



AUDIT ANALYTICS®

2020

FINANCIAL RESTATEMENTS

A TWENTY-YEAR REVIEW

November 2021

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INTRODUCTION

Financial restatements are a significant measure of financial reporting quality. A financial restatement occurs when a company discovers an error or misstatement in previously issued financial statements, and they correct that error by adjusting previous periods.

Companies have three methods for correcting errors and misstatements in financial statements: reissuance restatements, revision restatements, and/or out-of-period adjustments.

Reissuance restatements are material errors and misstatements announced in a form 8-K item 4.02. The announcement is followed by the reissuance of previous financial statements with corrected financial information.

Revision restatements are immaterial errors and misstatements that are corrected by revising the previous periods in the current financial report. These restatements are disclosed in the footnotes of the current financial statements rather than in a separate notification.

Out-of-period adjustments are immaterial errors and misstatements that are corrected in the current period of the current financial report. These are not restatements because previous financial statements are not affected. This report will not include a review of out-of-period adjustments.

Companies should use the Securities and Exchange Commission's (SEC) Staff Accounting Bulletin (SAB) Topic 1.M, also known as SAB 99¹, to evaluate the materiality of an error or misstatement. The SEC staff further clarifies how to apply quantitative and qualitative analyses of materiality in SAB Topic 1.N, also known as SAB 108². And the application of accounting standards for correcting errors and misstatements is codified under the Financial Accounting Standards Board's (FASB) Accounting Standard Codification (ASC) 250-10-45.

If a company decides that the correction of an error or misstatement would affect a reasonable investor's assessment of a company's results, they should correct the error with a reissuance restatement. However, if the correction of the error or misstatement would not influence a reasonable investor, the company should correct the error with a revision restatement or an out-of-period adjustment depending on whether correcting the error in the current period would have a material impact on the financial statements. The distinction is important because the goal of financial reporting is to avoid, when possible, the occurrence of a material error.



¹ <https://www.sec.gov/interps/account/sab99.htm>

² <https://www.sec.gov/oaca/staff-accounting-bulletin-108>

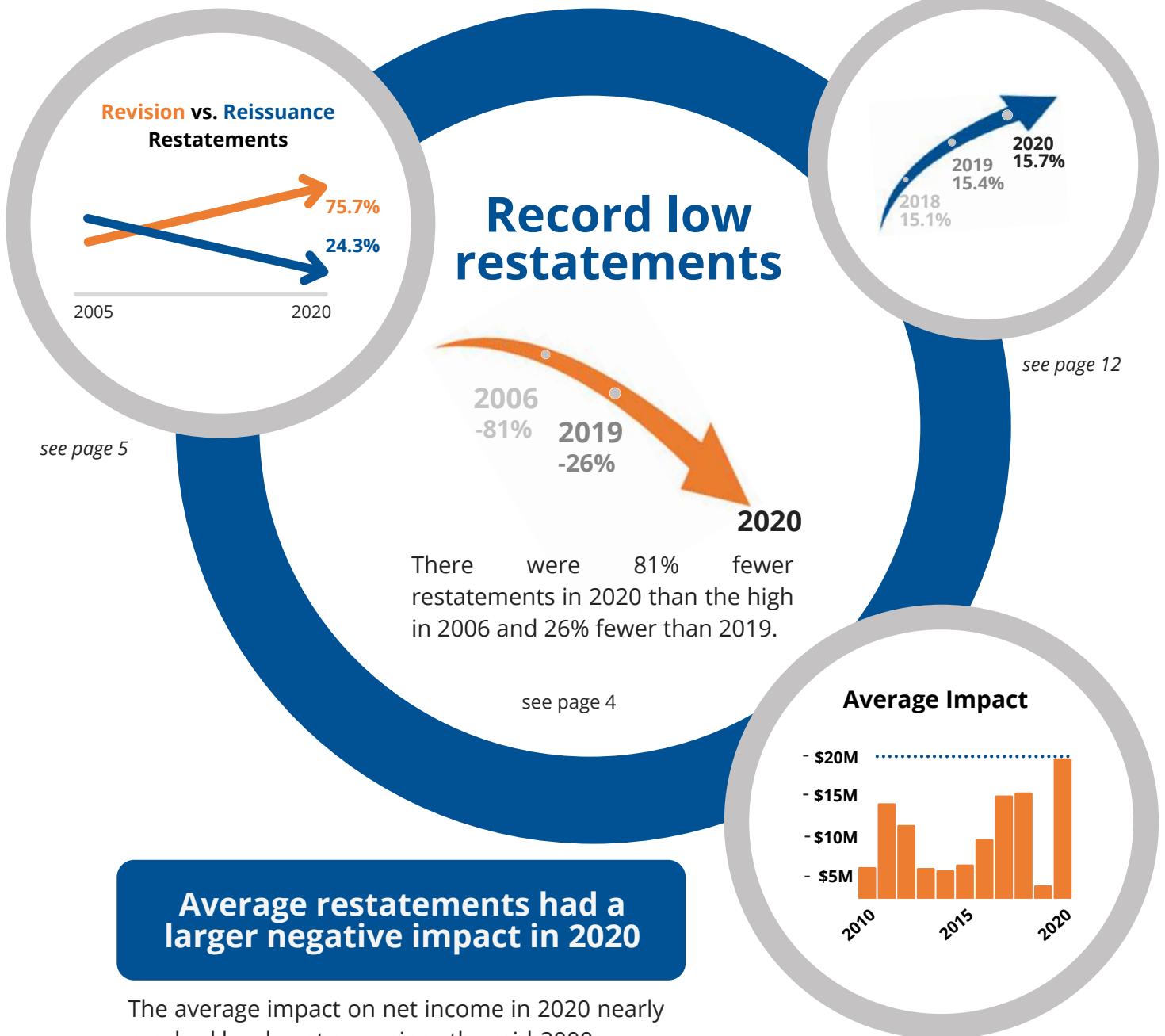
EXECUTIVE SUMMARY

Majority of restatements were immaterial

The use of the revision restatement method has continued to outpace reissuance restatements at a 3:1 ratio.

Revenue recognition was the #1 accounting issue in 2020

Revenue recognition was the most common accounting issue cited for the third year in a row, corresponding with ASC 606 implementation.

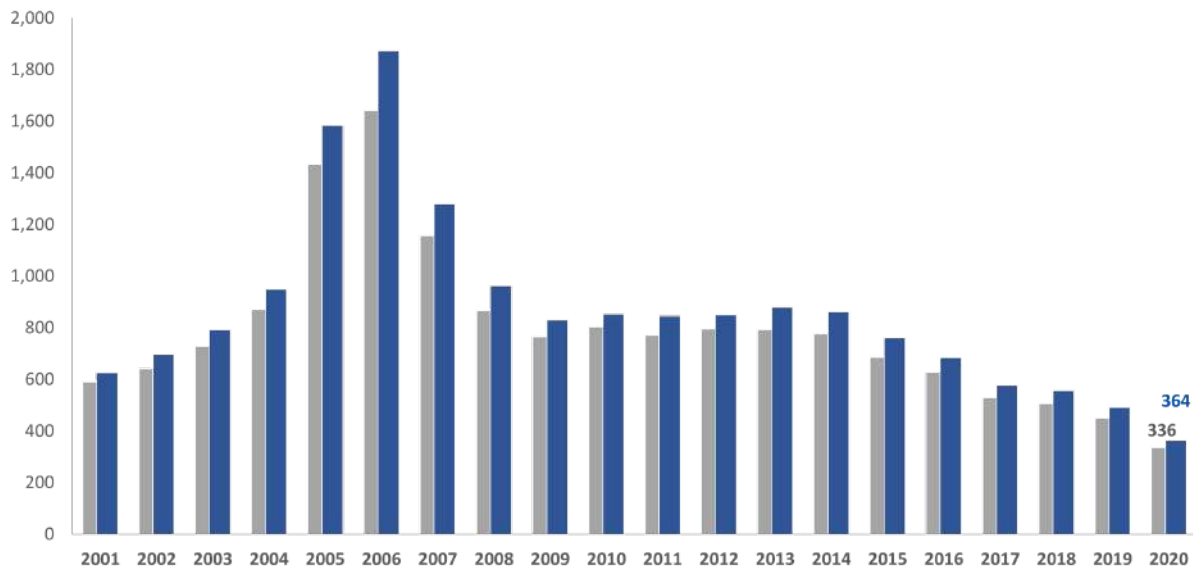


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OVERVIEW

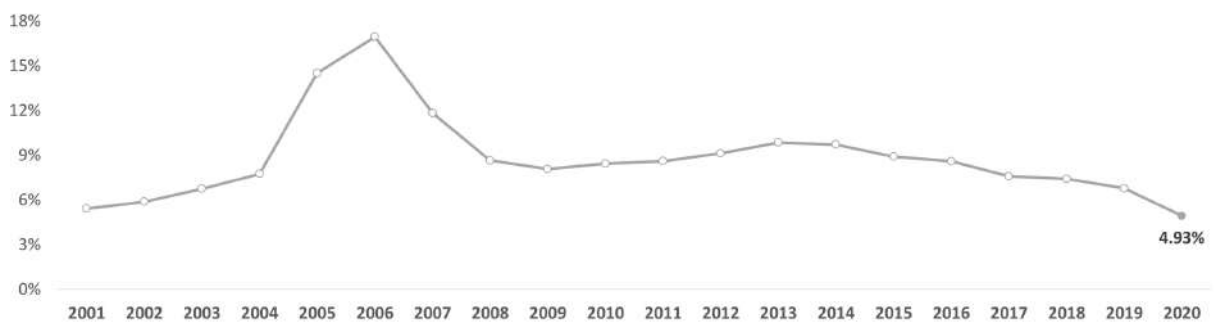
Following the passage of the Sarbanes-Oxley (SOX) Act of 2002, which ushered in major audit and corporate governance reforms, the number of financial restatements rose in the mid-2000s. Since their peak in 2006, the number of annual financial restatements has declined by over 80%.

Total Restatements by Year
Unique Filers | Restatements



In 2020, we saw the lowest percentage of companies disclose a financial restatement in the 20 years we consider in this report. This continues the decline noted in each of the past six years. In 2020, just 4.9% of companies restated previous financial statements, compared to 6.8% in 2019 and 17.0% at the peak in 2006.

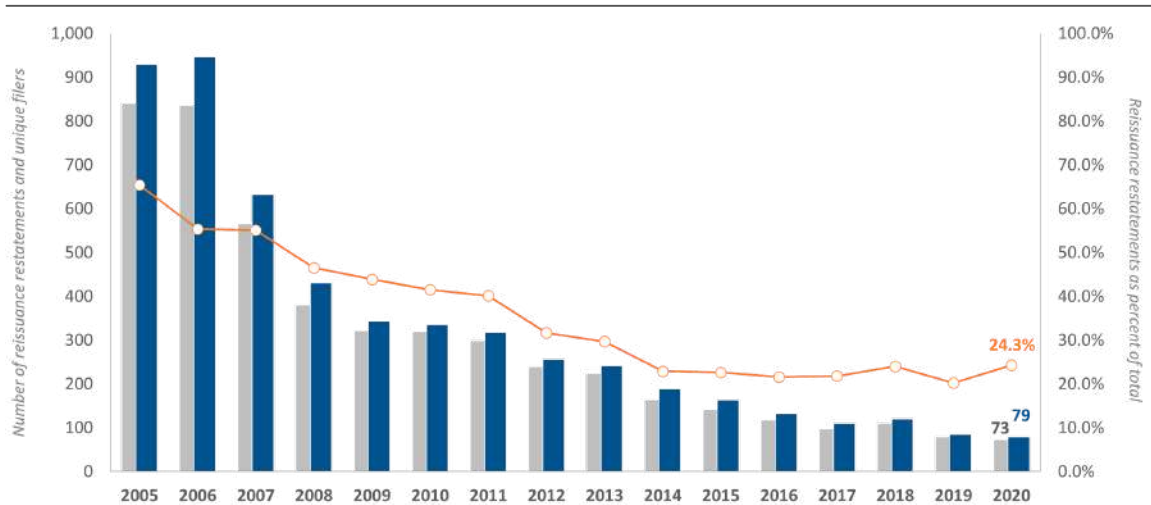
Percent of Registrants with a Restatement



CLASSIFICATION

Reissuance restatements, which are the most severe type of restatements, have continued to decline. There were just 79 reissuance restatements disclosed by 73 companies during 2020. This represented roughly 25% of all restatements in 2020.

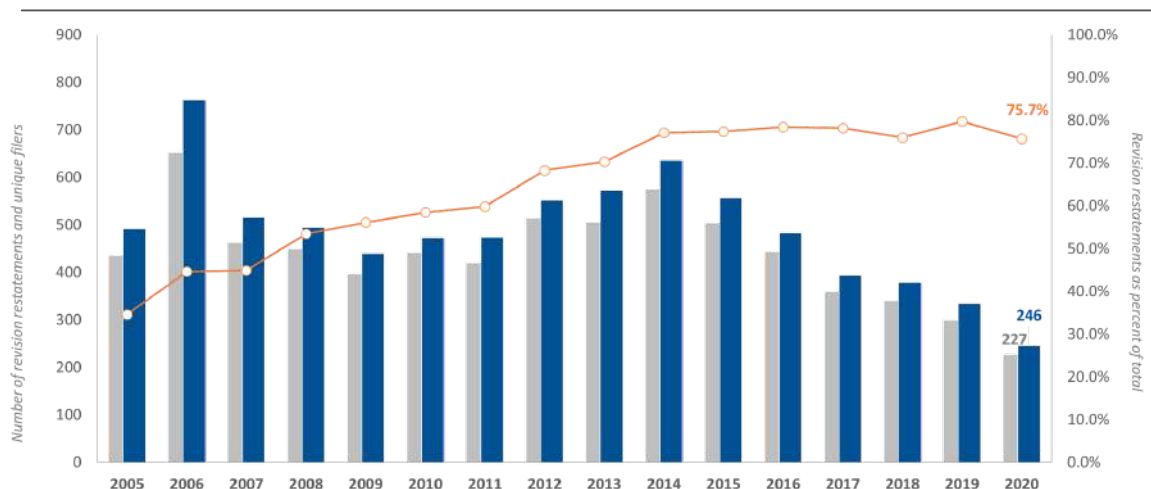
Reissuance Restatements by Year
Unique Filers | Restatements



Revision restatements have also continued to decline. However, they continue to make up most restatements representing 75% of all restatements in 2020.

Clawback policies can influence a company's desire to classify a restatement as a revision. The SEC's proposed rule around clawback policies would allow the SEC to require the remittance of executive compensation when a reissuance restatement is disclosed. The proposed rule, as currently written, does not require clawback policies to apply when a revision restatements is disclosed. Though, the SEC reopened the comment period in October 2021 to review whether clawback policies should apply to a wider range of error and misstatement corrections.³

Revision Restatements by Year
Unique Filers | Restatements

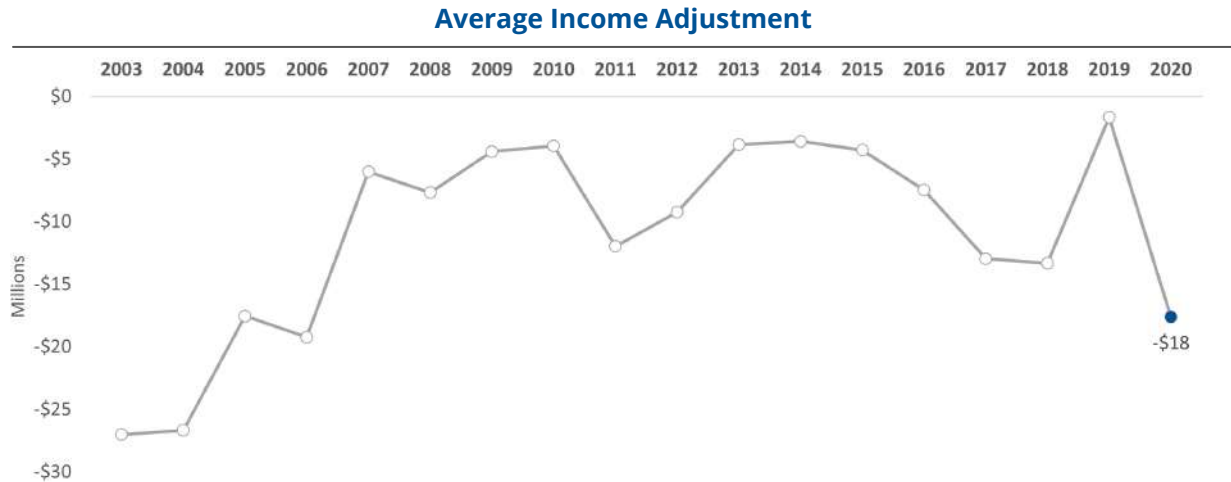


³ <https://www.sec.gov/rules/proposed/2021/33-10998.pdf>

IMPACTS⁴

Average Income Adjustment by Year

The average net income impact of financial restatements in 2020 was the fourth highest in the past 18 years at -\$17.6 million. This comes one year after recording the lowest average net impact in 2019 of just -\$1.7 million.



The sudden rise in average net income impact of financial restatements is due to three factors. First, there were several restatements in 2020 that had large negative impacts on net income. Second, the average adjustment for restatements that had a positive impact on net income was historically low. And third, 2020 saw the greatest proportion of restatements that had a negative impact on net income since 2011.

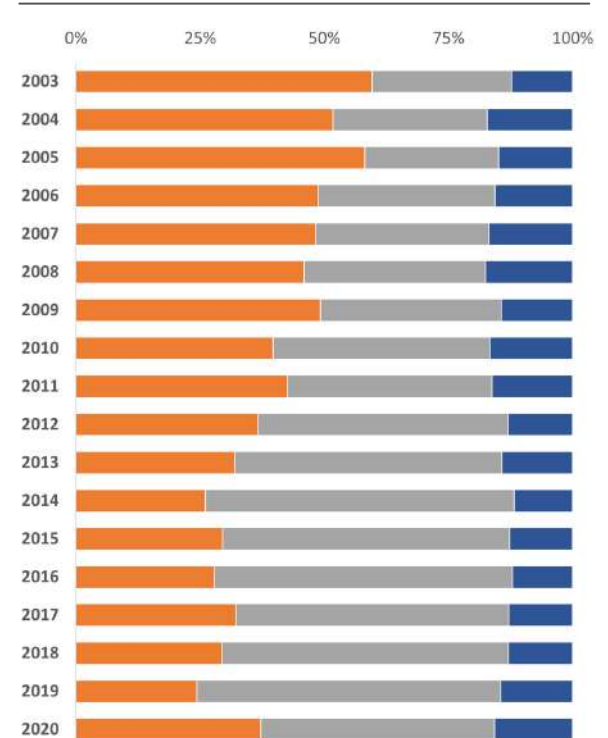
There were six financial restatements disclosed during 2020 that had a larger negative impact on net income than the largest negative restatement of 2019. The increased number of substantial negative restatements drove the average impact on net income for negative restatements to its fourth highest in the past 18 years at -\$49.6 million.

Conversely, the average impact on net income for positive restatements during 2020 was \$5.5 million. This was the lowest average impact on net income for positive restatements in the past 18 years.

And the 37.2% of 2020 financial restatements with a negative impact on net income is the highest proportion observed since 2011.

Breakdown of Restatement Impact on Net Income

Negative Impact | No Impact | Positive Impact



⁴ The financial impact analysis only includes companies that are or were listed on major US exchanges (NYSE, Nasdaq, and formerly AMEX).

Largest Negative Impact by Year

WPP PLC disclosed the financial restatement with the largest negative impact in 2020. WPP is a UK-based advertising agency. The company's financial restatements had two components: a balance sheet classification error and a comprehensive income statement classification error. The comprehensive income statement classification error reduced cumulative net income by nearly \$1 billion by reclassifying exchange rate adjustments from comprehensive income to net income. The balance sheet classification error had no impact on net income.

WPP's financial restatement was over three times as large as Baxter International's – the company that disclosed the largest restatement of 2019. However, the largest restatements of the past decade continue to be relatively small compared to those disclosed in the mid-2000s.

Largest Negative Restatements by Year

Disclosure Year	Company	Market	Impact on Net Income
2002	TYCO INTERNATIONAL LTD	NYSE	(\$4,512,700,000)
2003	HEALTHSOUTH CORP	NYSE	(\$3,997,662,000)
2004	FEDERAL NAT'L MORT. ASSOC. (Fannie Mae)	NYSE	(\$6,335,000,000)
2005	AMERICAN INTERNATIONAL GROUP INC	NYSE	(\$5,193,000,000)
2006	NAVISTAR INTERNATIONAL CORP	NYSE	(\$2,377,000,000)
2007	GENERAL ELECTRIC CO	NYSE	(\$341,000,000)
2008	TMST, Inc.		(\$670,730,000)
2009	UBS AG	NYSE	(\$357,210,000)
2010	TELECOM ITALIA S P A	NYSE	(\$716,971,200)
2011	CHINA UNICOM (HONG KONG) Ltd	NYSE	(\$1,556,743,500)
2012	LEAR CORP	NYSE	(\$1,204,100,000)
2013	QUICKSILVER RESOURCES INC	NYSE	(\$419,880,000)
2014	COMPUTER SCIENCES CORP	NYSE	(\$286,000,000)
2015	ALPHABET	NYSE	(\$711,000,000)
2016	ING GROEP NV	NYSE	(\$1,085,484,400)
2017	PERRIGO CO plc	NYSE	(\$1,177,100,000)
2018	OI S.A. (formerly Brasil Telecom SA)	OTC	(\$1,992,666,000)
2019	BAXTER INTERNATIONAL INC	NYSE	(\$276,000,000)
2020	WPP PLC	NYSE	(\$979,816,860)

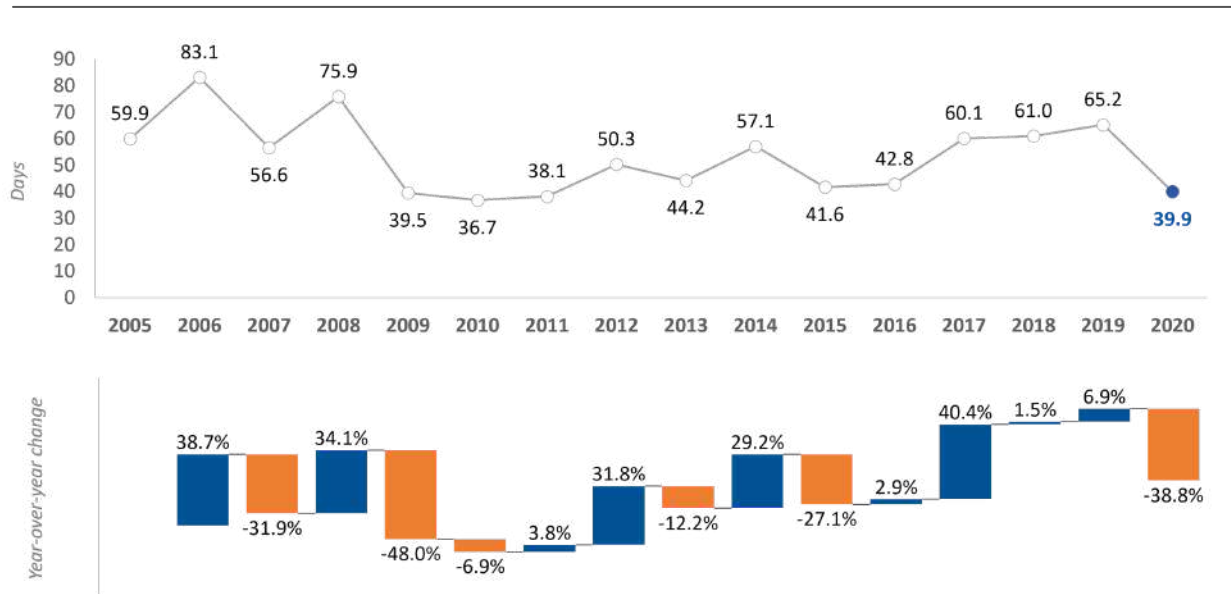


SEVERITY MEASURES

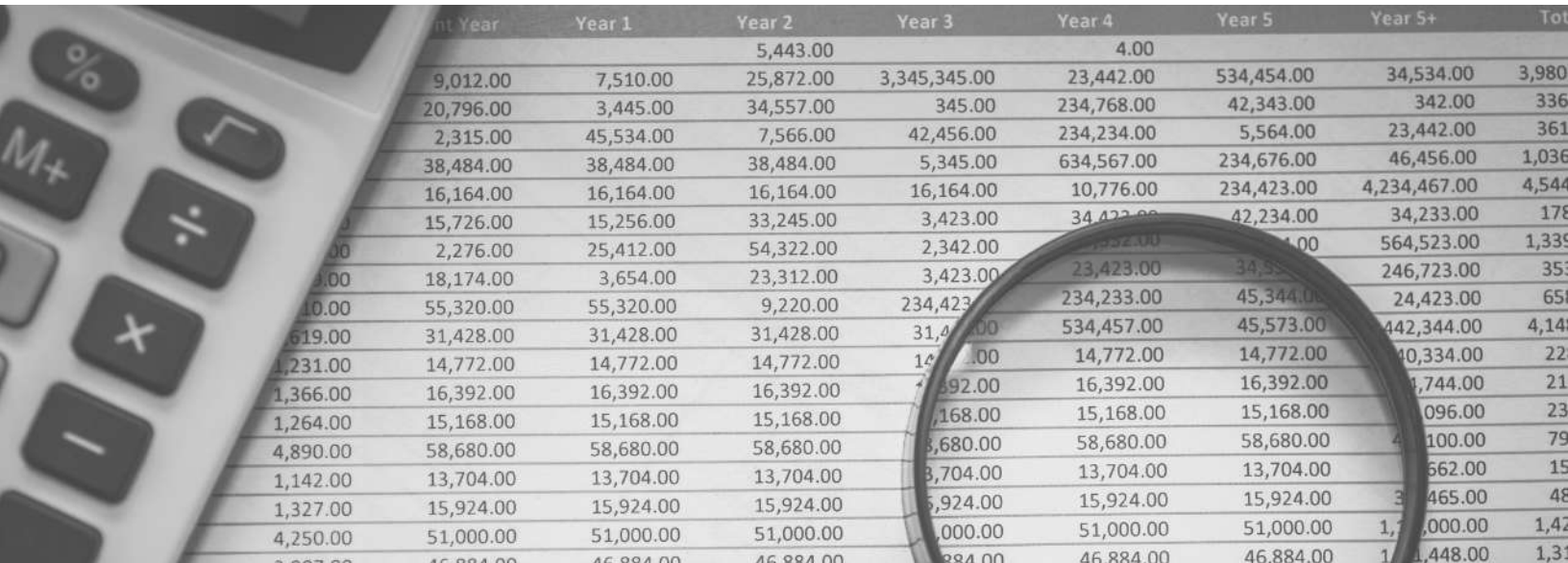
Average days to restatement⁵

Companies that discover material errors and misstatements are required to disclose that their previous financial statements are no longer reliable within four days of its discovery in form 8-K item 4.02. These companies often require time to investigate the errors and misstatements, produce new financial reports, and, if the restated period covered an annual period, have the corrected financial statements audited. A long period before a company files a restatement can indicate that the financial restatement is more complex. The average number of days to file a restatement in 2020 declined 39% from 2019. But these numbers can change as laggard companies issue their restated financial reports.

Average Number of Days to File a Restatement



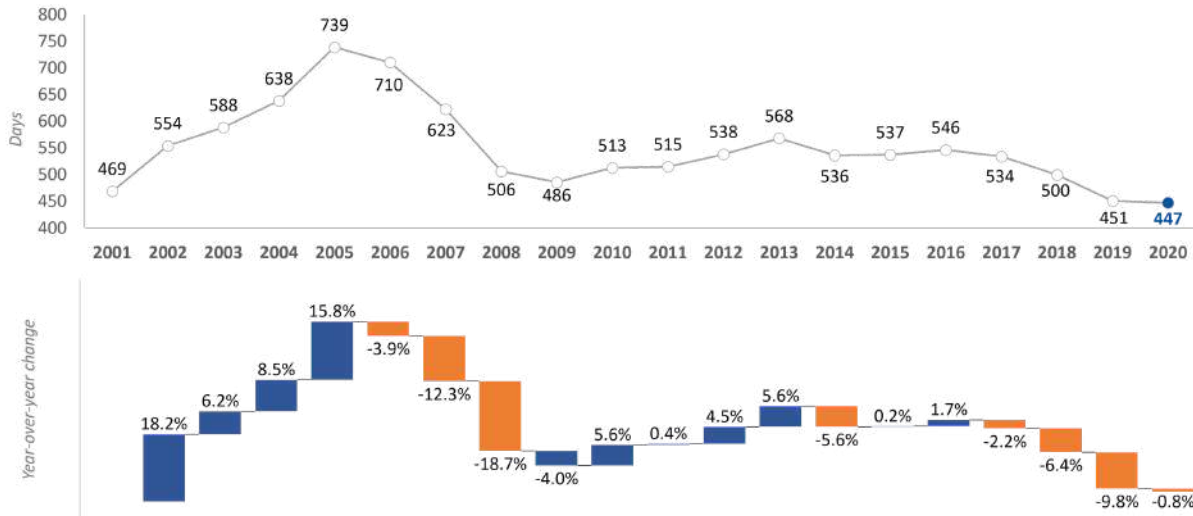
⁵ This analysis only includes reissuance restatements because revision restatements are not announced prior to the financial statements being issued. The analysis only goes back to 2005 because this was the first full year the itemized form 8-K included item 4.02 to announce reissuance restatements.



Average days restated

The length of a restatement can also be used to indicate the severity of a financial restatement. A financial restatement that covers more periods suggests financial reporting systems that have operated ineffectively for a longer time. This results in investors and other stakeholders consuming more inaccurate financial information. The average restatement period in 2020 saw a 1% decline from 2019 and a 43% decline from the high of 739 days in 2005.

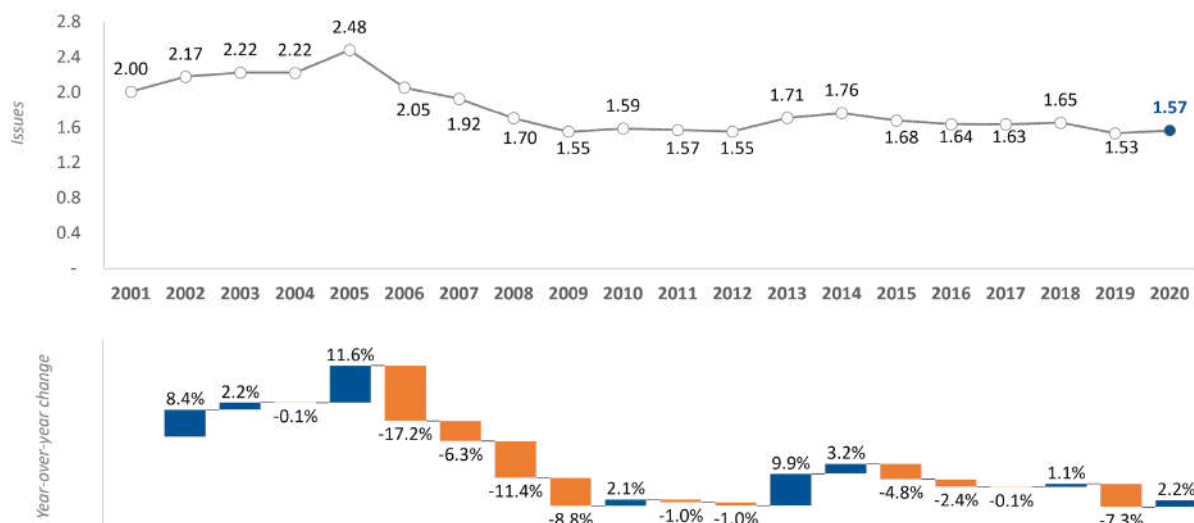
Average Number of Days per Restatement Period



Number of issues per restatement

The number of issues disclosed per financial restatement can help financial statement users understand the severity of the errors or misstatements. Restatements that have a greater number of issues are related to companies with poorer financial control systems. The average number of issues per financial restatement rose slightly in 2020 but is down nearly 40% since its high point in the mid-2000s.

Average Number of Issues per Restatement



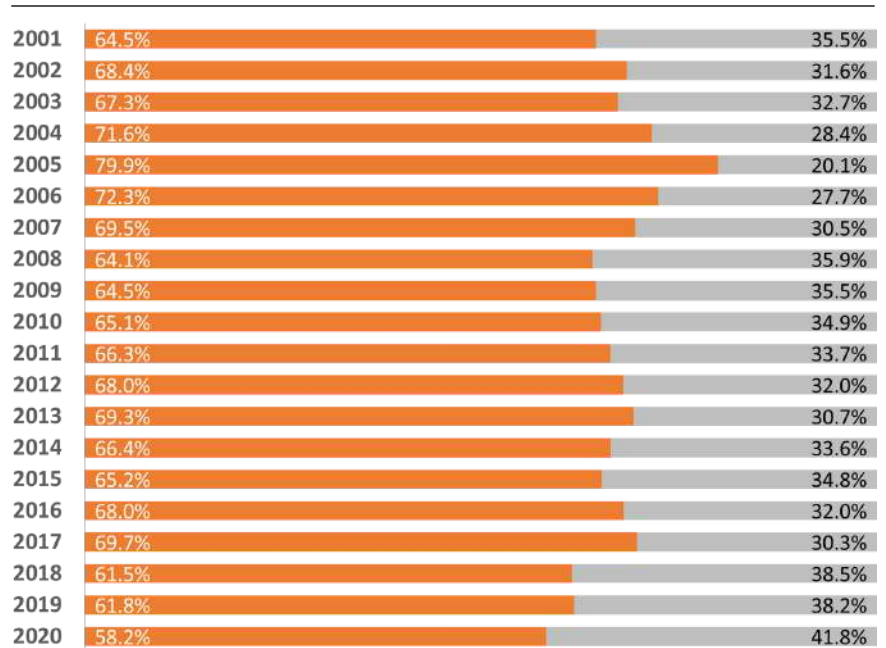
Annual vs. quarterly restatements

The restatement of an annual report can reflect on the severity of a restatement because annual reports must be audited by an independent accounting firm. An error or misstatement that occurs in an annual report is not only missed by management but it's also missed by the independent accounting firm that conducts the audit. Quarterly financial statements are reviewed, though not required to be audited.

According to the Public Company Accounting Oversight Board's (PCAOB) standard for conducting a review, "the objective of a review of interim financial information differs significantly from that of an audit conducted in accordance with generally accepted auditing standards."⁶ Most notably, "a review of interim financial information does not provide a basis for expressing an opinion about whether the financial statements are presented fairly in all material respects" as an audit would.

The percentage of restatements that impact an annual report has declined in recent years. Just 58% of restatements covered an annual report in 2019 and 2020. This is down from the high of 80% in 2005.

Yearly Percentage of Restatements
Annual | Quarterly



⁶ <https://pcaobus.org/oversight/standards/archived-standards/details/AU722>

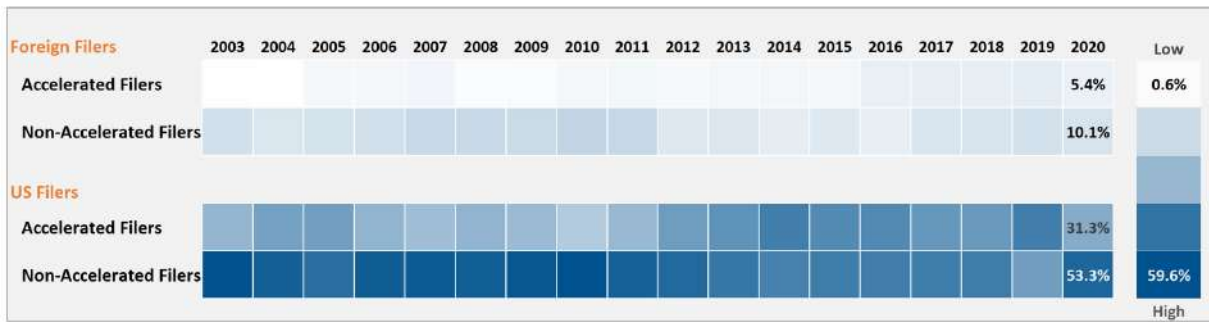


SIZE AND LOCATION

Non-accelerated US filers accounted for the greatest proportion of financial restatements in 2020 since 2011. This is especially notable, as accelerated US filers in 2019 accounted for the greatest proportion of financial restatements ever recorded in a single year.

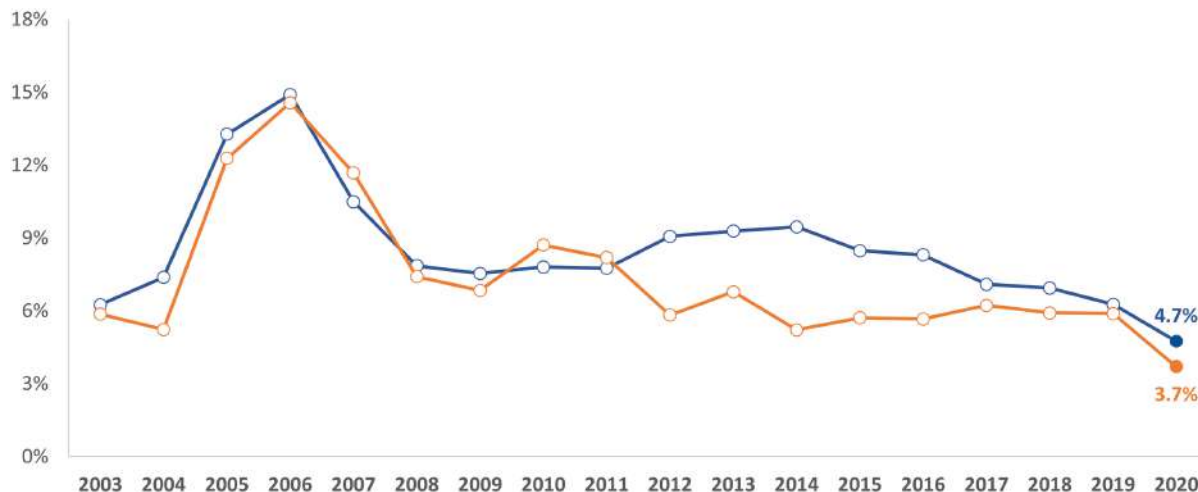
Financial restatements by non-accelerated US filers increased from 36.0% in 2019 to 53.3% in 2020. Conversely, financial restatements by accelerated US filers decreased from 46.0% to 31.3%. And financial restatements by foreign issuers decreased from 18.0% to 15.4%.

Restating Registrant by Accelerated Filer Status



Foreign filers make up a smaller part of SEC registrants, but they have also restated financial information less frequently than US filers. In 2020, just 3.7% of foreign issuers disclosed a restatement compared to 4.7% of US filers. But, as seen in the 'Largest negative impact by year' section of this report, foreign issuers have been responsible for the largest negative restatements in four of the past five years.

Percent of Registrants with a Restatement
Foreign | United States



ISSUES

Revenue recognition was the most frequently cited issue in financial restatements for the third year in a row. Coinciding with the new revenue recognition standard that became effective in 2018, revenue recognition supplanted debt and equity securities issues as the most frequently cited issue in financial restatements.

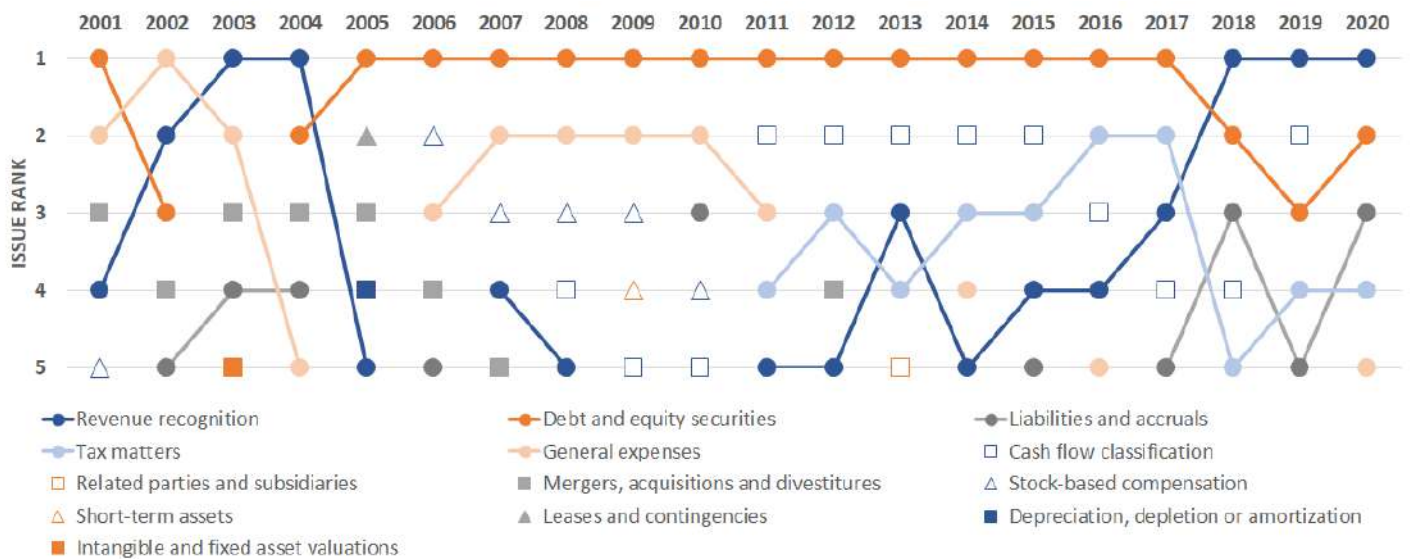
The second most frequently cited issue of 2019 – cash flow classification – fell outside the top five in 2020. Cash flow classification had been a top-five issue every year since 2008. This was replaced by general expense recognition, which returned to the top five for the first time since 2016.

Debt and equity securities, liability and accrual recognition, and tax matters round out the top five most frequently cited issues in 2020's financial restatements. Debt and equity securities and tax matters have each been among the top five issues for at least the past decade. Liability and accrual recognition has been among the top five since 2017.

Top 5 Restatement Issues of 2020

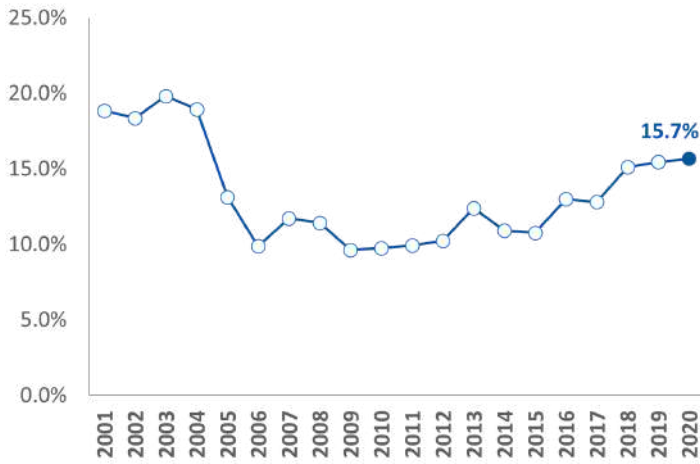
	Issue Frequency
1 Revenue recognition	17.3%
2 Debt and equity securities	14.3%
3 Liabilities and accruals	12.6%
4 Tax matters	12.1%
5 General expenses	11.0%

Restatement Issues, Ranked by Percent of Restatements Citing Issues

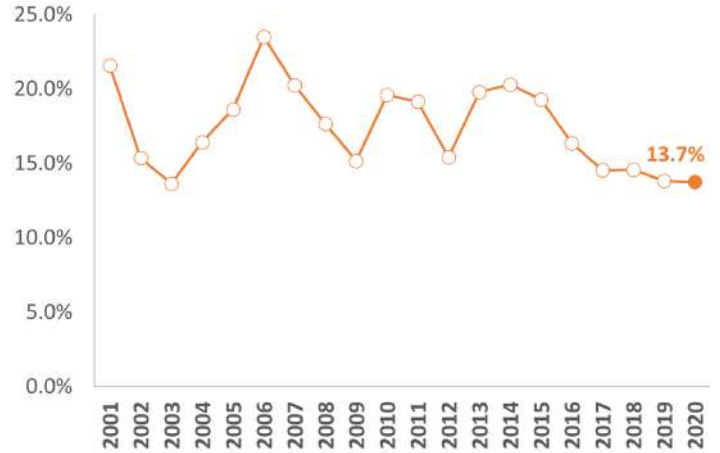


Restatement issue analysis: Top 5 issues of 2020

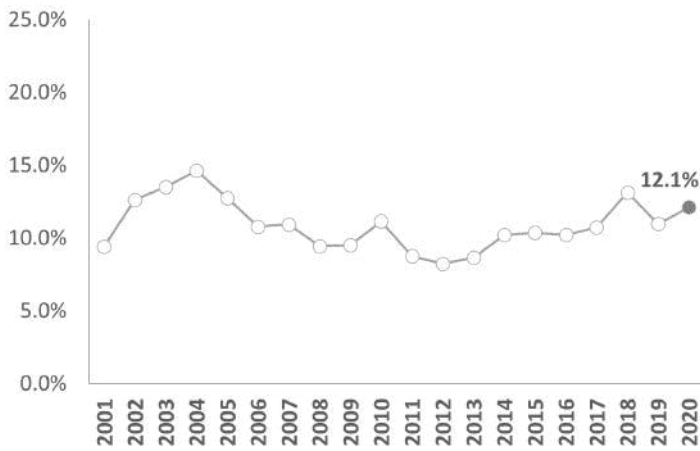
Revenue Recognition
Issues as a Percentage of All Restatements



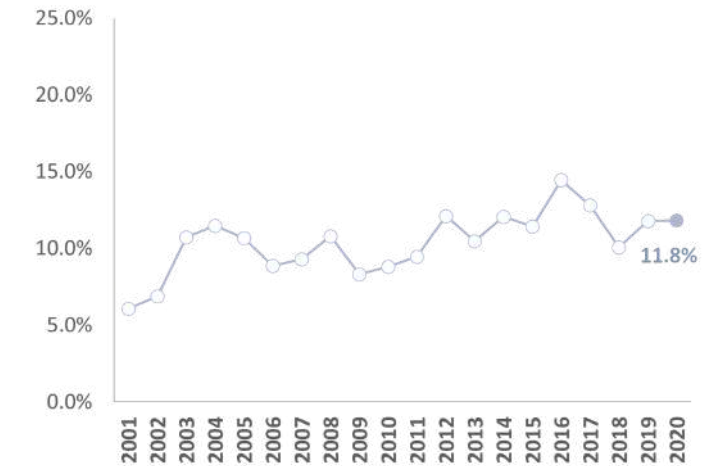
Debt and Equity Securities
Issues as a Percentage of All Restatements



Liabilities and Accruals
Issues as a Percentage of All Restatements



Tax Matters
Issues as a Percentage of All Restatements



Expense Recording
Issues as a Percentage of All Restatements



DATABASE OVERVIEW

The Audit Analytics Financial Restatements database includes data from more than 18,000 financial restatements and/or non-reliance filings disclosed by over 10,000 SEC public registrants since January 1, 2001. In addition to the areas identified in the charts contained in this report, the database employs a taxonomy (issue classifications) of more than 40 different accounting error categories (e.g., Cash Flow Statement, Tax, Revenue Recognition, Intangible Assets, etc.). Search results from this level of granularity can be filtered by other demographic data such as industry, financial size, filer status designation, location, audit firm, and any number of peer groups.

The relational nature of the database allows researchers to introduce and compare financial restatement search results into other data sets, such as accelerated filer status, legal exposures, director and officer changes, auditor changes, audit fees, internal control reports, and other data populations. This content extension further allows an analyst to identify anomalies and market patterns that would not be readily apparent without performing this layered approach.



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ABOUT US

Whether for market intelligence, risk management, compliance, or research and public policy, Audit Analytics provides the highly structured data you need to make informed decisions.

Our expert team meticulously collects, organizes, and analyzes data – making it easy for our customers to find what they need to know. We are trusted to simplify the complex; to illuminate trends; and to reveal actionable insights.

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