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The Impairment of Purchased Goodwill: Effects on Market Value

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Abstract


This paper examines the value relevance of goodwill impairment and the information content of impairment announcements with the introduction of Financial Reporting Standard (FRS) 11 in the UK in 1998 which allowed an annual impairment review as an alternative to capitalisation and subsequent systematic amortisation of goodwill. In contrast to systematic amortisation of capitalised goodwill, our results suggest that goodwill impairment is associated with economically significant reductions in market value. We also find evidence of a significant negative market reaction to goodwill impairment announcements. The negative impact is greater for firms with a higher proportion of assets carried as goodwill and for firms that release little information prior to the announcement. Our results also confirm previous findings that capitalised goodwill is significantly associated with market value in the year of acquisition, but weakens thereafter; and that systematic amortisation of capitalised goodwill is not value-relevant.

Keywords: Goodwill, impairment, amortisation, value relevance, information content

JEL Classification: G14, G18, G34, M41, M44, M47

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