

Radu-Daniel LOGHIN
ACADEMIA DE STUDII ECONOMICE BUCURE TI,ROMANIA

EMERGING COMMON LAW DECISIONS IN GOODWILL ACCOUNTING REGULATION

Empirical
studies

Keywords

Goodwill
Common law
emerging markets
South Africa

JEL Classification

G32, K20, M41

Abstract

In respect to financial reporting, statutory accounting standards and regulations form only a part of the normative landscape. Considering the case of common law countries, besides these classic sources of norms and practices there is an alternative base for exercising the professional judgement of the accountant, the case law precedents which drive and supplement in cases accounting regulations. For the purpose of this paper, goodwill accounting is explored from a normative perspective which draws from case law precedents in Zimbabwe and South Africa, two emerging common law countries which share a rich common law heritage, resulting in a set of findings relevant to the understanding of the nature of goodwill as well as an understanding of the factors which lead to early adoption of International Accounting Standards. .

Introduction

As part of the globalization process, standard-setters and jurists have had to accommodate the issue of financial information as a tool for the identification and ensurance of commercial rights for business and individuals alike. Of particular interest for the international convergence is the right of goodwill. As an immaterial right, goodwill can be used for multiple simultaneous purposes and any initial advantage in returns based upon it can lead to a domination of the market, due to specific network effects (Lev, 2001). By recognizing goodwill as an asset on the balance sheet, shareholders not only improve their credit scores, but also enhance the possibility of a favorable price for the trading of their company, while fulfilling a social role for the implementation of tax brackets.

According to proponents of the Austrian school of economics, the intrinsic and extrinsic reasons of the economic subjects can be added up in a meaningful way (Magliulo, 2010). From a motivational perspective, the writing off of goodwill is dependent on both external and internal factors. Internal motivation would rest on the intellectual challenge associated with the valuation of goodwill under the fair value model while extrinsic motivation would rest with the benefits of such measures for the legal standing of the company. Thus the valuation of goodwill is closely tied with the risks provided by its absence from the financial statements.

Emerging markets provide a window into a loosely regulated environment which can either endorse the legal developments of developed markets or provide the world innovative local frameworks, based in part with their connection to the developed markets. Emerging markets are more exposed to leverage (Komulainen & Lukkarila, 2003), the drivers of the P/E are the same as in developed markets (Ramcharran, 2002) while in general being more segmented than their counterparts (Chambet & Gibson, 2008). Such characteristics make the recognition of goodwill on the balance sheet an imperative, since it enhances both shareholder's equity and financial integration of various markets.

The normative framework which allows a fair value measurement of goodwill for legal purposes is that provided by the International Financial Accounting Standards (IFRS) which are endorsed by major financial equity markets.

As far as goodwill is concerned, previous research pertaining to the regulations and treatments applied in practice is diverse ((Arnold, Eggington, Kirkham, & Macve, 1994), (Catlett & Olson, 1968); (Hughes, 1982), (Ding, Richard, & Stolowy, 2008)), and employ various frameworks for explaining the evolution of goodwill accounting. In the normative research field,

relevant studies, such as those the most relevant are Nobes (1992), who sets out to explain the history of goodwill in the UK, proposing a cyclical model of standard-setting as a political process influenced by six parties namely corporate managers, auditors, users, government, international opinion and upward force and Bryer (1995), who develops an alternative framework to explain standard SSAP 22 (ASC, 1984) on accounting for goodwill, drawn from the Marxist precepts applied in the context of a capitalist phenomenon.

However, few research papers have addressed the phenomenon of goodwill accounting in the context of the legal system in a normative-empiric research. Interdisciplinary studies relating to both accounting and legal matters are the topic of Johnson (1985) when exploring the origins of accounting standards pertaining to goodwill accounting, or Simon (1956) whose study has shown that the common law case decisions are quite generally in accord with the accounting principles and ideas concerning the subject of goodwill, or (Sha'bani Nashtaei & Shahrudbari, 2012) who try to separate two different concepts, the right to goodwill and the right to business vocation

The current approach tries to find the accounting implications of common law case rulings on the accounting practice and regulations, as well as the legal environment ideal to the endorsement of International Financial Accounting Standards

Goodwill accounting under common law and civil law systems

The crux in the recognition of goodwill as an asset is the overlay between the concepts of *ius* and *dominium*. In the philosophical sense of the Will Theory, *ius* and *dominium* overlap. In a strict sense, *dominium* means „ownership” and „property” which in a broad sense can be applied to any sort of authority. Such an interpretation stems from the Latin roots of the word *God* (*Domine*) which implies normative control. The Latin word “right” stems from the term “*ius*”. If goodwill is an asset of an enterprise in the sense that it is something which can be appropriated by the owners of the enterprise, we face a moral and legal dilemma. Does a natural *dominium* overlap with a legal right and does that mean that licit uses of intangible property imply the legal right to that property. The very notion of “right to goodwill” implies the notion that *dominium* is exerted within the sphere of legal rights.

There are two approaches to the issue of „the right to goodwill”. In the natural world some individuals have *dominium*, a territory which they claim in the sense of “*ius*”. These rights are enforced through violence. Others use a *dominium* without claiming it. If we accept that goodwill

forms part of a natural right the matter would be like debating the right of a pack of wolves to appropriate a portion of the migrating caribou. In this aspect, the first challenge to the “right to goodwill” arises with the accepted notion that humans unlike animals have free will and thus the social effort of the enterprise to attract and maintain a customer base does not confer it control over the minds of those consumers, since consumers have the capacity to decide on matters relating to their providers of goods and services, as well as the urgency of the orders and the funds they are willing to have the provider charge them for in exchange for the goods and services exchanged.

The translation from a right governing the choices available to the merchant to a right governing the choices of others, which acknowledges the normative right of the merchant to the consumer’s behavior within the confines of the market would seem fallacious to most individuals unless we accept that in fact the transaction involved the renouncement of will on behalf of the seller and that the consideration exchanged for the goodwill implied the renouncement of will on behalf of the seller to compete with the buyer in regards to his or her old business. According to this vision, the right to goodwill is opposable to the seller in a consensus or to any other party which inherits the legal rights of the seller. However, such an action would imply sacrificing the will of the entity, constraining the expression of its personhood. In a legal sense the right to goodwill would translate into a trade restraint on behalf of the seller.

It is here from which we draw the recognition of the right to goodwill, the dilemma whether or not goodwill can be considered a right of property in the sense that individuals or companies can claim it or if goodwill belongs by right of necessity to all parties which act on the market and that an individual or company can uphold their right to goodwill only with the approval of the other agents on the market. This dilemma can be seen in Table 1.

For reasons why this configuration forms a valid framework for analysis, consider the following example. Consider a feast where the host has to feed a number of guests who are provided with dinner plates. Consider a guest appropriating a slice of lemon from the plate of the neighbor. The guest complains to the host about the whole affair and the host is to decide if he/she removes the plaintiff from the table or allows this to happen. If the host applies the Will Theory than the first guest has misappropriated the slice of lemon since the right was granted to the second guest and thus the first guest opposed his/her will. If the host applies the theory of Interests, than he/she would admit that the first guest was entitled to the slice of lemon

by virtue of his/her needs and their status at the dinner table.

Goodwill in this example could be for instance the monetary expression of the social efforts involved in acquiring the position at that table and the right to be served accordingly.

There are many sources of legislation from which the right to goodwill is drawn but the constructs which stand in opposition to each other as regarding the matter are as illustrated in Table 3.

According to doctrine of subjective rights, the value of such a right is found in the power or entitlement over the legal object under such a right (Merwe, 2013). The power or entitlement includes the use and enjoyment and the ability to dispose or otherwise alienate the legal object of such a right. The use and enjoyment in the appropriate case involves the gaining of financial benefit while the power over such a right is naturally enforceable against alleged infringers.

Under the above doctrine goodwill has been identified to be adequately independent, of properly defined existence and of adequate value to be recognized as an (immaterial) object in law in relation to which a legal subject can hold a subjective right. To the same effect it is also able to satisfy a legally recognized need. The subjective right is accordingly called the “right to goodwill”. The holder of the right to goodwill in an enterprise, amongst others, has the right to gain financial benefit from such a right.

Any goodwill that becomes associated with an enterprise requires, amongst others, effort from the person or persons that are involved in its launching. Although (hopefully) only existing for a brief period of time, an enterprise that has just been launched cannot be said to necessarily already have generated goodwill (in the sense of the existence of a beneficial disposition in entrepreneurial context) right from the outset, though depending on a campaign of pre-advertisement.

In the sense that the right to goodwill forms the entitlement to a market position, it is important to recognize its sources, Statutes on Monopolies in civil law countries and case law concerning restraint on trade imposed in common law countries, while recognizing common sources of legislation such as Anti-trust Laws which are public laws enacted by both common law and civil law legislatures as a means of protecting the rights of necessity.

Codified civil law is arguably the most influential legal system today, with the highest population of legal subjects. The oldest code is that of Hammurabi (Kent, 1903). The key feature of the system is a codified system of norms which can be referred as primary sources of law into a referable system which serves as the primary source of law. Modern civil law draws from a legalist philosophy

of Roman and Chinese conception which advocates the utilization of codified laws and harsh punishment to achieve abstract norms of public good and public interests.

Conceptually, civil law proceeds from abstractions, formulates general principles, and distinguishes substantive rules from procedural rules, holding case law to be secondary and subordinate to statutory law.(Fromont, 2001) The marked feature of the system is that code articles deal in generalities and must thus be supplemented with very long and very detailed, statutory schemes.

Such is the case of the defense of goodwill within Vietnam, an emergent Asian market, the Civil Code imposes compensation for damage caused by harm to honor, dignity or reputation which it covers in detail in including the following recoverable damages including reasonable expenses for limiting and restoring the damage; loss of or reduction in actual income; and the compensation for the victims' mental suffering due to the infringement of honor, dignity or reputation. In addition to compensation for the above mentioned damages, the persons infringing upon another person's honor, dignity or reputation shall be liable to pay a sum of money to mitigate the victims' mental suffering. It is clear that the burden of proof lies with the defendant.

Common law is a legal system developed by courts of justice through the decisions of courts and similar tribunals, as opposed to laws and acts adopted by the legislature or regulations issued by the executive branch.

A "common law system" is a legal system that gives great precedential weight to common law, developed by Edward Plantagenet on the basis of English-Norman law (Jenks, 1902)on the principle that it is unfair to treat similar facts differently on different occasions. The history of previous court rulings are binding and are thus referred to as precedents, which are regarded when the lawyers can not agree on the issues at hand. If an issue which resembles a past case is brought by one of the parties to enforce their viewpoint, the Court is forced to follow the reasoning as put forth by the judge who presided in the previous case. If however no similar reasoning is found from historical cases which resembles the issue presented before the court, the judge issues a ruling by their authority and duty, creating a precedent which is treated on footing with statutes and laws, and becomes binding to all future decisions.

The mechanism provided by common law is expanded by additional rules pertaining to decisions binding in certain jurisdictions, even though judges may consider common law systems are considerably more complicated than the simplified system described above. The decisions

of a court are binding only in a particular jurisdiction, and even within a given jurisdiction, some courts have more power than others. For example, in most jurisdictions, decisions by appellate courts are binding on lower courts in the same jurisdiction, and on future decisions of the same appellate court, but decisions of lower courts are only non-binding persuasive authority. The first court case involving a restriction of trade was formulated in Common Law England in 1620 during the *Broad v Jolyffe* case, where consideration was exchanged for a verbal agreement of restraint of competition.

According to the will theory, the seller had waived his will to compete in exchange for consideration and thus the purchaser had dominion over the trading capacity of the seller within the jurisdiction.

Methodology, sample and hypothesis

After developing the case for common law as a root for goodwill accounting regulations and linking the adoption of accounting standards based upon the enforceable rights acknowledged by the legal system as assets and liabilities projectable on the balance sheet of the company.

First, I sampled a legal history of court cases in South Africa and Zimbabwe, two emerging common law African markets who adopted IFRS as the basis for the filling and presenting financial statements.

The relevant issue as stake with the selection of the jurisdictions lies in the recognition of the said jurisdictions as emerging markets.For Zimbabwe the arguments are diverse and are drawn from the body of scientific literature such as (Rouwenhorst, 1999) based upon the Emerging Markets Database (EMDB) and the International Finance Corporation (IFC), (Umutlu, Akdeniz, & Altay, 2010),(Lagoarde-Segot, 2009),(Alagidede & Panagiotidis, 2009).(Owunsu-Ansah, 1998). For South Africa the issues pertaining to the emerging market classification are much simpler since South Africa is part of the BRICS group(Chun, 2013)

The question is if the discrepancy in the endorsement of International Financial Accounting Standards can be accounted for by the close examination of the legal framework of the countries in question. While laws and statutes are a part of the legislation, the emphasis of this paper is on the legal precedents which draw upon the concept of goodwill.

For issues of representation, the paper covers 12 selected cases involving the right to goodwill and determining the implied consequences for goodwill accounting. The relevance of those cases was then analyzed from an accounting perspective after which the legal

precedents invoked by the judge in arguing the decision were quantified.

In theory, a common law legal framework which relies more on external source of legal precedents are less likely to innovate in matters pertaining to goodwill accounting. Also, a common law framework which relies on old legal precedents will provide less relevant decisions in regard to the issue in which the decision is pronounced.

Thus the measures analyzed were the age of the legal precedents in regards to the decisions and the source of the said decisions. In theory the jurisdictions with the least original contributions to the matter of goodwill accounting will be more biased towards an early adoption of International Financial Accounting Standards.

A positive result would imply that the jurisdiction which endorsed IFRS earlier would be less contextualized than the jurisdiction which endorsed IFRS later. A null result would not reveal such a bias.

The Cases Zimbabwe

1.1. Zapchem Detergent Manufacturers Versus Polaris Zimbabwe Limited (2003)

This provides a relevant case for goodwill accounting from Zimbabwe since it explicitly binds goodwill to intangible assets as cash-generating units. The plaintiff was a South African company averred which exported the detergent powder to Zimbabwe from 1995. A local company was appointed as its sole agent for the importation of the detergent powder through a unique distributor which had one customer in Zimbabwe namely the defendant. The defendant stopped buying the plaintiff's product in September 1999, and packaged an Austrian brand of detergent into the remaining boxes belonging to the plaintiff, which brought an order interdicting the defendant from passing off the Austrian product as its own.

The judge decreed that goodwill cannot exist in any other context than that of the undertaking which produces the goods to which the force of attraction relates and thus belongs to the plaintiff. Thus, the owners of goodwill are those who generate the assets which are linked to it and not those who build its reputation.

The alternative rejected was that goodwill and reputation attaching to the detergent powder arose from the direct marketing and distribution of the product.

Goodliving Real Estate Private Limited Versus Jerome Ndubisi Okeke (2013)

This is another landmark case since it discusses the issue of goodwill within the context of a leasing contract. The case not only reveals that goodwill must be considered for cases where the rights pertaining to a purchase of cash-generating

units but also the prohibition of goodwill acquirement through any other means. The background to the dispute giving rise to the appeal is as follows. In March 2010, the defendant entered into an agreement with the plaintiffs for payment of what the parties termed "a commitment fee" in respect of premises undergoing renovations at the property in question.

This practice was consistent with a tendency which has arisen in the housing market where prospective tenants seeking rental space in buildings where there is a high demand for such space are requested by the lessor to pay what is variably termed "a commitment fee", "goodwill of the rental space" or "lease preference fees". The purpose of such a fee is to enable the prospective tenant to be given first priority in concluding a lease agreement in respect of the premises once they are available for occupation. Without payment of such a fee, a prospective tenant would stand little, if any, chance of even being considered for possible occupation of the premises.

In terms of the agreement entered into between the parties, the defendant agreed to pay the total sum of \$35,000 as "goodwill" in respect of the premises in question.

No alternative was considered from the defendant.

The argument according to the Commercial Code is that no lessor shall, in respect of commercial premises let or to be let by him, require or permit the lessee or prospective lessee of the premises to pay, in consideration of the grant, continuation or renewal of the lease concerned, any bonus, premium or other like sum in addition to the rent, or any amount for negotiating the lease. Superprofit can not be achieved from forcing the customers of a cash-generating unit from entering into an agreement with the owner of the goodwill.

Boka Investments (Private) Limited Versus Thirdline Trading (Private) Limited And Onclass Investments (Private) Limited (2013)

This an application for the confirmation of a provisional order, granted on 23 February 2011, for the winding up of the 1st and 2nd defendants (the defendants). The latter companies were the tenants of the plaintiff and jointly operate a tobacco auction floor under the trade name of Zimbabwe Industry Tobacco Auction Centre (ZITAC) together with their sub-tenants.

The plaintiff avers that the defendants have failed to satisfy an arbitral award for moneys owed that was granted in its favour on 16 April 2010 and registered by this Court on 19 May 2010. The plaintiff contended that the negative net identifiable assets were not recoverable since the defendants were not licensed for the 2011 season and thus lacked the ability to generate income. The defendants argued that the plaintiff ignored the

goodwill which was determined from a valuation. The premises of the enterprise had been vacated by the provisional liquidator appointed by the plaintiff. The court decided that, from a commercial perspective, goodwill based on prospective revenues may be treated as an asset in valuing a company's business when it is sold or transferred as a going concern.

However, goodwill is utterly valueless and cannot assist in discharging the company's debts and liabilities as and when they arise. Thus, internally generated goodwill can not under any alternative circumstances be recognized as an asset without the purchase of the assets to which it is attached. In a liquidation context, goodwill can not be used to offset any liabilities without the distribution of the other assets.

Unilever P.L.C. & Unilever South East Africa Vs. Vimco L.T.D & Registrar Of Companies (2004)

The plaintiff was a company from the United Kingdom which manufactured and sold a wide range of products with worldwide operations, the external part being carried out through subsidiaries. The second plaintiff was a subsidiary of the first plaintiff. The latter manufactures and sells in Zimbabwe while applying the trade marks of the first plaintiff, in terms of agreements between the two parties. Vimco, the defendant in question, was registered with a name similar to the plaintiff's trade mark. The order requested by the plaintiffs in question was to force the first defendant to change its name and prohibit it from selling products under the VIMCO trademark.

The second plaintiff further contended that the first defendant has "passed off" its product, being scouring powder, sold under the mark "VIMCO" as being the product of the second plaintiff. In a matter where relief is sought on the grounds of "passing off", it is settled that a party has to establish a goodwill or reputation acquired or associated with it in connection with the mark or "get-up" copied by another entity. The issue for determination is whether or not the plaintiff has established that its mark had become distinctive and associated with the plaintiff. The plaintiff sold its products for a long period of time with rising volumes of sales. This criteria were sufficient for the court to accept the request filed by the plaintiffs.

From an accounting perspective the elements relevant to goodwill recognition are the sales volume and age of the company.

Makesh Enterprises vs. Executor Nominee Estate Late Gunther Kaiser (2004)

The defendant is the executor nominee of the estate of a deceased person whose estate has as part

of its assets a company called Kaiser Engineering (Pvt) Limited, while the plaintiff had an agreement with the deceased regarding the purchase of his assets and goodwill. While the issue did not concern goodwill as a matter of passing-off, it did mention the possibility of acquiring goodwill and assets without transfer of the shares as an alternative to conventional business combinations. The case is also meaningful for accounting research from another reason relating to the separation between personal and business goodwill, since the goodwill of the deceased was still claimed by the plaintiff post-mortem.

Greendale Hardware&Electrical LTD vs. Goodfellow Bangara (2007)

The plaintiff is a member was a member of a group of companies carrying on the business of retail and wholesale of general hardware, specialized mining and industrial cutting tools and protective clothing. The defendant was a former employee of the plaintiff who was engaged as a salesman. On 31 October 2004 the defendant left employment with the plaintiff and entered the services of another undertaking. When the plaintiff and the defendant entered into the contract of employment they acknowledged that, by virtue of his duties, the defendant would become possessed of knowledge of proprietary rights of the plaintiff in the business carried on. Such proprietary interests included trade secrets and details of trade connections. They also agreed that for the purpose of protecting the proprietary rights which constituted goodwill it was necessary for the defendant to undertake a restraint of trade.

The accepted proposition was that the employee is entitled to use to the full any personal skill or experience even if it has been acquired in the service of his employer. It is this freedom to use to the full a man's improving ability and talent which lies at the root of the policy of the law regarding non-competition restraints. The additional knowledge and skill acquired during employment belong to the employee and their exercise cannot be lawfully restrained by an employer as they are not his property. An anti-solicitation restraint can cover the trade connection and being severable from a no-competition restraint, can be enforced. From an accounting standpoint it is clear that goodwill is not a reliable measure in the emerging markets if it is meant to cover intellectual capital as gained by means of a skilled work-force since this skilled work-force can not by a covenant be forced into a non-competition covenant. Their personal competence could still be valued as personal goodwill but not business goodwill.

South Africa

McDonald's Corporation v. Joburgers Drive-Inn Restaurant (1996)

This is a dispute about the use and continued registration of the plaintiff's trade marks. The plaintiff was one of the largest franchisers of fast food restaurants in the world, if not the largest. The plaintiff operates its' own restaurants and also franchises others to do so. The plaintiff obtained registration of its trade marks in South Africa several times, with a total number of trade marks reaching 52 by the time of the trial, which also consisted of the distinctive „M” letter.. Those trade marks are registered in respect of goods, mainly in classes 29 and 30, and for services in class 42.

When the proceedings commenced the plaintiff had not traded in South Africa nor had it used any of its trade marks there. The defendant was a South African company which engaged in the fast food industry since 1968 which also held a considerable amount of trade marks registered. Before the trial, the defendant had tried to acquire registration of the trademarks under its name which belonged to the plaintiff. An advertisement in the media also announced the defendant's plans to develop a franchise similar to that of the plaintiff, without the plaintiff's approval. The Trade Marks Act, No. 194 of 1993, which came into force after the proceedings started, provided protection for well-known trade marks from certain foreign countries. The contention was that the protection granted to foreign marks by the law of passing off was limited, however, by the requirement that a plaintiff had to establish goodwill in the country. The issue cited was damage to goodwill, and thus the plaintiff had to show that he had goodwill capable of being damaged in addition to reputation. Thus goodwill is local and tied to the market where the business operates. While a business may establish a considerable reputation, its business has to be established in the country in order for goodwill to exist. The court also contended that a trader cannot acquire goodwill without some sort of user in the jurisdiction where the trial takes place. Without consideration for the section 35 of the new Trade Marks Act, no decision in favour of the plaintiff would have been issued.

For accounting purposes, such a pronouncement reveals that while goodwill may be the attribute of an international enterprise, it must be allocated to individual markets where it has established operations. The mere reputation established among the foreign customers of an enterprise can not be upheld within the customers' jurisdictions.

Alliance Property Group PTY vs. Alliance Group LTD&Auction Alliance KwaZulu Natal PTY (2011)

The plaintiff in this matter sought a permanent interdict restraining the defendants from passing-off their services in the field of property as those of the Plaintiff, or as being associated with the Plaintiff in the cause of trade by using the name, mark & trading style “Alliance Group” or any other name, mark & trading style which is confusingly or deceptively similar to the plaintiff's mark & trading styles “Alliance Group”. The plaintiff conducted business in the field of commercial and industrial property including property development and facilitation, evaluations and consultancy, property sales, property letting, property management and public auctions of property. The Defendants conduct the business of property inspections and evaluation, property auctions, business sales and property finance throughout South Africa. However, the core business of the Defendants is that of property auctions.

The Plaintiff contended that the demands arose out of the Defendants' change of the trading style from “Auction Alliance”, used essentially in relation to the conduct of auctions of immovable property to “Alliance Group” in September 2007, in the face of the Plaintiff's existing reputation and goodwill residing in the trading styles “Alliance” and “Alliance Property Group” in the fields of property, including auctions. The plaintiff contended that the effect of the defendants conduct was to remove the only feature of their trading style, which distinguished their services and business from those of the Plaintiff and to add group element of the Plaintiff's trading style to their trading style, thereby misrepresenting that their business is that of the Plaintiff or associated in the cause of trade with the Plaintiff. The case was lost by the plaintiff in favour of the defendants.

For accounting purposes, the relevant aspects which are drawn from this case are the relevance of advertising expenses for the establishment of goodwill. In fact one of the issues examined by the court was the amount of advertising expenses incurred for the purposes of acquiring customers. Also, another relevant factor in establishing the ownership of the goodwill acquired with the name and trading style was the geographical distribution of the income and customer base. Thus for valuation purposes goodwill must be valued with risk margins attached to individual business segments.

Plascon Evans Paints LTD vs. Van Riebeeck Paints LTD (1984)

The plaintiff, a company dealing in paints and allied products, is the proprietor of a trade mark registered in terms of the Trade Marks Act 62 of 1963 ("the Act"). The trade mark in question was registered on 13 September 1971 in respect of the following goods falling within class 2 of the fourth

schedule of the Trade Marks Regulations. The defendant was a company also carrying on business as a dealer in paints and allied substances.

Early in 1980 the plaintiff instituted motion proceedings against the defendant claiming that the defendant was using a mark which infringed plaintiff's registered trade mark and also was wrongfully passing off its goods as being those of the plaintiff; and claiming interdicts against infringement and against passing off and consequential relief. The application was opposed by the defendant, which also applied for the striking out of certain passages in a replying affidavit filed by the plaintiff.

The plaintiff's predecessor in title hit upon the idea of using a component of its texture coating for his trademark. Due to advertising costs and product quality, the plaintiff established a substantial market for the product in question and had a considerable goodwill attached to the trade mark. The alternative view was that the original registration of plaintiff's trade mark was invalid, was considered off target because the trade mark had been registered for a considerable period.

The issues concerning goodwill valuation is that the age of an enterprise is of relevance when considering the goodwill attached to its trademark. Thus the goodwill acquired by means of a business combination is more relevant if the acquired business has a longer history than its direct competitors.

Caterham Car Sales & Coachworks Ltd. Vs. Birkin Cars LTD (1998)

This was a passing-off case which concerned the exclusive right to manufacture market and sell reproductions of a sports car. The plaintiff claimed exclusivity for its product, and alleged that the product of the first defendant was being passed off as that of its own. Both these sports cars were replicas of this particular model, a car with a classic and distinctive shape and appearance. Even an expert found the models hard to distinguish from a relatively short distance.

The essence of the plaintiff's contention on appeal is that the use of the numeral Seven has become distinctive of a sports car having the particular shape and external configuration of the product and that the use of a Seven in relation to a sports car having this shape and configuration serves to identify the car as emanating from the plaintiff and its predecessors. The plaintiff, at the hearing of the appeal, abandoned any claim for damages and limited the relief sought to an interdict restraining the respondent from manufacturing, marketing, selling and exporting from South Africa a sports car having the said shape and configuration which uses upon or in relation thereto the numeral in either alphabetic or

numeric form. There were no registered trade marks, designs or patents that had a bearing on the plaintiff's rights. It was no longer argued that the defendant was guilty of the general infraction of unfair competition. In the proceedings it is mentioned that a third party and the plaintiff entered into a number of agreements in which copyright, and the alleged rights to goodwill and the unregistered trademarks were assigned to the plaintiff.

The trial judge accepted as correct a statement that since the ordinary rules relating to jurisdiction apply to an action for passing-off, it is essential for the plaintiff to prove that the goodwill he seeks to protect extends to the area of jurisdiction of the court in which he sues. That, he held, meant that the plaintiff had to prove the existence of goodwill "generated by sales" within the area of jurisdiction of the court.

The plaintiff's case as formulated in the court was that the party with which it had entered into an agreement carried on business in South Africa and had a goodwill and reputation in the : Lotus carried on business in South Africa; Lotus had a goodwill and reputation in the sports car; the goodwill and reputation became that of the plaintiff during 1988 by virtue of the assignment from the third party and since 1988 the defendant had made a number of misrepresentations relating to its car's provenance and that amounted to a passing-off. The problem was that, if one applied the law as just stated, the motion was doomed to fail. The party with whom it entered into agreement stopped production of the brand before 1973, either in South Africa or elsewhere. There is also no indication that it had any business of any sort in South Africa by 1988.

There was thus no residual goodwill which could have been assigned in 1988. Following a similar factual route, the previous judge dismissed the case as put forward by the plaintiff. The case put forward by the plaintiff was also rejected in the appeal phase.

From an accounting perspective the relevant issues regarding goodwill recognition and measurement are the continuity of the cash-generating unit from which the enterprise draws its goodwill and reputation. According to the common law approach to goodwill recognition, goodwill has no independent existence. Once the cash-generating unit in question has disappeared from the market, no goodwill can be drawn from it by any other party in extensor. Common law practitioners from common law jurisdictions recognize goodwill as the totality of attributes that lure or entice clients or potential clients to support a particular business. Thus no goodwill can be transferred between a discontinued business and an existing one. Thus while a particular business establishment can draw from the goodwill of a previous cash-generating

unit, for instance through an oral or written agreement with the former owners of the previous intangible assets, goodwill can not be drawn from an asset which was liquidated or disposed by the previous owners.

A vs. The Commissioner for the South African Revenue Service (2014)

This case concerned a problem frequently experienced in South African Tax Law disputes, of deciding whether certain expenditure was of a capital or income producing nature. In the present case the expenditure consisted of the payment of interest. The plaintiff, the taxpayer, contended that the payment of interest was expenditure in the production of income and therefore a deductible tax item in accordance with the Income Tax Act. The defendant contended that the interest paid by the defendant fell foul of the provisions of the Act and could, therefore, not be deducted from the appellant's taxable income. Until that point it had been established that what is required of the taxpayer is affirmative evidence that satisfies a court upon a preponderance of probability that the amount is deductible or alternatively not taxable.

It is common knowledge that three doctors conducted a medical practice which held considerable goodwill in the patients which frequented the establishment and by incorporating it they stood to gain a considerable return. Dr. A testified that he and his partners were convinced by reading various newspaper articles that they stood to gain by having the partnership incorporated. In a partnership goodwill constituted an unrealisable asset which, once the incorporation ended, would appear on the financial statements of the company owning the practice, as an intangible asset. Such asset could then be pledged as collateral for finance, a feature not possible under the partnership system. The partnership had the problem of going concern since when a partnership ends; the assets and liabilities are divided among the partners. Such a problem does not arise under a corporation. The expert testimony was carried out on the behalf of the plaintiff coming from the plaintiff's accountant and auditor respectively.

The goodwill was determined based by multiplying the turnover from a previous fiscal year to a period exceeding a fiscal year (i.e. 19 months), which was then rounded down to establish the goodwill of the enterprise. The assets were calculated at net book value for the purpose of the sale, without assumption of debt incurred by the practitioners. The consideration transferred was made through a technique called seller financing, by which a loan is provided by the seller of a property or business to the purchaser. That loan was bearing interest. In order to liquidate the

personal debt owed to the directors, one of the practitioners obtained a further medium-term bank loan which was also bearing interest. The defendant refused to recognize the interest as a deductible on the grounds that the interest incurred was not incurred in the production of income which was not lay out or expended for purposes of trade and was an expenditure of a capital nature. The argument laid down by the defendant was that expenditure is said to be incurred in the production of income when it is closely related to the act which produces such income. The interest incurred was considered to be paid for the acquisition of a cash-generating asset and thus a capital expense which is not a deductible item. The defence did not however concede to the point that under the seller financing the interest was not intended or calculated to, nor did it in fact, improve, augment or preserve the capital assets acquired, or form part of or add to the cost of acquiring them or enhance their value. The point of view of the court was that interest expenses for the purposes of acquiring goodwill were a deductible expense and thus the case of the plaintiff was accepted.

From an accounting perspective the relevant issue here is the expenses incurred by the buyers of goodwill. The purchase of a cash-generating asset and the goodwill attached to it does not incorporate the interest expensed in acquiring the cash-generating unit. It also conveys the message that for tax purposes, an investment in goodwill is an investment is made for the purpose of earning an income.

Patricia Anne Grobelaar vs. Paarl Airconditioning Services Cc (2003)

The Plaintiff, the Liquidator of Paarl Verkoeling en Ventilasio, claimed damages it allegedly suffered because of the conduct of the Defendant. The amount claimed is the alleged value of Paarl Verkoeling en Ventilasio's goodwill which was allegedly appropriated by the Defendant. The Plaintiff's case is that the income generating aspect from the business of Paarl Verkoeling en Ventilasio was taken over by the Defendant, without value, when the latter started operations in early 2002. The Plaintiff's contention is that the manner and circumstances in which the alleged appropriation of Paarl Verkoeling en Ventilasio's business occurred rendered the conduct of the Defendant unlawful, since some of the creditors of the business had not received their proper payment. The Plaintiff's claim may be described as a delictual action for damages flowing from unlawful competition although there was a dispute of facts in this regard. The liquidator sold the goodwill of the defendant as part of the liquidation process. This happened since the business had acquired considerable goodwill. The

owners of the liquidated enterprise then had established a new business which began to trade in the same area.

The issues presented to the court were if the operation conducted by the liquidated enterprise at the end of 2001 had any goodwill left, whether this goodwill was personal goodwill or business goodwill and if the case was that of business goodwill what was its amount. The goodwill was sold in without a transparent calculation and in 2000 appeared on the balance sheet of the enterprise and by then IAS 36 „Impairment of Assets” goodwill should have been tested for impairment annually but since IAS 36 was not in force by the time that the alleged infringement took place, the amounts were not impaired accordingly. Also, the value of the goodwill as determined by using a consumer price index to determine a larger amount than that which was transferred by the liquidation.

The expert witness from the defendant’s side, as an auditor and accountant testified that goodwill is hard to count on, because its value can come from abstract and often measures which involved concepts of trust which do not work forever for a company. The argument of the expert was that goodwill presented in lump sum the value of brand names, patrons, customer base loyalty, competitive position and development of other hard to price assets a company might own. His argument against the consideration of goodwill in the case of the liquidation was that people find undesirable a losing business and that goodwill does not move in line with the consumer price index.

The arguments set forth by the defense were that the new business did not conduct business from the same location as its predecessor; that its telephone line was not used to attract new customers for the new business; that the new company never made use of its predecessor’s client list to acquire customers or that it solicited the clientele of its predecessor and lastly did not trade under a name similar to the English translation of the former’s trade name.

The arguments brought by the plaintiff was that during 1996, the defendant sold his personal goodwill for a significant consideration; that the defendant commenced operations immediately after the former enterprise ceased trading; the defendant employed the former owner, who necessarily brought with him his personal knowledge, contacts and experience in the field of the supply, installation and servicing of airconditioning equipment.

The definition for goodwill considered by the Court was that from investorwords.com which defines goodwill as “an intangible asset which provides a competitive advantage, such as a strong brand, reputation, or high employee morale. In an

acquisition, goodwill appears on the balance sheet of the acquirer in the amount by which the purchase price exceeds the net tangible assets of the acquired company.” The court also found the defendant as misappropriating the goodwill of the former company. The reasons why the court found that the transfer had occurred was that the new company which had sprung up was successful because of the personal goodwill which came with the hiring of the owner, since the difference between a corporation without goodwill and one with goodwill is that the latter is more successful because it has a customer base attached to it.

From an accounting perspective the following case is of critical importance for goodwill recognition and valuation. First, it establishes goodwill as a real, intangible asset of the enterprise from which the owner can draw a profit. Secondly, the Court decided on a conservative amount corresponding to the book value of goodwill in the liquidated enterprise’s financial statements instead of a residual amount or a superior amount as proposed by the plaintiff. Also, in keeping in line with the decision, the Court held that for the said goodwill the defendant should pay an interest, thus proving that goodwill is an asset capable of fulfilling multiple simultaneous roles in a company in accordance to the theory as put forth by (Lev, 2001).

Results

Thus, seeing that the case law in both Zimbabwe and South Africa endorse goodwill as a subjective right which can be accounted by the owners of the entity on their balance sheet, it is significant to determine if the dynamics of the legal system support the implementation of the International Financial Accounting Standards within their statutory framework.

As we can observe in Table 4, Zimbabwe, the first to adopt IFRS as the national framework of choice for financial reporting back in 1996 has a much earlier legal reference set than South Africa. Also, the ratio between domestic citations and foreign citations is skewed in favor of foreign jurisprudence as opposed to South Africa which has a larger set of legal precedents generated from its own court history.

This reasoning would be consistent with the view that convergence is favored when the accounting profession has serious local issues to contend with while endorsing the interpretations put forth by the IASB. Indeed, the ASB (Accounting Standards Board) of South Africa is very active and very vocal when it comes to proposing amendments to the exposure drafts issued by IPSASB. In fact when we analyze the range of citations in South Africa the most important revelation lies in the diversity of legal

sources and traditions selected as a basis for the issuing a decision.

Also, a vast majority of legal literature in Zimbabwe was based upon precedents set forth in South Africa, while South Africa had itself a richer source of court precedents. The most recent citations for the Zimbabwe legal landscape are indigenous while the oldest are British and thus part of the colonial heritage. It is apparent that Zimbabwe draws less from this heritage than South Africa. Judging from the hierarchy of the age of citations within the context of Zimbabwe, the order of influence is historical-regional-local, while in the context of South Africa, the pool of precedents is represented rather equally among the pure common law states, meaning that the decisions based in the South African courts are more stable and reliable than those issued by the Zimbabwe courts which lack a truly international dimension to it.

Conclusions

As the research conducted in the case of Zimbabwe and South Africa suggests, in the modern case law environment fostered as part of a common law framework, goodwill is an asset recognized within the setting of personal relationships developed by the entity within its competitive framework. It concerns the identity of the entity and its assets which are imbued by the financial and legal effort on behalf of the entity to achieve recognition and *dominium* with regards to its will to associate itself with a particular style of conducting business. When a seller disposes of his or her business for consideration which is judged to be appropriate for the matter, the seller gives up dominium in performing that business if the deal provided the seller with consideration beyond the fair value of the assets exchanged.

This is a notion that anyone can accept as part of the „theory of will”. If the right to goodwill is defined as strictly existing within the confines of the contract as an exclusive covenant between the seller and purchaser, we could argue that within the confines of the contract the right to goodwill is inalienable and infinite since the implied covenant does not extend to third parties for the scope of blocking illicit competition. From this line of reason, the right to goodwill should be amortized over a reasonable period like the previous IAS 22 “Business Combinations” required with a test for impairment to account for the social changes which harm the right to goodwill but which can not be enforced under the principles of subjective law.

The other consideration is from behalf of the market as a whole. If the right to own goodwill in a brandname can be opposed to other unrelated parties then goodwill is not directly tied to an exchange and a waiver of will, but forms a quasi-

permanent entitlement passed indefinitely, and thus is not to be amortized but tested for impairment regularly.

Also, the cultural context which can be drawn from the legal sources consulted by the legal system of the jurisdictions provides a reliable variable for predicting the convergence to an international accounting framework.

Awnkoldegments

This work was cofinanced from the European Social Fund through Sectoral Operational Programme Human Resources Development 2007-2013, project number POSDRU/159/1.5/S/134197 „Performance and excellence in doctoral and postdoctoral research in Romanian economics science domain”

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Appendices

Appendix A

Table No.1
The right to goodwill according to conflicting views on natural law

Basis	Is Goodwill a Dominion?	Accounting consequences
Will Theory	Yes	Goodwill is tested for impairment
	No	Goodwill is expensed
Theory of interest	Yes	Goodwill is depreciated
	No	Goodwill is expensed

Source (own research)

Appendix B

Table No.2
The framework of rights as defined by legal domain and type of rights

Legal Domain	Rights	Corporate Governance Model	Preferred Legal System
Public Law	Monopoly Rights	Stakeholder Model	Civil Law
Private Law	Non-compete clauses	Shareholder Model	Common Law

Source (own research)

Appendix C

Table No.3
The types of legal systems by percentage of economic subjects

Type of legal system	Percentage of subjects
Civil Law	60.06
Common Law	35.17
Mixed Systems	3.84

Source (<http://www.juriglobe.ca/eng/syst-demo/tableau-dcivil-claw.php>)

Appendix D

Table No.4
The metrics relating to the relevance of the legal source material

Jurisdiction	Total citations	Average age of citations	Number of ZB citations	Number of SA citations	Average age of ZB citations	Average age of SA citations
South Africa	95	25	13	82	22	25
Great Britain	21	55	2	19	83	52
Zimbabwe	5	11	5	0	11	-
Australia	2	18	0	2	-	18
Canada	2	27	0	2	-	27
USA	4	25	0	4	-	25
New Zealand	4	34	0	4	-	34
Total	133	28	20	113	39	30

Source (own research)

