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Companies' goodwill impairments expected to substantially spike this year

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Companies will likely report more goodwill impairments than they might have planned for the first quarter this year because of the coronavirus (COVID-19), a pandemic that will cause them to have to determine whether the intangible asset declined in value, accounting practitioners said.

Goodwill is an intangible asset that comes on balance sheets through mergers and acquisitions (M&A) activity and can impact a company's earnings if it declines in value (becomes impaired). The COVID-19 crisis comes at a time when FASB rules that simplify the test for goodwill impairment take effect for large public companies.

“Clearly, the COVID-19 pandemic is a triggering event that would cause many companies to test goodwill for impairment on an “interim basis” – i.e., before the scheduled annual testing date,” **Scott Ehrlich**, president of Mind the GAAP, LLC, said. “Because of the overall decline in market values, more reporting units would likely fail the goodwill impairment test ... the fair value of the reporting unit will be less than its carrying amount.”

Airlines, cruise ships and hotels have been especially impacted by COVID-19. Companies in those industries would find the new FASB rules especially meaningful.

“I do think that there will be more impairments at the quarter because of the COVID-19 crisis causing companies to have more triggering events,” David Gonzales, senior accounting analyst at Moody’s Investors Service, said on March 30, 2020. “And more triggering events mean more testing and then it is likely that we will get some more impairment in Q1 and then kind of an expansion of that logic for the rest of the year that there will be more impairments throughout the year.” The information, however, would confirm what credit analysts expected, Gonzales said.

Crisis hits with goodwill rule change

Goodwill is determined by deducting the fair market value of tangible assets, identifiable intangible assets and liabilities obtained in the purchase, from the cost to buy a business. In 2017, the FASB issued Accounting Standards Update **(ASU) No. 2017-04, *Intangibles—Goodwill and other (Topic 350): Simplifying the Test for Goodwill Impairment***. It took effect Jan. 1, 2020, for calendar year-end public companies. The standard eliminates step 2 of the goodwill impairment test, a process companies said was costly and complex to comply with. The elimination of step 2 was aimed at reducing costs for companies while retaining the information value of the goodwill impairment test.

“The impairment loss would be measured as the difference between the carrying amount of the reporting unit and its fair value, capped at the amount of goodwill within the reporting unit,” Ehrlich said. “This is a different method than how goodwill impairment losses used to be measured. Compared with the old GAAP, the ASU No. 2017-04 approach will likely increase the number and amount of goodwill impairment losses reported.”

The accounting for goodwill has been under substantial discussion over the past year, with a variety of viewpoints raised depending on the post held. Even among analysts and investors, views differ.

“The people that care most about this are people that rely on metrics that involve net income and equity so they have big hits to their total equity and things like that in their calculations,” Gonzales said. “But from a credit ratings perspective, the information in a goodwill impairment is typically stale by the time it’s in our hands. It’s not predictive information that we incorporate into our core operating earnings,” he said.

Goodwill figures on public companies’ balance sheets skyrocketed by \$386 billion last year as a result of record M&A, the highest level since the 2008 financial crisis, according to the latest Duff & Phelps study released Dec. 3, 2019.

The FASB is considering whether to allow for amortization of goodwill and/or to somehow change the testing for goodwill impairment to make it more operational. The board in July 2019 issued an Invitation to Comment **(ITC) No. 2019-720**, *Identifiable Intangible Assets and Subsequent Accounting for Goodwill*, which generated more than 100 responses. The feedback was mixed.

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