

ARGUING ABOUT GOODWILL

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ABSTRACT

This paper reviews the debate on the accounting treatment of goodwill between the publication of the Accounting Standards Committee's Discussion Paper of 1980 and the issue by the Accounting Standards Board in 1997 of FRS 10. It considers the responses to six discussion/working papers and exposure drafts, analysing the pattern of respondents and reviewing the consistency of the representations submitted, the arguments employed and their development at each stage of the debate. Submissions were found to vary greatly in quality, ranging from well-argued, coherent documents maintaining a consistent outlook over time to poorly-argued responses and submissions involving unexplained inconsistencies with the respondent's previous stance. Considerable overlap was found with arguments used in the explanatory notes of accounting standards; almost all of the types of argument used by the ASC to justify any accounting standard showed up on one side or the other of the goodwill debate. The resulting standard is better understood in the context of the very wide range of arguments brought to bear on this complex debate.

INTRODUCTION

Several factors distinguish the debate about accounting for goodwill. The first is the length of the debate and the number of documents which have been issued during its course. Ignoring the abortive attempt by a committee in the early 1970s, which foreshadowed the subsequent divisions of opinion by dividing into two and producing conflicting recommendations, there have been a total of eight major documents on the topic. These are shown in **Table 1**.

Table 1: Major Documents on Goodwill

	Document	Title	Date	Number of sub-missions
1	Discussion Paper	Accounting for goodwill	1980	77
2	ED 30	Accounting for goodwill	1982	76
3a	SSAP 22	Accounting for goodwill	1984	n/a
3b	SSAP 22 (revised)	Accounting for goodwill	1989	n/a
4	ED 47	Accounting for goodwill	1990	148
5	Discussion Paper	Goodwill and intangible assets	1993	96
6	Working Paper	Goodwill and intangible assets	1995	78
7	FRED 12	Goodwill and intangible assets	1996	71
8	FRS 10	Goodwill and intangible assets	1997	n/a
n/a = not applicable				

The second major factor is the degree to which the arguments rehearsed in the initial discussion paper have continued to be employed in the debate that took place on each subsequent document. The domain of discussion was, at first glance, largely determined by that original draft.

It is not the purpose of the present paper to offer directly any suggestions on the appropriate accounting treatment for goodwill. Nor is it the intention to defend or attack any of the documents listed in **Table 1**. The concern is rather with the way in which the debate on the topic has been conducted. Accordingly, the submissions made to the Accounting Standards Committee (ASC) and the Accounting Standards Board (ASB) on the documents open to comment have been extensively reviewed. (There has been no direct attempt to consider views expressed on the Statement of Standard Accounting Practice (SSAP 22) itself between 1984 and its replacement by FRS 10; effectively, any views are expected to be subsumed into the views expressed on the issue of the subsequent documents in the series.) The documents concerned are the Discussion Paper of 1980 (DP80), the Exposure Draft of 1982

(ED30), the Exposure Draft of 1990 (ED47), the Discussion Paper of 1993 (DP93), the Working Paper of 1995 (WP95), and the Exposure Draft of 1996 (FRED12).

The paper explores the submissions to the ASC and the ASB from a number of perspectives characterised by a rhetorical viewpoint. In particular, the paper reviews the specific arguments employed by respondents. These are categorised under headings developed by Warnock (1992) in his analysis of the arguments used by the ASC itself in the explanatory notes to accounting standards. The analysis of submissions is supported by reference to many of the specific submissions, referenced by the designation of the document as set out in the previous paragraph, the name of the commentator and the relevant page numbers of specific quotations. The submissions were consulted in the library of the Institute of Chartered Accountants in Ireland.

The second section of the paper discusses some descriptive aspects of the submissions: how many were made on each document, the extent to which the same commentators made regular submissions, the question of the consistency of submissions and some differences in the basic approach to submissions. The third section discusses in detail what arguments are presented by those making submissions, using as a basis for classification the headings developed in Warnock's 1992 analysis.

The fourth section considers the sequence of submissions made by two of the major accounting firms, Arthur Andersen and Price Waterhouse. In contrast to the other major accounting firms, these two firms produced a series of coherent submissions each clearly linked to their previous documents in the sequence. However, their approaches were marked by different characteristics; Arthur Andersen remained consistent in the method of accounting for goodwill which they favoured throughout the debate, while Price Waterhouse appeared to alter the stance taken in the light of the position in the debate at the time, seeking to influence the debate to secure what appeared to the firm to be the best available option.

The fifth section takes up in more detail the crucial arguments about the nature of goodwill, and attempts to show how early in the debate it was possible to discern the germs of the ideas that were developed by the

ASB in the process which, with the publication of FRS 10 in December 1997, seems to have succeeded in producing a compromise which finds broad acceptability. Not surprisingly, this section reveals again the nature of standard-setting as a political process beset by compromise. It was clear from the very beginning that the area was highly controversial. There appears during the course of the debate to have been little by way of persuasion, little by way of genuine changes of mind as the result of rational and conclusive argument. Rather, the detailed review of the ASC/ASB documents and the submissions on them suggests the search for a formula of words that will satisfy a sufficiently large number of the major parties involved. It is noteworthy that for the majority of companies the application of FRS 10 produces the same result as the much-maligned ED47 (Company Reporting, 1999). Not to be ignored is the further possibility that 17 years of debate induced a sense of exhaustion.

No attempt has been made in the analysis to deal with the topics of negative goodwill and the transitional arrangements proposed at various stages. The emphasis is not on a comprehensive review of all aspects of the broader topic of goodwill, but on the arguments used and the skill or otherwise with which they have been employed. In general, the related debate on intangible assets has also been ignored. Inevitably, however, because of the way in which the ASB has since 1993 combined the two topics in its discussion papers and exposure drafts, aspects of that sub-debate will intrude on the discussion.

As the remarks above indicate, it is not the intention in this paper to discuss directly the arguments for or against any particular approach to accounting for goodwill. Grinyer, Russell and Walker (1990) make the case against the immediate write-off of goodwill to reserves and in favour of the capitalisation and amortisation of purchased goodwill; their paper is based on approaching the problem from the perspective of monitoring management. During their discussion they acknowledge that (p.228):

the immediate write-off approach has been advocated by many able thinkers (including Gray (1988) [and] Ma and Hopkins (1988)

Other frequently-cited academic contributions to the debate on goodwill include Gynther (1969) and Lee (1971). Lee returned to the topic more recently in a review article on an Institute of Chartered Accountants in England and Wales (ICAEW) research report (Lee, 1993).

More directly relevant to the present paper are contributions dealing with submissions on proposed accounting standards or the lobbying process in general, such as Hope and Briggs (1982), Hope and Gray (1982), MacArthur (1988), Napier and Power (1992), Tandy and Wilburn (1992), Weetman, Davie and Collins (1996) and Gilfedder and Ó hÓgartaigh (1998). The more general topic of the application of rhetorical principles to the study of the creation of accounting standards is dealt with by Warnock (1992, 1993).

AN OVERVIEW OF THE SUBMISSIONS

Counting the Submissions

Overall, approximately 324 parties contributed to the debate by responding to one or more of the six documents (the precise number depends on how one accounts for such matters as the amalgamation of major accounting firms taking place during the period). The numbers making submissions on each paper are shown in **Table 1**. This shows a stable pattern disrupted by the number of responses to ED47, which was about double the average for the other five documents. Clearly, this is evidence of a radically different level of response. Thus, it is no surprise that in a debate not noted for its reticence and good manners, it was ED47 which attracted the most angry and bitter comments. Some additional evidence of the atypicality of the response is that the number of comments from companies increased, in comparison to DP80 and ED30, by about 200 per cent. As might be expected, this was because of the almost overwhelmingly negative reaction to ED47's proposals. Further, ED47 attracted a much higher level of one-off responses. On four of the other documents reviewed, commentators who responded on that and no other document amounted to between 35 and 40 per cent of the total, while for FRED 12 the proportion fell as low as 28 per cent; in the case of ED47, by contrast, no less than 63 per cent of respondents produced their only contribution to the debate.

Of the total number of respondents, 222 were identified who made one submission only, a further 52 who made two. This means that approximately 85 per cent of respondents contributed on fewer than fifty per cent of the documents open to comment. Eighteen made submissions on three, fourteen on four, five contributors responded to five of the documents, and 13 made submissions on all six. **Tables 2 and 3** provide a breakdown of those making six and five submissions respectively (the figures may not be entirely accurate because of the possibility of amalgamations which are not apparent from the names).

The figures support an interpretation that sees companies as more likely to contribute when they see that their interests (or perhaps the self-interest of the managers who actually prepare the submissions) as threatened by a particular proposal, with accounting firms and bodies of professional accountants more likely to feel an obligation to make an input to the debate regardless of whether they have strongly held views.

Table 2: Entities Making Six Submissions on Goodwill

Accounting firms

Arthur Andersen	Deloitte & Touche
KPMG	Coopers & Lybrand
Ernst & Young	Price Waterhouse

Companies/representative bodies

ICI	Shell
Unilever	

Professional bodies

Chartered Association of Certified Accountants
Chartered Institute of Management Accountants
Institute of Chartered Accountants in England and Wales
Institute of Chartered Accountants of Scotland

Note: Entities are listed under the name used in their final submissions

Table 3: Entities Making Five Submissions on Goodwill

Accounting firms

Pannell Kerr Forster

Companies/representative bodies

Confederation of British Industry

Reed Elsevier

Professional bodies

Institute of Chartered Accountants in Ireland

The Law Society

Note: Entities are listed under the name used in their final submissions

Some Perspectives on Consistency

One interesting aspect of multiple submissions is the possibility of internal inconsistency. For example, Guest Keen Nettlefold went from suggesting a maximum of 40 years for amortisation (DP80), to arguing that 'If an amortisation option is offered at all, the proposed standard should require a maximum period of five years' (ED30, p.41) (It might of course be argued that this was a tactical approach designed to help in having this alternative rejected, since it was not the company's preferred option.) ICI first favoured immediate write-off to reserves (DP80), but switched within three years to holding a directly opposing view (ED30). Reckitt & Coleman endorsed the amortisation policy favoured by the 1980 Discussion Paper, but by the time of the response to ED30 had moved to favour management discretion.

Pannell Kerr Forster first seemed to favour amortisation over useful economic life (DP80), but then switched support to immediate write-off to reserves (ED30). This change of heart resulted, perhaps, in the submission on ED47 which stated that there were strong arguments both for and against amortisation and that a firm standard was needed. (The argument for a firm stand shows the desire for comparability which was, not surprisingly, a feature of some submissions following the option granted by SSAP 22 to choose either immediate write off or

capitalisation and amortisation). Thomson McLintock were unusual in acknowledging their inconsistency, noting that their position on ED30 (p.172), opposing immediate write-off to reserves, 'has changed from our submission on the earlier Discussion Paper.'

In their submission on ED30 Touche Ross gave clear support for the amortisation approach (p.181):

Our preferred solution is that which was proposed in the original discussion paper, namely that goodwill should be amortised through the profit and loss account. In our view a payment for goodwill represents expenditure incurred for the purpose of earning future profits and the objective should be to write off that expenditure systematically over the periods expected to benefit from it.

Their submission on ED47 maintained that this was still the position supported by theoretical argument, but recognised that compromise was necessary to produce a solution that was workable (in the sense, it would seem, of acceptability to industry). This position had, however, been reversed by the time of their lengthy submission on DP93, where the Executive Summary includes as Proposal 1 (p.426):

In view of these advantages, Touche Ross regard the ceiling test approach as preferable to either of the existing methods, and supports its further development and use.

Unfortunately, as in virtually every other case of inconsistency, we are denied the interesting disclosure of how and why the position has changed. It might be simply a change in the personnel dealing with the matter; it might be that the commentator has been persuaded in principle that what was believed previously was "wrong" and what is now supported is "right"; it might be that practical problems now recognised for certain alternative approaches had not been given adequate weight in the past. Unfortunately, submissions include no history of their development analogous to what is provided by the ASB. Perhaps the Touche Ross case, with its acknowledgement of the importance of acceptability in the submission prior to a change of position, is as close as we might expect to get to seeing the process in action. A more benign explanation of inconsistency in submissions is suggested by a recogni-

tion of the changing environment in which the debate was taking place. Elements contributing to this would be the establishment of the Financial Reporting Council and the ASB increased debate on accounting abuses and financial reporting issues, and greater awareness of international differences.

Some Different Basic Approaches

Voting/Vote-Reporting

One style of submission may be described as the voting style. No arguments for or against any of the alternatives are mentioned, let alone discussed, and commentators simply indicate their preferred choice. An example is provided by Hilton, Fish, Hopkins & Co. (ED30, p.126), who vote for showing goodwill at cost in all company balance sheets and say of the two alternatives mooted by the ASC simply that:

It is the opinion of the partners of this practice that neither of the above should apply but that the existing practice of showing goodwill at cost should be shown on all Company Balance Sheets.

Another form of submission may also be linked to the concept of voting. This is the vote-reporting style, where a single submission summarises some collective process of discussion and reports to the ASC or the ASB on the outcome of that process. Two submissions from accounting firms on DP80 provide instances of this. Arthur Young McClelland Moores & Co. report that a majority of those within the firm favour amortisation, but a significant minority favour immediate write-off. The submission from Coopers & Lybrand states (DP80, p.68) that 'Opinion within our firm is divided ...'. This type of submission is not confined to accounting firms. The Group of Scottish Finance Directors' submission on DP93 stated that there was a clear consensus favouring capitalisation, followed by a majority for annual review and a minority for systematic amortisation. As a further example, KPMG offices in Birmingham and Leicester undertook to report on the views of local finance directors in response to the same document.

The most detailed exercise in vote-reporting comes from one of the professional bodies. The ICAEW's submission on ED30 starts by admitting (pp.192-3) that standardisation is seen as desirable, but that there is a divergence of views on the direction that it should take. The dilemma of collective decision making was further illustrated by some of the detailed submissions from the District Technical Accounting Committees (TACs); the Humberside TAC commented (ED30, p.221):

... the majority were against there being an option at all but could not agree which of the two methods proposed in this Exposure Draft was to be preferred.

Returning to the submission of the ICAEW itself, it reported the views of 21 District TACs (providing copies of their reports amounting to 43 pages, 13 per cent of the total pages submitted on ED30), and the votes of the Institute's own TAC: ED30 was acceptable to 11 TACs, not acceptable to 10; the TAC itself voted 19 to 10 in favour of ED30.

Generally, the submissions of professional accounting bodies were not compelling, reflecting the difficulty of making a forceful and persuasive case where a topic is divisive, genuinely held beliefs differ diametrically, and there is no driving self-interest as a focus for development of a clear position.

In the light of this type of response, it is clearly important that the process of "counting votes" by taking the percentage of submissions supporting different positions is conducted with caution.

Equal caution is required from the fact that "votes" may be the result of organisation by a party which feels particularly strongly about a topic. There is nothing improper in this: democratic processes work on the basis that a vote counts equally no matter what legitimate forms of persuasion lie behind its casting. But it is very striking that on ED47 there appears to be significant Price Waterhouse influence, with many submissions quoting directly or indirectly the views of Price Waterhouse on the Exposure Draft. For example, set out in **Table 4** are extracts from three submissions on ED47. The material in the first column (Creffield/PW) is from the Appendix to a submission on Hambro Countrywide plc notepaper, filed under the name of the individual submitting the comment; the Appendix contains extracts from a document

published by Price Waterhouse on ED47. (There were two further submissions on Hambro Countrywide plc notepaper from two other individuals.) The second column consists of material from a submission by a former Price Waterhouse partner E. R. Jeynes (Jeynes). The third column reproduces material from a submission dated 2 July 1990 by J. R. Savage (Savage); Mr. Savage's submission is accompanied on the ASC file by a letter on company notepaper also dated 2 July 1990 stating that 'I am just writing to you to confirm that I have commented upon Accounting for Goodwill in a personal letter from my home address' (ED47, p.480). The reference to a 'personal letter' sits strangely beside the words 'my fellow directors and I' in the letter itself.

A footnote to the discussion of vote-reporting submissions provides a reminder of the difficulty of the debate: the British Bankers Association in their final submission (FRED12, p.57) remarked that 'Such is the strength of feeling that the BBA has been unable to generate a single industry view ... '

Table 4: A Comparison of Three Submissions on ED47.

Creffield/PW	Jeynes	Savage
	I am a director of a number of Public and Private companies. Previously I was a Partner in Price Waterhouse in charge of their West Midlands offices.	I am Group Financial Director of Wheway Plc.
Goodwill is quite unlike tangible fixed assets whose physical substance demonstrably wears out. The value of a business can clearly be maintained or improved by careful management and by cash expenditure charged against the profit stream. Reducing these profits further by the application of a regular amortisation charge, simply because one makes an artificial distinction between purchased and self-	Goodwill is quite unlike tangible fixed assets whose physical substance demonstrably wears out. The value of a business can clearly be maintained or improved by careful management and by cash expenditure charged against the profit stream. Reducing these profits further by the application of a regular amortisation charge, simply because one makes an artificial distinction between purchased and self-	Goodwill is quite unlike tangible fixed assets whose physical substance demonstrably wears out. The value of a business can clearly be maintained or improved by careful management and by cash expenditure charged against the profit stream. Reducing these profits further by the application of a regular amortisation charge, simply because one makes an artificial distinction between purchased and self-generated goodwill,

self-generated goodwill, does not, in our opinion, lead to a meaningful measurement of earnings.	generated goodwill, does not, in our [sic] opinion, lead to a meaningful measurement of earnings.	does not, in our [sic] opinion, lead to a meaningful measurement of earnings.
We support the view that a group's goodwill acquired through specific transactions should be reflected in its balance sheet. To write it off against reserves, as is the current practice, seems to us to lead to an unrealistic view of the financial position of an acquisitive group and to distort any meaningful assessment of management's performance in utilising the economic resources of the business and in earning a return on capital expenditure	I support the view that a group's goodwill acquired through specific transactions should be reflected in its balance sheet. To write it off against reserves, as is the current practice, seems to us [sic] to lead to an unrealistic view of the financial position of an acquisitive group and to distort any meaningful assessment of management's performance in utilising the economic resources of the business and in earning a return on capital expenditure	I support the view that a group's goodwill acquired through specific transactions should be reflected in its balance sheet. To write it off against reserves, as is the current practice, seems to us [sic] to lead to an unrealistic view of the financial position of an acquisitive group and to distort any meaningful assessment of management's performance in utilising the economic resources fo [sic] the business and in earning a return on capital expenditure
	I suggest that companies should be required to have an accounting policy as set out above but that they should look each year at the value of the goodwill based upon the transaction and profits of the companies which	I suggest that companies should be required to have an accounting policy as set out above but that they should look each year at the value of the goodwill based upon the transaction and profits of the companies which

	gave rise to the goodwill and where there is any diminution this should be provided for in full from the goodwill. Obviously any increase should be ignored.	gave rise to the goodwill and where there is any diminution this should be provided for in full from the goodwill. Obviously any increase should be ignored.
	I feel you should know that both I and my fellow directors in the various <i>companies agree quite strongly with</i> the above views and would not welcome an accounting standard based upon the original views put forward.	I feel you should know that my fellow directors and I agree quite strongly with the above views and would not welcome an accounting standard based upon the original views put forward.

Partisan/non-partisan

Some comments are clearly based on the idea that the object of the submission is to put across the respondent's views and argue for the acceptance of the respondent's chosen position. In contrast to what might be described as such partisan submissions, other respondents are more openly conscious of the clash of different opinions and the possibility that others will have strongly opposing views. Such submissions often acknowledge sympathetically the difficulties of the ASC or the ASB in reaching a conclusion. Whereas some move on from the indication of the standard-setters' predicament to the claim that they must be decisive and take a lead in imposing a solution (examples are provided by Moore Stephens & Co. (ED30) and Spicer and Pegler (ED30)), others recognise that concessions may have to be made to achieve acceptability. Examples of this latter position are provided by Coopers & Lybrand (ED30), Ernst & Whinney (ED30), Neville Russell (ED47) and the Group of Scottish Finance Directors (ED47).

THE ARGUMENTS USED

The arguments used in the debate on goodwill fall into two categories. The first category consists of the type of argument used generally by accounting standard setters themselves to justify the rules they introduce. A catalogue of such arguments derived from an analysis of the 22 SSAPs extant at the time of the ASC's demise is presented in Warnock (1992). **Table 5** shows that catalogue, indicating which of those arguments appear in the submissions of respondents on the goodwill debate and are therefore considered below. The second category consists of arguments particular to the goodwill topic itself.

Table 5: Argument Types in Accounting Standards and in Submissions on the Goodwill Debate.

	Arguments Used in Explanatory Notes¹	Explicit Use in Goodwill Debate
1.	Generally accepted accounting practice	
	(a) The accruals concept (including matching)	Yes
	(b) The prudence concept	Yes
	(c) The consistency concept	Yes
	(e) Other instances	No
2.	Fair presentation	
	(a) General	Yes
	(b) Substance over form	Yes
3.	Information needs of users	Yes
4.	Other arguments	
	(a) Reference to existing SSAPs	Yes
	(b) Coincidence with cash flows	No
	(c) Legal authority/constraints	Yes
	(d) Comparability	Yes
	(e) The entity concept	Yes
	(f) Accounting for stewardship	Yes
	(g) Economic consequences	Yes
	(h) Practicality	Yes

¹ Based on Table 1 in Warnock (1992)

General Arguments

The accruals concept (including matching)

The desirability of matching, as a support for amortisation, has been a consistent feature of the submissions on all documents. It probably reached its fullest expression in the submissions of two academics who entered the debate with comments on ED47, D. W. Myddelton and John Grinyer. However, the theme had been stressed before (e.g. London Young Chartered Accountants Group, DP80; Reckitt & Colman, DP80; Arthur Young & Co., DP80). The basis of the argument, though con-

fused by some of the terminology employed, was set out in paragraph 6.1 of the 1980 Discussion Paper itself. This saw purchased goodwill as 'an asset which is specifically intended to enhance or protect its future earnings or position' and which 'does not continue to exist as such but affects only the profits of a limited number of years'. Paragraph 7.4 went on to argue that goodwill 'should be amortised against the profits generated'.

The Prudence Concept

As if to match the strength of the accruals and matching argument in favour of amortisation, we find the recurrent use of the prudence concept argument to support immediate write-off (e.g. BL, DP80). This argument had been acknowledged from the beginning of the debate (Appendix 3 to DP80, III (1)), but dismissed by the ASC on the grounds that there would be provision for write-off in the event of permanent diminution in value. Implicit in this dismissal was the sense that the risk of value loss was generally insufficient to offset the arguments in favour of an accruals/matching approach.

The Consistency Concept

The four fundamental accounting concepts have often been observed to be insufficiently precise to resolve conflicts over accounting policy choices (Warnock, 1992, p.185). This is evident not just from the clash between the first two concepts considered, but by the way in which the third, consistency, was used in the goodwill debate to buttress conflicting cases. Some respondents used the original ASC argument for consistency with the treatment of internally generated goodwill (e.g. ICI, DP80; Gray, DP80). Some accepted the ASC's *volte-face* in paragraph 1.5 of ED47 in favour of consistency with other purchased assets (Levy Gee, ED47); others rejected this in favour of the ASC's original position (British Bankers Association, DP93; BMBA, DP93).

Neither the ASC nor the ASB seem to have attached any great significance to the argument that a write-off of goodwill without a corresponding write-down of the investment in the subsidiary in the parent company's balance sheet contributes to a discrepancy between group and parent financial statements. While a number of commenta-

tors (Booker, DP80; Bowater, DP80; Shell, ED30; Department of Trade, ED30; ACCA, ED47) felt that this possibility was not a matter of concern, the majority of submissions dealing with the matter considered this aspect of consistency important. KPMG in their submission on ED47 listed consistency between group and parent company financial statements as the first of four fundamental principles which they felt an appropriate accounting treatment should follow. Many other accounting firms agreed on the importance of such consistency (examples include Dearden Farrow, DP80; Price Waterhouse, DP80 and ED30; Touche Ross, DP80; Arthur Andersen, ED30; Coopers & Lybrand, DP93); companies supporting this view included GKN (DP80) and Ford (ED47). The most comprehensive attempt to address the problem of consistency between group and parent company financial statements is to be found in David Damant's submission for Credit Suisse on DP93, where there is also one of the few explicit considerations of *the entity concept*.

Fair presentation

The next major category of argument is concerned with fairness of presentation. There are various ways in which the underlying argument can be presented. In some cases there is a positive approach, emphasising the fairness of a particular presentation, or stressing its coincidence with reality; this drifts into a second subtype of this argument that a particular presentation avoids distortion. But the most common variant is the third, an inverse approach by which another accounting alternative is attacked as 'distorting' or 'ignoring commercial reality'. An example of the second subtype is to be found in the Bank of England submission on DP80. Examples of the third are the ICI submission on ED30, a host of submissions on ED47 (e.g. James Crean, The Hundred Group, Ladbroke, Interpacific, RHM), and the Inchcape submission on DP93.

A particularly virulent form of the 'distortion' and 'lack of commercial reality' arguments in the goodwill debate is that which ascribes the proposal to require an amortisation policy to 'academic' or 'theoretical' considerations. Generally, this line of thought is presented as though the irrelevance of both academics and theory were self-evident. Interbrand (DP93, p.227) state:

A Balance Sheet prepared according to such structures of accounting theory may appeal to accountancy academics but will be of little help to those they intend to serve.

The academics have fought back on this point. Both Myddelton (ED47) and Grinyer (DP93) point out the self-interest problem for those who attack the 'academic' viewpoint. Myddelton suggests (ED47, p.456) that while finance directors may oppose amortisation, 'I do not believe such self-interested views should carry much weight.' He reaches tellingly for the support of Adam Smith, from whom he quotes the following (ED47, p.456):

The proposal of any new law or regulation of commerce which comes from (business people) ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention. It comes from an order of men, whose interest is never exactly the same with that of the public, who have generally an interest to deceive and even to oppress the public, and who accordingly have, upon many occasions, both deceived and oppressed it.

Grinyer states (DP93, p.161) that 'It is difficult to escape the conclusion that the problems are the result of pressures exerted because of vested interests.'

Substance over form

The debate is also informed at times by the related concept of substance over form. A twist to this familiar approach is given by the Avis attack (ED47) on the argument, considered in greater detail below, that purchased goodwill is replaced by self-generated goodwill. Avis believe (p.111) that this shows 'a preference for intellectual or philosophical form over commercial substance.'

Information needs of users

The Bank of England (DP80) appealed to the perceived information needs of professional users. Generally in the debate, the most common perception of professional users was that they would not be misled by any approach, provided there was adequate disclosure (Management School, Lancaster University, WP95; also Gray/Brown, ED30; British Bankers Association, ED47; Inchcape, DP93; United Biscuits, DP93). Quite common was the view that unsophisticated users would be misled by amortisation (Avis, ED47; BAT Industries, ED47).

Legal constraints

Reference to legal constraints tended to be more unquestioning in the early years of the debate. There was, perhaps, an acceptance in 1980 that if the law, based on EU Directives, laid down certain requirements, these had to be followed. It would be quite understandable if, given British political attitudes to Europe in subsequent years, a spirit of inventive evasion had grown. The constraints of law were noted in earlier contributions to the debate by the ICAEW (DP80) and the British Bankers Association (ED47). More interestingly, there are suggestions from KPMG (DP93) and the Law Society (DP93) that the legal status of the capitalisation and annual review method may not be secure; the former fear frequent use of this method requiring the true and fair view override, a situation which they regard as undesirable, while the latter appear to hope that its use will be rare. Cleaver and Ormrod (FRED12) queried the use of the true and fair override at the regulatory level, and others to question the approach on these grounds were M. and P. Davies (FRED12). BDO (FRED12) regarded the solution proposed as effectively allowing capitalisation of internally generated goodwill, though this was specifically prohibited by the Companies Act, 1985, as well as by the proposed standard itself. KPMG continued to express concerns in their submission on FRED12.

Comparability

Certain proposed accounting treatments for goodwill were vehemently opposed by many respondents. Perhaps this left them more willing than they normally would be to tolerate the availability of alternative treatments which might reduce comparability. For instance, on DP80 the Institute of Directors argued that though they generally favoured ac-

counting rules being imposed by mandatory standards allowing for a minimum of variation, goodwill was an exceptional case and they advocated flexibility. Comparability, however, remained a desirable objective for others, as in submissions by Booker McConnell, GKN, Moore Stephens & Co and Spicer and Pegler on ED30 and by Pannell Kerr Forster on ED47.

Accounting for stewardship

Almost all submissions in favour of amortisation over a predetermined life are based on the notion of stewardship, the need to hold the directors accountable for their use of shareholders' funds. Perhaps the clearest statement of this position came from BDO Binder Hamlyn (DP93, p.48) who referred to the immediate write-off method as 'particularly sinful', managing in two words to conjure up the stewardship notion and all its biblical foundations. (This might be contrasted with the Price Waterhouse view on ED30 (p.145) that 'There is no justification in matching for its own sake or to secure what is subjectively conceived to be "fairness".') The argument that matching for its own sake is not required would seem to be supported by the legal decision in the case of *Lloyd Cheyham & Co. Ltd. v. Littlejohn* (1985).

Economic consequences¹

Diametrically opposed views were apparent on the use of this line of argument. In their submission on ED30, the Institute of Cost and Management Accountants (now the Chartered Institute of Management Accountants) argued (p.274) that 'surely the possibility of a breach of the company's borrowing powers should not influence the implementation of sound accounting policies.' By contrast, the Law Society argued (ED30, p.293) 'we do not consider that it is acceptable, particularly in current economic conditions, for companies to be faced with a significant reduction in or breach of borrowing powers simply as a result of the introduction of a Standard.' This view was supported by some corporate submissions (Beecham, DP80, for example), though the Committee of London Clearing Banks (ED30) stated that bankers would be happy to allow the alteration of articles or trust deeds if there were problems over borrowing.

On the broader aspect of whether the accounting rules might or might not provide a commercial advantage or disadvantage to companies governed by them, opinion differed significantly. Arthur Young on ED30 argued that ignoring amortisation would encourage companies to over-pay for acquisitions. Bute Fabrics argued (p.128) *against* the proposals of ED47 on the grounds that they were 'rules to suit the takeover merchants', while the Costain Group's response to the same document *favoured* the amortisation process on the grounds that it helped to deter predators, as did the submission of Holmes. Myddelton (DP93) felt that existing rules under SSAP 22 gave companies an artificial boost towards growth by acquisition; Higson (WP95) felt that it was naive to imagine that a more permissive regime conferred an advantage.

On the impact of the rules for the classification of transactions for Stock Exchange purposes, opinion was again predictably divided. The International Stock Exchange itself (ED47) pointed out that immediate write-off to reserves created problems in this area; the CBI suggested (DP93) that companies might, for the purposes of the relevant tests, be permitted to take into consideration goodwill and other intangibles not included in the accounts. Revealingly, American Appraisal (DP93, p.6) suggested that 'the need to get around the Stock Exchange's class tests remain [sic] the principal reason why a company would seek to place intangible assets on its balance sheet.'²

The concept of economic consequences was also raised by Guinness (ED47) in supporting the importance of capitalisation of intangible assets; they stressed the inefficiency of markets, and how the perceptions engendered by lack of capitalisation or the unnecessary amortisation of intangibles might adversely affect the value of companies.

Practicality

Practicality of the various methods was a constant theme. Its most notable presence in the debate was in relation to the ceiling tests³, and there was a long list of submissions on DP93 challenging these: BDO Binder Hamlyn, BOC, British Bankers Association, BP, Cable and Wireless, ACCA, Coats Viyella, CBI, Ernst & Young, Grant Thornton, ICAEW, Institutional Fund Managers Association, Kingfisher, KPMG. This challenge continued to be expressed in various ways in submissions on subsequent documents (e.g. Arthur Andersen, FRED12;

Coopers & Lybrand, FRED12; Ernst & Young, FRED12; Marks and Spencer, FRED12). Drinkwater Subey (ED47) made the argument that amortisation with annual review is quite as impractical as capitalising non-purchased goodwill. Others, of course, argued that the impairment reviews were perfectly feasible (Cadbury Schweppes, FRED12; Guinness, FRED12).

Another aspect of the use of the practicality argument lies in the condemnations of amortisation on the grounds that it is not practical to identify a useful economic life over which to carry out the amortisation. The submissions of Arthur Andersen and Price Waterhouse, considered in detail in a later section, are good examples of this line. Others to reject amortisation on the grounds of its arbitrariness included Marsh (DP80), Egginton (ED47), and the Young Chartered Accountants Group (ED47). (The best reasoned defence of amortisation to acknowledge this weakness comes from Myddelton (WP95), while Shell (DP80) argued from experience that establishing useful economic life is not a problem.) It is a reflection of the compromise nature of the solution that eventually emerged that Grant Thornton (FRED12, p.148) should characterise the subjectivity of impairment reviews as 'a price worth paying.'

Specific Arguments from the Goodwill Debate

Useful life

In view of the way the debate over the amortisation period has tended to be seen as a choice between a maximum 20 year write-off and the US maximum of 40 years, it is particularly striking how many submissions went out of their way to emphasise their view on the extremely short life of purchased goodwill.

Unilever recommended a maximum of 10 years (DP80) or even five (ED30). Booker McConnell (ED30), while supporting immediate write-off, argued that if amortisation was to be the chosen method, a five year period was more sustainable. Guest Keen Nettlefold (ED30) agreed. The British Bankers Association was more interested in disclosure than the accounting policy choice, but (from this perhaps more neutral vantage point) suggested (ED47, p.364) that:

We cannot envisage any aspect of the goodwill of a company which owes anything to the circumstances of 20 years ago.

The Midland Industry Group of Finance Directors commented on ED30 (p.295) that if the method of writing off goodwill against reserves were adopted (they did not favour writing off against profits), there was no consensus as regards a number of years 'but there was a bias towards a maximum period of five years in line with the EEC 4th Directive general rule.' (In other submissions the same group favoured a much longer period, considering a forty year maximum too restrictive.)

Most prominent in this line of argument were firms of accountants, particularly the medium-sized firms. Arthur Young McClelland Moores suggested a maximum of say 10 to 15 years (DP80), Edward Moore a maximum of five years (but allowing a true and fair override for periods of up to 10 years) (DP80). Josolyne Layton Bennett & Co. favoured a normal maximum of 10 years (DP80). Touche Ross suggested that five years or even shorter was appropriate, certainly not more than 10 (DP80). Moore Stephens & Co. (ED30, p.130) considered 'an upper limit of 5 years to be more reasonable'. Stoy Hayward (ED30) favoured a normal five year maximum, with an absolute limit of 20 years.

Dearden Farrow commented on the 1980 Discussion Paper that a maximum of 40 years was acceptable but arbitrary, but argued by the time of ED30 that 20 years was too long and that a five year write-off was more realistic. Robson Rhodes also came down from acceptance of 40 years in the response to DP80 to arguing for a maximum period of five years when commenting on ED30.

Support for a very restricted useful economic life was by no means unanimous among accounting firms: Spicer and Pegler (ED30, p.153) suggested that 'an arbitrary period as short as 20 years is unsatisfactory'. Not surprisingly, most of the opposition to a short period came from companies. As noted above, most of the submissions of the Midlands Industry Group of Finance Directors regarded a restriction to 40 years as unnecessarily restrictive, and Shell (DP80), referring to its long experience in estimating useful economic lives, favoured a period of up to 40 years. However, there remained some opposition among companies to a longer amortisation period until the end of the debate (e.g. Standard Life, FRED12; Stakis, FRED12).

In some of the final submissions, it was clearly accepted that the 20 year presumption was a compromise (Association of British Insurers, FRED12; ACCA, FRED12). The compromise nature of the solution emerging was underlined by Myddelton's (FRED12, p.250) comment on the confusion in many commentators' minds between 'indefinite' and 'infinite':

I dislike using a word [indefinite] which may be ambiguous; but I appreciate that the Board may actually prefer to do so given the political nature of its task.

Double charge

A standard argument used by those resisting the case for amortisation is that it represents a double charge against profits when the ongoing expenditure which maintains goodwill is considered. Examples include Ellis & Everard (ED47), Hoskyns (ED47), James Crean (ED47), Thomson Corporation (ED47), Unigate (ED47), CBI (ED47) and AIB Group (FRED12).

Comparison to SSAP 12

Several contributors linked the argument that goodwill may be maintained in such a way as to remove the necessity for amortisation to the rules under SSAP 12 *Accounting for Depreciation*, ASC (1977, 1987). These included Thomson McLintock (ED30), Baachus (ED30), KPMG (ED47) and Touche Ross (DP93).

Other arguments

Conspicuous by its occasional presence only was the idea of two levels of profit, before and after a goodwill amortisation charge, reflecting the trading profits of the enlarged entity and the overall return earned for shareholders by the use of their funds (ICI, ED30). Linked to the fundamental aspect of the debate on the nature of goodwill, there were a number of submissions which strongly favoured an approach describing the amount to be accounted for as a 'premium on investment' (ICI, ED47; British Bankers Association, ED47).

In the early stages of the debate, international harmonisation surfaced periodically, but rarely as a major plank in any particular case (partly because few favoured amortisation or if they did they distrusted the use of the 40 year maximum period employed in the United States). Examples are Esso (ED30) and Gallagher (ED30). Later in the debate, international harmonisation was a more significant factor in submissions (e.g. Coopers & Lybrand, FRED12; Tate & Lyle, FRED12; Willis Corroon, FRED12).

THE ARTHUR ANDERSEN AND PRICE WATERHOUSE SUBMISSIONS

Of the major accounting firms, only Arthur Andersen and Price Waterhouse produced a series of coherent submissions each clearly linked to their previous documents in the sequence. For this reason, and because they provide an interesting contrast from a rhetorical perspective, their submissions are considered in some detail in this section.

Arthur Andersen & Co. were conspicuous for the consistency and articulateness of their position. Their six page letter with its single page appendix in response to DP80 included a carefully crafted description of goodwill, a simple but forceful statement of the case against amortisation, and a strong endorsement of the practice of writing off goodwill against reserves at acquisition. The position was maintained in the reply to ED30, and again in the response to ED47. The latter document in particular is striking in view of the range of arguments employed: there is discussion of the needs of users (p.8); there is reference to the international position and the historical origins of the US rules (pp.8-9); and there is an attack on amortisation based on a reasoned case that it does not (despite what its supporters might argue) appropriately implement the principle of matching. The response to DP93 modified the position slightly to favour the separate write-off reserve, and confirmed the line of argument begun in the response to ED47 that the ASB needed to change the suggested approach to intangible assets. (Their stance on this particular aspect may, it has been argued by Napier and Power (1992) reflect a professional interest in the position advocated in their sponsored 1992 contribution to the debate on intangibles.) The Arthur Andersen submission on WP95 (a mere two page letter confirming support for deduction from equity) was the shortest of all their

submissions. Perhaps at this stage the firm recognised that it was in a minority and that repetition of its case would not succeed in persuading those who had not been persuaded already, though the letter does refer to particular time constraints on the individual making the submission. Arthur Andersen returned to their strong and consistent opposition to capitalisation and amortisation in the submission on FRED 12. In acknowledging the ASB's attempt to achieve a solution, they warned that in their perception the consensus emerging 'will be fragile and based partly on exhaustion with debating the topic and partly on pragmatic judgments by preparers ...' (p.15). They restated their support for the immediate write-off of goodwill against reserves.

In summary, the Arthur Andersen position was argued with thoroughness, consistency and skill. Despite this, the final outcome did not follow their recommendations. Two conclusions are possible: either they were in some sense "wrong" in the position that they adopted, or they were insufficiently persuasive. Included in the second possibility, of course, is the notion that other parties to the debate, for reasons of principle or otherwise, were simply not open to persuasion.

The Price Waterhouse submission on DP80 had many similarities to the Arthur Andersen submission in its condemnation of amortisation as unnecessary. The arguments were not so fully developed and they led to the conclusion that (p.97):

We would prefer to show goodwill in group accounts at cost, subject to the same requirement to write down on permanent impairment as applies to the investment in a subsidiary in the accounts of a holding company.

The much lengthier submission on ED30 seems to be responding to the position that had developed since DP80. The proposal on the table was to permit a choice between capitalisation with amortisation and immediate write-off. The Price Waterhouse position was opposed to the former, for presumably the same reasons argued in the submission on DP80, and the decision then seems to have been to support the latter. In part, this was done by using some of the arguments advanced by Arthur Andersen. They also state (ED30, pp.147-8) that in certain circumstances 'we would be prepared to allow the retention of goodwill in group capital employed where there is an insufficiency of reserves to

permit immediate write-off'. Although the wording here is unusual, it seems to be an endorsement of the separate write-off reserve. This may have been a tactical response, justified by the argument that the ASC must make a choice rather than permit the two proposed accounting treatments of ED30 to co-exist. The preferred alternative might have been at risk in face of the argument that some companies might have insufficient positive reserves to absorb the write-off.

When Price Waterhouse commented on ED47, this position had been abandoned in favour of the original principle which the firm supported (p.47):

We therefore support the view that acquired goodwill should be recognised as an asset in the investing company's balance sheet. Failure to do so, as currently permitted by SSAP 22, seems to us to lead to an unrealistic view of the assets of the purchaser.

Combined with continuing opposition to amortisation, this led to endorsement of the carrying of goodwill at its original cost subject to review for impairment. The submission included a particularly succinct statement of the lack of significance in the distinction between purchased and internally generated goodwill (p.48):

The value of a business, and thus of its goodwill, does not necessarily wear out. It can be maintained or even enhanced by good business management and by cash expenditure charged against the income stream, and its effective life thus prolonged. Such management action is not, as suggested by the ASC, replacing purchased goodwill with self-generated goodwill (in our view, an artificial distinction) but rather, the maintenance of that business value which was measured at the acquisition date.

If the assessment that Price Waterhouse's submission on ED30 was tactical is correct, this reflects an adherence to the idea that submissions to the ASC or the ASB are designed to achieve a practical outcome that is favoured against alternatives, rather than a search for some unique position which is supported by true principles. It is significant that the accounting firm which seems to have adopted a tactical response in its

own submissions is the one whose influence on other respondents is most apparent (as discussed in an earlier section of this paper).

The Price Waterhouse responses on the later documents, commencing only four years after the submission on ED47, appear to abandon the vehement opposition to amortisation in favour of a more overt recognition of the pragmatic nature of standard-setting. The response to DP93 was to reiterate support for capitalisation and annual review, with the only acceptable alternative (should it be concluded that ceiling tests were impracticable) the use of a separate write-off reserve. Despite the response's firmly stated opposition to capitalisation and pre-determined life amortisation, the acknowledgement (p.359) that 'only very large and sophisticated companies will have the resources to apply the [ceiling] tests in the manner envisaged' foresaw a situation where amortisation might become the most common method in practice. This therefore may represent a significant dilution of the strong opposition to ED47, unless one accepts as a possible interpretation of that opposition that it was undertaken on behalf of 'very large and sophisticated' clients.

The apparent dilution continued in the submissions on WP95 and on FRED12. The former emphasised the importance of consensus-seeking, and softened the previous strong support for capitalisation by saying (WP95, p.289):

We are neutral as to whether the Board eventually requires goodwill to be capitalised as an asset or deducted from reserves with disclosure to enable users to identify easily the amounts involved.

The latter submission completed an apparently pragmatic abandonment of the position taken on ED47, referring (FRED12, p.268) to 'those rare circumstances where it is appropriate to consider use of an indefinite life.'

THE NATURE OF GOODWILL

Conflicting ideas on the nature of goodwill permeate the various documents issued by the ASC and the ASB and the submissions on them. This section reviews some of the key ideas.

Part of the discussion proceeds on the basis that goodwill is undoubtedly an asset, something that may confidently be described as existing, continuing to exist, ceasing to exist, wearing out through the effluxion of time or not wearing out, being consumed, being used up or not being consumed. (For examples of the confident use of such metaphors, see Clark Whitehill (ED47), Grant Thornton (ED47), Shell (ED47) and Embrey (ED47).) It is as though, despite the ASB's definition of assets in terms of rights or other access to future economic benefits, there is a lingering collective acceptance among those concerned with accounting that there must be some "thing" to serve as a nexus between past and future. In contrast to the many confident assertions or poorly thought out metaphors, there were other commentators who referred to the exceptional characteristics of what is described as goodwill and argue or hint that goodwill is not an asset and may not even be a thing whose existence or lack of it can be discussed so confidently. Is this of any significance, or is it merely a philosophical curiosity? The significance of the debate lies in the fact that if we accept the concrete existence of goodwill it becomes easier to talk of there being a difference between two things, purchased goodwill and internally generated goodwill. If we do not accept its concrete existence, if we accept that goodwill is not a "thing" of any sort but a way of talking about the consequences of a series of past transactions and events in the light of the present and predicted future environment, then we have much greater flexibility. In essence, it seems that the debate moved in that way over the years, allowing the ASB to adopt a solution to the problem of accounting for goodwill that had been unacceptable earlier.

In many ways the crucial turn in the debate seems to have been the coincidence of the comprehensive opposition of preparers to ED47, combined with the changes in position of Price Waterhouse and other commentators who were prepared to move in the same way. However, there were significant indications of that possible direction much earlier.

Pilkington (DP80) pointed out that there was no need to 'replace' purchased goodwill, a position also taken by Mercantile House Holdings, who linked the idea of amortisation specifically to that of a cash source for replacement. Bowater (ED30) stressed the maintenance of the value of goodwill, while Cadogan Oakley (ED30, p.31) argued that it was 'wrong in principle to discuss purchased goodwill and non-purchased goodwill as if they were separate things'. They argued that 'there is only one goodwill which almost certainly fluctuates in value all the time'. The artificiality of the distinction between purchased and non-purchased goodwill was stressed in many submissions, and in those on ED47 in particular this line of argument was extended to emphasise the possibility of expenditure to maintain purchased goodwill and thus justify the recognition of an asset of indefinite life. The Northern Rock Building Society provided an analogy of body cells (ED47, p.464):

It seems to me that goodwill is, in many ways, analogous to body cells where the old ones are constantly dying off to be replaced by new ones, leaving the overall body more or less unchanged, and that this process of self-renewal happens over a relatively short timescale, i.e. the goodwill which exists at the time of purchase is relatively quickly replaced by internally generated goodwill, the creation of which is reflected by expenditure, albeit not specifically identifiable, going through the profit and loss account.

Supporters of amortisation reject the implication that expenditure subsequent to an acquisition could be seen as maintaining the original goodwill. Ernst & Young (FRED12, p.125) provide one of many examples of this position:

Although an entity's overall goodwill might be maintained over time, purchased goodwill is depreciating and being replaced by internally generated goodwill.

Newton (ED47, p.461) followed much the same initial argument as the Northern Rock Building Society but came to a different conclusion:

In a situation where the value of goodwill appears to be maintained or increased, there seem to be two possible views:

1. The value of purchased goodwill has been maintained, probably with maintenance expenditure charged to the Profit and Loss Account, the amount of which cannot be determined.
2. The goodwill purchased has diminished but has been replaced with internally generated goodwill.

The persuasive argument is what happens to the factors that make up the goodwill at the time of acquisition. In all arguments I have seen these demonstrably decline in value, unless maintained or replaced, being such things as the quality of the workforce and customer relations.

It is this difference of opinion which can perhaps explain the co-existence of a large number of submissions insisting, as we saw, that the amortisation period would have to be no more than five to ten years with arguments claiming that the life was indefinite (as opposed to merely indeterminate). In addition to the references to submissions claiming a life of forty years or more previously considered, there were others such as AIB Capital Markets and the Midlands Group of Finance Directors (both on ED47) claiming that life could be infinite, and many claiming that the life of purchased goodwill was indefinite with a strong implication that this meant very long indeed rather than merely indeterminate (ICI, DP80; Fisons, ED47; Grand Metropolitan, ED47; Ladbroke, ED47).

The response of the Institute of Chartered Accountants in Ireland to FRED12 is interesting, noting that while it is difficult to justify seeing goodwill as 'repaired' or 'maintained' rather than replaced, a solution on these lines is acceptable on pragmatic grounds. A similar view was put forward by Reed Elsevier (FRED12).

CONCLUSION

The differences of opinion apparent from all aspects of the debate have made the finding of a "solution" to the goodwill problem extremely difficult. We have seen in the opinions summarised in this paper that there have been radically different views on (among other topics) the accounting treatment to be adopted, the likely useful economic life

which goodwill might typically be expected to have, and even the fundamental question of what goodwill is. All of these differences seemed to place the ASB in a situation where there was no solution which would come close to attracting majority support. Perhaps it is no surprise that the result that has emerged in FRS 10 may be seen as another compromise to replace that of SSAP 22.

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NOTES

- ¹. Economic consequences arguments assert that standard setters should consider not just the technical accounting aspects of their proposals but also the economic impact of any costs or wealth transfers likely to arise as a result of their implementation.
- ². Stock Exchange class tests involve the classification of transactions such as acquisitions by reference to various tests such as the comparison of the net assets of the acquirer and the acquired entity. Whether limits set by the tests are exceeded or not is influenced by the accounting treatment of intangible assets.
- ³. Ceiling tests were proposed in DP93 as the basis on which capitalised goodwill might be monitored for possible impairment of value. The role of such tests has now been taken over by the impairment reviews required by FRS 11 *Impairment of Fixed Assets and Goodwill*.

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