

# *Goodwill as an economic resource in the digital economy: recognition and measurement*

Plotnikov V.S.

Novosibirsk State University of Economics and  
Management  
Novosibirsk, Russia  
vcplotnikov@yandex.ru

Plotnikova O.V.

Novosibirsk State University of Economics and  
Management  
Novosibirsk, Russia  
vcplotnikov@yandex.ru

**Abstract** — At present, there are often theoretical and applied discussions on the digital economy. In the context of the transformation of the digital economy into a systemic economy, the problem of the conformity of modern accounting statements to the needs of a wide range of stakeholders in a reliable assessment of business value is manifested to a greater extent. This problem cannot be solved at a time. A deep analysis of the assessment and recognition of individual elements of the financial statements will be required, which is difficult without digital transformation of data. This article analyzes a separate problem of the possibility and necessity of reflecting the economic category of goodwill in the structure of financial and integrated reporting. This issue concerns not only the accounting and reporting system, since analysis of the effect of goodwill and intangible assets on the business value of foreign companies [1] showed that the share of goodwill in the cost structure of organizations ranged from 36% (by type of activity - energy production) to 70.4 % (in terms of activities - Internet business and electronic business). However, in only six types of activities, the share of goodwill was less than 50%. Unfortunately, it should be noted that in Russia, this economic resource is either not reflected at all in the accounting and reporting of economic entities, or its value is significantly underestimated. Nevertheless, it is possible to change the current situation based on the provisions of the institutional economy and the catalization of management financial accounting information in the context of its digitalization. Changes in the goodwill accounting methodology will require: justifying the recognition and measurement of internally generated goodwill as the capitalized cost of transaction costs, justifying the market capitalization of the value of internally generated goodwill and determining goodwill as the result of a business combination transaction. Note that the solution to these problems is possible only in the unity and interconnectedness of all three elements of the systemic economy: institutional economics, accounting and reporting, and digitalization of economic information, on the basis of which it is possible to form a new direction in accounting - business accounting and integrated reporting aimed at on digitalization of information on a real assessment of business value and prospects for its sustainable development.

**Keywords** — goodwill; economic resource; business valuation; digital economy

## I. INTRODUCTION

Considering the economic content of goodwill as an element of an economic resource and, accordingly, an accounting object, it should be assumed that goodwill reflects certain economic relations of market economy entities based

on an assessment of the value of the business and the prospects for sustainable development of the organization. The basis of the theoretical study of goodwill is taken by the provisions of institutional economics, which make it possible to comprehend changes in the accounting methodology, which ensures clear and reasonable management of the organization's economic resources.

The organization's activities in the long-term interests of its owners (existing and potential) are based on the effective management of relations with its employees, suppliers and customers, social behavior and environmental protection. In this context, institutional economics is able to combine economic disciplines and show them as a whole. In this case, integrated reporting (IR) may become a new direction in the development of accounting, since IR should reflect a holistic picture of the combination between factors affecting the organization's ability to create value for a long time.

A good example of the relationship and interdependence of the theory of institutionalism and accounting is goodwill. At the same time, the indicator of internally generated goodwill in the financial statements can be reflected as a set of capitalized transaction costs, in accordance with the theory of neoinstitutionalism - the costs of managing an economic unit. On the other hand, internally generated goodwill is a market factor and forms part of the market value of the organization's capitalization.

The main problem of recognition and measurement of internally created goodwill in an organization's financial statements is that the regulatory economy, including accounting, treats this indicator as an unidentifiable asset and, according to existing accounting rules, it cannot be classified as an asset. However, according to the same rules of traditional accounting, if the funds are used up and they are not directly involved in the process of creating value, but are used up to bring future economic benefits, then they should be capitalized. Consequently, the costs that form the value of internally created goodwill are capitalized and recorded on a separate subaccount of the Intangible Assets account.

## II. MAIN PART

### A. *Internally generated goodwill - capitalization of transaction costs*

Considering internally created goodwill as an object of intangible assets, it is necessary to proceed from the fact that this accounting category is an economic resource of an organization should become an element of financial reporting, because: "An economic resource is a right that has the potential to create economic benefits. For the existence of such a potential, it is not necessary that with absolute certainty or even with high probability it can be argued that this right will create economic benefits" [2, paragraph 4.14]. The main thing is that "Law can meet the definition of an economic resource and, therefore, be an asset, even if the likelihood that it will create economic benefits is small" [2, p. 4.15].

The theory of property law found its development in the studies of neoinstitutionalists as the theory of contracts and the theory of transaction costs associated with it, which K. Arrow defined as "the costs of managing the economic system" [3, p. 53].

The recognition of goodwill as an unidentifiable asset as intangible assets is not so obvious. "If expenses incurred in this reporting period will bring income in subsequent reporting periods, then such expenses are subject to capitalization, that is, exclusion from the expenses of this reporting period and inclusion in the composition of assets" [4, p.462]. Such a definition of capitalized expenses corresponds to the requirement of capitalization of transaction costs, reflected in the structure of long-term intangible assets as internally generated goodwill. These costs must be recorded in accounting in conjunction with a potential accounting object. "The recognition and communication of intangible assets is pivotal, being their actions' effectiveness scarcely measurable by traditional accounting tools and having relevant inputs" [5, p.7]. "The fundamental problem perceived by scholars is related to the recognition of these types of assets, as they often do not meet the required accounting definition, making it difficult to fully recognize their value through traditional accounting tools, thus excluding them from financial statement [6].

The gap in the conceptual framework between theoretical studies of the goodwill category and goodwill accounting practice has led IAS 38 "Intangible assets" to deny the recognition of internally generated goodwill as an accounting item: "Internally generated goodwill shall not be recognized as an asset" [7].

The developers of IFRS came to this conclusion because of the very wide range of elements of internally created goodwill, including intellectual capital and know-how, brand names, competencies and knowledge of personnel, etc., up to the elements of client capital in this economic category. This allowed developers to define internally created goodwill as an unidentifiable asset with its complex valuation, and, therefore, not to be reflected in accounting and financial reporting.

One could still agree with this approach, if one does not take into account the rapid penetration of the new institutional economy in the age of digital transformation of information into the sphere of accounting. It is these factors that predetermine serious changes in the theory and methodology

of accounting and reflect the need for changes in experimental accounting practices, that is, of how academic work can inform emerging practices — in this case, integrated reporting (IR).

According to this approach, most of the elements of internally created goodwill should be excluded from its composition and reflected in IR as a reserve of the value of certain types of capital: "In this Standard, capitals are divided into financial, industrial, intellectual, human, socio-reputational and natural capital" [8 paragraph 2.10].

The capitalized cost of transaction costs remains unchanged for the recognition and measurement of internally generated goodwill. R. Coase wrote about transaction costs: "In order to carry out a market transaction, it is necessary to determine with whom it is desirable to make a deal, inform those with whom they seek to deal and on what conditions, conduct negotiations leading to the conclusion of the transaction, prepare a contract, collect information so that make sure that the terms of the contract are fulfilled, etc. [9].

Developing the theory of transaction costs, O. Williamson divides them into two areas: "management, where the main attention is paid to the mechanism of making adaptive sequential decisions, and measurement, where problems with the secrecy of complete information are considered. Strictly speaking, these two sides of the contract process are usually considered simultaneously" [3, p. 338].

The first "managerial" direction can be attributed to the field of management accounting and considered as accounting for the types of management activities.

The second "measurement" relates more to financial accounting: "In order for an asset or liability to be recognized, its value must be estimated. In many cases, such estimates must be determined by calculation and, therefore, they are subject to uncertainty. ... the application of sound estimates is an integral part of the preparation of financial information and does not reduce the usefulness of such information if these estimates are clearly and accurately described and explained" [2, paragraph 5.19].

Regarding accounting in general, it can be said that the unity of these two directions will allow us to identify the starting point for the capitalization of transaction costs in the formation of the value of internally created goodwill. IR is also aimed at such a unity of information: "An integrated report should not be a simple summary of other information products (for example, financial reports, a report on the application of the principles of sustainable development, telephone conferences with analysts or information on a website), rather, it contributes to the manifestation of the related information and explains how value is created over time" [8, p.1.13].

Without going into details of the organization of management accounting, the authors of the article propose to maintain management accounting by types of transaction costs, such as: information search costs; negotiation costs; measurement costs; contracting costs; the costs of monitoring and preventing opportunism; costs of specification and protection of property rights, etc. with their further capitalization. The aggregate capitalized cost of such costs should be recorded as intangible assets, sub-account "Internally generated goodwill".

### B. Goodwill value market capitalization

The basis of the study on the market capitalization of the value of goodwill is our pleasure: the theory of institutional economics, the concept of sustainable business development, the Conceptual framework for the presentation of financial reports to assess the need for recognition and market valuation of this business accounting facility and integrated reporting.

In the new institutional economy, as in other economic sciences, goodwill is interpreted as an indicator that reflects the difference between the market capitalized value of the organization and its net assets. Under the "market capitalized value of the organization" refers to the total value of the shares of the organization listed on the stock exchange. For this, it is necessary that "a field of objective estimates based on naturally formed market prices allows correct correction of calculated indicators, taking into account the fundamental changes that have occurred in their structure and absolute value, which is achieved by analyzing the relationship of its elements" [4, p. 208].

In this case, Ya.V. Sokolov emphasizes the objectivity of the market valuation of stocks listed on the stock exchange, which determines the value of the organization's market capitalization. At the same time, Ya.V. Sokolov emphasizes that market valuation indicators are subject to volatility, which should be taken into account when calculating the capitalized value of goodwill. Here we should pay attention to another indicator - the indicator of net assets of the organization, taken into account when calculating goodwill. The net assets of the organization are calculated at the time the financial statements are presented. In this situation, there is a significant time gap in the calculation of these two indicators - significant in the calculation of goodwill. Therefore, it is advisable to talk about the time range of relevance of goodwill. In the context of the digitalization of the economy, this time range should decrease.

In addition, the authors of the article would like to draw attention to another factor in the market capitalization of goodwill. We are talking about the organization's own shares held for sale on the stock exchange (issue of shares). As a rule, such shares are valued at face value, and sold at market value. Income derived from the sale of such shares forms the share premium of the organization.

Nevertheless, experts are losing sight of yet another question: what about the recognition and valuation of own shares, which at the time of presentation of the financial report were not sold on the stock exchange? In our opinion, unsold own shares should be valued at market value in the financial statements. Moreover, in the financial accounting system, such shares should be reflected twice:

at the value of the net assets of the investee - as part of intangible assets, sub-account "Own shares held for sale";

the difference between the market value of shares and the value of net assets is reflected in the debit of the Intangible Assets account, the subaccount Internal Created Goodwill and the credit of the Non-monetary profit account, as this profit is not confirmed by cash flow.

In this case, internally generated goodwill reflects a right that has the potential to create economic benefits.

### C. Goodwill as a result of a business combination transaction

Goodwill is the most significant asset for most organizations in the global economy. However, its recognition and evaluation as an organization's asset is hindered by its unidentifiability and the inability to separate it from the value of the organization itself. As a result, when evaluating goodwill, there is a practice of recognizing goodwill as the difference between the market value of an organization and its net assets. This approach to the recognition and measurement of goodwill can be used in assessing the value of a business in any organization whose shares are listed on the stock exchange, if you do not take into account the differences in the time range of capitalization of the value of the organization and the calculation of its net assets. Of course, in the context of the digitalization of the economy, this gap will narrow.

However, in the article, the authors decided to pay attention to another problem - the problem of accounting for the transformation of internally created goodwill into a real financial asset in a business combination transaction, for this the authors propose developing a concept for accounting for this transaction: "allowing to summarize information on the capitalized cost of an economic association of legally independent enterprises as a whole in the consolidated financial statements" [10, p.139].

First, we'll give a definition of goodwill from IFRS 3 "Business Combinations": "goodwill An asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized" [11, Appendix A].

Interesting, but not without flaws, interpretation of goodwill.

First of all, a business combination transaction is basically a long and consistent process as a result of which the investor gains control over the investee.

Secondly, on the stock exchange, as a rule, options and not shares of a subsidiary are sold and bought in a business combination transaction.

At the same time, the call option gives its owner the right to buy the underlying asset on a certain day at a certain price, and the put option gives its owner the right to sell the underlying asset on a certain day at a certain price. The price of shares fixed in the option is unchanged until the expiration of the contract (option). The time value of the option itself, which is a commodity on the stock exchange, varies.

Thirdly, the day (date) of the option purchase / sale should be recognized as the beginning of investment in a business combination transaction, although the option price is much lower than the share price fixed in the agreement. It is the value of an option for a certain date that can reasonably be recognized as the value of internally created goodwill. Therefore, in the buyer's accounting of the call option reflecting the market capitalization of the goodwill value, the volatility of the value of the call option is determined.

In the financial accounting of the buyer of the "call" option, the investments for its acquisition should be reflected: debit of the account "Intangible assets", sub-account "Goodwill" and credit of the account "Settlement accounts". It should be noted that the goodwill confirmed by the option

reflects the right to receive economic benefits in the future. In addition, the volatility of factors affecting the value of an option should be reflected in the value of internally generated goodwill. At the same time, the act of selling the option must be recognized in the financial accounting of the seller of the put option. Consequently, the non-monetary profit of the seller of the option is transformed into revenue from sales and can be reflected in the debit of the account "Non-monetary profit" and the credit of the account "Other income and expenses" with subsequent reflection of this profit in other comprehensive income of the shareholders.

Summarizing this section, we note that when a subsidiary is included in the consolidation perimeter and the consolidated financial statements are presented, investments made by the investor in the investee are eliminated with the corresponding amount of the net assets of the subsidiary. Consequently, only the cost of goodwill as an element of financial capital is reflected in the consolidated financial statements. Thus, the market value of internally generated goodwill as an element of intangible assets is transformed into the cost of financial capital.

### III. CONCLUSIONS

The existing objective and subjective reasons for the difficulty of recognizing and evaluating internally created goodwill in a digitalized economy should not be the reason for its non-recognition in financial and integrated reporting. For this it is necessary:

- In the absence of an active financial market, internally generated goodwill should be reflected as the total capitalization of transaction costs in intangible assets.
- The difference between the nominal and market value of own shares held for sale but not sold should be reflected as internally generated goodwill at the time of presentation of the financial statements.
- In a business combination transaction at the time the subsidiary is included in the perimeter of the consolidation and, accordingly, the presentation of the opening consolidated financial statements, goodwill should be reflected as an element of financial capital

### References

- [1] C. Klingbeil, "Intangible Assets and Goodwill in the context of Business Combinations: An industry study", Available at: <https://www.consultancy.nl/media/KPMG%20-%20Intangible%20Assets%20and%20Goodwill-836.pdf>.
- [2] Conceptual Framework for Financial Statements, Retrieved 09/15/2019 from [http://www.minfin.ru/common/upload/library/2014/06/main/kontseptualnye\\_osnovny\\_na\\_sayt.pdf](http://www.minfin.ru/common/upload/library/2014/06/main/kontseptualnye_osnovny_na_sayt.pdf). URL: [http://www.minfin.ru/common/upload/library/2014/06/main/kontseptualnye\\_osnovny\\_na\\_sayt.pdf](http://www.minfin.ru/common/upload/library/2014/06/main/kontseptualnye_osnovny_na_sayt.pdf).
- [3] O.I. Williamson, "Economic Institutions of Capitalism: Firms, Markets, Relational Contracting." SPb.: Lenizdat; SEV Press, 1996, p. 776.
- [4] Y.V. Sokolov, "Fundamentals of accounting theory". Moscow, Russia: Finance and Statistics, 2000, p. 473.
- [5] C. Busco, M.L. Frigo, A. Riccaboni and P. Quattrone. "Towards integrated reporting: concepts, elements and principles." In: Busco C., Frigo M.L., Riccaboni A., Quattrone P. (eds) *Integrated reporting: concepts and cases that redefine corporate accountability*. Springer Science & Business Media. Springer International Publishing, Switzerland, 2013, p. 3-18.
- [6] S.U. Wayne *Business and financial reporting: challenges from the new economy*. Financial Accounting Series, 2001, 219 / A.
- [7] *International Financial Reporting Standards 2013: Russian edition*, Moscow: Askeri-ASSA, 2013, p. 1075.
- [8] *International Standard for Integrated Reporting*, Retrieved 09/15/2019 from [https://integratedreporting.org/wp-content/uploads/2014/04/13-12-08-THE-INTERNATIONAL-IR-FRAMEWORK.docx\\_en-US\\_ru-RU.pdf](https://integratedreporting.org/wp-content/uploads/2014/04/13-12-08-THE-INTERNATIONAL-IR-FRAMEWORK.docx_en-US_ru-RU.pdf).
- [9] Coase R.H. *The Nature of the Firm*. *Economica*, New Series, 1937, vol. 4, no. 16, pp. 386-405.
- [10] V.S. Plotnikova, O.V. Plotnikova, A.I. Shevchuk "Assessment of the capitalized value of business processes in the analysis of a business combination transaction", *Economic Analysis: Theory and Practice*, 2016, vol.12 (459), pp.139-152.
- [11] *International Financial Reporting Standard (IFRS) 3 "Business Combinations"* / introduced by order of the Ministry of Finance of Russia dated December 28, 2015 No. 217n) (Appendix No. 31), Retrieved September 15, 2019 from ATP "Consultant Plus". - URL: [http://www.consultant.ru/document/cons\\_doc\\_LAW\\_193677/#dst0](http://www.consultant.ru/document/cons_doc_LAW_193677/#dst0).