodwill historian has put it, "accounting literature was almost British, discussion there dealt with problems encountered in British practice" (Hughes, 1982, p. 24). As we have seen, the dominant British practices and doctrine of the time considered that acquired goodwill was not a true asset and should be immediately, or rapidly, expensed. The situation appears to have been the same across the Atlantic. Symptomatically, the authors of one study of changes in the treatment of goodwill took their opinions from Harris (1884, p. 11) and assert that prior to the late 19th century, "accountants appeared in substantial agreement that amounts expended for goodwill should not be carried very long in the balance sheet" (Catlett & Olson, 1968, p. 38).

More (1891, p. 286), in England, quotes an eminent American author who declared that goodwill "is nothing more than a hope grounded on a probability". Knight (1908, p. 197), another author, speaks of goodwill as an "uncertain value" and deems that "the best course is to dispose of such an account through a charge to depreciation", the writing off … having to be "encouraged". This view had a long-lasting influence, to be found in the statements of one of the leaders of American accounting thought in the period 1900-1920, for whom goodwill

was “not merely immaterial but also imaginary” (Hatfield, 1913, p. 115). He recommended rapid write-off against profit, in view of its uncertain nature.

3.1.3. Germany: the static phase (1880 - 1985)

Germany was the country with by far the longest initial phase: from 1880 to 1985. This pure static phase can be divided into two sub-phases.

a) First sub-phase, 1880 - 1931: static approach in practice but not in the law

Prior to 1931, the law made no reference to treatment of goodwill, leaving only doctrine and court rulings as our sources.

Doctrine

The history of the accounting treatment of goodwill in Germany cannot be fully understood without reference to the country’s accounting tradition. This tradition dates back to the 1850s and 1860s, the period that saw Germany’s first Commercial Code (1857). At the time the German lawmakers, under the influence of Napoleonic lawyers, adopted a static view of accounting: no item could be recognized as an asset unless it would have an individual market value (the separate saleability approach) in the event the company ceased to exist, i.e. went bankrupt, hence the term static (Richard, 1996, p. 31, 33). As a result of this doctrine most intangibles, particularly goodwill, that were not separable from the company and had no individual market value, had to be expensed immediately. This was to be the dominant practice for a great many years.

In around 1900, the “old” static doctrine was still present and still outlawing recognition of any goodwill, not only acquired but also created goodwill (Greve, 1933, p. 20). The only major voices raised in favor of recognizing acquired goodwill came from precursors of the dynamic doctrine such as Simon and Fischer (Greve, 1933, p. 22).

Mörschel (1933, p. 34) shows that at the time, goodwill was treated in the same way as advertising expenses, and consequently immediate expensing or at least rapid amortization was required.

This doctrine still held sway in Germany in the 1920s and 1930s. Only a few authors, even in the field of business economics, dared to propose recognition of goodwill followed by amortization over more than five years (Take, 1939, p. 116). Among the main proponents of this approach were Schmalenbach (1949), Müller (1915), Schreier (1928), Stern (1907), and Schmidt (1927) (on these authors, see Greve, 1933, p. 32; Take, 1939, p. 111-112), all of whom were in favor of long-term, systematic amortization.

Court rulings

There were relatively few relevant court cases in Germany between 1900 and 1931. According to Greve, the rulings issued were (1933, p. 31), "of the same opinion as the commentators on the Commercial Code", which suggests they looked favorably on rapid expensing/amortization. Only one decision, in 1915 (quoted in Greve, 1933, p. 31), was in favor of compulsory asset status for acquired goodwill (this status was always refused for internally generated goodwill). The others (in 1901, 1909 and 1914) allowed recognition of acquired goodwill as an asset but considered it as an "ideal" asset (in the sense of imaginary, as opposed to a "real" asset) (Greve, 1933, p. 31-36; Mörschel, 1933, p. 34).

b) Second sub-phase, 1931 - 1985: introduction of a law

The second sub-phase saw the introduction of a formal obligation by the German commercial legislators. It was a period of deep mistrust regarding treatment of goodwill as an asset, culminating in 1965 with the introduction of compulsory rapid amortization for any goodwill recorded as an asset. This development in German commercial law was all the more striking because at around the same time, the courts and tax administration were expressing their opposition to systematic amortization of goodwill.

The first German law concerning goodwill was an emergency law of July 19, 1931. It added a new article to the Commercial Code (article 261) prohibiting recognition of internally generated goodwill as an asset, and (merely) allowing acquired goodwill to be recognized as such only on condition it was then amortized by "appropriate annual amortization charges". According to Greve (1933, p. 35) and Take (1939, p. 116), this law simply gave formal expression to the dominant doctrine of the time.

The measures introduced in 1931 were included without amendment in the law (AktG) of 1937 (article 133, paragraph 5), and then almost without amendment in the law (AktG) of 1965 (article 153, paragraph 5). The only noteworthy difference is that in 1965, the law stipulated that the systematic amortization against goodwill entered as an asset must be at least one-fifth annually. This remained applicable until 1985.

This very strict position (purely static in nature) stands out all the more because of its stark contrast with the approach taken by the tax administration. As early as the late 19th century, the *Preussische Oberwaltungsgericht* refused systematic amortization of goodwill, and demanded a "real-value reduction" (Rechtmann, 1926, p. 128). In 1930, the *Reichsfinanzhof* (the Reich's financial court) stated that goodwill was a "living thing" and unlike commercial law, refused any decrease in book value not due to actual loss of value (Greve, 1933, p. 75-79). On the same lines, the *Reichstfinanzhof* issued a ruling on July 29, 1931 that goodwill "does not lose value regularly over time" and cannot therefore be amortized, only "written down if necessary". The tax law of 1934 confirmed and even reinforced this position: in replacing the concept of *gemeine Wert* (sales value) with the concept of *Teilwert* (value in use) for impairment testing, it made it even more difficult for the taxpayer to prove loss of value. Take (1939, p. 120) calls this a "probatio diabolico" (impossible evidence).

To justify non-amortization, German tax courts invoked the "exchange theory" (*Austauschtheorie*) that there was no boundary between acquired and created goodwill, meaning that any loss of value in acquired goodwill could be offset by new created goodwill

(Hirschfeld, 1959). Goodwill was a “unique organic item” (ruling of September 30, 1931) (quoted in Greve, 1933, p. 80). Mörschel (1933, p. 48) believed that this theory was a screen to hide more prosaic arguments: the tax administration already allowed secret reserves in the form of rapid depreciation of machines, and wanted to protect its fiscal revenues by preventing amortization of goodwill. Whether theoretical or pragmatic, this argument failed to convince the commercial world who generally does not considered goodwill, when it was capitalized, as a true asset but only as a means to reduce the indebtedness (Dziadkowski, 1980, p. 1515, quoted by Söffing, 1988, p. 597-599).

3.1.4. France: the static phase (1880 - 1917)

In terms of both doctrine and case law, the static phase in France was dominated by the purely static approach: goodwill was not considered a true asset and was to be expensed immediately, or at the very least rapidly.

a) Doctrine

In the 1880s, the authors of the first chart of accounts such as Didier (1885) with his “strict” balance sheet, Courcelle-Seneueil (1872) and Vavasseur (1868), who stressed the difficulty of realizing fixed assets (in Verley, 1906, p. 121), recommended that assets, including goodwill, should be carried at liquidation value. To this way of thinking, a “good” asset is one with totally amortized goodwill.

In the 1900s, most authors also insist that acquired goodwill is not a real asset. While they accept recognition of this “fictitious” asset, rapid amortization (generally total amortization within less than five years) or a similar solution is required.

Kopf (1904, p. 27) is in favor of “management based on the assumption that a company will be liquidated”, and considers that it is “prudent to amortize patents rapidly” (and by implication customer bases, which he puts on the same level).

Verley (1906, p. 39) considers French law is "inspired" by and sometimes even "obsessed" with German law, stressing that while goodwill "can" be entered as an asset, it will be a "highly uncertain value" and a "fictitious" asset that should be eliminated without delay. Like Didier (1885), he believes that "the lower the figure for fixed assets, the greater our confidence in the company" (p. 133), and that the value of intangibles should not be "pumped up" (p. 141). Amiaud, a leading lawyer of the time, and (already) defending a "continental" view of the balance sheet against the "Anglo-Saxon" view (1920, p. 6), recommended that start-up costs (and in the minds of the period this generally included goodwill) should be written off "immediately" (1920, p. 104).

On the whole then, the doctrine of the time was clearly in favor of the purely static approach. The dynamic approach of long-term amortization was only supported by Magnin (1912), whose writings, inspired by the German dynamic school, were fiercely criticized by most other authors.

The only real resistance to the static view came from French followers of the famous German lawyer H.V. Simon, principally Duplessis (1903) and above all Charpentier (1906), who were in favor of goodwill remaining in the balance sheet at its acquisition value, unless a fall in its "useful" value could be proved. This is in effect a conservative version of the actuarial approach.

b) Case law

The few relevant court rulings issued were in favor of the purely static approach, i.e. rapid amortization regardless of its value in use[1]. Briefly, from this standpoint goodwill becomes an immediate expense, although as a "favor" for companies, it could in exceptional circumstances be amortized over a brief period.

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[1] Besançon, Feb. 1, 1895, Journal des Sociétés, 1895, p. 356; Revue des Sociétés, 1895, p. 429; Lyon, Feb. 20, 1903.

3.2. Phase 2: the "weakened" static phase (excluding France)

This phase is identifiable in all the countries except France: unlike the other countries where accounting law is independent of tax law, from 1917 the situation in France was dominated by tax concerns, which prevented change of the same sort as in other countries. While the tax rule in the other countries was similar to the French rule of recognition without amortization, its influence was not as great as in France. France will therefore be examined separately (below). France was to return to a "normal" situation as domestic tax influence declined and international influence increased.

3.2.1. Great Britain: the "weakened" static phase (1900 - 1990)

During this phase, the purely static approaches (immediate expensing or rapid amortization against the year's profits) increasingly fell from favor, while a "weakened" static approach involving charging goodwill to equity became more popular.

The demise of the immediate expensing or rapid amortization practice is visible from the work of influential authors of the first half of the 20th century: Dicksee (1897), Garke and Fells (1922) and Lancaster (1927) all reject the practice of quick "writing down" against income.

The dominant solution is to make goodwill disappear by charging it to equity, a practice that combines the basic static approach – goodwill is not an asset – with dividend distribution, depending on future profits.

The idea of charging goodwill to equity comes from the leading author for the second half of the 19th century, Dicksee (1897), who took a stand on the issue as early as 1897. This "king" of British accounting was caught between two conflicting views:

- influenced by the static doctrine of the time, he accepts that goodwill is an asset of "arbitrary" value (1897, p. 45) that can be considered equivalent in nature to "Establishment expenses" (1897, p. 46) and must be treated with "the greatest caution"

(1897, p. 46). He arrives at the conclusion that this "undesirable" and "embarrassing" asset should be eliminated "with all due speed" (1897, p. 45-46);

- on the other hand, he also has shareholder's interests in mind, and believes that goodwill "should not be written off out of profits" (1897, p. 46) because that comes down to creating "a secret reserve" (1897, p. 47).

To settle this problem, Dicksee first raises the possibility of reducing the "Capital account" by the whole amount of goodwill (1897, p. 46), although he acknowledges that this ideal solution is not actually possible, and would not be acceptable to lawyers (1897, p. 46). Since he would rather leave the reserves alone (1897, p. 46), he seeks unusual solutions (such as the creation of founders' shares) (1897, p. 47) but is forced to admit that they are probably "unworkable" (1897, p. 48). Failing to find an optimum solution, Dicksee, in agreement with Tillyard (1920, p. 106), appears to have finally accepted that acquired goodwill should be charged to reserves, particularly if the goodwill was artificially inflated.

As in the precedent period, many authors are drawn to this view for practical reasons. One such is Hamilton (1914, p. 218), who puts forward a theoretical defense of the actuarial approach (no systematic reduction), before conceding that "as to the practical desirability of writing off goodwill, I agree". Another is Lancaster (1927, p. 146), who like Hamilton, thinks there is no theoretical reason to reduce goodwill, unless it is to reflect an effective loss of value. But "on the other hand, in view of its intangible nature and the fact that its value is always dependent upon the financial stability of the undertaking, it is considered sound financial policy to write down goodwill as and when profits are available".

Some authors, as noted above, take a clearly dynamic position (Leake and Guthrie for example), but this approach met with little success in practice, as we shall see.

Garke and Fells (1922) occupy a somewhat ambiguous position: in theory, they are against systematic amortization of goodwill, but they consider that in practice it is "desirable to create gradually a special reserve fund" (see Bryer, 1995, p. 306). There are also some "extremist"

supporters of the actuarial approach, like the author (Anonymous, 1919, p. 200-201) who wages war on those who see goodwill as “an illusory asset”, and asserts that it “is not subject to depreciation as such”.

But the apparent diversity can be misleading: the “weakened” static approach is “in the air”, although the fact that a good many authors defend the actuarial approach (at least from a theoretical standpoint) shows that some of the accounting community were looking for a new way.

In spite of that, one can say with an historian of British accounting that in the early part of the 20th century, at a time when “creditors and long-term investors were regarded as the principal users”, “the use of conservative valuation procedures was advocated by influential contemporary authorities” (Edwards, 1989, p. 110).

This weakened static solution was to win the day but remained in the UK the standard approach until the end of the 1980s. Apart from reference to the influence of the dominant doctrine, two facts support this statement:

- Firstly, in spite of one attempt to change the situation (a discussion paper dated 1980 with a proposal for capitalization and systematic amortization), at no time were the British lawmakers in a position to impose a solution contrary to the dominant practice (Paterson, 2002b). Furthermore, SSAP 22 (ASC, 1984, revised in 1989) admitted again goodwill to be written off immediately against reserve while (only) offering the possibility of capitalization and amortization against future profits over its “useful economic life”. The first treatment was adopted almost universally (Arnold et al., 1994; Peasnell, 1996).
- Secondly, on the whole, this solution seemed to satisfy practitioners. In a 1974 survey of large British companies’ financial statements by the ICAEW, of 209 companies, 129 eliminated goodwill without amortization, (only) 6 amortized it and 72 recorded it in fixed assets and applied no amortization. This proves that the weakened static solution was predominant. However, the existence of a non-negligible practice of keeping

goodwill in the balance sheet at (unamortized) cost also shows that even the weakened static solution was not considered satisfactory by a certain number of businesses, and presumably that treating goodwill as an unamortizable asset was approved by certain auditors.

In our opinion, the weakened static solution is effectively a "convenient" variant of the purely static approach. Its aim is not to make goodwill an asset, but to make it disappear "softly, softly". Our view appears to correspond to the position currently defended in Great Britain. Holgate (1990, p. 11) for example, describes how two schools of thought emerged at a discussion by the ASC in 1980 on the treatment of goodwill. One school considered that "goodwill was not like other assets in that it could not be separately realized..., was of no value … and should be written off directly against reserves…" The other school believed "that goodwill was an asset … (on a going concern basis)". What clearer indication could we wish for that writing off against equity remained a static-type approach!

During all that period pooling (or merger accounting) was possible under some conditions but rarely practiced (Paterson, 2001, p. 98).

3.2.2. USA: the "weakened" static phase (1900 - 1970)

As in Great Britain, the static approach still dominated in the United States during this period, the basic view being that goodwill was not a real asset and should be made to disappear as soon as possible. This observation which we will support below, is corroborated by one contemporary opponent's regrets: "current doctrine for the most part holds that, even purchased, goodwill should be written as soon as possible" (Anonymous, 1913, p. 817).

However, rather than being charged to expenses, goodwill was increasingly charged against equity, and so the "weakened static approach" began to predominate as it did in England.

In theoretical terms, Dicksee's ideas were widely echoed in the United States, where many authors favored the solution of an immediate write-off against earnings or capital surplus (Kester, 1922, p. 419; Lincoln, 1923; Mac Kinsey & Meech, 1923, p. 538).

This philosophy was also reflected in the first US regulations. In 1917, a memorandum entitled "Uniform Accounting" issued by the American Institute of Accountants (predecessor to the American Institute of Certified Public Accountants) was accepted by the Federal Trade Commission and Federal Reserve Board, for application by companies wishing to obtain a loan. It recommends that goodwill should be "shown as a deduction from net worth" (AIA, 1917). While this treatment was only compulsory for financial statements produced for the purposes of a loan, it still reveals the state of mind at the time (see below).

But the standard (pure) static approach had not lost all its influence: there were still authors, and not just minor ones, who preferred rapid amortization of goodwill and in fact most intangibles. One of them was Hatfield, whose position remained unchanged (1927). Others were in favor of recognition at cost with no systematic amortization (Dickinson, 1917, pp. 79-80; Freeman, 1921, p. 263; Bliss, 1924, p. 350; Esquerré, 1927, p. 130). This view had considerable support from the tax administration through the 1918 Revenue Act, which did not include goodwill in its list of intangible items for which a systematic allowance for obsolescence is possible, and the Revenue Act of 1928 which stipulated that "no deduction for depreciation, including obsolescence, is allowable in respect of goodwill" (Catlett & Olson, 1968, p. 57).

There was an increasing trend recommending recording goodwill at cost, followed by systematic amortization over the useful life or a period corresponding to the period on which discounting to present value was based. Heading the line in this school were Gilman (1916, p. 195), Paton and Stevenson (1922, p. 531), Yang (1927, p. 196) and Paton and Littleton (1940, p. 92).

Under this flood of contradictory opinions, it may seem tempting to conclude like Saliers (1923, p. 580) that all opinions are equal. But some opinions appeared more widespread than others. It is undeniable that supporters of speedy amortization soon found themselves in the minority, and their views were not taken up by the emerging regulations.

It is also clear that supporters of recording at cost (or even at actuarial value) were in a difficult position and found themselves on the defensive. Esquerré (1927, p. 130) was forced to observe that "in some mysterious way the intangible asset goodwill has become very objectionable to business people. To them it is symptomatic of insufficiency of real values".

But despite all this, the United States were already taking a less static approach than the Germans (see below): a German writing a thesis on treatment of goodwill in "Anglo-Saxon" countries at the time considered from his outsider's point of view that charging goodwill to equity was an "Anglo-saxon" specificity (Mildebrath, 1931, p. 97).

Of course, a significant event of this period was the serious economic crisis of 1929 in American industry, which had several consequences in terms of treatment of goodwill. Its main impact was to reinforce the positions of those who saw goodwill as an unstable, if not undesirable, item: not only was it noted that, as in the previous period, "financiers frequently deduct all intangible values from the net worth section of the balance sheet when a loan is being contemplated" (Walker, 1938b, p. 259), but companies themselves appeared to be continuing such drastic measures in their accounts. A 1931-32 study of listed companies' financial statements showed that of the 86 balance sheets showing goodwill as a separate item, 31 of them listed goodwill at $1.00 (Fjeld, 1936, p. 333). While it was true, as one of the commentators pointed out, that "the practice could have been the result of either a write-up, a write-down, or of amortization of the cost of purchased goodwill until only a nominal valuation remained" (Hughes, 1982, p. 99), another study undertaken a little later confirmed a clear trend in favor of writing down goodwill and recording it at a nominal value (Avery, 1942, p. 356, 363).

In general, as Canning (1929, p. 43) or Nobles et al. (1941, p. 198) underline, there was at the time a "popular practice of writing off"; hence, rapid amortization techniques, either charging to expenses or even more often, when goodwill was too large for the profits to "bear", charging to equity, could very plausibly have been widespread.

Goodwill still had the bad reputation associated with it in the previous period: otherwise, Sanders, Hatfield and Moore (1938) would not have been able to assert that there was a "pervasive feeling" that goodwill added nothing to the balance sheet and a leading opponent of this view would not have felt obliged to stress that there was "no reason to exclude it from the respectable family of assets" (Paton & Stevenson, 1922, p. 409).

The dominant practice continued to favor "killing off" goodwill: "nobody seems to regret its disappearance when accomplished by methods which fully disclose the circumstances" (Sanders, Hatfield & Moore, 1938, p. 14; Catlett & Olson, 1968, p. 94). There was an "almost universal feeling that the balance sheet looks stronger without it" (Sanders, Hatfield & Moore, 1938, p. 14).

Indications of a move towards the dynamic approach start to appear near the end of this period, although those indications are slight: for instance, the AIA (American Institute of Accountants), referring to the write-off treatment in its ARB 24 (AIA, 1944), considers that "since the practice has been long established and widely approved, the committee does not feel warranted in recommending, at this time, adoption of a rule prohibiting such dispositions. The committee believes, however, that such dispositions should be discouraged, especially if proposed to be effected by charges to capital surplus". In view of conflicting opinions on the matter, the AIA left its members the choice of the most appropriate solution, including the possibility of keeping goodwill on the balance sheet with no reduction in value – although on the whole, this was not a highly regarded technique. Significantly, at the end of this period, Werntz, the SEC's chief accountant, declared "in those cases in which a registrant has retained goodwill indefinitely in its accounts, the staff has inquired into the propriety of this accounting treatment. As a result of an analysis of the nature of the account, a number of registrants have undertaken programs of amortization that will result in charging the goodwill to income, or, in some cases, earned surplus, over a reasonable number of years" (Werntz & Rickard, 1945, p. 5-6).

Clearly, the "retaining" technique was not yet accepted at the time. Writing off goodwill (with the losses charged against equity) was considered a good solution because it did not affect current profits. On the other hand, if the losses were large, they would probably end up causing problems for many companies, whose "dividend reserves" would dry up while their indebtedness rates soared.

3.2.3 Germany: the weakened static phase (1985-2000)

The main difficulty for the analysis during that period is due to the fact that Germany has introduced in the lump the European accounting directives in its regulation and has reformed both the individual and consolidated accounts, with different solutions for the sake of goodwill. We accordingly present in a separate way both sets of regulations before drawing a global conclusion on the state of the question in that country.

a) The case of individual accounts

The German law of 1985, which incorporated the fourth EU directive into German regulations, includes a paragraph 255 with three sections on the treatment of goodwill in individual financial statements:

- section 1: goodwill may be capitalized if it has been acquired;
- section 2: if goodwill is capitalized, it must be amortized each succeeding year by at least 25 per cent;
- section 3: the amortization may, however, also be distributed systematically over the years which are likely to benefit (Ballwieser, 1996).

A first look at this "hesitating" text allows to draw the following conclusions: the law does not compel to treat goodwill as an asset and allows as it was before the case to write off immediately the corresponding disbursements in expenses. It can be even ascertained that the "expense-solution" remains the normal solution (Küting, 1997, p. 49; Duhr, 2003) as far as section 2 obliges, as a matter of principle, if the goodwill is nonetheless capitalized, to

proceed to a very rapid amortization within a lapse of time inferior to 5 years. This basic solution is explained, according to the doctrine, by the traditional rule of prudence (Walz, 1999, Margin note 82; Duhr, 2003, p. 973; Ellrott, 2003, Margin note 245).

But the section 3, introduces a doubt in the solidity of the basic solution: for the first time in the history of Germany an official text permits to treat the goodwill according to the dynamic view with a real capitalization and an amortization all along the period of use.

It is not surprising that, faced to that ambiguousness, judged by some specialists deprived of logic (Busse von Colbe & Ordelheide, 1993, p. 234; Küting, 2000, p. 102), the German doctrine hesitates on the nature of goodwill in the individual accounts. It seems that the majority of the German authors (see namely Busse von Colbe, 1986, p. 87; Förschle & Kropp, 1986, p. 155; Söffing, 1988, p. 599; Weber & Zündorf, 1989, p. 334; Förschle, 1995, margin note 7; Küting, 1997, p. 461; Ludz, 1997, p. 70; Baetge, Kirsch & Thiele, 2002, p. 262) consider that neither the text of the law nor the character of goodwill (which is neither individually resalable nor individually valuable and which represents anticipated benefits) could permit to confer to goodwill the status of a true asset. For a good number of these authors, the goodwill, if it is capitalised, is only a "balance sheet-help" ("Bilanzierungshilfe", an item which can be recorded by exception in the balance sheet although it is not an asset), i.e. (according to our own interpretation) a fictitious asset to be scrapped the most rapidly possible. A few number of these authors, while denying to the goodwill the status of a true asset, are not making of it a balance sheet-help as far as they deem that contrary to the traditional true balance sheet helps, such as the preliminary foundation expenses, the law has not provided for a prohibition of the distribution of dividends if the capitalized goodwill has not been totally amortized. These authors (like Adler, Düring & Schmalz, 1995-2000, § 255, p. 421; Krolak, 2000, p. 16; Baetge, Kirsch & Thiele, 2002, p. 263) think that the goodwill is an "aliud" (a special being not classifiable). It also seems that only a minority of authors (like Brezing, 1991, margin note 28; Moxter, 1993, p. 860) consider goodwill as a true asset while

principally leaning on the fact that the article 255,4.3 allows for a dynamic treatment (in that sense Söffing, 1988, p. 598). Indeed, since 1956 (and even since 1931, according to several authors), legal decisions from the BFH had not made of the salability of a good a necessary condition to its capitalization but the BFH still required the objective separate valuation (Söffing, 1988, p. 598-599; Moxter, 1993, p. 855; Hommel, 1997, p. 354-361), what Moxter considered to be a fundamental barrier to the evolution towards the full recognition as an asset (Moxter, 1993, p. 861; Moxter, 1998, p. 478).

At this stage of the reasoning, we should conclude that, although, from the point of views of regulation, there is a break-through of the dynamic solution, which constitutes an undeniable novelty in the German context, the basic solution, ascertained by the dominating doctrine, remains that one of the classic static conception. This view can be strengthened by the opinion of those who think, on the basis of legal sources, that the introduction of the dynamic solution is only due to tax motivations: to permit to the companies to opt for the new regulation for the amortization of goodwill in 15 years as decided by the tax legislator in 1985 (Söffing, 1988, p. 606-607). But this view must be confronted to the solutions provided for in matter of consolidated accounts.

b) The case of consolidated financial statements

The treatment of goodwill in consolidated accounts is codified by the article 309-1 of the Code of Commerce. This article shows two fundamental oddities in comparison with its equivalent for the individual accounts.

The first novelty, which obligatorily derives from the European text, is that, as a matter of principle, the goodwill must be (and not may be) capitalized (article 309-1, alinea 1). At first sight one could think that this difference of writing presages a different treatment from the one applied to individual accounts. But a second oddity must be taken in account.

The latter lies in the fact that the German legislator has used the flexibility of the article 30 §2 of the seventh directive which permits to the States to authorize the companies to write off

goodwill against equities. A good number of German authors followers of the unicity of individual and consolidated accounts, notably Busse von Colbe and Ordelheide (1993, p. 233) and Küting (1997, p. 455) underline, referring to Niehus (1986, p. 239), that this liberality is the result of a demand of Great Britain and constitutes an "error". At all events this "error" has been legalised by the German legislator whereas he was not obliged to reproduce it. Indeed the article 309-1 alinea 3 authorizes the German groups to write off goodwill on the consolidated retained earnings (without specifying, at the difference of the seventh directive, that the write-off must be immediate). Let us precise, to complete the scene, that the German legislator has integrated for the consolidated accounts the other solutions recognized in matter of individual accounts: rapid amortization in a maximum of 5 years (alinea 1) and amortization over the period of use (alinea 2).

What can be thought of this rather astonishing flexibility? Two remarks can be done taking account of the texts and their implementation. Following the texts the obligation of capitalization is purely a formal one as far the goodwill can be immediately written off against the reserves or even recognised as an expense: the only real change in comparison with the individual accounts lies in the fact that the weakened static solution (of an "English style") is now possible.

From the point of view of practice, the studies described by Busse von Colbe and Ordelheide (1993, p. 234, note 31) and Küting (2000) show that, for the examined period, there was a real craze from the part of the German groups for the weakened static solution. According to Küting (2000), who made a study on 193 groups in 1988, only 41.7% of groups amortized goodwill in expenses in a rapid way or according to the period of use (while precising that the solution of a long period of depreciation is preferred to the short one which represents only 10% of the cases). On the contrary, 58.3% of the groups choose the solution of a total or of a partial write off on equities. Germany in that respect owns a specificity: the lack of clarity of the texts permits to the groups to choose a progressive write off of goodwill

against equities and even to restrict this solution to certain subsidiaries which stirs the reprobation of the majority of authors.

These observations permit to draw the following conclusions. From 1985 onwards the German legislator has opened the doors to allow for the use of dynamic solutions (in the individual and the consolidated accounts) and the weakened static solution (consolidated accounts only) while retaining the possibility of a pure static solution. The German groups have "voted" and showed their clear preference for a solution of the weakened static style. The dynamic solution although not negligible is a secondary one. The pure static solution has become an oddity.

All that material permits to ascertain that, due to the decisive importance of the consolidated accounts, the 1985-2000 period has rather been that of the weakened static solution. So, what could appear for Mildebrath in 1931 (Mildebrath, 1931), as an anglo-saxon specificity has become 50 years later a German oddity!

3.3. Phase 2 in France: the fiscal approach (1917 – 1982)

From 1917, a new, powerful actor began to intervene on the French accounting scene: the tax administration. Its theory of how goodwill should be treated was to have great influence on commercial doctrine and regulations, so much so that the situation has been described as the "hijacking" of accounting by taxation. This phenomenon was unique in the four countries studied and lasted more than sixty years from 1917 to 1982.

a) The new doctrine of the French tax administration in the individual financial statements

To begin with, when the first major French law (the law of July 31, 1917) on income taxes was enacted, the tax view was not openly hostile to the static approach. Article 4 of the law simply stated that taxable profit was the amount after deduction of all expenses, including "amortization generally accepted in the practices of each type of industry".

But subsequently, no doubt for budgetary reasons (Prospert, 1934, p. 71), the tax administration, in an instruction of March 30, 1918, refused all systematic (and a fortiori rapid) amortization of goodwill, arguing that "the value of goodwill generally increases… except in rare cases of depreciation" (Brière, 1934, p. 181).

From 1918 to September 1925, the French tax administration's position was as follows: all amortization was impossible, unless it could be proved (generally this was very difficult for taxpayers) that the goodwill had really lost value. As we shall see, this position was based on doctrine inspired by ideas from the actuarial view. In 1925, the administration took a more hardline position. A ministerial decision of September 15 ruled that no amortization (or provision) would now be allowed, and this was confirmed in article 29 of the Instruction of January 31, 1928.

How can this extreme position be explained? The main reason is that under pressure from taxpayers, the administration came to accept that capital gains on business transfers should be tax-free[2]. In exchange for this concession, capital losses would no longer be deductible, even when proven (Brière, 1934, p. 64-67).

This radical system only lasted three years, from 1925 to 1928. In 1928 the matter was brought before the courts by disgruntled taxpayers. In response to their complaints, the *Conseil d'Etat* finally allowed amortization of goodwill on condition that the loss of value was "effective", "permanent" and affected the goodwill "in its entirety"[3]. This decision was confirmed four years later in a very interesting ruling which stipulated that goodwill was "not a start-up cost" but "an asset"[4].

The administration had to give way to the judges and acknowledge that amortization was possible if the overall effective loss of value was demonstrable. In fact, the issue ceased to be relevant when the laws of March 28, 1933 and decree of July 20, 1934 reintroduced the

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[2] (Ministerial decision of September 15, 1925 confirmed by a *Direction Générale* circular of September 19, 1925 and a circular of June 29, 1925 issued by the Direct Contributions department).
[3] Conseil d'Etat, Aug. 3, 1928, comment Brière, 1934, p. 185.
[4] Conseil d'Etat, Jan. 8, 1932, Gazette du Palais, Feb. 23, 1932.

"balance sheet approach" and systematic taxation of all capital gains, including gains on sales of goodwill. There was no longer any reason to oppose the possibility of depreciating goodwill.

From then on, and practically from 1928 to the modern day, the French tax administration's position remained almost constantly as follows:

- goodwill is an asset (but start-up costs are not);
- goodwill cannot be systematically amortized;
- goodwill can be reduced in exceptional circumstances.

b) The influence of the tax administration on French doctrine

We shall consider tax and commercial doctrine separately.

Tax doctrine

Most major specialists in taxation defended the stand taken by the tax administration. This was the case for Lecerclé (1922), Besson, Bocquet, Durand and Bourrel (quoted in Brière, 1934, p. 26-36). Lecerclé (1922), who appears to have been one of the leaders in this school of thought, reflects the thinking of the time: goodwill can only be amortized "in very exceptional cases" if there is a regular, constant decline in the value of the business (Brière, 1934, p. 176).

Commercial doctrine

Supporters of the static doctrine naturally found themselves on the defensive against tax theorists. For supporters of the actuarial approach, on the other hand, such as Charpentier and Hamelin (1933), convictions were strengthened.

Some authors, including major names, remained faithful to the static approach. Batardon, for example (1931, p. 185-187), continued to group goodwill together with start-up costs and called for rapid amortization, at least for limited liability companies. Prospert (1934) also

declared he was for "precipitate" amortization of start-up costs (1934, p. 123) and opposed the commercial and tax solutions for treatment of goodwill (1934, p. 127).

But defence of the static approach grew half-hearted. Dalsace (1944, p. 93-96), the final defender of a strictly static conception of accounting over the period 1940-1965, did not dare mention goodwill as part of start-up costs and made no comment on how it should be treated.

c) The influence of the tax administration's position on French accounting regulations

Its influence was considerable. As early as 1944, Dalsace (1944, p. 142) was complaining about all those who were "giving in" to the tax administration's ideas and pointed out that "all financial or fiscal considerations should be independent of asset valuation and amortization". A few years later, one essay was entitled "the hijacking of accounting by taxation" (Rives, 1962).

As regards goodwill, this hijacking was obvious from 1947. From the first French General Accounting Plan (*Plan comptable général*) (CNC, 1947, p. 79-81) it is clear that tax (i.e. actuarial) concerns had got the better of static and dynamic approaches: there is no (systematic) amortization account for goodwill, merely a provision account (but no indication of how it should be used). The situation was unchanged ten years later when the 1957 General Accounting Plan was issued (Poujol, 1965, p. 96), and continued until 1982.

In fact, the tax administration's grip on accounting dates back to the circular of January 25, 1930, which states "(tax) amortization must be effectively applied and shown in the profit and loss account". Although a few years later the *Conseil d'Etat* allowed commercial amortization to differ from tax administration (Conseil d'Etat, 1933, quoted by Prospert, 1934, p. 98), businesses and even the French standard-setters got into the habit of taking tax rules into consideration when drawing up balance sheets for commercial purposes.

France's acceptance of the tax administration's position disallowing systematic amortization of goodwill should not be taken to mean that France was in advance compared to other countries; on the contrary, it is the sign of a delay in its "normal" development towards

stock market capitalism. Tax doctrine, meanwhile, only used "modern" accounting theory when it served its budgetary purposes.

d) The case of consolidated financial statements

The preceding developments handled with individual accounts. In the case of consolidated statements the situation in France also showed a peculiarity in comparison with the other countries. Indeed, up to 1985, there had not been any strict obligation for the French groups to establish consolidated accounts. In 1969, the COB had published a recommendation for the listed groups to establish and publish consolidated accounts but in spite of net progress in comparison with the situation in 1967 (at that time only 22 companies freely published group accounts), the situation yet remained very below a normal one: even in 1982, only 333 companies (i.e. less than 67% of the listed companies) established consolidated accounts (Raffegeau, Dufils & Corre, 1986, introduction). During all that period the only French text which the groups wishing to establish consolidated accounts could refer to was a CNC's report published in 1968 (CNC, 1968) and revised in 1978. This text proposed that the goodwill (named at that time "*Prime d'acquisition des titres de participation*" – "Acquisition premium of long-term investments") should be maintained without change in the consolidated balance sheet (without any systematic amortization), "except if some special circumstances justify the reduction of its value by the constitution of a provision for impairment" (CNC, 1978, § 4102a). It is to be seen that this solution remained in line with the tax and accounting doctrines which prevailed at that time for individual accounts. But it should be noted that, in the absence of strict rules, the groups were not obliged to follow this framework.

The first French books on consolidated accounts are visibly inspired by American or English solutions. So Richard and Veyrenc (1954, p. 6, 18) quote Montgomery, Paton and Robson and publish the SEC rules so as the English law of 1948 on groups. Some studies seem to show that as soon as at time a few French groups take a hint from the most "modern" American rules. So Péchiney amortized its goodwill over 10 years in 1969 and 40 years in

1973 (Bensadon, 2002, p. 58). There was then at that time a conflict between the French "regulation" and the "desires" of groups.

3.4. Phase 3: the dynamic phase

3.4.1. United States: the dynamic position comes out on top (1970 - 2001)

In a free competition economy, the accounting standards system is not generally in favor of pluralism: to regulate competition, the standards must have the dominant interests at heart. This does not mean matters are always simple.

In the 1940s, three main phenomena were visible on the American scenery: the doctrine and practice of writing off goodwill was in decline, the dynamic doctrine and practice began to take over, and there was still some resistance to doctrines and practices that wanted goodwill to have no impact on profit.

a) The decline of the write-off

The decline of the write-off approach can be observed in the theory, regulations and practice. This calls for some explanation. In the doctrine, the decline is clear, at least from around 1945-1970. The leading author of accounting literature at the time was the renowned Paton (1962), who like other authors such as Walker (1953), Kripke (1961), Hylton (1964; 1966) and Wolff (1967, p. 258), was in favor of dynamic approaches and against goodwill write-off. His opponents were only minor authors, often practitioners such as Catlett and Olson (1968), and Spacek (1973), who found themselves in the minority in discussion committees on the development of accounting standards.

The decline in the regulations is just as obvious. In 1948, the American Accounting Association (AAA) decided that "adherence to the cost basis of accounting requires that there should be no suppression or unwarranted assignment to expense of the cost of existing assets" (AAA, 1948, p. 340). Although not stated explicitly, this was aimed at "arbitrary" write-offs, particularly charging to reserves.

The AIA took an even clearer stand a little later: “lump-sum write-offs of intangibles should not be made to earned surplus immediately after acquisition, nor should intangibles be charged against capital surplus” (AIA, 1953, p. 39-40).

The AIA’s basic position was that acquired goodwill should be systematically amortized by reduction of current income. But write-offs were still allowed. A decisive attack on this stand came in 1966 in the form of APB Opinion No. 9 concerning prior-period adjustments. This argued that write-offs should in principle be charged against current income. They could only be charged to retained earnings if ... they were “not attributable to economic events occurring subsequent to the date of the financial statements for the prior period and [depended] primarily on determination by persons other than management and were not susceptible of reasonable estimation prior to such determination”. In such cases, “goodwill amounts which previously would have been charged to retained earnings under the provisions of Chapter 5 of ARB 43 (AIA, 1953) would now be classified as extraordinary items” (Catlett & Olson, 1968, p. 3). The final attack (at least openly) came in 1970 with APB Opinion No. 17 (AICPA, 1970b) which totally prohibited immediate write-off.

The decline of the write-off was equally strong in practice. Taking nominal valuation to be equivalent to a write-off, then enthusiasm for the rapid depreciation of goodwill can be seen to wane over the period 1958-1973 in the statistics provided by Hughes (1982, p. 156), based on figures from the Accounting Trends and Techniques. Interestingly, this decline begins before the appearance of the regulations of 1966 and 1970, but is also greatly influenced by them.

The reasons for the declining popularity of the practice are not clear. The standard argument of the time, used by upholders of the dominant doctrine and the regulations, is that a write-off precludes matching of expenses to revenues, and more broadly, prevents accurate assessment of performance. But in the light of goodwill’s global history, this is not necessarily convincing. It is also possible that charging goodwill to equity, particularly to

reserves, turned out to be less than "optimal" despite its merits, because it eliminated reserves that were useful for dividend distribution. This appears to be confirmed by the opinion of one of the leading professional actors of the time, the audit firm Arthur Andersen. One of its best-known partners declared quite unambiguously that pooling of interests, a method that was to develop subsequently (see below) was invented for two reasons:

- to prevent goodwill appearing;
- to make it possible to "maintain the earned surplus" (Spacek, 1973).

The second reason, mentioned by Spacek, but also by Kripke (1961, p. 1029, note 3), is particularly interesting, because it shows that the write-off approach is not optimal given its sudden impact on retained earnings.

Another problem for the write-off solution was that it reduced the financial surface: "killing" of the balance sheet at a time when it was more and more important to show the creation of value on the stock markets (see below) was not so good. Some companies, taking this view, sought another "acceptable" if not better approach.

b) The rise to dominance of the dynamic approach

The move towards the dynamic approach happened slowly. It probably began in the 1930s, a period of serious economic depression when businesses tried to reassure shareholders by providing a "smoothed" (to apply a modern term) presentation of income. This is what is apparently suggested by the Correspondence between the Special Committee on Co-operation with Stock Exchanges of the American Institute of Accountants and the Committee on Stock List of the New York Stock Exchange: "Some method, however, has to be found by which the proportion of a given expenditure to be charged against the operations in a year, and the proportion to be carried forward, may be determined; otherwise, it would be wholly impossible to present an annual income statement" (Correspondence, 1932-1934, p. 6, quoted in Catlett & Olson, 1968, p. 32). But in a context of economic crisis with conservative approaches still very strong at the time (Kripke, 1961, p. 1032), it was too early for full

application of this “new” doctrine, at least for goodwill. It was only in the 1960s and 1970s that the dynamic doctrine came to dominate in treatment of goodwill in a period of slacking stock markets, and big failures showing that the defence of creditors by the state was no more the worry of the state which prompted some economics to wonder if the corporation “can survive” (Jensen & Meckling, 1978).

Although it was not absolute (as we shall see below), this domination is clear in both regulations and practices. The main explanatory factor is the introduction of particularly interesting measures for companies. Nelson (1953), a practitioner, develops a “momentum theory of goodwill” to advocate the amortization of goodwill.

In terms of regulations, the main official document reflecting the domination of dynamic practices is APB Opinion No. 17 of 1970, which stipulates that “all assets which are represented by deferred costs are essentially alike in historical-cost based accounting” and that goodwill, in keeping with this view, must be “amortized by systematic expenses over a certain period”. This effectively cancelled out the options left open by ARB 43 ch. 5, which had favored write-offs. It is worth while noting that the same year 1970 the APB adopted the Statement No. 4, Basic concepts, and specified that “assets also includes certain deferred charges that are not resources but that are recognized and measured inconformity with GAAP” (§ 132). At that time this was the definitive victory of the dynamic theory and goodwill could be at last treated as a respectable cost-asset!

In terms of practices, the study by Hughes (1982) referred to above shows that although the practice of systematic amortization stagnated from 1958 to 1959, once the regulation of 1970 came into force there was a resulting increase in this type of treatment. It was clearly the majority choice by 1972, and had become the dominant practice by around 1975.

But it was a hard-won victory. To persuade a majority of companies of the merits of the dynamic approach, the APB had to allow them to use a very long amortization period for goodwill: up to 40 years. This was well in excess of the periods proposed by the early

proponents of the dynamic approach, and the average term of investments. Kripke, among others, believed that a suitable maximum term would be 20 years (in Catlett & Olson, 1968, p. 142). The APB's 40-year maximum was generally understood to be a "compromise", granted to companies as an incentive to replace the old write-off method (Arthur Andersen, 1970, p. 4; quoted in Hughes, 1982, p. 149) (and in our opinion, this change of method was beneficial for the companies). It must be remembered that this compromise took place in an environment where many companies were actively seeking an even "better" solution.

c) Continued opposition

It is always difficult to satisfy all companies, as they all operate in different conditions. APB 17 was adopted by 13 votes for over 5 against, indicating significant "resistance" to the dynamic approaches. The other traditional views in the history of goodwill treatment in the Unites States – the static view and the actuarial view – not only made their presence felt but additionally gained a certain degree of recognition by being prepared to adapt, and proposing solutions that were even more beneficial than the dynamic approach.

Resistance by the static view

For some companies, busy around 1970 with massive mergers on a scale the United States had never seen before, the prospect of having to amortize enormous amounts of goodwill – even over 40 years – was problematic. The immediate reduction in income that would result was felt to be a less satisfactory solution than a reduction in reserves or equity. These companies, specifically in the high-inflation environment of the time, contended that the result of purchase accounting and systematic amortization of goodwill "is to destroy earnings", and "the public will not readily accept the concept that earnings are destroyed" (Kripke, in Catlett & Olson, 1968, p. 128). In fact, they argued, "it is likely that many of the business combinations … would not have occurred if purchase accounting and amortization of the resulting goodwill had been required" (Catlett & Olson, 1968, p. 53).

Arthur Andersen came to the defense of these companies, and through its main spokesmen, Catlett, Olson and Spacek, brought back the static theory: goodwill was not a (true) asset. It was instead the unstable result of simple expectation, and as such should be removed from the balance sheet immediately by charging to reserves or capital (Catlett & Olson, 1968). Interestingly, these authors are taking up one of the fundamental arguments of the static doctrine, that it is impossible to sell the goodwill separately: “the goodwill of a business may be different in nature from the other elements in the value of the business in that goodwill is not separable in the sense of being saleable apart from the business as a whole” (Catlett & Olson, 1968, p. 12). Colley and Volkan (1988, p. 41) are also in favor of writing off goodwill against equity, for the unidentifiable portion of the excess payment over fair values of net assets acquired, the identifiable part being capitalized and amortized. Miller (1973, p. 280, 291), who contends that recorded goodwill exists because of an inadequate theory of aggregation of assets, concludes that “the least harmful resolution appears to lie in the immediate write-off against income”.

As one commentator on Catlett and Olson’s work remarked, their reasoning appears to be “resurrecting the spirit of the late 20’s and early 30’s, when in the interest of conservatism, it was popular to write off anything that might embarrass future reported results” (Defliese, in Catlett & Olson, 1968, p. 118). In fact, despite appearances, the spirit of their thinking is very different from the 1930s. In preferring a write-off against capital to a write-off against reserves (1968, p. 92), Catlett and Olson are not really in line with the static approach. It is as if the static doctrine was used only as an excuse for a particular objective – to avoid any drain on profits – that has nothing to do with its traditional purpose.

In parallel to the “doctrinal resistance”, pressure was put on members of the APB, with a certain degree of success. The result was a “modern” and “beneficial” version of the static solution: pooling of interests. Until 1950, the only business combination method that existed was the purchase accounting method (Catlett & Olson, 1968, p. 45). Pooling of interests was

“discovered” in 1950 with ARB 40 (AIA, 1950), but was not of great interest until 1957 because the write-off method was neither yet discredited nor prohibited. But starting from 1957, in a high-inflation context that saw goodwill values shoot up, pooling began to play a strategic role for companies who were reluctant to amortize and wished to carry on using practices similar to write-offs (Catlett & Olson, 1968, p. 3-4). Throughout this period there was great pressure to broaden the criteria for application of the pooling of interests method, which paid off in 1957 when ARB 48 (AIA, 1957) “provided greater endorsement of this accounting” (Catlett & Olson, 1968, p. 4). As it has been emphasized “the unanimity with which the leading public accounting firms, the SEC and the NYSE have acquiesced in the process is evidence that accounting under the pooling method operates as a safety valve and fills a real need” (Kripke, 1961, p. 1036). As in this era net income figures are the life blood of the capital markets (Kripke, 1961, p. 1038), the pressure continued nonetheless, and in 1965 – only one year before the write-off method was eliminated! – the APB stated that the limits for use of pooling (resulting from ARB 48) were simply “for guidance”.

The struggle was not yet over: in 1969, the APB considered prohibiting pooling in a political environment calling for checks on mergers, seen as bad for national employment (Spacek, 1972). But once again, under pressure from businesses the APB backed down, in two stages:

- initially, it agreed to the continuation of pooling of interests provided restrictions were introduced, principally a required minimum size (one third) for the main company;
- subsequently, it gave more ground over the question of the restrictions themselves, so that not only was pooling of interests recognized as a practice, but it was more flexible in application.

To conclude, the pooling of interests method could be used by any group undertaking a merger by exchange of stock. While this meant that the write-off technique was no longer as widely accepted as in the previous period, it remained possible to use it in a particularly

"advantageous" form (elimination of goodwill with no impact on reserves) for some merger transactions.

But this was a long way from the spirit of the static approach supporters of the early years of the century. The underlying issue now was no longer the drop in profits caused by expensing an "embarrassing" asset, but on the contrary the need to preserve earnings! It is not unreasonable to wonder whether the pooling of interests method had not sounded the death knell for the static doctrine, no longer well regarded in accounting. Its only remaining supporters, who continued to defend it up until the 1960s, were certain financial analysts and lawyers (Kripke, 1961, in Catlett & Olson, 1968, p. 83) (see also Paton in Catlett & Olson, 1968, p. 153). Some last defenders of the static exchangeability principle are yet to be find in the nineties (Schuetze, 1993).

Resistance by the actuarial view

The history of goodwill shows that even as far back as 1900, some companies considered that the "best" way to treat goodwill was by not depreciating it at all. Neither ARB 24 (AIA, 1944) nor ARB 43 (AIA, 1953) ruled out this option. But the dominant cultures of the first two phases, both the static culture up to the end of the 1940s and the dynamic culture that then replaced it, prevented any real recognition of this solution in either doctrine or practice.

As Hughes (1982) points out, there are few references to the actuarial doctrine in publications over the period 1958-1980. Only few authors dare, like Knortz (1970), and especially May (1943; 1957; quoted in Catlett & Olson, 1968, p. 88-89) and Gynther (1969), to speak openly in defense of this approach. Representatives of audit firms, however, continued to support this position (as did four of the five opponents to the systematic amortization method in the vote on APB Opinion No. 17).

This resistance explains why APB Opinion No. 17 does not affect existing practices, and allows non-retroactivity for the new rule of systematic amortization.

This review of practices shows that temptation to keep goodwill unamortized in the balance sheet assets was still extremely strong in the United States throughout this phase, particularly between 1966 and 1972. After 1972, the dynamic doctrine took over, but the desire to use the actuarial approach remained at the back of the minds of a good many US businesses. This fact is important to fully understand the current situation.

As far as pooling is concerned it must be noted that this method, although possible, was not a dominant one: "the purchase method was used to account for most business combinations" (Johnson & Petrone, 2001, p. 100). As Johnson notes, "many combinations that could have been accounted for by the pooling method were treated by the purchase method" (1999, p. 80). However, in the 1990s, there was a growing trend, especially for high technology companies that buy start-up businesses, to use pooling (Ayers, Lefanowicz & Robinson, 2000, p. 8-9; Johnson & Petrone, 2001, p. 100; Moehrle, Reynolds-Moehrle & Wallace, 2001, p. 247). This trend again indicated that the dynamic solution was not optimal for some (influent) enterprises especially those for whom goodwill represented very large proportions of assets and whose returns could be greatly impacted by the purchase method (Ayers, Lefanowicz & Robinson, 2000, p. 12-16). Some of them did not hesitate to "pay" to achieve pooling accounting (Robinson & Shane, 1990; Lys & Vincent, 1995; AAA - Financial Accounting Standards Committee, 1998, p. 88; AAA - Financial Accounting Standards Committee, 1999, p. 302).

3.4.2. France: third phase: the dynamic phase (1982 – 2005)

After a period of more than sixty years' "stagnation" in France, this phase brought sudden signs of a clear change in treatment of goodwill, and the dynamic approach became more popular.

The first sign came in the third postwar official General Accounting Plan (*Plan comptable général*) of 1982. This reintroduced a goodwill amortization account, and stated that "intangible items making up goodwill do not necessarily benefit from legal protection that

confers a certain value" (CNC, 1982, p. 120). Thus a degree of incentive for amortization for accounting (rather than tax) purposes appeared. A survey of the treatment of goodwill in financial statements of the largest French groups between 1988 and 1998 shows that almost one half of these groups applied a systematic amortization of goodwill. This confirms a clear evolution towards the dynamic approach (Richard, Becom Simons & Secafi Alpha, 2000, p. 168).

The move towards the dynamic approach was confirmed by the regulations governing consolidated accounts. Decree 67-236 on companies, amended following the law of 1985 on consolidated financial statements, ruled that unallocated goodwill arising on first consolidation "must be included in income over a period of amortization", while regulation 99-02, paragraph 21130 of 1999, stated that "the amortization period must… reflect the assumptions used and objectives evidenced at the time of acquisition".

It is true that even regulation used the flexibility allowed by the seventh directive and introduced for French groups the possibility to write off goodwill against reserves. But, contrary to its German counterpart, French regulation stated that this write off could only happen "in exceptional circumstances duly justified in the note" (Decree of 23 March 1967 modified in 1986, § 248-3). Obviously, the French legislator wanted to restrain the use of the weakened static approach in favor of the dynamic view.

Survey of practices of French groups provides evidence of the (forced) alignment of these groups on dynamic theses. Richard et al. (2000, p. 163-164) show that from 1987 to 1998, the systematic amortization of goodwill (over a longer and longer period, reaching more that 10 years in 92% of cases in 1998) became the rule for the 100 largest groups, whereas the write off against reserves concerned at the end of the period only 2 or 3 groups.

The last issue deserving our interest is pooling. At the beginning of the period, the method is unknown in regulation as it is unknown in practice (Raffegeau, Dufils & Corre, 1986, p. 444) although its use became possible, under certain conditions, with the article 20 of the

seventh directive. It is only in 1999 that the French regulator, wishing no to "disadvantage" French groups, has decided to introduce this method of treatment of goodwill in French regulation (CRC, 1999, § 215). But this method has been rarely used for two main reasons (the second one being probably more important). On the one hand, this method was "derogatory", submitted to strict conditions. On the other hand, its appearance on the French scenery took place not long before the regulator announced its project to put an end to its use. In 2000, this method concerned only 4 French groups (Anonymous, 2001, p. 90).

The last question is why most French companies (with enough influence to achieve substantial change in the regulations) wanted to adopt a dynamic approach. In our opinion, it was certainly not simply in opposition to the tax administration's non-amortization position! In around 1980, a time of significant development at the Paris stock exchange, the influential businesses were the large companies listed in France or in other countries which having no desire to see their financial income sapped by systematic amortization, were in favor of non-amortization of goodwill and other similar intangible assets such as brands and market shares (Richard, Becom Simons & Secafi Alpha, 2000, p. 173). The tax administration's recommended approach should in theory have been perfect for these companies.

The main reason for the move towards a dynamic approach was, we believe, a process of imitation: in order to build an international reputation, large French companies had to comply with US and/or international rules, i.e. rules which at the time favored the dynamic treatment of goodwill. The third "French" phase was in fact an international phase dictated by the dominant solutions of worldwide capitalist accounting (see below).

3.4.3. Great Britain: the move towards the dynamic position (1990 – 2005)

The period from 1990 to the modern day saw the arrival of laws that either recommended or imposed amortization of goodwill. To fully understand this evolution, we need to look at what was happening in international standards. In 1990 ED 47 (ASC, 1990) recommended systematic amortization of goodwill, but no final draft followed due to fierce opposition from

the part of companies (Brown, 1998, p. 61; Paterson, 2002b). In 1993, a discussion paper (ASB, 1993) also recommended systematic amortization, and in 1997, FRS 10 (ASB, 1997), preceded by FRED12, made capitalization plus systematic amortization over a period of up to 20 years the preferred method, although non amortization with application of an annual impairment test was also allowed.

As far as the company law required that goodwill is amortized and non-amortization can be justified only under the conditions to provide a true and fair view and to justify that goodwill has an indefinite long life it is possible to ascertain that the basic new rule was the systematic amortization. This assertion can be confirmed by the facts. In spite of the fears of some authors who think that most of companies could choose to let goodwill unamortized (Paterson, 1998, p. 124), nearly all companies choosed the amortization solution with a majority opting for a period of amortization of 20 years (Arthur Andersen survey commented by Powling & Rigelsford, 1999). However, not all the British companies were satisfied with this solution: not only the very few that used the merger solution but also some companies that changed goodwill into brands and newspaper titles in order to escape the amortization (Paterson, 2003, p. 98).

Globally, in spite of the fact that goodwill was yet not formerly recognized as a true asset, the rules were clearly leaning towards the dynamic solution. But an alternative approach is always an option. This dualistic stance can be interpreted in two ways:

- the most plausible interpretation is that the British standard-setters had to yield to the solutions adopted in the United States and the IASC (IASC, 1993), which favored systematic amortization;
- but alternatively, it may indicate that some British businesses were looking to stop the write-off practice in favor of another, more favorable approach: non-amortization with impairment tests. This would make the deal not write-off versus amortization, but write-off versus the actuarial approach.

3.4.4. Germany: the (short) dynamic phase (2000-2005)

In a context of globalisation and of rising power of the American type of governance backed by some international accounting organisations such as the IASB it is not surprising that numerous voices could be heard in Germany at the end of the 20th century saying to put an end to the German "peculiarities" and proposing an alignment on the dominant American views. A lot of studies have shown that the German companies the most oriented towards the American market and more broadly towards the international markets wished a "convergence" of the consolidation rules with those of the IASB and even those of the FASB. This influence has weight on the position of the accounting standard-setters and the representatives of the chartered accountants, leading to what Busse von Colbe (1995) has described as a "change of paradigma". But an unexpected problem raised with another change of paradigma that occurred in the US at the very time when a new philosophy, already obsolete, came to the birth in Germany: hence the extreme shortness of this phase.

Paradoxally, it is the tax jurisprudence which had first given the example in abandoning as soon as 1971 its actuarial position while asserting that the goodwill was indeed a "mortal" economic asset: this new position had leaded to the admission of the deductibility of tax depreciations in 1985 (Söffing, 1988, p. 612).

But in 1988, the Board of the Chartered accountants had taken a position against the write-off of goodwill in compensation of retained earnings and proposed a systematic capitalisation with an amortization over its period of use assorted with a limit of 40 years in the mood of the American regulation (Küting, 2000). But, as in France, the positions of the Chartered accountants have not the character of regulations and have remained a dead letter, all the more than the length of the amortization period had been criticized (Küting, 1997, p. 451).

In 1998, the law "on the facilitation and the reception of capitals" (KapAEG) had introduced an article 292a in the Commercial Code that allowed the German groups (until 2004) to adopt the IAS rules and even the FASB's rules for consolidated accounts, under the

condition that these rules will be compatible with the European Directives and the GoB's ("*Grundsätze ordnungsmässiger Buchhaltung*", i.e. "Principles of proper accounting") positions.

The DSR (Deutscher Standardisierungsrat - German Accounting Standard Board), that new organism charged by the Ministry of Finance to forge a new regulation in matter of consolidated accounts, had confirmed with its first standard, the DSR1, that the American rules could be considered as an equivalent to the GoB. Then in July 2000, the DSR had published the DRS4 (DSR, 2000) on the "acquisitions of companies and group accounts. This DRS, schematically:

- imposes the systematic capitalization of goodwill as an element of the companies' wealth (DRS 4.1f);
- prohibits all write-offs against the equities (DRS 4.27-29);
- imposes a systematic amortization (normally a straight line) over the period of use with a limit of 20 years (DRS 4.31). This amortization is assorted with an eventual impairment if the recoverable value is inferior to the net book accounting value (DRS 4.34). Clearly, as a whole, the DRS had espoused the IASC's thesis, itself fundamentally in line with the American conception of the time.

So at the end of the year 2000 things seem to be clear in Germany. Under the influence of the US and the IASC and at the demand of more and more companies that wanted to be able to invest in the American market without to be obliged to (largely) modify their accounting statements, the new German regulatory board had, in spite of the resistance of partisans for a static conception of accounting, boldly opted for the dynamic solution.

But "lack of chance", in 2001 the American standard-setter published the FAS 142 which rang the bell for the systematic amortization of goodwill to the profit of actuarial solution (simple impairment based on the estimation of future cash flows). The DSR found itself before a difficult problem: could it go on asserting that the new American rules were compatible with the European and the GoB rules?

In spite of the preventions of a large part of the major actors of the German doctrine such as Busse von Colbe (2001, p. 879) and Hommel, (2001, p. 1943), and, more largely the majority of the members of the Scientific Committee for Accounting (according to Siegel, 2002, p. 749), the DSR, after an "animated debate", published in 2002 the DSR1a (DSR, 2002) specifying that the new American doctrine on goodwill did not prevent the adoption of the FASB's standards as a substitute for the GoB. Moreover it maintained the DSR4 in the same state as before. These decisions had the effect of a bomb in Germany. Very rare were the professors who as Zimmerman (2002) defended the position of the DSR. The most moderate of the commentators did not fail to underline the totally contradictory character of the two standards and the apparent illegality of the adopted American rule as referred to the texts of the seventh directive and the GoB (Krawitz cited in Siegel, 2002, p. 749; Duhr, 2003, p. 974). Busse von Colbe (2004), in a very clear synthesis, deals with the "application of American criteria from a German perspective". Moxter (2001, p. 1) referring to Louis XIV ascertained that in violating the text of the European Directive (that provides for a systematic amortization) the DSR had acted according to its "*bon plaisir*". The partisans of the traditional prudent approach denounced an "insane" way of capitalization which allowed for the registration of a part of the created goodwill (Siegel, 2002, p. 749) and opened the road for an "Enronisation" of the German accounting (Schildbach, 2005, p. 1). The only hope that remains for these numerous opponents was the possibility of a veto by the Ministry of Justice. Unfortunately for them the text of the DSR was ratified on the 6 of April 2002 (*Bundesanzeiger*).

It can be concluded that the case of goodwill has been played in very dramatic conditions in Germany. While the majority of the enterprises were preferring a weakened static solution the fringe of companies mostly vested in the globalisation, sustained by the Chamber of public accountants, a part of the doctrine and the new DSR, wished to align, for the sake of international credibility and financing problems, on the dynamic solutions proposed by the

IASC and the FASB before 2001. That claim was granted without a true resistance of the actors of the German accounting. But hardly it was known that every thing was put in question by the "revolution" coming from the FAS 142. In a context of very strong resistance by the German doctrine to the new American deal the defendants of the new international order needed the "forceps" to pass the new philosophy of impairment in the expectation of its ratification by the European Union. Because of the American change the dynamic phase has been very short in Germany, at least for the sake of consolidated accounts.

3.5. Phase 4: the actuarial phase (recognition with impairment)

The ideal dreamed of by authors like May (1957), who had recommended non-amortization of goodwill, came true for the first time independently of any tax considerations in the United States, the leading country in financial accounting, at the end of the second half of the 20th century.

3.5.1. USA: the fourth phase: the actuarial phase (2001 - Nowadays)

The adoption of an actuarial conception of accounting in the USA goes back to the concepts Statement (CS) No. 5 (FASB, 1984) and 6 (FASB, 1985). It is worth noting that at that time the Board rule out the old static exchangeability condition (CS number 6, § 26) while having "both the business combinations and conceptual framework projects on his agenda at the same time and thus may have at least been thinking about goodwill when considering how assets should be defined" (Johnson & Petrone, 1998, p. 301, note 5). But it took rather long to apply these new actuarial conception of assets. Only after more than 20 years did the revolution appear with the adoption of SFAS 141 and 142 (FASB, 2001a, 2001b) which supersede APB Opinion No. 16 and 17 (AICPA, 1970a, 1970b), and were a major event in the United States. Under these new standards, goodwill, whether acquired individually or in a business combination, will no longer be amortized but submitted to an impairment test, by comparing

the fair value of reporting unit goodwill with the carrying amount of that goodwill (FASB, 2001b, § 20).

These new standards represent a victory for the actuarial approach: goodwill is an asset whose value depends on future factors. A large part of the doctrine recognizes that while permitting to take account for the sake of impairment of the whole of future cash flows the door is opened to the integration as an asset of some part of created goodwill (IASC, 1993, § 47; Hommel, 2001, p. 806-807).

3.5.2. Other countries: moving towards the actuarial phase?

As this article was being written, another important event took place: the adoption in March 2004 of standard IFRS 3 (IASB, 2004b) which replaces IAS 22 (IASC, 1993), and the revised standard IAS 38 (IASB, 2004a). IFRS 3 requires goodwill acquired individually or in a business combination to be recognized as an asset, prohibits the amortization of goodwill acquired and instead requires the goodwill to be tested for impairment annually. As the IASB explicitly states (2004b, § IN3), "it would be advantageous for international standards to converge with those of Australia and North America".

Since all listed EU companies will have to prepare their consolidated financial statements in accordance with International Accounting Standards/International Financial Reporting Standards from 2005 onwards at the latest (European Union, 2002), the three other countries in our study, Great Britain, Germany and France, will thus enter the actuarial phase in 2005, at least for the consolidated financial statements of listed companies.

4. Discussion

4.1. The reasons for the new solution

As said above, in all our four countries the first phase was one of great reluctance to see goodwill as a true asset. It was considered an "embarrassing" asset, which should be made to disappear quickly by any method. This hostility to goodwill originates in the influence of

lawyers, or bankers defending creditors' interests. They were firmly against recognition of "fictitious" assets that would be unable to cover debts in the event of bankruptcy. Of course, this position was problematic in countries where the stock market played a dominant role and "demanded" profits right from the beginning of the investment cycle. For that very reason, compromise solutions were found earlier in Great Britain and the United States than in Germany. Rather than "getting rid of" goodwill by expensing, which did not reflect well on the company's profitability, these two countries preferred to write it off against shareholders' equity. But this compromise can still be considered part of the first phase due to the underlying philosophy – non-recognition of goodwill. Curiously, France followed a very individual path in this respect. At the start of the period studied, the doctrine of non-recognition was dominant in France as in the other countries, but a disruption factor came into play in 1917: the influence of the tax administration, which, for essentially budgetary reasons, took an official stand in favor of recognizing goodwill as an asset and prohibited its amortization. Viewed internationally, this position was nothing unusual in purely tax terms, and can also be observed in the other countries in our study. But what sets France apart is the way its tax administration "hijacked" the accounting system (to borrow a well-known phrase from French research), imposing its thinking on accounting rules despite opposition from commercial lawyers. It is thus paradoxical that France apparently soon became the most "modern" of the four countries concerned here.

The choice of this actuarial solution was accompanied by a suppression or a quasi suppression of the pooling (merger) option. It is an optimal solution in the sense that it permits to better manage the results (Kleindiek, 2001, p. 2576; Küting & Reuter, 2005) and, during the life of the firm, at the macroeconomic level, to increase the mass of assets without diminishing the mass of results if impairments are deleted to the last moment when the companies are in a state of bankruptcy (see Paterson, 2002a, for a similar view). This actuarial view, for a short-term oriented manager or shareholder, is much better than the pure static

view which conducts to massive losses at the beginning of the investment cycle and even better than the dynamic view that reduces the earnings all along the cycle (Richard, 2004a, 2004b).

Pooling was a good solution for the sake of results but not a good one for the sake of balance sheet: it created "hidden reserves" (Johnson & Petrone, 2001, p. 101) which was problematic in a context where firms will show their "strength" to their shareholders. Furthermore it has a very bad reputation and prevented the comparability of results (Johnson & Yokley, 1997; FASB, 1998, 1999; Johnson, 1999, p. 80). The new solution was optimal in the sense that it offered nearly all the advantages of pooling without its defaults.

It is interesting to note that globally this solution was judged to be a good one by the "elites" of the four countries at that time (see below).

4.2. U.S.A.

A fundamental question here is to understand why the US was the first to refute the static solution (in a pure or even in a moderate way) and adopting first the dynamic solution then switching to the actuarial one and why it took so long to the other countries to discover the merits of these "modern" solutions.

As far as the US are concerned our study is in line with recent works of economists especially those of Lazonick and Sullivan (LS in the rest if paper) (2000) and Aglietta and Rébérioux (AR in the rest of the paper) (2004). These authors have shown that "corporate governance for most US corporations from their emergence in the late nineteenth and early twentieth century through the 1970s was based on the strategy of retain and reinvest" (LS, p. 24). They have also shown that during all this period the pressure of professional stock market investors was very low (LS, p. 31) and that "top managers tended to be integrated with the business organizations that employed them" (LS, p. 24) which means that the power was generally, in the hands of block shareholders and banks. The merit of our study if any is to show that this strategy of retain and reinvest has been nevertheless declining as far as the

accounting system has gone from a pure static to a dynamic stance. The reason for this decline is presumably linked with the "conglomeration mania" and the "massive expansion of corporations that had occurred during the 1960s" that "resulted in poor performance" and "huge debt burdens" in the 1970s (LS, p. 15-17): to face this situation big American corporations were obliged to switch their accounting system to a dynamic one.

The same economists show that in the 1980s "as part of a parcel of the Reaganite revolution" (LS, p. 14), there was a new phenomenon with "the exclusive focus on shareholder value" (LS, p. 14). Due to problems of performance and international competition the American economy switched towards a more financial approach with a focus on short-term gains (LS, p.15-16). There were progressively a deregulation of the banking sector in favor of saving and loans institutions (LS, p. 17). There was also a rapid development of pension and mutual funds. This rise of the importance of the professional shareholders was accompanied by a decline of the strength of trade–unions in a context of job tenure decline (LS, p. 19-21). All these various and converging factors explain why the power went to short-term oriented professional shareholders and why there were a strong trend towards maximal and short-term profits so as so a distribution of massive dividends experienced by the rise of pay-out ratios in the 1980s and 1990s (LS, p. 22, AR, p. 83).

No wonder that the killing of the dynamic solution and the choice for the actuarial solution were the natural consequences of this evolution.

In the course of that description, the managers have disappeared. As it is well known the place of managers in the context of the play of powers is a contested one. According to the famous Berle and Means's thesis (1932), in most American big companies, the managers have taken the power due to the dispersion of shares. This thesis has also been used as one of the pillars of the agency theory whose main purpose is to find means to solve the (basic) conflict between managers and shareholders (Jensen & Meckling, 1978). But as soon as 1974, the Berle and Means's thesis has been contested by Zeitlin (1974), and afterwards by many other

authors. Even at the time of the birth of the agency theory, Demsetz proposes a kind of "theory of alliance" according to which there could be a "strong linkage between management and owners interests" (1983, p. 390). This kind of position has been recently resumed by Lazonick and O'Sullivan. They point out that contrary to those who have argued "often without justification, that the managers who control the allocation of corporate resources and returns are self-serving in the exercise of this control (…) shareholders *and* (our emphasis) top managers have certainly benefited under the rule of share holder value" (2000, p. 27).

As far as accounting for goodwill is concerned it is difficult to find in the American literature any text expressing the opposition of big managers to the concealment of the systematic amortization of goodwill. The victory of the actuarial positions seems to be more in line with the theory of alliance than with its counterpart, the agency theory. Globally speaking it seems, as one leading American economist seems to acknowledge (Stiglitz, 2003, p. 175), that managers have followed the holders of power: this explains why we renounced to consider them as a special social force.

4.3. Great Britain

To European continental actors, the case of Britain is the most surprising one, because this country is often associated with the idea of the domination of stock markets and dispersed shareholders on accounts in a similar and may be even more accentuated way as the USA. But this picture is a false one. Historians of British business have shown that financial capital and especially stock market capital has only begun to play a leading role for the majority of (even) big British firms in the 1970s (Wilson, 1995, p. 193) and that "the shareholder preeminence achieved in the 1980s and 1990s, far from being a normal state of affairs, is an anomaly (Davies, 2002, quoted by Armour, Deakin & Konzelmann, 2003, p. 2). Before that period, the famous family firm directed by "gentlemen" (it means owners-managers), was the dominant feature of the British economy (Coleman, 1987, p. 8; Gourvish, 1987, p. 33-34; Wilson, 1995, p. 155). No wonder in these conditions that, up to that time, self generated capital was still the

most popular means of funding the investment (Hannah, 1983, p. 62; Wilson, 1995, p. 129-130). If we add that British banks went on pursuing a conservative and liquidity conscious strategy it is easy to understand why the traditional "weakened static" solution initiated by Dicksey could have been so long successful: both self financing family owners and prudent bankers could only been pleased with such a solution! This de facto alliance between creditors and long-term investors was particularly acute during the inter-war years, as it has been stressed by Edwards (1989, p. 138) and Maltby (2000), but it has had very long consequences as far goodwill is concerned. Of course as soon as the 1970s, and the rise of the financial capital, the British economy became a kind of dualistic economy with the persistence of the traditional family firm and the rise of international giants financed by external capital. This explains why as soon as 1980, at the time of discussion of SSAP 22, in the early 1980s, there was a clash between the proponents of the "weakened static view" and the tenants of the dynamic approach. With the era of the takeover bids (second half of the 1980s) and the necessity to inflate the balance sheets in order to avoid the predators, the static solution became more and more problematic for many British giants. This plus the influence of the dominant international solutions of the time may well explain why the dynamic solution emerged in the 1990s. In spite of the fact that, as Armour et al. (2003, p. 22) underline it, the provisions of European Community Directives could be "a major countervailing force to shareholder primacy", the main fact is that in 2002 a large majority (74%) of UK CFOs say that companies are eager to apply the IAS before 2005, presumably because UK has a strong capital market (Holgate & Gaul, 2002). In the same sense Paterson noted that if "a charge for goodwill amortization is not of great interest to the City, having to adjust the target's net assets to fair value is more significant" (2001, p. 98).

4.4. Germany

Germany has been the country were the (pure or weakened) static solutions have been the longer to disappear. This is not astonishing: up to a recent period, say the mid 1990s, the

environment was very hostile to shareholder value. Only after that period are sign in favor of a change. As it is well known, the traditional German system of governance is based on three pillars (Jürgens, Naumann & Rupp, 2000, p. 59): the banks, the co-determination and a company-centered management.

Up to 1998 the role of the stock market has been marginal for the financing of German companies. For example from 1991 to 1997 the average percentage of financing by the stock market represented less than 4% of the total financing while self financing represented 62% and financing by bank credits about 21% (Deutsche Bundesbank, 1995, p. 25, cited in Jürgens, Naumann & Rupp, 2000, p. 62). Before 1998 the role of private pension funds was minor (Jürgens, Naumann & Rupp, 2000, p. 71). The power was largely in the hands of the big German families and the banks but under the pressure of the representatives of employees. These three groups form the traditional "governing coalition" (Hackethal, Schmidt & Tyrell, 2003). In 1992 the banks had no less than 61% of the voting rights of the 100 listed companies thanks to the virtue of proxy votes (Baums & Fraune, 1995, p. 103). The influence of the representative of employees although variable was quite important in a majority of supervisory boards (Gerum, 1991). In such a context the problem was not to create values at short-term and distribute dividends but find self financing, reimburse bank loans and assure the stability of the work-force in the long-term. Even the German managers formed in the spirit of technical rather finance engineers (Eberwein & Tholen, 1990) participated to that consensus in favor of accumulation for long-term tasks. No wonder in these conditions if accounting and notably accounting for goodwill was directed towards prudence and the retention of results for the sake of creditors and their allies the managers. This fundamental characteristic has been shown by German authors (Barth, 1953; Döllerer, 1971; Beisse, 1993; Schön, 1997; Moxter, 1998; Weber-Grellet, 1999) as well as French ones (Richard, 2002a).

But in the middle of the 1990s things have begun to change. A series of inquiries (Förschle, Glaum & Mandler, 1998) showed that, in a context of globalization of markets and necessity

(due partly to the needs coming from the reunification) to find new ways of financing coming from Anglo-American stock-markets, some of the top managers of the bigger and the most internationalized listed German companies began to think the development of their companies after the model recommended by American consultants and academics in favor of shareholder value (see also the examples given by Jürgens, Naumann & Rupp, 2000, p. 74). Presumably under this influence the government issued a series of regulations aiming at developing a more Anglo-Saxon type of management: creation of a "German SEC" (1995) merged in 2001 with the German Financial Services Authority, detaxation of capital gains (1998), allowance for the creation of private pension funds (1998), creation of the "new stock market" (1997), abolition of multiple voting rights and restrictions for the banks to use their proxies and cross-shareholdings (1998), introduction of a mandatory bid into the new takeover law of 2001, creation of a new private organ for the promotion of international accounting standards.

All these measures and particularly the related rapid development of private pension funds guided by shareholder value principles significantly changed the landscape and the style of management of the elite of the big listed companies and banks (Jürgens, Naumann & Rupp, 2000, p. 71). This extremely rapid change may explain why as soon as 1998 it was permitted to the listed German groups to opt for the international or even the American accounting principles and why at Brussels there was no opposition from the part of Germany to adopt the new international rules concerning goodwill in matter of consolidated accounts. All in all the famous laws of 1998 on the "Raising of Equity Relief - Kapital-Aufnahme erleichterungsgesetz" and Kontrag, as described by German authors (Böcking & Orth, 1998; Claussen, 1998; 1999; Hommelhoff et al., 1999; Haller & Eierle, 2004), and commented by Richard (2002c; 2002b), have permitted a clear evolution of the big German capital towards the US criteria of management.

4.5. France

Like Britain the case of France could be surprising. In spite of its traditional reputation to be state and family driven (the famous "*cent familles*" – hundred families - that govern France), this country has adopted a dynamic treatment of goodwill (as far as consolidated accounts are concerned) much sooner than Germany and even Britain. The explanation is relatively simple. As it has been showed by French economists, notably by Morin (2000, p. 41-42), on the basis of documentation provided by the Banque de France, France is a country where the influence of foreign investors (especially "anglo-saxon") is very high. As soon as 1985 the share of foreign ownership held on various French stock exchanges represented 10%; and this share has grown up to 35% in 1997! During that period, probably in line with this evolution of the power on the stock market, the traditional "cross-shareholding" model has been disintegrating especially rapidly after 1996 (Morin, 2000, p. 38). The growing influence of foreign investors, notably the North American pension funds, has driven a new style of management oriented towards shareholder value. As Morin says (2000, p. 45), after interviews held in 1998 with managers of leading French companies, he "has been able to verify that this diktat regarding norms is being observed throughout the CAC 40 index companies". He adds (p. 49) that "many directors admit that it is impossible to escape the demands made by the US and British investors" which confirms our hypothesis of a link between management and shareholders. This evolution of the French capitalism towards a growing power of shareholders is also observable in accounting regulation: Colasse and Standish (1998) have shown how the composition of the CNC (*Conseil National de la Comptabilité* – National Accountancy Council), in charge of the regulation of accounting, has rapidly evolved in the nineties in favor of the representatives of big (listed) enterprises and audit companies to the detriment of the public sector. All these factors explain why the French accounting legislation in matter of goodwill have always followed since at least 1985 the American or international standards.

5. Conclusion

Our article sets out to study the evolution of accounting for goodwill in four countries, Great Britain, the USA, Germany and France, and over a period of more than one century. We show that at the outset these four countries were in an identical position, with a static vision of accounting for goodwill, and that they are currently converging towards a similar phase using the actuarial approach (recognition and impairment testing). Interestingly, the actuarial view, which is in the process of becoming the dominant practice, was already in existence in the 1900s.

We have attempted to explain this evolution with reference to the social nature of accounting. Four groups of social forces were identified: lawyers, bankers, tax administrations and the capital markets. While lawyers were the most dominant social forces at the start of the period covered by our study, capital markets are obviously the major influential forces of our own time. The tax administration's role varies according to the country: it is a major player in France but a minor player in the United States, where tax and financial reporting are independent of each other. The tax administration's influence can also be considered inversely proportional to the influence of consolidated financial statements. In the United States, the first country to invent consolidated financial statements, the influence of taxation has been consistently low. The US model was therefore the first to feel the need to change the old system (expensing or charging to reserves), then the first to adopt amortization, then impairment testing. The lawyers and creditors have lost power to the shareholders, who are demanding faster and faster reactions and results. Unlike Nobes (1992), who refers to the image of a cycle in accounting regulation, and unlike Mattessich (1992) and Saghroun and Simon (1999), who introduce the principle of a pendulum, we show a "one-way" evolution of accounting regulation on goodwill in the four studied countries towards the actuarial phase, which is totally different from the initial phase, the static approach.

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Figure 1 – Summary: Influence of social forces

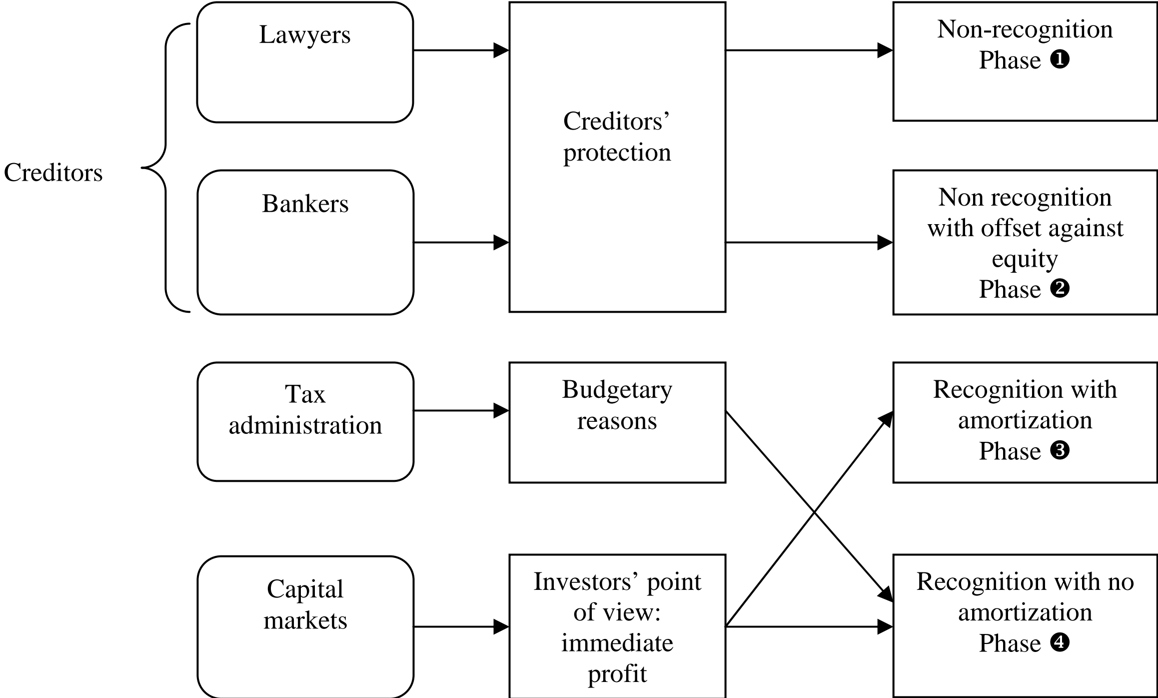

Figure 2 – Summary: Four phases of accounting regulation on goodwill: