

# UPS Penalty Demonstrates Goodwill Impairment Red Flags

By **Francis McConville, William Schervish and Connor Boehme** (January 23, 2025)

On Nov. 22, the U.S. Securities and Exchange Commission announced that it had imposed a \$45 million penalty on UPS Inc. for failing to follow generally accepted accounting principles, or GAAP, in valuing its UPS Freight business unit.[1] Specifically, the order found that UPS had been overvaluing the goodwill it assigned to UPS Freight by nearly \$500 million.

Such overvaluing is more common than many investors think, and a delayed goodwill impairment charge can conceal substantial financial problems at major companies, costing investors a lot of money. But what exactly is a goodwill impairment charge?

Let's say that Lemon Inc., a publicly traded lemonade business, decides to expand by acquiring Orange Juice Industries. After the acquisition, GAAP require that Lemon's balance sheet recognize the value of the assets acquired in this transaction, such as inventory, equipment and real estate.

Further, any intangible assets of Orange Juice Industries that are difficult to value individually and are not accounted for elsewhere, are collectively accounted for on Lemon's balance sheet as "goodwill." [2] Assets that are typically part of goodwill include customer relationships, employee expertise and brand reputation.

Goodwill can decline over time. When this occurs, a company is required to book a goodwill impairment charge to reflect the decline in goodwill value. At a minimum, a company must test the value of its goodwill annually and is also required to test for potential impairments when a triggering event occurs, such as the underperformance of the acquired business.[3]

So, let's say it turns out that Orange Juice Industries begins using a new juicer that gives the drinks a plastic taste that long-standing customers hate, causing a material decline in sales. As much as Lemon might try to squeeze juice from a rind by delaying a goodwill impairment charge, the orange juice business has been seriously harmed.

Because of the decline in business, under GAAP, Lemon Inc. is required to test for a goodwill impairment and record any decline in value on its balance sheet and income statement.[4]

Failing to do so, as the SEC alleges UPS did, can severely mislead investors. According to the SEC, UPS determined internally in 2019 that its freight business was likely worth far less than the goodwill value UPS attributed to it publicly. However, the SEC said UPS maintained the high valuation of UPS Freight for years, even as it agreed to sell the freight business for less than that publicly stated value, strongly indicating its lower value.[5]

The UPS case is not an isolated incident. Major corporations such as Walgreens Boots Alliance Inc. and Verizon Communications Inc. have each taken substantial goodwill



Francis McConville



William Schervish



Connor Boehme

impairments recently — \$12.4 billion and \$5.87 billion, respectively.[6] And there is evidence that many more companies could be delaying necessary goodwill impairments.

For instance, an analysis by Shivaram Rajgopal at Columbia Business School identified 507 firms globally displaying warning signs that an impairment was needed.[7] According to the Wall Street Journal, high interest rates, which have sustained in the U.S. and elsewhere, can also lead to impairments because companies use current interest rates in determining whether goodwill is impaired.[8] There was an estimated \$82.9 billion of goodwill impairments in 2023, above historical averages.[9]

Further, a relatively high volume of impairments is announced in the first few months each year. It is common for goodwill impairments to be booked early in the year, especially February, as many companies perform their annual goodwill testing on the first day of their fourth quarter.[10] This means any impairments they identify will often be announced along with their fourth quarter results, which are frequently presented in February.

Therefore, as 2025 begins, it is particularly important for market participants to be aware of the risks posed by goodwill impairments.

For instance, the announcement of a goodwill impairment can lead to a drop in the price of the company's publicly traded securities. This is because a goodwill impairment can reveal underlying issues with the acquired business that affects its future earnings. These declines harm investors and can be the basis of securities fraud class actions, which help investors recoup their investments.

Of course, not every goodwill impairment is the basis of securities fraud allegations. However, when companies improperly delay taking these charges in violation of GAAP, they can mislead investors regarding the strength of the relevant business unit.

Plaintiff-side securities litigators evaluate numerous factors in determining whether a goodwill impairment could be the basis for a lawsuit. One example of a delayed goodwill impairment that became a strong fraud case was the 2021 securities litigation against the Kraft Heinz Company in the U.S. District Court for the Northern District of Illinois.[11]

This case stemmed from a \$15.4 billion impairment to goodwill and other intangible assets that Kraft Heinz took several years after the merger of Kraft Foods Group Inc. with The H.J. Heinz Company.[12] Plaintiffs in the Kraft Heinz case alleged that the company's disclosures of the values of its business were misleading because they concealed a substantial risk of impairment to the value of intangible assets such as goodwill.[13]

Securities fraud cases require plaintiffs to provide evidence that the company knew an impairment was necessary but delayed taking the impairment. In Kraft Heinz, the scale of the impairment itself, \$15.4 billion, provided some evidence of undisclosed ongoing issues with the business.[14]

The court ultimately determined that it was likely Kraft Heinz improperly delayed taking the impairment. The Kraft Heinz case ended with a \$450 million settlement to compensate harmed investors.[15]

Such claims are also supported by evidence that there were triggers that require defendants to reassess for goodwill impairment, because this shows defendants knew or should have known about the decline in value. In a 2021 case in the U.S. District Court for the Middle District of Tennessee, *Strougo v. Tivity Health Inc.*, the court sustained the plaintiffs' claims

over a motion to dismiss where they argued that the defendants fraudulently recorded an inflated goodwill value of an acquired company.[16]

The plaintiffs in Strougo argued that several events should have forced the defendants to reassess the goodwill value of the acquired company, and thus the defendants knew or should have known an impairment was necessary and chose not to inform investors of this impairment.[17] These triggers included a severe decrease in the acquiring company's share price, underperformance of the relevant acquired business, declining financial results and lowered guidance.[18]

A goodwill impairment charge, especially one that is a large percentage of the goodwill value, or a charge that comes long after a triggering event, may indicate that a company has been improperly delaying an impairment in violation of the federal securities laws.

As investors navigate the increased risk of goodwill impairment posed by current market conditions, plaintiff-side attorneys should carefully analyze each instance for the telltale signs that a company has used tricky accounting to delay recognizing the true value of its assets.

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*Francis McConville is a partner at Labaton Keller Sucharow LLP.*

*William Schervish is of counsel and the director of financial research at the firm.*

*Connor Boehme is an associate at the firm.*

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[1] Press Release, SEC, UPS to Pay \$45 Million Penalty for Improperly Valuing Business Unit (Nov. 22, 2024).

[2] Ernst & Young Global Limited, Realizing the strategic value of goodwill impairment valuations (Sept. 23, 2022), [https://www.ey.com/en\\_us/insights/strategy-transactions/realizing-the-strategic-value-of-goodwill-impairment-valuations](https://www.ey.com/en_us/insights/strategy-transactions/realizing-the-strategic-value-of-goodwill-impairment-valuations).

[3] Id.

[4] ASC350-20-35.

[5] Press Release, SEC, *supra* note 1.

[6] Mark Maurer, Rates Staying Higher for Longer Could Mean More Big Goodwill Write-Downs Ahead, Wall Street Journal (May 1, 2024), <https://www.wsj.com/articles/rates-staying-higher-for-longer-could-mean-more-big-goodwill-write-downsahead-58435b02>.

[7] Shivaram Rajgopal, How Many More UPS Like Goodwill Write-Downs Hide In Plain Sight, Forbes (Nov. 26, 2024), <https://www.forbes.com/sites/shivaramrajgopal/2024/11/26/how-many-more-ups-like-goodwill-write-downs-hide-in-plain-sight/>.

[8] Maurer, *supra* note 6.

[9] *Supra* note 6.

[10] Deloitte & Touche LLP, *On the Radar: Goodwill and Intangible Assets* (July 2024), <https://dart.deloitte.com/USDART/home/publications/deloitte/on-the-radar/goodwill-accounting-intangible-assets>.

[11] *In re Kraft Heinz Sec. Litig.*, No. 19-cv-1339, 2021 WL 3566602 (N.D. Ill. Aug. 11, 2021).

[12] *Id.* at \*1.

[13] *Id.* at \*20.

[14] *Id.* at \*13.

[15] Kevin LaCroix, *Kraft Heinz Securities Litigation Settles for \$450 Million*, *The D&O Diary* (May 9, 2023), <https://www.dandodiary.com/2023/05/articles/securities-litigation/kraft-heinz-securities-litigation-settles-for-450-million/>.

[16] *Strougo v. Tivity Health Inc.*, 551 F. Supp. 3d 839, 849 (M.D. Tenn. 2021).

[17] *Id.*, 551 F. Supp. 3d at 849.

[18] *Strougo v. Tivity Health Inc.*, 551 F. Supp. 3d at 849.