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Goodwill is often confounded with what it is not, and accordingly it sometimes receives improper treatment in the profit-and-loss statement as well as in the balance-sheet. Some things that goodwill is not, although it is frequently made to stand for them, are incorporation and promotion expense, discount or bonus on stock, discount on bonds, litigation expense, franchise, patent and copyright, lease.

In differentiating goodwill from all these things it is not forgotten that even accepted authorities have at times given undue elasticity to the term. For instance, the *Accountants' Handbook*, edited by Earl A. Saliers, includes under goodwill copyrights and patents.

If goodwill were to be used merely as a generic term and the other assets constituting it were to be classified thereunder, no harm would be done. The term is not, however, so used. It is given a specific meaning, as one of the intangible assets and should be clearly distinguished from the other intangibles mentioned. The need for distinction of each of these assets from the others is because they have different origin, are of different periods of duration, and may represent either actual investment or gift, expense or prepayment. They are consequently to be differently valued for credit purposes and to be differently treated for profit-and-loss purposes.

A few examples will suffice to show why these intangible assets should be set up as separate and distinct asset accounts and should be so shown on the balance-sheet.

Incorporation expense and stock bonus, which generally and properly go together, have clearly no value for credit purposes. To include them in goodwill is to give rise to misapprehension that they have been acquired as goodwill, which is customarily set up only when paid for, some recent innovations to the contrary notwithstanding.

A franchise is acquired by public grant, usually without any substantial payment, although, of course, it may be bought from the grantee at a high price. It carries with it a provision, express or implied, that the price to be charged for the service rendered under the franchise is subject to government regulation, so that the profits may be limited to a fair return on the actual investment, leaving little or nothing to be attributed to goodwill. The asset value of a franchise as such is, therefore, doubtful, even though the fixed assets representing enormous investment may be useless without the franchise. And it would be extravagant indeed to add to the actual investment in the fixed assets, so set up for obvious reasons, a fanciful franchise value, when in fact nothing had been paid for such franchise. If the franchise had been paid for and were of limited duration, as many franchises are, its value would have to be decreased according to the number of years that had expired since its acquisition, based upon the full number of years it then had to run.

A patent has a specified term of life and the investment therein should be, and generally is, depreciated in the same manner and upon the same principle as a limited-term franchise which has been paid for.

A lease is something very often confounded with goodwill, especially by lawyers, when a business is bought, the value of which apart from the physical assets depends almost entirely on the location. Just because a fairly high rental is provided for the future occupancy of the business premises, lawyers think that the excess paid for the business over the amount covered by the merchandise and fixtures must represent goodwill, and not a payment for the lease, or prepaid rent. Accountants, guided by the terms of agreement, set up the assets as therein specified, to the injury of the vendor on the one hand, who is made to pay a large lump-sum tax on profits which constitute prepayments, and to the vendee on the other hand, by failing to depreciate the asset lease, just because it has been erroneously termed goodwill.

Granting that there is some such thing as goodwill, over and above the other intangibles that are frequently merged with it, and that its value is determined by capitalizing the expected profits of a number of years after deducting a fair return on the capital invested in the business, the remainder being properly termed "superprofits," how shall such goodwill be treated for balance-sheet and profit-and-loss purposes? The answer depends upon whether the goodwill has or has not been paid for. If it has been paid for it must perforce be set up as an asset, but it may or may not be gradually written off. If goodwill has not been paid for, it should not be set up as an asset, and does not, of course, enter into consideration for profit-and-loss purposes.

It is urged, with some show of reason, that if goodwill exists, the question of how it was acquired does not affect its validity. The proponents of this view may even, for the sake of consistency, urge that if the superprofits are expected to diminish, the goodwill be proportionately written off even though it has been paid for. Thus, if the expected superprofits would be reduced to zero, the goodwill should likewise be reduced to zero. The logic of such treatment of goodwill would be perfectly sound if the mathematics of profit making were to end at zero. But unfortunately the end is not there. Losses are just as potent economic factors as are profits, and cause even greater concern to a business. If, then, losses are to be expected for a number of years, consistency would require that the capitalization of such losses be set up as a liability in the balance-sheet. But has this ever been done by the advocates of goodwill?

If goodwill has been paid for, its cost must be set up as an asset account. There is no implication, however, that it must be kept there for all time. Conservative business policy would require that it be written off in proportion as the superprofits which have been paid out therefor in advance are realized. Such treatment would consider goodwill, which had been bought and paid for, as a prepayment, gradually to be charged off either as expense of the business, as is depreciation, or as a charge against the net profits or surplus account, as is a true dividend payment. If the annual superprofits are in excess of the amounts estimated and capitalized to fix the goodwill value, such excess may be considered as superprofits created by and accruing to the present ownership of the business and may be added to the surplus account, to be retained therein or to be distributed in dividends.

The question arises, what if the superprofits which have been estimated and paid out for goodwill are not realized, or if, in fact, instead of profits the business registers losses? Shall the goodwill remain on the books when it ceases to have any value and be written off when its value has been maintained or even increased? The answer is an unequivocal "no." Goodwill shall in all instances be treated as a prepayment, even though the losses otherwise incurred be increased thereby for bookkeeping and financial-statement purposes. The logic becomes thereby invulnerable, and the pursuit of it has the advantage that any depreciation taken in years of prosperity relieves the financial strain in years of adversity. If one writes off goodwill when he can afford it, he may not have to do so when he can not afford it but when such writing off may, nevertheless, become imperative.