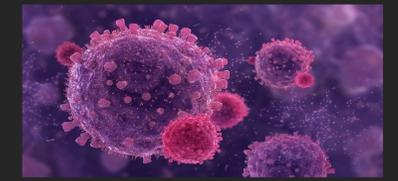


Covid-19 — Bad Effects on Goodwill

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1 Exploring Goodwill Impairment in Relation to Covid-19 and Critical Audit Matters

Covid-19 wreaked havoc on almost every aspect of the world and companies with goodwill assets were no exception. In our research, we examined the annual financial reports of 36 public companies with operations in the United States and abroad to determine the effects of Covid-19 on goodwill impairment as well as whether goodwill impairment related to Covid resulted in Critical Audit Matters (CAMs).

In addition, we looked at whether companies with international segments were more likely to have goodwill impairment due to Covid.

Goodwill is an intangible asset that can be substantial yet provide questionable future economic benefit. It represents the price paid to acquire another company in excess of the value of its net identifiable assets. (1) Rather than being amortized, Goodwill is tested on an annual basis for impairment and more often if certain events indicate impairment.



Effective in 2019, the Public Company Accounting Oversight Board (PCAOB) began requiring auditors to present Critical Audit Matters (CAMs) in their reports under Auditing Standard 3101 (2).

Critical Audit Matters are those relating to financial statement accounts or disclosures that have been communicated or are required to be communicated to the audit committee and involve especially challenging, subjective, or complex auditor judgment. (1)(2)

2 Data Sources

- Audit Analytics
- Bloomberg Terminal database
- Edgar Database of public company SEC report filings



Goodwill impairment was identified as a CAM for many companies in 2019 and 2020.

We examined the auditors' reports (within Edgar) for 36 public companies that reported goodwill impairment for the period impacted by the Covid-19 pandemic, from March 2020 to December 2020. Within this sample, Auditors identified 23 companies with a total of 45 CAMs, including 19 CAMs for goodwill impairment.

3 Methods

Raw statistical analysis

Logistic Regression Analysis with the following equation:

$$\text{Prob (CAM} = 1) = \alpha_0 + \alpha_1 \text{GWIMP/TA} + \alpha_2 \text{Segments} + \alpha_3 \text{Segments Impaired} + \alpha_4 \text{International Segments Impaired} + \alpha_5 \text{GWIMPS} + \alpha_6 \text{TAS} + \alpha_7 \text{Separate Line Item} + \varepsilon_q$$

We examined the determining factors for inclusion in the Auditor's Report as a CAM. Our analysis suggests that a CAM for goodwill impairment is more likely when the size of the impairment relative to goodwill is large and when the company is audited by a Big 4 accounting firm.

Logistic regression analysis indicates that CAMs are less likely for companies with international segments.

4 Results

Many companies cited a substantial decline in market capitalization as the indication that goodwill might be impaired and should be tested.

We examined the footnotes to determine whether restrictions and/or lockdowns imposed due to the pandemic were mentioned as causes of the impairment. Thirty-four of the 36 companies analyzed reported goodwill impairment related to Covid. A full 92% reported goodwill impairment due to a decline in demand for their products/services.

Raw statistical analysis showed that the companies with international segments were less likely to report goodwill impairment during the Covid-impacted period. Ten companies, or 28%, identified international segments with goodwill impairment.

Additionally, our logistic regression indicated that the coefficient on International Segments Impaired (α_4) was -7.57 with a significance level of 5% ($p = 0.023$), indicating that firms were much less likely to receive a CAM if at least one of the impaired segments was international (outside the US).

Twenty-one of the 23 companies with CAMS (91%) were audited by one of the Big Four accounting firms: Pricewaterhouse Coopers; Ernst & Young, Deloitte & Touche; and KPMG.

Auditors highlighted going concerns (raising questions about the ability of the company to continue operations) for three of the companies, or 8%.

Auditor	Companies with CAMs by auditor	CAMs per auditor
*Deloitte & Touche	7	13
*Ernst & Young	7	13
*Pricewaterhouse Coopers	4	9
*KPMG	3	8
Other auditors	2	2
Totals	23	45

*Big 4 Auditor

5 Discussion

Shortly after the PCAOB issued Auditing Standard (AS) 3101, requiring auditors to monitor Critical Audit Matters "to inform investors and other financial statement users about significant matters in the audit and how they were addressed" (3), a study was conducted by four CPAs to gain initial insights about CAMs. (3) They reviewed the annual reports of the first companies required to adopt AS 3101 (large accelerated filers with June 30 and July 31, 2019 year-ends).

What they found: of 105 CAMs reported, 32 (30%) were related to Goodwill and intangible assets; 22 (21%) related to revenue, with the remaining CAMs were related to other issues.

They concluded:

1. The number of CAMs should not necessarily be interpreted as "good" or "bad." Inaugural issues in the manufacturing industry reported more CAMs than those in other industries.
2. CAMs appeared to increase audit fees, at least for the inaugural issuers.
3. Auditors did not use "boilerplate" language for CAMs, which the authors viewed as a positive development as "issuer-specific descriptions improve transparency in the audit process."

6 Conclusions

Compared to the inaugural issuers, the companies analyzed for this project reported 19 CAMs related to Goodwill (83%) out of 45 total CAMs, providing **convincing evidence that Covid-19 had a major impact on factors that caused Goodwill to become impaired, directly affecting the number of CAMs reported.** In addition, Big 4 auditing firm tend to report more CAMs.

References

1. Whittington, O. Ray and Kurt Pany, *Principles of Auditing & Other Assurance Services*, 21st ed., McGraw-Hill Education, 2019., p. 47.
2. Clikeman, Paul M. The PCAOB's New Auditor Reporting Requirements, *The Journal of Corporate Accounting & Finance*, Vol. 29, Issue 3, 2018, pps. 7-15.
3. Dougherty, Brian E. et al., Initial Insights on Critical Audit Matters, *TSCPA Journal*, Sept.-Oct. 2020, pps. 12-16.

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