

THE ESTIMATION OF THE COMMERCIAL CAPITAL - GOODWILL

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Abstract: The notion of commercial capital is used in present bookkeeping law in Romania and it represents the part from the commercial capital that is not mentioned in other elements of patrimony, but which take part at the maintenance or the development of the unity as: the customers, the commercial good custom, the reputation, outlets. For the evaluation of the commercial fund must be taken into account the fact that the requests stated in the international standards of applicable bookkeeping, the specifications and the provisions of the internal legislation with reference to the norms of evaluating the actives. As a viable method for determining the size of the goodwill it remains the difference between the rentability value and the bookkeeping net active. In certain situations (acquisition, merging, division, liquidation, taxing) it is necessary the estimation of the commercial fund in an anticipated way, be it for the establishment of a negotiation base or for other motives. The evaluators benefit in this case of certain methods presented within the evaluation that can be grouped in direct and indirect methods. The direct methods have as ground in their landing the super profit, and the indirect ones the super value.

The goodwill concept may have many forms, depending on the way in which it is viewed:

- according to the evaluation standards of A.N.E.V.A.R. (Romanian National Assessors Association), the goodwill represents the immaterial active that appears as a result of the commercial name, of the customers' reputation, the placement of the firm, the characteristics of the products, the qualification of the staff and other similar factors which have not been identified and evaluated in a distinct way, but which bring their support to obtaining profit.

The landing of goodwill by means of assessors generated a new concept too, called MVA (Market Value Added), which is the difference between the market value of the firm and the cumulative value of the shareholders' investments and of the reinvested profit.

- goodwill is the ensemble of the immaterial elements that can not be detached of the economical entity and that can not be evaluated in isolation, but which contribute to a enterprise value that is superior to the sum of the component values. The commercial capital determined in this way takes the form of a immaterial active, that obeys the standards regarding the immaterial actives of liquidation, inventory, the evaluation at the date of the balance sheet and the giving up;

- the goodwill is an intangible active which normally represents the excess of an enterprise value opposed to the value of its tangible actives [5];

- the goodwill is an intangible active account which indicate the bonus paid over the inventory value of an acquisition [1].

In French terminology the anglo-saxon notion of goodwill is used throughout other two more restrictive notions, respectively the notion of superevaluation and more often the notion of trade fund. The trade fund is an ensemble corporal or uncorporal elements managed by a trader or by an industrialist, in his enterprise.

In the present bookkeeping law from Romania the notion of commercial capital is used and it represents the part from the commercial capital that is not mentioned in other elements of patrimony, but which take part at the maintenance or the development of the unity as: the customers, the commercial good custom, the reputation, outlets.

The commercial capital should not be mistaken by the trade capital, which represents an unitary asset characterized by the reunion of immaterial elements with some material elements belonging to one tradesman and permitting him to develop his customers.

Regarding the obey of the prudence principle, there are not included in the commercial capital elements that were created by the enterprise, but only if the component elements of the commercial capital have been acquired, the goodwill have been generated internally and its value being attested in time in the moment of the transaction.

Also the registration of the commercial capital in the bookkeeping is done in the case of the contribution to the social capital, its value being given by the difference between the utility value and the correct value.

In the case of the transaction of the firms there appeared many problems of the correct determination and the transfer of the goodwill from the seller to the buyer. From this point of view the quantification and the separation of the goodwill elements that are transferred from the elements that are attached to the seller is difficult (for example good custom, fame or eventually, employees) and it cannot be transferred to the buyer, like a good management, the relationship that the seller has with authorities and other elements connected to the personal characteristics of the seller.

In order to register in the bookkeeping of the commercial capital at the moment of the acquisition of a commercial society, the commercial capital is determined with the relation:

$$FC=CA-(TA-D)=CA-ANC \quad (1)$$

In which:

CA = the acquisition cost;

Ta= the total of the assets evaluated at their correct value;

D= the debts evaluated at their correct value;

ANC= the net bookkeeping assets.

The main elements that draw the existence of goodwill are:

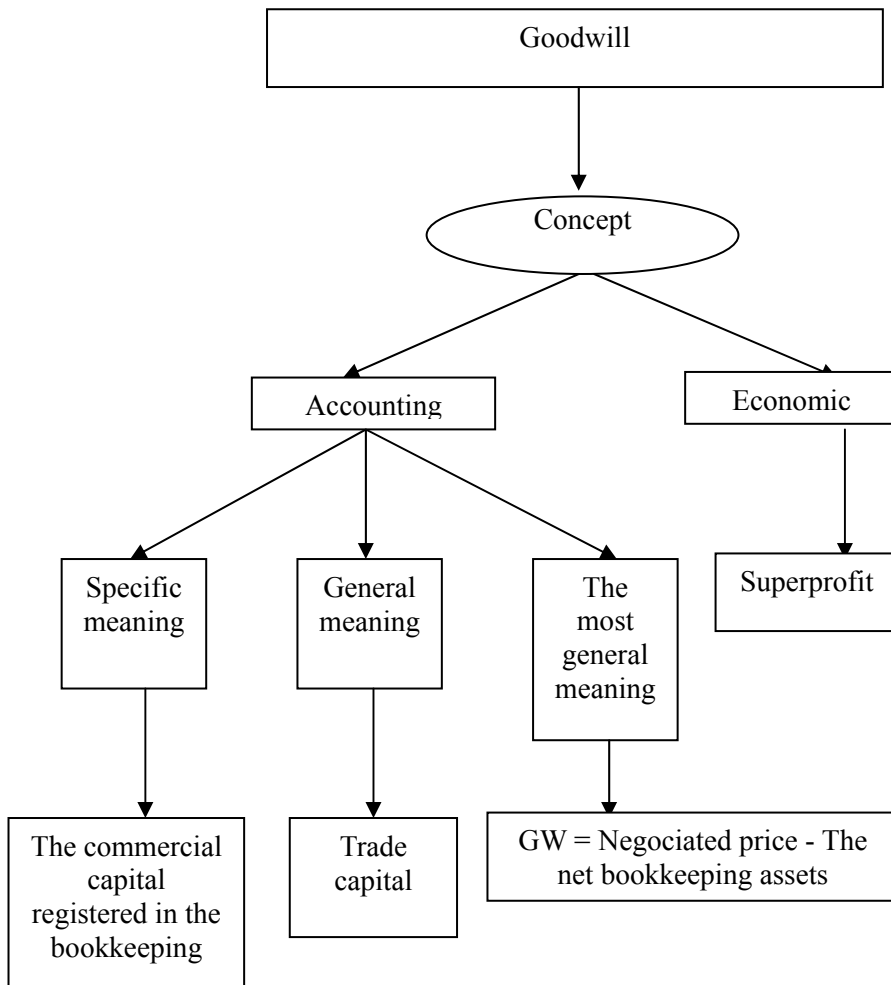
- the permanent and occasional clients, which is the main structure, influenced by the emplacement and by the enterprise image, aiming at making clients faithful, creating good relations with the customers, also the possibilities of the customers development;

- the firm or the sign of the producer or the seller, his reputation, which are elements that implicitly lead to the relationship this has with the contractors, the clients, the financial institutions, the banks, etc.;

- the competence of the enterprise staff, the knowledge accumulated by this, the managers performance, the adaptability and the receptivity of the staff to the performant methods of management;

- the right of industrial, commercial, literary property, studies and researches that are done;
- different material elements made mainly of materials, equipment that serves to the development of the exploration activity, informatical apparatus;
- the quality of the products or the services;
- competition elements, like the number and the position the competition has on the same market segment.

According to the presented definitions goodwill can be seen as the following diagram:



In practice there are many methods to estimate the value of the commercial fund of an enterprise:

a) the commercial fund can be calculated by the actualization of the superprofit. Superprofit means the extra profit made by an enterprise for the invested capital in its actives as opposed to a capital investment of the same value paid for at the medium rate of the market:

$$GW = P - i \times A \quad (2)$$

Where: Gw = the commercial fund or the goodwill

P = the profit of the enterprise taken into account for the evaluation

I = the medium profitability rate on the market

A = the net active of the enterprise.

The value of the commercial fund will be estimated by the actualization of these supplementary profits above the number of years of the business existence.

b) The evaluation of the commercial fund under the form of the difference between the global value of the enterprise and the net bookkeeping active.

$$GW = Vr - A \quad (3)$$

Example:

Concretion Elements	The X Enterprise	The Y Enterprise
Net Bookkeeping Corrected Active (A)	50	50
Corrected Net Profit (P)	6	8
The Profitable Value (Vr)	10x P	10xP
Goodwill (GW)	GW _x = 10x6-50=10	Gw _y = 10x8-50=30

It can be seen that the Y enterprise, having the same net active and the same multiplier of the profit as the X enterprise, has a commercial fund three times bigger, because of the rectified profit which comprised the goodwill implicitly.

c) The commercial fund can be determined by the evaluation of the components elements. Because it is difficult for the assessor to estimate the immaterial actives in the structure of the commercial fund, this method is relatively little applied.

There are situations in which the rectified net active is bigger than the rentability value and this leads to a negative commercial fund.

For estimating the global value of the enterprise, in the case of the negative commercial fund, the assessor can have two solutions:

- not to accept a negative value for the commercial fund and to give it the minimum value zero;
- the negative commercial fund is seen as a sanction for the insufficient rentability in comparison with the medium market rentability, and the negative value, the badwill is subtracted from the rectified net active.

In accordance with the harmonization of the Romanian bookkeeping with the 4th norm of the Economical European Community and with the International Bookkeeping Standards, the bookkeeping treatment of the intangible and immaterial actives, is mainly comprised in the rules of IAS 22 "Enterprise combination" and IAS 38 "Immaterial actives".

The immaterial form of these actives makes their identification difficult, their quantification being based mainly on the waves of anticipated superprofits, having as main determinants the unique way of the processes and the enterprise's abilities. It results from here the great subjectivity of the approaches regarding the commercial fund, the goodwill, the determination of its size, its amortization being at the will of the bookkeepers. The length of the amortization period must reflect the best estimation of the period during which it is expected that the enterprise obtains future economical advantages [7].

The low efficiency of the stock market makes this comparison between the market value and the bookkeeping value to be used by investors more in order to establish if the market is super evaluating or subevaluating the stocks of the enterprise.

IAS 38 makes this idea stronger by a distinct paragraph: “The difference between the market value of a firm and the bookkeeping value of the net actives identifiable at any moment can contain a range of factors that affect the value of the firm. Anyway this kind of differences cannot be considered as representing the cost of the immaterial actives controlled by the firm”. Therefore they try to avoid the bookkeeping in the account of the commercial fund of some surpluses of value with temporary speculative aspect.

In conclusion, as a viable method for determining the size of the goodwill it remains the difference between the rentability value and the bookkeeping net active. It will disappear from the evaluation the connection with the market, the length of the goodwill depending not so much on the capacity of the enterprise of generating it but on its evaluation on the market. Taking into account the raised volatility of the profits resulting from the exploitation of the commercial fund of the enterprise, the investors associate to these super profits high risks of realization. When the unrealising risk is very high the value of the commercial fund tends to zero, which implies its non-acknowledgement as an immaterial active of the enterprise.

According to IAS38 “ an immaterial active must be recognized if and only if :

- a) it is estimated that the future economical benefits which can be attributed to the active will be obtained by the firm;
- b) the price of the active can be evaluated in a right way”.

The carefulness principle bars the way of the recognition and capitalization of the commercial fund created by the enterprise.

The welter of fulfillment conditions for the recognition of goodwill produced by proper resources determines the bookkeepers to pass the costs of its production on loss. Therefore the rapture between the bookkeeping value and the market value of the enterprise is made larger.

From the table presented below we can observe that the norms from other countries are less drastic in this field of activity.

Regarding the commercial fund from an acquisition, the determination of its size and its capitalization are stated by IAS 22.

Although IAS 22 (paragraph 22) insists on the idea that the “ commercial fund” represents a payment made by the debtor by anticipating the future economical benefits, its value can be raised by the direct acquisition costs. Therefore, depending on the permission of the bookkeeping rules ,it can be often met the creative bookkeeping practice through which a part of the expenses present in the profit and loss account of the buying enterprise are evaporating at the time of the acquisition, being capitalized in a sublime way as a acquisition commercial fund.

The bookkeepers creativity occurs more when we talk about the liquidation of goodwill at an international level existing a great diversity of rules in this field of activity.

Table 1

The bookkeeping reglementation of commercial fund (goodwill) reazed of proper resources

Country	The bookkeeping rules
Australia, Canada, Sweden, USA, Holland, Spain, Great Britain	- The same rules as in the case of the acquired goodwill
France	- The capitalization of goodwill without the requirement of any liquidation of this one , but with the possibility of its provisioning
Italy	-The liquidation in a period of until five years -The liquidation in a period that doesn't surpass the life of the active
Japan	The liquidation in a period of maximum five years
Germany	-The liquidation in a period of until five years - The liquidation in a period that doesn't surpass the life period of the active

According to IAS 22 (paragraph 44) “ the commercial fund must be liquidated on a systematic bases during the useful life period. The liquidation period must reflect the best estimation of the period in which the future economical benefits are expected to be generated by the enterprise(..). The useful life of the commercial fund will not go beyond twenty years of its initial recognition.” There is a hypothesis (disapproving) according to which the useful life of the commercial fund will not go beyond twenty years from its initial recognition.

If the using period is longer than twenty years IAS 36 imposes the yearly concretion of the recovery value of the commercial fund, from the moment of its initial bookkeeping. If the using duration of the commercial fund was estimated at less than 20 years from its initial recognition, and after that the duration of the utile life goes beyond twenty years, starting with the moment of its initial bookkeeping , the enterprise makes the depreciation test and gives the imposed information.

In the context of the former specifications, the commercial fund is presented in the balance sheet at its cost minus the liquidation cumulated or a loss from debasement. Sometimes it is difficult to establish if the commercial fund is depreciated or if its value has risen. This is because the potential of economical advantages initially acquisitioned is progressively by the potential of economical advantages that results in the further improvement of goodwill. In other words the acquisitioned goodwill is replaced progressively by an internal goodwill generated by the enterprise.

Moreover, the difficulty of establishing the depreciation has as a cause the fact that the commercial fund must be taken as a whole , but the different component elements have very different statuses , some can be evaluated by reporting them to the information offered by the market, while others are impossible to quantify.

For determining the length of utility of goodwill more factors are taken into consideration:

- a) the nature and the predictable life duration of the acquisition of the enterprise;
- b) the stability and the predictable life duration of the activity field to which goodwill corresponds;

- c) the information regarding the characteristics of goodwill in the enterprises or the similar fields of activity and the type life cycles of the similar fields;
- d) the effects of the products becoming out of fashion, of modifying the sale market request and of other economical factors that can influence the activity of the acquired enterprises;
- e) the professional life span of the persons or groups of employees and the problem of knowing if the acquired enterprise is could be managed in an efficient way by another managing staff;
- f) the level of maintenance costs or the required finances for obtaining the future economical advantages that are expected from the acquired enterprise and the capacity and the intention of the enterprise of reaching this level;
- g) the expected actions from the part of the competitors or the potential competitors;
- h) the length of control over the acquired enterprise and the legal or contractual stipulations that affect its utility duration.

In certain situations (acquisition, merging, division, liquidation, taxing) it is necessary the estimation of the commercial fund in an anticipated way, be it for the establishment of a negotiation base or for other motives. The evaluators benefit in this case of certain methods presented within the evaluation that can be grouped in direct and indirect methods. The direct methods have as ground in their landing the super profit, and the indirect ones the super value.

In the case of the negative commercial fund resulted from the acquisition (in the case in which the acquisition cost is smaller than the correct net value of the identifiable values), according to IAS 22, this will presented as a subtraction from the reporting enterprise actives, in the same classification of the bookkeeping balance sheet as the commercial fund.

If this badwill is in direct relation with the expected future loss, its passing on income in the profit and loss account will be made when the loss and the future expenses are recognized.

The international IAS 22 was replaced by the international organism, that imposes to the European enterprises directioned to the IFRS system to apply the international standard of financial report 3- combinations of enterprises, made after the American thought, so it is passed by the convergency filter.

Therefore the enterprise management must take into account every international standard of bookkeeping and its specifications, in the matter of establishing the bookkeeping politics in accordance with the reality.

From the many modifications brought into the new standard we can retain two:

- The bookkeeping method
- In accordance with IFRS 3 all groups of enterprises that come under its incidence will be bookkept using the acquisition method, that is applied starting from the buyer's interests, taking into account the fact that the evaluation of the actives and the debts is applied only in the account of the buyer and only for the actives and the debts acquisitioned.
- The further bookkeeping of the commercial fund
- In accordance with IFRS3 the commercial fund acquisitioned from a group of enterprises will be evaluated after the initial recognition at the cost level diminished with the losses accumulated after the debasement. Therefore, the commercial fund is

not liquidated but it is verified annually or every time there are signs that it suffered a loss by depreciation.

- This approach generated many bookkeeping controversy, being considered more difficult the establishment of the depreciation of the commercial fund after doing the test in accordance with the IAS 36 standard regarding the depreciation of actives, compared to the liquidation of the commercial fund.

- The determination of the overplus of the part rate from the buyer's interests in the active value of the actives, the debts and the eventual debts acquisitioned in report with the cost.

The term excedent is used when the acquisition cost is lower than the part rate from the buyer's interests in the correct value of the actives, the debts and the eventual acquisitioned debts.

Case Study Regarding the Evaluation of the Commercial Fund According to IFRS 3

On the 1st of September, year N, the firm X obtained 80% from the shares of the Y firm, at a price of 26.800 u.m. We know the following information about the Y firm at the acquisition date: identifiable actives expressed in the historical value of 42.000 u.m.; proper capitals evaluated at the historical value of 20.800 u.m.; identifiable actives expressed in the correct value of 43.200 u.m.. The benefit tax rate: 16%.

We suppose that at 31st December N there are clues that the Y firm, that represents a generator unity of treasury according to IAS 36 "The Depreciation of Actives", lost part of its value. At this date the bookkeeping value of the generative unity of treasury is , for example, 50.000u.m. (formed by the net value of the identifiable actives – 40.646 u.m. and the value of the commercial fund of 9.354 u.m.), and its retrievable value was estimated at 45.000 u.m..

The initial evaluation of the commercial fund at 1st September N:

The actives and the debts resulted from the grouping operation must be evaluated at the correct value.

From the financial point of view there are further recognized the historical values. The evaluation differences between the bookkeeping and the taxation system generate postponed incomes.

a) The annual postponed tax rate:

The temporary taxing differences due to the identifiable actives (43.200 – 42.000) 1.200 u.m.

The debt regarding the postponed tax:

$1.200 \times 16\% = 192$ u.m.

b) The calculation of the net active of the Y firm expressed in a correct value:

The proper capitals evaluated at a historical value: 20.800 u.m.

(+) The value plus due to the actives: 1.200 u.m.

(-) The debt regarding the annual income 192 u.m.

= Net active in correct value 21.808 u.m.

c) The calculation of the commercial fund:

The acquisition cost 26.800 u.m.

(-) The part of X in the net active of correct value

Y part (80% x 21.808) 17.446 u.m.

= Commercial fund 9.354 u.m.

d) The bookkeeping of the commercial fund:
Commercial fund = Participation titles 9.354 u.m.

The subsequent evaluation of the commercial fund (at 31st December N):

a) It is made a depreciation test of the unity producer of treasury Y:

The bookkeeping value of the Y unity: 50.000 u.m.

The recoverable value of the Y unity: 45.000 u.m.

= Depreciation 5.000 u.m.

b) It is bookkept the depreciation of the generative Y unity of treasury, by imputing the commercial fund:

Commission expenses for = Commissions for the depreciation of the 5.000u.m.
depreciation commercial fund

Consequently at 31st December N the commercial fund is evaluated at a value of 9.534 – 5.000 = 4.354 u.m..

From this case study results the fact that the commercial fund was not anymore depreciated by liquidation and after applying the depreciation test it resorted to the constitution of an impairment.

Conclusions

The evaluation of the commercial fund has as a support not only the future provisions regarding the super profits generated as a consequence of the exploitation of the individual and unique characteristics of an enterprise, but also the unfinancial information published by this one.

As a result a better quantification by the market of an enterprise goodwill will be made a tight connection with the quantity of nonfinancial information present in the annex of the financial reports.

Moreover, for the evaluation of the commercial fund must be taken into account the fact that the requests stated in the international standards of applicable bookkeeping, the specifications and the provisions of the internal legislation with reference to the norms of evaluating the actives. The lack of explicit specifications of some insufficiently developed principles led to numerous controversy connected to the way of evaluating the commercial fund, respectively of establishing their depreciation, the normalizers oscilating between liquidation and debasement.

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