Shareholder Letters: Accounting Themes

Economic vs. accounting goodwill

Berkshire letters: 1983, 1999, 2015

Jaeyoon Yu, Ph.D.
Central Michigan University

What the Letter Says

> *“We own several businesses that possess economic Goodwill ... far larger than the accounting Goodwill that is carried on our balance sheet.”*
>
> Warren E. Buffett, 1983 letter

- Key letters: 1983, 1999, 2015
- Course fit: ACC250 Ch9 · ACC531 — · Difficulty: Intermediate

Step 1: The Purchase

EX. Pay $500 cash for a company. Fair value of its assets: $450; liabilities: $70.

	Amount
Fair value of assets	$450
− Fair value of liabilities	(70)
Identifiable net assets	$380

Step 2: Goodwill = Price − Net Assets

	Amount
Purchase price	$500
− Identifiable net assets	(380)
Goodwill	$120

Acq. date:

Assets (+A)	450	
Goodwill (+A)	120	
Liabilities (+L)		70
Cash (−A)		500

Step 3: After the Purchase

- Goodwill is **not amortized** (U.S. GAAP since 2002); it is tested for **impairment**.
- Goodwill a company **builds itself** (brand, reputation) is **never** recorded.

Back to the Letter

- Buffett (1983): **economic** goodwill = the power to earn high returns on tangible assets.
- **Accounting** goodwill = only what was paid in an acquisition → the two can differ enormously.
- See's Candies: large economic goodwill, small accounting goodwill.

Questions

1. A company pays $500 million for another company whose identifiable net assets have a fair value of $380 million. How much goodwill does it record ($ millions)?
2. Why can a business's economic goodwill be far larger than the goodwill on its balance sheet?

   A. Goodwill is always amortized to zero within one year

   B. Auditors require goodwill to be recorded at half its value

   C. Goodwill is a liability, not an asset

   D. Goodwill is recorded only when a business is purchased; goodwill a company builds internally is never recorded

Sources

- Warren E. Buffett, 1983 letter (berkshirehathaway.com/letters)
- Warren E. Buffett, 1999 letter (berkshirehathaway.com/letters)
- Warren E. Buffett, 2015 letter (berkshirehathaway.com/letters)
- Reading packet and question sheet for this theme

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