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Little value in making goodwill even more intangible

How much of the inner workings of a deal do you want to know?

The usual answer is as much as possible. We want price, rationale, forecasts for the combined businesses – and, if it can be had, gossip about the ego clashes and who said what to whom and why.

It is only far down the line that accounting really comes into it, by which point the glamour has gone and investors are left with a couple of dull-sounding phrases discussing synergies and "goodwill".

Is this good enough? This lack of detail comes in spite of the efforts of the rulemakers, who have for a long time sought to make managers more accountable for the prices they pay, by pushing them to explain more. Efforts have focused on goodwill, the accounting catch-all that refers to the part of a business that cannot be boiled down to a hard number already in the books – factors such as reputation or customer loyalty. The more cynical call it the amount by which the acquirer overpaid.

First, the authorities banned the amortisation of goodwill. This black hole of a number cannot now be written down steadily over time but is subject to annual impairment tests.

Among the best-known casualties of the rule change was AOL Time Warner, which took a one-off charge of $54bn in 2002 to reflect the fall in its value since its merger just two years previously. Last year Ebay wrote off $1.4bn of the $2.4bn goodwill it booked in its $2.6bn acquisition of Skype.

Yesterday Marsh & McLennan announced a goodwill charge of $425m, or 81 cents per share, in the first quarter, for a fall in the value of Kroll, the corporate security firm it bought for $1.9bn in 2004 (original goodwill total: $1.6bn).

Rulemakers' attention has recently focused on so-called "identifiable intangibles" – things such as customer lists and brands that can be valued. Acquirers are now required to report "qualitative descriptions" of these. For example, the value of its brands does not appear in Coca-Cola's books but any buyer would have to put a number on them.

The net effect, as more of goodwill is explained, should be its shrinking, but it is proving a tough asset to break up. According to research by the Intangible Business consultancy, almost half the value of deals done by top European and US companies in recent years is still accounted for under goodwill.

Its point is that more could be explained, some intangibles can be reliably valued, and companies should be making the effort to do just that. Mumblings about expected synergies is no longer enough.

But do investors really care? The answer seems to be: "Not that much."

"Acquirers don't look at businesses as a bucket of assets and liabilities," said Peter Elwin of Cazenove. "The value of the deal is about future activity: cash flows from combining what you have with what you're buying, and access to new markets."

Mr Elwin is a member of the Corporate Reporting Users' Forum, a group of accounting analysts. "We're really not that keen on getting goodwill as small as possible if it simply results in new intangible assets that then get amortised."

Analysts usually add back amortisations (gradual write-offs that cover the depreciating value of assets over time) as an accounting adjustment that means nothing in the real world. Adding more of these only complicates that task.

That is not to say companies could not and should not do more to provide financial breakdowns of their deals, even if they do not have to. Among the lessons to be learnt from the current climate of investor suspicion is that having a reputation for explanation and genuine, above-and-beyond openness can be a real asset, albeit of the hard-to-quantify, intangible kind.

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