

Goodwill impairment test Angle of audit quality research

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Abstract: In recent years, mergers and acquisitions of Chinese a-share listed companies have confirmed A large amount of goodwill, and auditors need to focus on the audit risk of goodwill when issuing audit opinions. The fair value measurement of goodwill makes it difficult to obtain active quotation in the open market, and the management has great discretion, which makes the initial recognition of goodwill and its impairment treatment subjective and increases the difficulty and risk of auditing for certified public accountants. Therefore, it is of great practical significance to study how to identify and evaluate the material misstatement risk of goodwill and reduce the audit risk of goodwill. This paper comprehensively analyzes the audit risk of goodwill impairment. Firstly, the audit risk of goodwill is analyzed, and the initial recognition and subsequent measurement of goodwill are organically linked. According to the identification framework of the material misstatement risk of goodwill, this paper analyzes how to identify and evaluate the material misstatement risk of goodwill from the two levels of material misstatement risk at the level of financial statements and material misstatement risk at the level of goodwill identification, so as to control the inspection risk of goodwill and reduce the audit risk of goodwill to an acceptable level. Finally, some Suggestions are put forward to reduce the risk of goodwill impairment test.

1. Introduction

Currently, Chinese enterprises are facing huge challenges in their development. Mergers and acquisitions are an effective way to help enterprises integrate resources, rapidly upgrade and transform, and improve market competitiveness. In order to help enterprises carry out mergers and acquisitions, the state has carried out reforms in administrative approval, transaction mechanism, fiscal and tax policies and other aspects. The relaxation of policies and the introduction of relevant supporting systems have created a profitable external environment for listed companies to conduct regulatory arbitrage.

In 2006, the new accounting standards for business enterprises stipulated for the first time that the goodwill holding period would not be amortized, and an impairment test would be conducted at the end of each year to further ensure that the carrying value of the goodwill can truly reflect the value of the goodwill. Under this method, auditors confirm whether there is a real significant audit risk of goodwill impairment provision in the process of auditing. There is no active public market for goodwill itself, and certain experience judgment and subjective estimation are required for asset impairment test, which all increase the audit risk. Therefore, how to effectively identify and report the material misstatement related to goodwill and reduce the audit risk in the audit process is an issue that needs in-depth study in the current audit practice field.

This paper sorts out the accounting measurement of goodwill, which is of certain significance to the subsequent research on the accounting treatment of goodwill and earnings management. Then, I read and sorted out the literature on audit risk judgment, analyzed the application of audit risk in the audit process, and analyzed the existing problems in the audit of goodwill. Then with the combination of accounting and auditing theory, it puts forward the specific improvement measures and direction. Finally, Suggestions on improving the existing auditing standards are put forward, which is conducive to improving the audit quality of goodwill audit and improving the fairness and

accuracy of statements.

2. Literature review

2.1 Quality of commercial reputation

There are three representative theories about the nature of goodwill in the theoretical circle. The first view, “excess return theory”, holds that goodwill is the discounted present value of the expected future net income of an enterprise exceeding the average investment return. The second view, “goodwill value theory”, holds that goodwill is a favorable factor and resource owned by the acquired party, such as geographical location, high-quality employees and good reputation. The third view, “total valuation account theory”, holds that goodwill is the amount set up by an enterprise to account specifically for the value of the enterprise as a whole over the sum of its elements. In 2006, according to China's new accounting standards for enterprises, the business reputation formed only a business combination not under the same control to the enterprise in the financial statements to confirm that the accounting standards for enterprises no. 20 - merger of enterprises “: with the provisions of article 13 of the” the purchaser obtaining from the merger of the combination costs is greater than the fair value of the identifiable net assets share the difference, shall be recognized as goodwill.”

2.2 Research on the recognition and measurement of goodwill

Ge jiashu (1996) believed that goodwill is the most intangible asset, which can bring excess profits to enterprises. Li minghui (2002) pointed out that direct write-off method, systematic amortization method and permanent reservation method can be used to calculate consolidated goodwill, and systematic amortization method is the most commonly used method.

American accounting standards and international accounting standards have basically the same accounting measurement method for consolidated goodwill, and the subsequent measurement standard of consolidated goodwill is to conduct impairment test on goodwill at least at the end of each accounting year to confirm the corresponding impairment loss. China's accounting standards are internationally aligned.

2.3 Research on goodwill and audit risk

Few scholars directly study the relationship between goodwill and audit risk, mainly focusing on the impact of goodwill and its impairment on audit fees and audit quality.

Lu Yu, QuXiaoHui (2006) empirical analysis on the goodwill of the earnings management motivation, in China's a-share listed companies from 2003 to 2017 as sample, the study found that goodwill impairment exists surplus management motivation, with surplus smooth motivation is deducted before goodwill impairment loss surplus is higher, and has A “big bath” motivation is A goodwill impairment loss before the surplus low company, goodwill is the company's executives by earnings manipulation tools.

2.4 The study of overstating the risks

Wang guilan (2007) introduced case-based reasoning method into material misstatement risk assessment, and built a case-based reasoning audit material misstatement risk assessment system by combining qualitative and quantitative indicators. Xiao-fen huang (2011) proposed the material misstatement risk identification mechanism of theoretical framework, certified public accountants audit process can be divided into business to undertake, carrying out audit services, audit report issued by stages, and using the principal component analysis (pca) to the material misstatement risk factors are extracted, the concrete is divided into four major risk factors, namely customer management risk, the external environment, internal control, risk and customer risk of fraud.

3. Audit risk in goodwill impairment audit

3.1 Auditors are not strong in professional competence

According to the provisions of “auditing accounting estimates (including fair value accounting estimates) and relevant disclosure” of China auditing standards for certified public accountants no. 1321 “auditing accounting estimates (including fair value accounting estimates)”, in the goodwill impairment test audit, auditors shall fully understand the detailed process of accounting estimates made by the auditees. At the same time, certified public accountants should evaluate whether the measurement methods adopted are appropriate in specific circumstances and whether the assumptions used by the management are reasonable according to the measurement objectives determined by the applicable accounting standards and relevant accounting systems. Auditors should gather evidence to determine whether management has assessed the uncertainty of its own accounting estimates and the impact of that uncertainty. In the process of collecting evidence, when faced with the method of goodwill impairment of the auditees and other issues, auditors should also use a lot of experience to judge the goodwill due to its special nature. Due to the limitation of the professional ability of auditors, the final audit conclusion may be too subjective. At the same time, in the process of audit, auditors need to maintain professional doubt on the recognition of goodwill impairment. Due to the subjective and the complexity of goodwill accounting, the audit staff of professional competence the demand is higher, but in reality because of the auditors' own quality and ability to suit the requirements of audit project should have, in the process of implementation of the audit fail to keep due to goodwill related professional skepticism, eventually increase the goodwill of the audit risk. □

3.2 Audit evidence proves inadequate

Audit evidence needs to have the characteristics of adequacy and appropriateness. The former refers to the fact that audit evidence is sufficient in quantity to provide a basis for drawing audit conclusions, while the latter reflects the authenticity and reliability of audit evidence. The obtained audit evidence needs to have a logical connection with the purpose of corresponding audit procedures. The large quantity of audit evidence does not mean the good quality of the evidence, but the higher quality audit evidence can reduce the sample quantity of auditors to some extent. When using the information generated by the auditees, auditors should confirm that the information generated is complete and accurate enough, maintain professional skepticism, and implement additional procedures to ensure the quality of the information generated. In the sufficiency of audit evidence, due to the goodwill impairment test involves a number of subjective judgment, group assets value evaluation needs a lot of assumptions data, for example: third-party payment licences valuations, revenues, costs and profit forecast, the growth rate of management expenses, sales expenses forecast, capital expenditure forecast and so on, so the auditors need to gather more evidence. However, it is difficult for auditors to fully obtain the data of the auditees, so the adequacy of audit evidence cannot be guaranteed. In terms of the appropriateness of audit evidence, audit evidence should have relevance and reliability. On the one hand, in considering the correlation of audit evidence, audit group of assets evaluation and management of prediction results are used to help the audit conclusion, but did not consider other sources or different nature of audit evidence may be associated with the same goodwill valuation, leads to audit evidence about goodwill correlation is poorer, strong enough to support the auditor audit conclusions. On the other hand, when considering the reliability of evidence, if the asset appraisal report of the audited company is continuously issued by the same institution, when the first appraisal report is issued, the subsequent business situation weakens the accuracy of the appraisal result to some extent. When the audit project team plans to utilize the work of experts, it should consider the professional competence and independence of experts. If the audit project team employs other asset appraisal institutions, it may obtain more reliable evidence.

3.3 Influence of the status of the auditees

After the implementation of all audit procedures, the auditors should analyze and evaluate the misstatement found in the audit process, consider the impact of each single misstatement on the importance, and also consider whether the misstatement has a common impact. In some cases, even if the misstatement below the level of importance, but related to the misstatement of individually or together with other misstatement accumulation during the process of auditing, or considering the undiscovered misstatement, did not correct the misstatement and the effect of the auditor still want to consider the importance of misstatement, appropriate audit conclusion, reduce audit risk. Auditors if failed to annual performance for the auditees management to make future growth more optimistic assumption is reasonable for sufficient and appropriate audit evidence, and the use of asset appraiser's work, audit conclusion will be strongly influenced by subjective forecast, in different forecasting situation, audit conclusion will be very different. When the audited entity and asset appraisal institution think that the optimistic performance growth is in line with the actual situation of the company, there is no need to make provision for goodwill impairment. On the contrary, in the case of relatively conservative future performance changes, the auditees need to make provision for impairment, and the impact of their potential misstatement may exceed the set significance level of the auditees. That is, according to the optimistic situation, goodwill does not need to be prepared for impairment. According to the conservative situation, goodwill needs to be prepared for impairment. Therefore, when the auditors predict a relatively optimistic future performance, there is no need to make provision for goodwill impairment, and the goodwill impairment determination of the auditee does not need to be corrected. In the case that no other material misstatement is found, the auditors can issue a standard unqualified opinion report. On the contrary, after the auditors collect audit evidence and implement audit procedures, the performance of the auditees will change conservatively in the future, at which point the auditees shall make provision for goodwill impairment. When other sufficient and appropriate audit evidence is not obtained to support the rationality of management's forecast, auditors are limited to obtaining sufficient and appropriate audit evidence and issue audit reports that cannot express their opinions. The audit conclusion varies with the forecast of the business condition of the auditees, and the conclusion has great flexibility.

4. Measures to deal with the risk of goodwill impairment audit

4.1 Improve the professional competence of auditors

Auditors should have professional competence, maintain due professional caution in the audit process, and pay careful attention to the risk of material misstatement of financial statements. To the misstatement caused by errors or frauds, always keep a cautious and vigilant attitude. The audit evidence acquired in the audit process shall be analyzed and evaluated separately and as a whole. Due to the recognition and impairment of goodwill, it is of great significance for auditors to express their audit opinions. During the audit process, auditors shall strictly implement the risk assessment procedures and discover any risks related to goodwill. When issued audit opinion, as a result of goodwill alone cannot generate cash flow, need to stand in the enterprise overall level, this requires that the auditor can no longer be a single perspective view about goodwill misstatement, should stand in the customer's macro to gauge the impact on the financial statements as a whole, the evidence of deliberate analysis have been collected, cannot easily when insufficient evidence to issue a standard audit report, and should be considered not found the possibility of misstatement, issue a proper conclusion reduce their legal liability.

4.2 Objectivity of the audit process

Auditors shall strictly maintain independence and objectivity in the audit process, and conduct the audit in accordance with the procedures formulated to review the goodwill impairment test. In audit management goodwill recognition process, the auditor should be note: income growth, gross margin, operating margin, net profit margin and other related parameters, need both industry growth

cycle, macroeconomic environment, enterprise development, enterprise management level, enterprise strategy, corporate internal resources, and other factors. The auditor should consider to lend help to the expert's work to the controlled units of the competitive environment in a comprehensive analysis and solution. The collection of such evidence will affect the objectivity of the goodwill impairment test.

4.3 Collect audit evidence in various ways

Auditors should not be satisfied with the existing channels of obtaining audit evidence, and try to use a variety of methods to obtain evidence from a variety of angles. They should consider to obtain relevant audit evidence from the outside of the auditees, and combine internal and external evidence. For example, when the management of the audited company predicts a high growth in future performance, auditors should not listen to one-sided statements and should investigate and understand the external market environment and market share. In the goodwill impairment audit, auditors should pay attention to the collection of non-financial information of the auditees. Goodwill cannot exist alone. It is judged by the overall development of the enterprise, and is often associated with the development strategy, operation situation and industry trend of the enterprise as a whole. In addition, in the selection of evidence, auditors should choose the audit evidence with high reliability.

5. Summary

Mergers and acquisitions of listed companies performance improvement and business transformation plays an important role, since 2014, national policy loosening, mergers and acquisitions rise year by year, being under the “premium” m&a “high reputation” brings to the future performance of listed companies greater uncertainty, goodwill impairment become the main risk of listed companies, goodwill impairment audit also become the company's management and external auditors thorny issues. Under the risk-oriented audit mode, auditors need to use a lot of professional judgment, and the quality of professional judgment undoubtedly affects the quality of audit. This paper analyzes the audit risk presented by auditors when conducting goodwill impairment audit, and puts forward corresponding countermeasures to improve the quality of auditors' professional judgment in goodwill impairment audit, so as to improve the audit quality and reduce the audit risk.

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