

Goodwill Impairment Troubles Cost UPS \$45 Million

Lucas Parris, CFA, ASA-BV/IA

Executive Summary

A recent \$45 million settlement between UPS and the SEC over allegedly flawed goodwill impairment tests and earnings overstatements puts a spotlight on the goodwill impairment testing process. Whether it be market volatility, uncertainty around tariffs, or simply poor performance at a reporting unit (as was the case for UPS), proper evaluation of goodwill impairment testing inputs is critical to getting the process and numbers right and potentially avoiding a fine. The impairment charge in this case may have been a non-cash item but the civil penalty was a real expense.

Summary of the Allegations and Settlement

In November 2024, the SEC **announced** settled charges and a civil penalty of \$45 million against United Parcel Service, Inc. (UPS) for materially misrepresenting its earnings due to flawed goodwill impairment tests related to its UPS Freight reporting unit.

According to the **SEC Order**, UPS failed to share certain information with its external valuation consultant who prepared the goodwill impairment analyses in 2019 and 2020. When the unit was ultimately sold in early 2021, the sales price was far below the fair value used to support the goodwill. A timeline of key events and issues is summarized below:

- **Mid-2019** – An internal UPS corporate strategy group worked with external financial advisors on a months-long process to evaluate whether to sell the underperforming Freight unit. This analysis concluded that the likely sales price for Freight would range from \$350 million to \$650 million. Meanwhile, the carrying value of the unit on the balance sheet was approximately \$1.4 billion.
- **July 1, 2019 Goodwill Impairment Test** – The company's annual testing date was July 1, with results of the assessment reported in its third quarter filing released on **October 29, 2019**. The SEC Order alleges that the assumptions used by the external valuation consultant (and approved by UPS management) differed substantially from those that market participants would use to value the business.

Specifically, the projections used for revenue and profit growth were “aggressive” and the selection of guideline public companies included companies that were “not comparable” to UPS. The resulting valuation from the external valuation consultant was approximately \$2.0 billion. This was far higher than the corporate strategy group’s estimated range of \$350 million to \$650 million (which would have also resulted in a significant impairment charge). Notably, the corporate strategy group’s estimates and projections were not shared with the valuation consultant.

- **June - October 2020 Sale Process** – In June 2020, UPS began a process to sell its Freight business and soon began negotiations with a potential buyer. Internal documents again suggested that the sale price was unlikely to exceed \$650 million. In September 2020, the prospective buyer made a non-binding offer to acquire the unit for between \$750 and \$800 million, subject to various adjustments which were anticipated to reduce the final net price. In October 2020, UPS and the buyer signed a non-binding term sheet to move forward with the transaction.
- **July 1, 2020 Goodwill Impairment Test** – The Company again conducted its annual impairment test with the assistance of the external valuation consultant. The SEC Order contends that UPS gave its consultant forecasts for the Freight unit that were inconsistent with how market participants would approach the business. Further, UPS did not share details regarding the proposed sale or existence of the signed term sheet with the consultant. The consultant ultimately valued the Freight unit at \$2.0 billion relative to the carrying value of \$1.3 billion.

On November 2, 2020, UPS released its **third quarter 10-Q**, noting that “there were no events or changes in circumstances during the third quarter of 2020 that would indicate the carrying amount of our goodwill may be impaired as of November 2, 2020.”

- **Sale and Impairment** – On November 3, 2020 (one day after filing its 10-Q for the third quarter), the Board of Directors authorized management to conclude a sale of the Freight unit on terms consistent with the term sheet. Management informed the board that it expected to incur a goodwill impairment charge on the order of \$500 million upon closing of the transaction.

On January 25, 2021, UPS **announced** the sale of the Freight unit for \$800 million, subject to working capital and other adjustments, which would result in a pre-tax impairment charge of approximately \$500 million. The expected net sale price, after adjustments, was roughly \$650 million. The impairment charge reduced net income for fiscal 2020 by 20%, and lowered balance sheet goodwill and shareholders’ equity by 13% and 32%, respectively.

According to the SEC Order, UPS made materially misleading disclosures in 2019 and 2020 regarding its financial reporting that were premised on its determination that no goodwill impairment charges were required for the Freight unit. Had UPS properly valued the Freight unit, its earnings and book value would have been materially lower.

In addition to the \$45 million civil penalty, UPS (without admitting or denying the SEC’s findings), agreed to adopt training requirements for certain company individuals and retain an independent compliance consultant to review and make recommendations about the firm’s fair value estimates and disclosure obligations.

Implications and Takeaways

We’ve previously **discussed** the guidance for goodwill impairment testing under ASC 350 and best practices for conducting interim impairment tests. At a basic level, the financial projections and underlying fair value conclusion must reflect the expectations of market participants for the subject asset or reporting unit. But the UPS situation also illustrates a failure to follow the examples provided in the guidance when assessing events and circumstances that might make it more likely than not that an impairment condition exists. Specifically, entities should consider “changes in the carrying amount of assets at the reporting unit ***including the expectation of selling or disposing certain assets.***”

The role of the external valuation consultant is to assist management in the preparation of a company’s financial statements for financial reporting. Obviously, no one wants to record an impairment charge, but withholding information from the valuation consultant or communicating misleading financial forecasts in the goodwill impairment testing process is not likely to end well. A non-cash impairment charge might sting, but not nearly as much as a \$45 million cash settlement and other compliance penalties. This case is also a timely reminder for the valuation consultant assisting in an impairment test to ask – and management to answer, truthfully – whether the company is contemplating a sale of the subject reporting unit at the relevant measurement date(s).

Conclusion

The goodwill impairment testing process can be complex, particularly in times of market volatility and when certain business units have underperformed expectations. But the accounting guidance and valuation methodologies around fair value are well-established. The UPS case shows what can happen when the guidance and best practices are not followed.

The valuation specialists at Mercer Capital have experience in implementing both the qualitative and quantitative aspects of goodwill impairment testing under ASC 350 for public and private companies. If you have questions, please contact a member of Mercer Capital’s Financial Statement Reporting Group.

**Interested
in Previous
Articles?**

READ

What to Look for in a Purchase Price Allocation

READ

FASB Provides Clarity on Accounting for Profits Interest Awards Under ASC 718

Financial Reporting Valuation Services

In an environment of increasingly complex fair value reporting standards and burgeoning regulatory scrutiny, Mercer Capital helps clients resolve financial reporting valuation issues successfully.

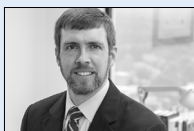
Mercer Capital provides a full range of fair value measurement services and opinions that satisfy the scrutiny of auditors, the SEC, and other regulatory bodies. We have broad experience with fair value issues related to public and private companies, financial institutions, private equity firms, start-ups, and other closely held businesses. We also offer corporate finance consulting, financial due diligence, and quality of earnings analyses. National audit firms regularly refer financial reporting valuation assignments to Mercer Capital.

Our professionals are nationally recognized as leaders in the valuation industry, and hold the most rigorous credentialing designations including the CFA, ASA, and CPA, among others, which are representative of the highest standards in the valuation and accounting industries. Mercer Capital has the institutional capability to tackle even the most uncommon or complex fair value issues. We understand the sensitivity of financial reporting timing needs and meet your deadline on time, every time.

Services

- Goodwill Impairment Testing
- Portfolio Valuation Services
- Purchase Price Allocation
- Equity-Based Compensation Valuation
- 280G Golden Parachute Valuation
- Other Fair Value Measurement Services

Professionals



Lucas Parris, CFA, ASA-BV/IA
parrisl@mercercapital.com
901.322.9784



J. David Smith, ASA, CFA
smithd@mercercapital.com
832.432.1011



Sujan Rajbhandary, CFA, ABV
sujanr@mercercapital.com
901.322.9749



Zachary M. Barber, CPA/ABV
barberz@mercercapital.com
901.322.9718



Koby Allen
allenk@mercercapital.com
901.322.9737