Study on the Similarities and Differences in the Treatment of Goodwill Impairment in Domestic and Overseas Accounting Standards

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Abstract: The mainstream accounting standards on goodwill impairment testing, such as IFRS, US GAAP and China Accounting Standards (CAS), have been revised and updated several times. On the basis of an overview of the latest progress of goodwill impairment measurement in the U.S. Financial Accounting Standards and International Financial Reporting Standards and China's new accounting standards, this paper analyses in depth the differences and similarities of the goodwill impairment test provisions, and specifically provides an in-depth analysis of the goodwill impairment test in terms of the time point of the test, the testing unit, the basis of test measurement and the testing and measurement methods. Together, they discussed how the asset appraisal industry and enterprises can pay proper attention to the goodwill impairment test.

***Keywords*:** accounting standard, goodwill impairment, china accounting standards, international accounting standards, American accounting standards

1. Background to the study

On 14 March 2024, the International Accounting Standards Board (IASB) issued Business Combinations - Disclosures, Goodwill and its Impairment (Exposure Draft) for global public comment. One, users of financial statements need better information to help them assess the performance of business combinations. Two, impairment testing of cash-generating units that contain goodwill is complex and time-consuming, and impairment losses are sometimes recognised too late. Attention to the key concerns of relevant stakeholders will help users make better decisions and better assess the performance of business combinations and how efficiently and effectively management uses the economic resources of the entity to acquire these businesses.

2. Mainstream accounting standards for impairment testing

2.1 Chinese Accounting Standards

① Article 6 of ASBE No. 8 ‘Impairment of Assets’ stipulates that the recoverable amount of an asset should be estimated if there is any indication that the asset is impaired. Even if there is no indication that goodwill is impaired, an impairment test should be performed at least at the end of each accounting year.

② Article 19 of ASBE No. 8 ‘Impairment of Assets’ stipulates that the basis for determining the carrying value of a group of assets should be consistent with the manner in which the recoverable amount of the group is determined; the carrying value of a group of assets includes the carrying value of assets that are directly attributable to the group and those that can be allocated to the group in a manner that is reasonable and consistent with the group's carrying value, and should generally exclude the carrying value of recognised liabilities except where the recoverable amount of a group of assets cannot be determined without taking into account the amount of such liabilities. except for the recoverable amount of the asset group, if the recoverable amount of the asset group cannot be determined without considering the amount of the liability.

③ ASBE No. 20 ‘Business Combinations’ stipulates that in a business combination that is not under the same control, goodwill should be recognised for the difference between the purchaser's share of the cost of the combination and the fair value of the purchaser's share of the acquiree's identifiable net assets acquired in the combination.

2.2 International accounting standards

① IAS 3 Business Combinations states that goodwill is valued as the difference between two numbers, the first being the sum of: the acquirer's fair value-based conversion consideration and the amount of any non-controlling interest and, at the acquisition date, the fair value of the acquirer's previously held equity interest in the acquiree; and the second being the fair value of the net assets of the acquisition. When this difference is greater than zero, goodwill is recognised as an asset.

② IAS 36 - Impairment of Assets states: the procedures that an enterprise uses to ensure that its assets are measured at an amount that does not exceed their recoverable value. If the carrying amount of an asset exceeds the value that would be recovered if the asset were used or sold, the asset is considered to be impaired, and the standard requires an enterprise to recognise an impairment loss on the asset.

2.3 United States accounting standards

The FASB issued ASC 350, Goodwill and Other Intangible Assets, in 2007, which essentially proposes that the subsequent measurement of goodwill no longer be amortised, but only tested for impairment. Under ASC 350, the goodwill impairment test is performed using a two-step approach, and in April 2017, the FASB issued an amendment to modify the quantitative test from a two-step approach to a one-step approach, whereby the quantitative test would only require recognition of whether or not the reporting unit is impaired by comparing the reporting unit's carrying value, including goodwill, to its fair value.

3. Analysis of the similarities and difference in the requirements for goodwill impairment testing under different accounting standards

3.1 Point of time for impairment testing

① IFRS requirements.

The International Accounting Standards Board (IASB) requires that goodwill should be tested for impairment at least at the end of each accounting year even if there is no indication that it is impaired. The latest discussion paper on goodwill impairment testing issued in 2020 mentions the abolition of the mandatory annual goodwill impairment test and the adoption of the sole indication approach. This means that an enterprise is only required to perform a goodwill impairment test if there is an indication of impairment.

② Provisions of Chinese Accounting Standards.

Chinese Accounting Standards require enterprises to determine whether there is any indication that an asset may be impaired at the balance sheet date. Goodwill and intangible assets with an indefinite useful life resulting from a business combination should be tested for impairment annually, regardless of whether there are indications of impairment.

③ U.S. GAAP related regulations.

According to Amendment No. 8 issued in September 2011, an enterprise may choose to perform a qualitative assessment to determine whether goodwill is impaired before performing the two-step goodwill impairment test. The amendment issued in April 2017 modified the quantitative test from a two-step approach to a one-step approach, which clearly indicates that the quantitative test under the one-step approach only needs to recognise whether impairment has occurred by comparing the carrying value of the reporting unit, including goodwill, to its fair value.

3.2 Impairment test module

① IFRS requirements.

In IAS, goodwill is allocated to the cash-generating unit of each acquirer or group to which synergies are expected, and the cash-generating unit allocated represents only the minimum level of goodwill that can be monitored within the organisation for internal management purposes and which cannot be greater in value than the value determined in accordance with the operating segment. Cash-generating units are used when it is not possible to recognise the recoverable amount of an individual asset.

② Provisions of Chinese Accounting Standards.

Chinese accounting standards require that assets that cannot generate cash flows independently should be tested for impairment and impairment losses should be calculated and recognised on the basis of the asset group to which they belong. An asset group is the smallest combination of assets that an enterprise can identify. The identification of an asset group should be based on whether the major cash inflows generated by the asset or asset group are independent of the cash inflows from other assets or asset groups.

③ U.S. GAAP related regulations.

U.S. GAAP uses a reporting unit as the unit for goodwill impairment testing. A reporting unit is the lowest level of an enterprise's operating plan and measurement of earnings for performance evaluation purposes, and listed companies that are not publicly traded may not disclose this part of the information, but listed companies that are publicly traded are required to report and a subject is a reporting unit.

3.3 Measurement basis for impairment testing

① IFRS requirements.

IFRS requires that a judgement be made as to whether goodwill is impaired by comparing the recoverable amount of a cash-generating unit with its carrying amount. The recoverable amount is defined as the higher of the net selling price and the value in use of the asset or cash-generating unit. If the net selling price is higher than the value in use, the recoverable amount is the net selling price and vice versa. Net selling price is the amount that would be obtained by selling the asset, net of disposal costs, in a fair transaction entered into on an equal and voluntary basis. Value in use is the present value of the estimated future cash flows expected to arise from the asset's realised use and disposal at the end of its useful life.

② Provisions of Chinese Accounting Standard.

The relevant provisions of the PRC Accounting Standards stipulate that the recoverable amount of an enterprise's assets should be estimated if there are indications of impairment. The recoverable amount should be determined as the higher of the asset's fair value less costs of disposal and the present value of the asset's estimated future cash flows. If the asset is held for disposal, its cost is measured at fair value less costs of disposal.

③ U.S. GAAP related regulations.

US GAAP determines impairment by comparing the fair value of a reporting unit to its carrying amount. Fair value is the price of a transaction that is entered into equally and voluntarily by both parties to the transaction. Quoted prices in active markets can be used as the basis for measuring fair value. If quoted market prices are not readily available, the fair value of a reporting unit may be estimated using the present value method. Where cash flow projections should be based on reasonable and demonstrable assumptions. In addition to this, fair value may be determined using market transaction prices for similar assets or other valuation methods.

3.4 Value Test Measurement Method

① IFRS requirements.

IAS recognises an impairment loss for the value of the carrying amount greater than the recoverable amount, which reduces the carrying value of the cash-generating unit to which goodwill has been allocated first, and on that basis reduces the carrying value of the other assets by a certain percentage.

② Provisions of Chinese Accounting Standard.

PRC accounting standards apportion the carrying value of goodwill to the relevant asset group or combination of asset groups in accordance with the proportion of the fair value of each asset group or combination of asset groups to the total. If there is any indication of impairment, firstly, asset groups and asset group combinations that do not contain goodwill are tested for impairment, and an impairment loss is recognised by comparing the recoverable amount with the carrying amount; secondly, asset groups and asset group combinations that contain goodwill are tested for impairment, and an impairment loss is recognised for the portion of the recoverable amount that is less than the carrying amount.

③ U.S. GAAP related regulations.

V. S. GAAP may determine whether there is a greater than 50% probability that the fair value of a reporting unit, including goodwill, is less than its carrying value by evaluating qualitative factors, which generally include general macroeconomic conditions, industry and market microeconomic conditions, cost factors, financial performance, etc., and a greater than 50% probability that the fair value of a reporting unit is less than its carrying value requires an impairment test for goodwill. The first step of the impairment test is to determine whether impairment exists by comparing the fair value of the reporting unit to its carrying value. If the fair value is greater than the carrying value, the next step is not required; if the fair value is less than the carrying value, then the goodwill is impaired and the next step in the measurement process is required. In the second step, the carrying value of the reporting unit that includes goodwill is compared to its implied fair value to recognise an impairment loss for goodwill, and the amount of the impairment loss is then allocated to the individual assets.

4. Suggestions and cautions

4.1 Provide a better system system to improve the quality of accounting information

While using internal information of the enterprise for goodwill impairment testing, appraisers and practitioners need to pay attention to whether the external market environment in which the enterprise is located is consistent with the appraisal results. Regulators will pay attention to whether the asset group or combination of asset groups in which the goodwill is located has specific indications of impairment. For example, overcapacity in the industry in which it is located, obvious unfavourable changes in relevant industrial policies or the degree of competition in the market, or the status quo of profitability is difficult to be maintained due to technological updates which have resulted in the replacement of similar products and services.

4.2 Improvement of government supervision function and quality of accounting personnel

Government regulators should increase the supervision of goodwill impairment, establish a strict review system for large amounts of goodwill to review whether it is in line with market norms under the merger and acquisition system and whether it is in line with the quality characteristics of accounting and the principle of prudence in accounting, to prevent profit manipulation of enterprises in which should be incorporated into the review of the external uncertainty of the environmental factors, in order to reduce the uncertainty of the external factors that lead to enterprises to bring The review should include external factors in order to reduce the huge amount of goodwill impairment caused by uncertain external factors. Under the ever-improving accounting standards and ever-optimising system, accountants should continue to improve their own quality and professional ethics, so as to provide higher-quality accounting information for the benefit of both internal and external users in making investment decisions.

4.3 Provide a better system regime to improve the quality of accounting information

Optimise the M&A system of enterprises to prevent inflated premium acquisition. Currently, the number of M&A transactions is increasing, in order to prevent enterprises from profit manipulation and other behaviours, we should do a good job at the source, optimize the merger and acquisition system, and prevent the inflated premium acquisition, which deceives investors and harms their interests.

Improve the information disclosure system of listed companies to enhance the quality of accounting information. China's securities market started late, and there are major deficiencies in the information disclosure system of listed companies. From the internal point of view of information disclosure system, China's capital market information has not yet realised effective flow, there is the phenomenon of 'information piling up'; from the external point of view of the information disclosure system, there is a single main body involved in the mechanism, and there is a lack of supervisory power to the quality of information disclosure. The system of information disclosure for listed companies should be converged internationally, learning from the advantages of foreign systems and combining them with the country's own characteristics to make improvements.

5. Conclusion

In the rapid development of domestic mergers and acquisitions (M&A), goodwill impairment plays an inestimable role in M&A. By comparing the different treatments of goodwill under China Accounting Standards, International Accounting Standards and U.S. Accounting Standards as mentioned above, we should absorb the advantages of the other two in the treatment of goodwill and goodwill impairment and combine them with the actual situation of our own country to continuously improve the existing treatment and the system in all aspects, so as to promote the better development of enterprise M&A.

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