

## **Suggestions on the Prevention of Goodwill Impairment in M&A**

Xi Chen

School of Economics and Management, Jiangsu University of Science and Technology, Zhenjiang,  
Jiangsu, China

531571636@qq.com

**Keywords:** Merger and Acquisition of Goodwill; Goodwill Impairment; Prevention Advice

**Abstract:** In recent years, more and more enterprises have expanded their business scale and stabilized their industry position. With the increase of enterprise merger and acquisition behavior, the goodwill value in the merger and acquisition enterprise merger statements is also getting bigger and bigger, and the amount of goodwill impairment withdrawn by enterprises is also getting bigger and more huge. The large impairment of goodwill will have a very far-reaching impact on the operation and development of enterprises. More and more enterprises pay attention to how to prevent goodwill impairment. Based on the three stages of merger preparation, merger and acquisition process and integration, the goodwill impairment is proposed.

### **1. Current Status of Domestic Enterprises**

Since 2008, the scale of overseas merger and acquisition projects and capital of Chinese enterprises have grown rapidly. In 2016-2019, the purchase scale of Chinese projects peaked, and 2017 ranked first in global economies, while overseas projects were significantly higher than the average in the world, also at the top in the world. So far, most of the main leading enterprises in China's industry have carried out one or more mergers and acquisitions, and many small and medium-sized enterprises have also carried out a large number of overseas mergers and acquisitions, but followed by the substantial impairment of goodwill after the merger and acquisition, the data show As of May 30, 2021, the A-share market has withdrawn a goodwill impairment of 15.073 billion yuan in 21 years.

### **2. Identification and Assessment of Goodwill Impairment Risk at All Stages of Enterprise Merger and Acquisition**

Goodwill impairment risk identification refers to the detection and identification of the possible risks in the process of high goodwill formation to impairment, and stating the potential risks. According to the current accounting standards in China, the recognized amount of goodwill impairment is the difference between the recoverable amount of the goodwill assets group that is less than the book value, so as long as it may affect the value of the goodwill asset group and the book value of the goodwill risk factors should be identified, and the risk identification is the basis of the risk assessment, which is of great significance. Through the collection of goodwill impairment of the merger and acquisition companies, the author puts the risk of goodwill impairment in the enterprise three different time periods of the acquisition are discussed respectively.

#### **2.1 Analysis of Goodwill Impairment Risk in the Preparation Stage of Enterprise Merger and Acquisition**

According to the views of different scholars, this paper holds that tax planning is the behaviour of tax personnel to plan the economic activities related to tax in order to reduce the tax payable and increase profits within the scope of legal provisions.

##### **2.1.1 Assess the Value Risk**

Valuation risk refers to the risk of substantial subsequent impairment of goodwill by the result of

the difference between the valuation of the target enterprise and the actual value of the target enterprise. Transaction price is the most important factor for whether the merger and acquisition can be implemented between enterprises. The valuation of the acquired enterprises directly determines the value of the merger and acquisition enterprises. In the initial evaluation process, due to the different industries between the merger and acquisition, the different financial reports and financial indicators, and the information asymmetry that is inevitable, the evaluation results will inevitably be inconsistent with the real value of the target enterprise, or even far different. If the enterprise has the high valuation of the target enterprise, the target enterprise naturally readily agrees, but the high valuation will inevitably lead to the high merger and acquisition price, which will inevitably aggravate the debt pressure of the merger and acquisition enterprise, and may bury hidden dangers for its future operation.

### **2.1.2 Decision-making Risk**

Decision-making risk refers to the risk of substantial goodwill impairment due to the imperfect understanding of the merger and acquisition strategic plan. It can mainly be divided into risks caused by unclear merger motivation and risks caused by blind self-confidence exaggeration of self-merger and acquisition ability. Enterprise merger and acquisition is generally to well avoid the barriers to new fields, can make enterprises quickly enter the target field, so as to strive for market opportunities, avoid all kinds of potential or existing risks or through the acquisition of existing enterprises, may produce or obtain synergies. This synergism is mainly complementary in resources, including information, personnel, product types and sharing of resources, advanced technology and management, distribution channels, trademark brands and financing channels, thus making the development of enterprises more smoothly. Once the motivation of the enterprise is not clear enough, it cannot achieve effective integration after the merger, resulting in the performance of the enterprise after the merger cannot meet the expectations, resulting in a large impairment of goodwill.

## **2.2 Goodwill Impairment Risk During the Implementation Stage of Enterprise Merger and Acquisition**

### **2.2.1 Pay Risk**

Payment risk refers to the goodwill impairment risk caused by the different payment methods in the merger and acquisition. The payment method adopted by the merger party has a direct impact on the initial recognition amount and the size of the merger cost. Therefore, selecting the appropriate method of payment is essential to the determination of consolidation costs. Enterprise merger and acquisition activities can choose different payment methods, including cash payment, share payment and cash and stock mixed payment, including cash payment is the longest, share payment is generally used for large merger and acquisition activities, using different payment methods for the valuation of the acquired company and the financial situation of the company will have a different impact. For high merger and acquisition consideration, if the cash payment, the company in the current assets will choose to borrow to get enough cash, enterprises through short-term borrowing and long-term borrowing will greatly reduce the solvency, is likely to make the company's cash flow shortage, but also will increase the company's loan interest fees, increase the financial burden, will greatly reduce the current assets, increase the current cash flow risk.

### **2.2.2 Financing Risk**

In a complete equity acquisition, a large amount of working capital is needed, but the working capital of most enterprises is not sufficient, and they cannot complete the acquisition independently, the enterprise will make financing choices at this time, causing the decisions made to have a huge impact on the risk of merger and acquisition financing. There may be many financing methods in mergers and acquisitions. When enterprises choose different financing methods, then the capital management structure will be different, that is, the capital management structure depends on the financing mode. When enterprises adopt equity financing, they should bear the greater cost of

capital and the pressure of distributing profits, to some extent, reduce the profitability of enterprises, weaken the competition of enterprises in the market, and increase risks. In the process of issuing additional shares, the CSRC and other regulators will pay additional attention due to the potential implied transfer of interests. Debt financing will also increase the risk. When the company has poor operating conditions, the interest expenses will greatly reduce the income of the enterprise due to leverage, and put the operation into difficulties.

### **2.3 Goodwill Impairment Risk during the Merger and Integration Stage of Listed Companies**

#### **2.3.1 Performance Commitment Risk**

In the process of merger and acquisition, the past more commonly used evaluation method is the income method. Using the income method, the valuation of the target company is often much higher than its book value, usually with a higher appreciation rate. However, in the income method, the determination of cash flow and discount rate has certain subjectivity. If the appraisers cannot make correct predictions for corporate macro policies, industry trends and future development, the results will be affecting. In addition, some enterprises with a profit of only 10 million before the acquisition, but ensure that the performance reaches over 100 million during the commitment period, the commitment target is far higher than the profitability of the enterprise's own, so as to improve the merger and acquisition premium. High valuations will bring huge goodwill to the buyer. When the commitment objectives of the acquired party cannot be completed, if the situation cannot be improved in the short term, it is likely to lead to the listed company to withdraw large impairment reserves for goodwill. If the target is set is far beyond the actual operating level of the acquired party, the performance commitment will lose its due incentive effect.

#### **2.3.2 Source Consolidation Risk**

Enterprises need to pay attention to the completion of the merger and acquisition activities and the resource integration of all parties. Enterprises will carry out a lot of preparatory work before the merger and acquisition activities to ensure the smooth development of the merger and acquisition activities, and then it is very easy to ignore the resource integration work after the completion of the merger and acquisition. Most enterprises obviously lack their work in this respect, which, to some extent, leads to the decline in the operating performance of the acquired company to a certain extent, but also affects their own management efficiency. There are many cases that show that enterprises do not pay attention to the later integration and management work after the merger and acquisition, and do not effectively play the financial coordination, operation coordination and management synergistic effect after the merger and acquisition, which leads to the unsatisfactory merger effect, resulting in the impairment of goodwill in the later stage.

### **3. Preventive Measures for Goodwill Impairment Risk at All Stages of Enterprise Merger and Acquisition**

#### **3.1 Preventive Measures for Goodwill Impairment Risk in the Preparation Stage of Enterprise Merger and Acquisition**

##### **3.1.1 Reasonable Determination of the Target Value**

When implementing the merger and reorganization, the listed company should conduct full due diligence, have an understanding of the target enterprise in detail, and employ professional intermediary agencies to conduct value evaluation, so as to prevent the risk of overestimate the value of the target enterprise. The management of the M & A party shall fully identify the operating risks of the target enterprise, make reasonable performance forecasts according to the actual situation of the target enterprise and the market development potential, carefully make high growth expectations, and avoid the overvaluation of the value of the target enterprise. During the pricing negotiation process, the merger and acquisition price should be determined on the basis of the appraisal institution to avoid the formality of the value appraisal of the appraisal institution.

### **3.1.2 Develop Scientific Merger and Acquisition Strategies**

Listed companies in the merger and reorganization strategy, to fully understand the macroeconomic policy, their own business environment and future development trend, to have clear merger and acquisition drivers, including scale expansion, break through industry barriers to entry, to deal with the change of external environment, increase market share, reduce business risk and play synergistic effect, etc After making the clear merger and acquisition strategy, the use of scientific methods to select the target enterprises, analyze the industry, laws, policies and other external environments of the target enterprises, and fully identify the opportunities and risks of the target enterprises. At the same time, it should also carefully evaluate the ability of the enterprise itself, to ensure that it has the ability to well integrate the acquired enterprise resources after the merger and acquisition, and play its due synergistic effect

### **3.2 Prevention of Goodwill Impairment Risk during the Implementation Stage of Enterprise Merger and Acquisition**

#### **3.2.1 Scientific Choice of Payment Method in the Merger and Acquisition**

The risk can be effectively transferred through the comprehensive selection of payment methods: the payment method cannot be too single, and the combination of equity payment and cash payment can effectively reduce the risk, but the payment proportion of the two payment methods must be noted, and the appropriate proportion can ensure that the risk is effectively reduced Because in the process of enterprise mergers and acquisitions, whether choose cash payment or equity payment will bring a certain degree of risk, so consider the long-term development of enterprises, most enterprises will choose mixed payment acquisition, but the proportion of mixed payment there is a certain risk, proportion choice is not appropriate, will also bring financial crisis to the enterprise. So enterprises should be in the merger and acquisition mixed payment ratio, fully the enterprise stock price, enterprise internal assets liquidity and the size of earnings per share, the enterprise's capital structure ratio and the enterprise tax situation, comprehensive payment ratio, choose the best combination of payment method, that is, the combination of cash and equity proportion of payment.

#### **3.2.2 Financing Risk Prevention**

Maintain risk through appropriate capital structure ratio: corporate capital structure risk affects financing risk, accounting for 29.70%. Therefore, the enterprise fully considers the risks caused by the capital structure when financing. The better the capital structure of the enterprise, the expected planning of the merger and acquisition enterprises will be more successfully completed. On the basis of ensuring the full development of its own enterprise, the enterprise combines the original assets of the enterprise with the assets obtained by financing to ensure the normal progress of the merger and acquisition process and the operation of the enterprise When clarifying the capital structure ratio, the enterprise combines the specific situation of the enterprise, the capital structure ratio is more coordinated with the specific situation of the enterprise, the enterprise can obtain the best financing method, and the ratio of risk and income can also be the best Compared with the equity financing, the cost of the debt financing consumption is relatively low, and the debt financing will not affect the control right of the enterprise, but the excessive debt financing will greatly enhance the financial risk and debt repayment pressure of the enterprise. The scientific ratio of debt financing and equity financing can keep the risks of enterprises within a controllable range.

### **3.3 Goodwill Impairment Risk Prevention Measures during the Enterprise Merger and Integration Stage**

#### **3.3.1 Strengthen Oversight and Punishment**

With the increasing number of performance commitments, the number of performance commitments is also rising year by year, and many target companies are completed with relatively low performance, in this part of the acquisition party is through surplus management and even financial fraud manipulation profits to achieve the performance target, which will lead to the

acquisition party performance quality has serious problems, damage. The legitimate rights and interests of listed companies and small and medium-sized shareholders need to be paid great attention to by the regulatory authorities. Supervisors can force listed companies in the annual report to disclose the target company's major business activities, business risks and business strategy and other important information, and listed in the report can reflect the number of non-profit indicators, investors can accurately judge the quality of the target company, so as to determine whether the target company performance commitment target is true.

### **3.3.2 Pay Attention to the Integration after the Merger and Acquisition**

Therefore, enterprises should take it as a mirror, increase the resource integration of the merged enterprises after the merger and acquisition, can integrate the culture, technical personnel, management and other aspects merged into the enterprise, and reduce the proportion of sales expenses and management expenses. In terms of operation, market information sharing can be realized to reduce costs, realize complementary advantages, expand the production scale of enterprises, and realize the economy of scale. On the other hand, enterprises can establish the subsequent impairment of goodwill more standardized by the establishment of a reasonable goodwill impairment test system, and use the system to reduce the possibility of management for surplus management. Strengthen the control of the accounting system, strictly abide by the relevant provisions of the enterprise accounting standards for goodwill, disclose the relevant information of the enterprise goodwill in detail, and control the risk of goodwill impairment within an acceptable range.

### **3.3.3 Establish a Hierarchical Disclosure Mechanism for Goodwill Information**

At present, there is still considerable room for improvement in goodwill information disclosure in China. The current information disclosure requirements are too simple to meet the needs of stakeholders, and it is difficult for investors to obtain sufficient information from the relevant information disclosure. In view of this situation, the author puts forward the following suggestions to divide the information disclosure into detailed disclosure and general disclosure at two levels according to the degree of enterprise goodwill impairment. When the goodwill impairment reaches a certain extent, or has a significant impact on the business performance, the enterprise shall issue the corresponding impairment report, to detailed disclosure, the impairment report shall fully disclose the cause of the goodwill impairment, the impact of the environment, impairment test application method, the basis for impairment test parameters calculation, management measures to prevent subsequent continuous impairment and plan, listed pharmaceutical enterprises are willing to pay high acquisition costs for asset reasons and rationality. When the impairment of goodwill does not reach to a certain extent and has no significant impact on the operating performance of the enterprise, the enterprise can choose to make general disclosure only in the notes to the financial statements.

## **4. Conclusion**

The huge goodwill impairment not only caused a great impact on the enterprise itself, but also sounded the alarm to investors and management. At present, the situation of domestic enterprise merger and acquisition goodwill is not optimistic, and this huge goodwill impairment event also reminds us that the huge goodwill is mostly a bubble, and we need to be treated carefully. The enterprise cannot be blindly optimistic before the merger and acquisition, the valuation of the target enterprise should be combined with the actual situation, choose the appropriate valuation method and payment method, not much to over evaluate the value of the target enterprise; the enterprise should be carried out carefully, not too aggressive; after the resource integration business, play the synergistic effect of mergers and acquisitions, enhance the strength of the enterprise to resist market risks.

## **References**

- [1]Beacon D, James J. Public Funds, "Price-Keeping Operations', Deregulation an 'Big Bang [M]// The Political Economy of Japanese Financial Markets. 1 999.
- [2]Jennings R, Thompson R B. Goodwill Amortization and the Usefulness of Earnings[J]. Financial Analysts Journal, 2001, 57(5):20-28.
- [3]Chalmers K G, Godfrey J M, Webster J C. Does a goodwill impairment regime better reflect the underlying economic attributes of goodwill[J]. Accounting & Finance, 2014, 51(3):634-660.
- [4]Chambers D J. Has Good will Accounting Under SFAS 142 Improved Financial Reporting?[J]. Social Science Electronic Publishing, 2006.
- [5]Wines G, Dagwell R, Windsor C. Implications of the IFRS goodwill accounting treatment[J]. Managerial Auditing Journal, 2007, 22(9):862 -880.
- [6]Amel-Zadeh A, Barth M E, Landsman W R. The contribution of bank regulation and fair value accounting to cyclical leverage[J]. Review of Accounting Studies, 2013, 22(2):1-32.
- [7]Chamber M, Beisland LA. Changes in the value relevance of goodwill accounting following the adoption of IFRS 3[J]. Journal of International Accounting Auditing & Taxation, 2014, 23(2):59-73.
- [8]Li K K, Sloan R G. Has goodwill accounting gone bad?[J]. Review of Accounting Studies, 2017,22(2):964-1003.
- [9]Hayn C, Hughes P J. Leading Indicators of Goodwill Impairment [J]. Journal of Accounting Auditing & Finance, 2006, 21(3):223-265.
- [10]Manna K,Watts R L.Evidence on the use of unverifiable estimates in required goodwill impairment[J].Review of Accounting Studies,2012, 17(4):749-780.10