

# Research on the Cause of Goodwill Impairment of Zhongtai Automobile

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## ABSTRACT

The high goodwill of M & A has laid a mine for the operation of listed companies. The target enterprise of M & A fails to fulfill the corresponding performance commitment, which directly leads to the parent company's high impairment loss of goodwill, and has a great negative impact on the interests of listed companies and shareholders. In this paper, through the analysis of Zhongtai automobile high premium M & A after the withdrawal of a large number of goodwill impairment cases, to explore the reasons for goodwill impairment, and put forward relevant suggestions.

**Keywords:** *Goodwill, Premium M & A, Impairment of goodwill*

## 1. INTRODUCTION

M & A, as a way of enterprise investment, is not only a means of market-oriented adjustment of industrial structure, but also an effective means of stock adjustment. From the micro level, M & A activities can not only enlarge the size of enterprises, but also enhance the overall strength of enterprises. According to wind data, the amount of M & A transactions of China's Listed Companies in 2019 is about 1109.1 billion yuan, and the amount of M & A transactions in 2018 is about 2270 billion yuan, which also brings a lot of goodwill generated by premium M & A.

Although high premium M & A is often guaranteed by performance commitment, in recent years, the target companies often face the situation that they can not fulfill the performance commitment on time, which leads to the problem of huge goodwill impairment. A huge amount of goodwill impairment will directly affect the company's net profit and have a huge impact on the business performance. If the listed companies focus on the outbreak of goodwill impairment, it will bring a huge impact on the capital market and form a systematic financial risk. Goodwill has already become one of the most important problems in the capital market, and the hidden danger of goodwill impairment can not be ignored. Therefore, it is of great significance to study the impairment of goodwill when listed companies frequently carry out high premium M & A.

Fu Chao[1] believes that due to the special nature of goodwill, the recognition value, impairment amount and impairment time of goodwill are largely dependent on the management's expectations, which leads to higher application difficulty and larger manipulation space in the impairment test of goodwill, and the accounting rules of goodwill impairment often become a tool used by the management as a "big bath" or "sugar cake box". Lu Zhenghua[2] found that there is a significant difference in the provision for goodwill impairment between profit making enterprises and loss making enterprises through empirical research, and loss making companies have more provision proportion than profit making companies. Wang Zhuo[3] found that the provision for goodwill impairment in loss making enterprises is relatively high, and in the fiscal year after the provision, the performance of these loss making enterprises has increased significantly.

This paper discusses the impairment of goodwill as the core, selects the representative Zhongtai automobile impairment of goodwill for practical analysis, combs its goodwill from the formation to the impairment of a series of processes, and then analyzes the reasons for the impairment of goodwill, finds out the problems existing in the process of merger and acquisition of listed companies and the impairment of goodwill, so as to better guide the development in China. In the process of the rapid development of domestic economy, it makes a little contribution to the research of goodwill related fields.

## **2. ROVISION FOR IMPAIRMENT OF GOODWILL**

Due to the fierce market competition, the overall prosperity of the automobile industry is not high, the company's liquidity shortage and other factors lead to a sharp decline in the sales of the company's vehicle vehicles and the profit is not up to expectations. The company confirms that the goodwill of Yongkang Zhongtai automobile has been impaired, and the amount of goodwill impairment accrued is up to 6107202484.40 yuan, accounting for 92.45% of the book value of goodwill.

In 2016, the company acquired Shanghai Feizhong Auto Parts Co., Ltd., forming a goodwill book value of 26.87 million yuan; in 2016, the company acquired Yongkang Zhongtai Automobile Co., Ltd., forming a goodwill book value of 6551.66 million yuan; in 2019, the company acquired Hefei Yiheng Intelligent Technology Co., Ltd., forming a goodwill book value of 27.2592 million yuan. According to the profit and loss report of the enterprise in 2018, after calculating the future income of the enterprise with the method of cash flow discount, it is found that the enterprise has signs of goodwill impairment, and accordingly, 319.9172 million yuan of goodwill impairment provision is withdrawn; at the end of 2018, a total of 6440.1415 million yuan of goodwill impairment provision is withdrawn, of which 610 yuan is withdrawn by Yongkang Zhongtai Automobile Co., Ltd, 7.0225 million yuan, and Shanghai Feizhong Auto Parts Co., Ltd. has withdrawn 13.0219 million yuan for goodwill impairment.

## **3. ANALYSIS ON THE REASONS OF GOODWILL IMPAIRMENT**

### ***3.1 The underlying asset price is too high***

There are four reasons for the high amount of consideration paid in M & A cases: first, because of the competition and incentive in the control market, high-quality assets attract investors from all levels of the market; second, the target enterprise's good business performance strengthens the confidence of investors. Third, because the new energy vehicle industry is a hot spot in the market, and the government subsidies and support for new energy vehicles, the management is too optimistic about the development of the new energy vehicle industry; fourth, the risk of diversified operation is reduced, and the transformation from a single low profit auto parts production to vehicle manufacturing is carried out, so as to improve the overall profitability and product profit margin.

Huge goodwill is also the basis of huge goodwill impairment, so the reason of huge goodwill impairment is directly related to the high premium of M & A. The high premium is formed by the joint action of the special

factors such as the booming M & a market environment at that time, the urgent needs of the company's industrial transformation and upgrading, the imperfect evaluation and supervision environment, and the uncertainty of the income method evaluation. Especially the income method evaluation, which is not careful in parameter estimation, directly leads to the excessive deviation between the evaluation price and the actual value of the company. From the point of view, the impairment of goodwill generated by M & A is an event with great probability.

### ***3.2 Delay in goodwill impairment test***

In the provisions of China's accounting standards for goodwill, we can see that the impairment test requires at least every year, but the essence of the impairment of consolidated goodwill is the discount of the future profitability of the purchased company, that is to say, the value of goodwill changes with the change of the business situation of the purchased company, and the impairment is also a dynamic process. Taking one year as the goodwill impairment degree. The unit of quantity will make goodwill impairment accumulate in turn, and the company will lose significantly from quantitative change to qualitative change at the end of the year.

In addition, considering the cost control of the company, if the goodwill impairment test is carried out in the middle of the year, in order to ensure the objectivity, fairness and scientificity of the impairment test, it is necessary to employ an asset evaluation institution with securities professional qualification to evaluate the value of the purchased assets. The workload is very heavy and the work cycle is very long, so it is difficult to ensure that it can catch up with the time of preparing the quarterly report. Based on the above factors, it is fundamentally limited to disclose the impairment of goodwill by impairment test. It is too slow to reflect the real situation of goodwill impairment in time, and it will accumulate and expand the impact of goodwill impairment.

From the relevant provisions of China's accounting standards on goodwill, we can guide that the requirement for impairment test is at least once a year, but the essence of consolidated goodwill impairment is the discount of the future profitability of the purchased company, that is to say, the value of goodwill changes with the change of the operation of the purchased company, and the impairment is also a dynamic process, which takes one year as an example. The unit that measures the impairment of goodwill will inevitably make the impairment of goodwill accumulate in turn, and the company will suffer significant loss from quantitative change to qualitative change at the end of the year.

### ***3.3 Performance commitment not up to standard***

In Performance commitment is the so-called gambling agreement. When the two parties sign the agreement, they usually promise to complete a certain amount of business performance in the next few accounting periods. If they fail to meet the commitment, they will make a certain amount of compensation to the merger and acquisition enterprises, which is a kind of guarantee for high profit merger and acquisition. With the development of the market and the increase of M & A, more and more investors believe that even if they pay a high premium, the existence of performance commitment can protect their own interests from loss. However, the acquired party may make an unrealistic performance commitment for its own interests, such as realizing high valuation and high income. When the acquired company fails to fulfill the performance commitment, the acquired party needs to carry out impairment test and withdraw a certain amount of goodwill impairment provision.

### ***3.4 Management motivation for earnings management***

From the perspective of contract motivation of earnings management, Zhongtai automobile has the motivation to manipulate the provision of asset impairment in order to improve its own profitability index or slow down the downward trend of return on net assets. Goodwill, as an extremely important asset, is likely to be manipulated.

In the case of adverse business environment, the provision of goodwill impairment can be used as a means to make up for the performance and a balancer of financial statements to a certain extent. China's accounting standards only stipulate whether enterprises should conduct goodwill impairment test at the end of each year, but enterprises still have strong subjective initiative to control or influence the results of goodwill impairment test. If the company has high goodwill in the early stage, then it will be more operational to use goodwill for earnings management. On the one hand, enterprises can not or less mention the impairment of goodwill, so as to maintain short-term profits and ensure stable growth of performance; on the other hand, enterprises can withdraw a huge amount of impairment at one time to release bad news in the same period.

## **4. CONCLUSION**

After reading the relevant literature and studying the merger and acquisition cases, it is found that some problems of Zhongtai's goodwill also appear in other enterprises. The reason why many companies are able to calculate the impairment of goodwill is that they have accumulated a lot of goodwill. The reason for the huge

amount of goodwill is that enterprises often have high premium mergers and acquisitions, and the proportion of goodwill in the merger cost can be as high as 90%. It can be seen that high premium M & A results in a large amount of goodwill and increases the risk of goodwill impairment. In the analysis of M & A cases, it is found that the large goodwill does not bring high income to the enterprise in line with its expectation, and the efficiency of the acquired company is not significantly improved, and the synergy effect is not obvious.

According to the performance of the acquired company in the performance commitment period and the year when the performance commitment is not completed, Zhongtai automobile does not make corresponding provision for goodwill impairment. Therefore, it can be suspected that the management intentionally ignores the sign of impairment, avoids making provision for goodwill impairment, thus affecting the net profit, and interferes with the time and amount of goodwill impairment out of the motivation of earnings management. Because of the information asymmetry, the management of the enterprise can obtain more internal information, so that the management can manipulate the earnings of the enterprise and avoid passing negative information to potential investors.

The original intention of making higher performance commitment is to protect the rights and interests of the M & A parties, but it increases their confidence in the prospect of M & A, and makes them willing to pay a high premium in exchange for the future income of the M & A enterprises, which will lead to the rise of M & a price and affect the accuracy of goodwill. It is because of the unrealistic high performance commitment that the target company is likely to fail to meet the performance commitment, and then accrue goodwill impairment, which has a negative impact on the company. It can be seen that, to some extent, high performance commitment will lead to the provision for goodwill impairment. If the goodwill of M & A can not bring excess income to the enterprise, the goodwill is not in line with the nature of goodwill at this time, the M & a party should immediately make provision for the impairment of goodwill. On the other hand, in order to fulfill the performance commitment, the acquired party may intervene in the results of performance, avoid performance compensation due to performance failure, which may sacrifice the future earnings of the enterprise, and ultimately harm the interests of both parties. Therefore, when the M & a transaction is completed, the M & a party should pay attention to the dynamics of the M & A enterprise at any time, including its industry status and market changes, so as to ensure that its profitability is not threatened; investors should pay attention to find the traces of goodwill impairment caused by unexpected events, so as to improve the ability of M & a risk prediction.

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