Study finds decrease in accounting mistakes among large US companies

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Improvements in financial reporting that stemmed from the 2002 Sarbanes-Oxley Act, or SOX, in the wake of Enron and other corporate scandals, have led to a major decrease in accounting mistakes at large U.S. companies, a University of Kansas researcher has found.

"There are fewer instances of companies reporting inaccurate financial results," said Susan Scholz, a professor of accounting in the School of Business. "More importantly, not only are the absolute numbers of restatements dropping, the serious ones are going way down."

The Center for Audit Quality commissioned Scholz, who had performed a similar study in 2008 for the U.S. Department of the Treasury, to research the nature of financial restatements filed with the U.S. Securities and Exchange Commission from 2003 to 2012. A restatement is a public company's revision of its previous financial statements when inaccuracies are discovered—from relatively minor errors to fraud.

Scholz found that the number of restatements hit highs in 2005 with 1,600 total and 1,784 in 2006. During those two years more than half of the restatements were reported using the SEC's Form 8-K Item 4.02, indicating that they were deemed relatively serious.

However, the overall number of restatements has dropped and leveled off, and the percentage of restatements that are the more serious, Item 4.02, restatements has also declined. She found that in 2012, companies issued 728 restatements, and only 35 percent of these restatements were reported under Item 4.02.

The regulation has seemed to be most effective at helping larger companies clean up their financial statements because in the most recent data the most serious restatements are concentrated among smaller public companies, she said.

The peak number of restatements in 2005 and 2006 was likely due to in part to implementation of SOX internal control reporting, which sometimes uncovered hidden errors. Internal controls are the processes, systems and procedures companies use to create financial statements, particularly to make sure transactions are accurately captured and recorded.

"The number of restatements going down is the result of having cleaned things up and an increased focus on preventing new errors," she said. "Part of that is the additional work SOX requires to insure control systems are working well, and part is a renewed focus on getting things right."

This has likely made it more difficult for someone to commit a large-scale fraud like in the case of Enron or WorldCom, she said.

Another likely outcome of SOX has been auditors returning to more independent roots.

"This is a story about regulation, having a good effect, but it's also a story of a shock to the system that caused a cultural shift," Scholz said. "Auditors are there to make sure financials are correct, and they really returned to their roots. It was a reminder that being an auditor is a very important role in society, because having good, accurate information that people believe in and can act on is vital to a strong economy."

Provided by University of Kansas