

2008 Stealth Restatement Analysis

A Supplemental Analysis to February Restatement Report

Mark Cheffers, CPA, CEO

mcheffers@ivesinc.com
508.476.7007 x223

Don Whalen, Esq., Research Director

dwhalen@ivesinc.com
508.476.7007 x222

Olga Usvyatsky, CPA, Research Analyst

ousvyatsky@ivesinc.com
508.476.7007 x248

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2008 Stealth Restatement Analysis

A Supplemental Analysis to February Restatement Report

Introduction – Prior Restatement Report

In February 2009, Audit Analytics published a restatement report providing an eight year review of restatement disclosures.¹ The analysis discussed two primary findings: (1) for the second straight year, restatements have gone down both in quantity and in severity and (2) in 2008, the percentage of stealth restatements filed with the SEC represented, for the first time, over 50% of all restatements. The purpose of this report is to supplement the February report by analyzing the financial consequences of the stealth restatements filed in 2008.

The phrase “stealth restatement” has been used for a few years, but has never been clearly defined. The SEC requires registrants to disclose within four business days a determination that past financial statements should “no longer be relied upon.”² This disclosure is to appear in Item 4.02 of an 8-K. In our report, a stealth restatement is defined as any restatement revealed in a periodic report without a prior disclosure in Item 4.02 of an 8-K. Although the phrase “stealth restatement” can be interpreted by some as implying sneaky conduct, not all stealth restatements are improper. Since a disclosure in Item 4.02 is required when it is determined that a past financial can no longer be relied upon, a restatement that provides an immaterial adjustment to the financials need not be preceded by a 4.02 because the adjustment does not undermine prior reliance.

Executive Summary – Breakdown of Stealth Restatements Filed in 2008

1. A review of issues implicated in restatements filed in 2008 shows “Comprehensive Income Issues” produced the largest percentage of stealth restatements while the lowest percentage occurred from restatements involving “Foreign, Related Party, Affiliated, or Subsidiary Issues.”

Audit Analytics maintains a taxonomy of over 65 issues identified as relating to the filing of restatements. A review of 24 selected issues shows that a total of 7 restatements in 2008 implicated “Comprehensive Income Issues” and of those 7 restatements, 6 (85.7%) were stealth restatements. (See table on right). Although the number of issue occurrences represents a small sample of restatements, its high percentage placed at the top of the table. The lowest percentage of stealth restatements occurred from restatements involving “Financial Derivatives/Hedging (FAS 133).” (See also, table on page 5: *Stealth Restatement Percentages; Frequency Analysis Based on Restatement Issues.*) This analysis shows that certain issues are more likely than others to be filed as a stealth restatement, presumably because these issues tend to be evaluated as less likely to undermine reliance in past financial statements.

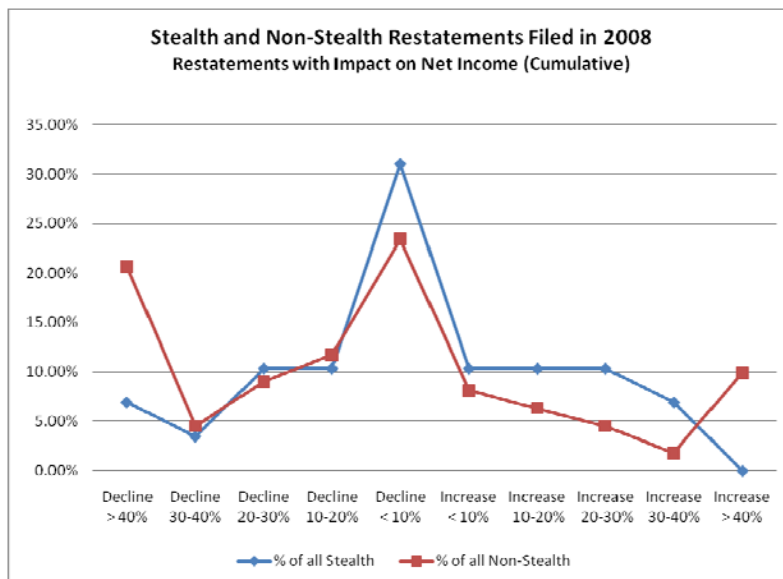
Restatement Issue	Total Restatements	Stealth	
		#	% of Issue
Comprehensive income issues	7	6	85.7%
Balance sheet classification of assets issues	20	16	80.0%
Pension and other post-retirement benefit issues	10	7	70.0%
Cash flow statement (SFAS 95) classification errors	113	68	60.2%
Gain or loss recognition issues	25	15	60.0%
Revenue recognition issues	98	34	34.7%
Depreciation, depletion or amortization errors	30	10	33.3%
Lease, SFAS 5, legal, contingency and commitment issue	15	5	33.3%
Foreign, related party, affiliated, or subsidiary issues	30	8	26.7%
Financial derivatives/hedging (FAS 133) acct issues	19	3	15.8%

¹ See Audit Analytics, *2008 Financial Restatements, An Eight Year Comparison*, February 2009.

² In response to Section 409 of the Sarbanes-Oxley Act of 2002, entitled “Real Time Issuer Disclosures,” the SEC identified new reportable items that must be disclosed in an 8-K. This new set of disclosure requirements became effective on August 23, 2004. One of the new reportable events is the conclusion that a past financial statement should no longer be relied upon. Such an event is to be disclosed in an 8-K under Item 4.02, entitled *Non-Reliance on Previously Issued Financial Statements or a Related Audit Report or Completed Interim Review*. See SEC Form 8-K Directions: <http://www.sec.gov/about/forms/form8-k.pdf>

2. Restatements filed in 2008 that had an impact on net income were more apt to be stealth restatements if the cumulative adjustment was a decline in net income of zero to ten percent.

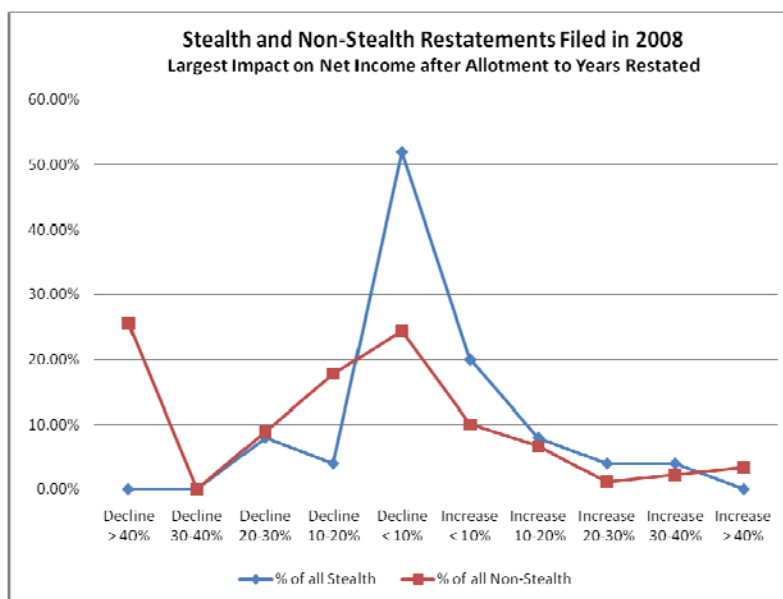
As expected, a restatement filed by a publicly traded company in 2008 that provided an adjustment in net income was more apt to be a stealth restatement if the adjustment amounted to a small decrease in net income. In 2008, a total of 197 restatements from publicly traded companies disclosed an impact on net income. Out of these restatements, 50 (25.4%) were not preceded by an Item 4.02. Also, out of the 197 restatements, a total of 140 companies disclosed their initial cumulative net income figures, thereby readily allowing for a quantification of the percentage of cumulative impact on net income.³ Of the 140 companies that provided this income information, 111 (79.3%) were non-stealth restatements



while 29 (20.7%) were stealth. The graph above displays a stealth line and non-stealth line to give a representation of the impact distribution of the two types of restatements. As shown in the graph, about 30% of the stealth restatements (9 of 29) disclosed a negative adjustment to cumulative net income of no more than ten percent. (See also, table on page 6: *Restatements with an Impact on Net Income (Cumulative)*). In addition, the stealth restatements tended to decline in amount as the percentage of the adjustment increased. This trend is consistent with the concept that low percentage adjustments are more likely to be immaterial to an investor's reliance on prior financial statements and thus an Item 4.02 disclosure in an 8-K is not required prior to the filing of the restatement

3. When the cumulative impact on net income is distributed and applied to each year restated, most stealth restatements are still those with a small adjustment.

The analysis above looked at the cumulative impact on net income of restatements filed by public companies in 2008. A look at the cumulative impact, however, may not reflect the analysis used by the company when it determined whether or not the restatement would negate any prior reliance on past financials. If a restatement adjusted a number of financials, the company may have looked at each year restated and how much each particular financial statement was adjusted. The company may have determined that no single financial statement was adjusted enough to harm the reliance on that particular year. To reflect this type of approach,

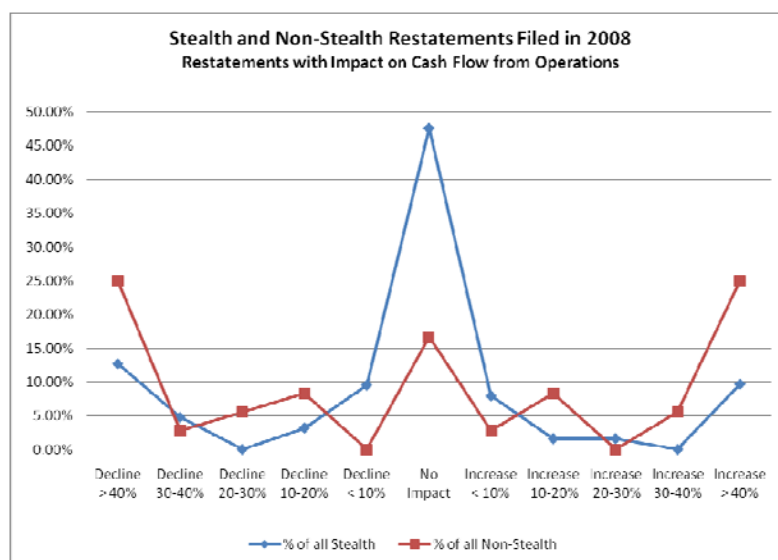


³ The primary reason why the population analyzed dropped from 197 to 140 is due to the fact that most companies disclose only 5 years of financial information and therefore restatements that had an impact of more than 5 years could not be included in the cumulative analysis.

where possible, the restatements filed in 2008 were broken down into each year restated in the amount of the actual adjustment applied to that year. The analysis then considered only the largest adverse impact experienced by a particular yearly financial (instead of the cumulative impact).⁴ This method of quantifying the significance of a restatement is presented in the graph immediately above. (See also, table on page 7: *Restatements with an Impact on Cumulative Net Income; Impact Allotted to Years Restated*.) As compared to the cumulative impact approach, this method shows a much higher percentage of stealth restatements disclosed small adjustments. The largest percentage of stealth restatements (52%) disclosed a negative adjustment to net income of less than 10%. In addition, 20% of the stealth restatements disclosed a positive adjustment of less than 10%. Therefore, this method revealed a higher concentration (72%) of stealth restatements that disclosed an adjustment of less than +/- 10%.⁵ In addition, only two stealth restatements disclosed a negative adjustment to net income of more than 20% and no stealth restatements disclosed a negative adjustment more than 30%. The number of positive adjustments decreased slightly because a positive cumulative adjustment that is presented as a series of restated years can contain a mixture of positive and negative adjustments.

4. An analysis of restatements filed in 2008 with a quantifiable impact on the cash flow statement from operations showed that most stealth restatements provided no impact or a low percentage impact on the cash flow from operations.

In 2008, publicly traded companies filed 98 restatements that made a quantifiable adjustment to the cash flow statement.⁶ Of those restatements, 62 made adjustments to cash flow from operations (as opposed to another cash flow item) while 36 had no impact.⁷ The largest percentage of stealth restatements, about 48% of total stealth cash flow restatements, were those restatements that provided an adjustment to cash flow, but not to operational cash flow. (See graph on right.) However, a substantial number of stealth restatements, about 13%, also occurred for downward adjustments to cash flow of over 40%. (See leftmost blue diamond in graph on right.) Out of a total of 62 stealth restatements adjusting cash flow, eight provided a negative adjustment to operational cash flow of over 40%. (See table on page 8: *Restatements with an Impact on Cash Flow from Operation*.) Therefore, with respect to these eight stealth restatements, it is to be assumed that the companies determined that the 40% decline to the cash flow for operations was considered insufficient to alter prior reliance on the adjusted financial statements.



⁴ Because quarterly restatements are not audited, this analysis focuses on annual restatements only.

⁵ The concentration could be, to some extent, due to the fact that this analysis focuses on annual restatements while the “cumulative” analysis included quarterly restatements. If companies were more apt to conclude that quarterly restatements of higher adjustment amounts were more apt to be immaterial, then the cumulative analysis would contain more stealth restatements disclosing higher adjustments.

⁶ As shown in the table on page 5, a total of 113 restatements in 2008 were, in part, the result of “Cash flow statement (SFAS 95) classification errors.” Of those restatements, 98 provided sufficient information for a financial impact review.

⁷ The table on page 8 shows that 30 stealth and 6 non-stealth restatements had “No Impact on Cash from Operations.” Cash flow statement items other than cash flow from operations include, for example, cash flow from finances, investments, and foreign cash exchange.

5. A Big 4 breakdown of cash flow restatements shows that clients of the Big 4 filed only about one third of the stealth restatements.

The graph above provides a financial impact distribution of 62 stealth restatements filed in 2008 that provided a quantifiable adjustment to the cash flow statements. A breakdown of the stealth restatements by the Big 4 accounting firms shows that Big 4 clients filed only 32% of the total cash flow stealth restatements (20 out of 62) while filing 61% of the non-stealth (23 of 36). (See table on page 9: *Auditor Breakdown of Restatements with an Impact on Cash Flow from Operations*.) Furthermore, all stealth restatements filed by the Big 4 clients that provided a negative adjustment to the operational cash flow, disclosed a negative

Degree of Impact on Cash Flow Statement (Operations)	Stealth Cash Flow Restatements				
	E&Y	D&T	KPMG	PwC	Other
Decrease of More than 40%	0	0	0	0	8
Decrease of 30-40%	0	0	0	0	3
Decrease of 20-30%	0	0	0	0	0
Decrease of 10-20%	0	0	0	0	2
Decrease of less than 10%	0	3	1	1	1
No Impact on Cash from Operations	4	5	1	1	19
Increase of less than 10%	1	0	1	0	3
Increase of 10-20%	0	1	0	0	0
Increase of 20-30%	0	0	0	0	1
Increase of 30-40%	0	0	0	0	0
Increase of More than 40%	0	1	0	0	5
Total	5	10	3	2	42

adjustment of no more than a 10%. (See table above.)⁸ In addition, 10 out of the 20 stealth restatements filed by clients of the Big 4 had no impact on cash flow from operations. Thus, the stealth restatements filed by the clients of Big 4 accounting firms appear to be in the adjustment range expected for a conclusion that prior reliance on financial statements would not be harmed.

⁸ If there was an auditor change during the restated period, this analysis counted the auditor that signed the last restated annual report.

Stealth Restatement Percentages (Frequency Analysis Based on Restatement Issues)

Restatement Issue	Total Restatements	Stealth		Non-Stealth	
		#	% of Issue	#	% of Issue
Comprehensive income issues	7	6	85.7%	1	14.3%
Balance sheet classification of assets issues	20	16	80.0%	4	20.0%
Pension and other post-retirement benefit issues	10	7	70.0%	3	30.0%
Cash flow statement (SFAS 95) classification errors	113	68	60.2%	45	39.8%
Gain or loss recognition issues	25	15	60.0%	10	40.0%
EPS, ratio and classification of income statement issues	41	24	58.5%	17	41.5%
Deferred, stock-based and/or executive comp issues	110	61	55.5%	49	44.5%
Debt and/or equity classification issues	19	10	52.6%	9	47.4%
Debt, quasi-debt, warrants & equity (BCF) security issues	173	90	52.0%	83	48.0%
Liabilities, payables, reserves and accrual estimate failures	85	44	51.8%	41	48.2%
Capitalization of expenditures issues	29	15	51.7%	14	48.3%
Expense (payroll, SGA, other) recording issues	125	64	51.2%	61	48.8%
Intercompany, investment in subs./affiliate issues	18	9	50.0%	9	50.0%
PPE intangible or fixed asset (value/diminution) issues	58	28	48.3%	30	51.7%
Accounts/loans receivable, investments & cash issues	74	35	47.3%	39	52.7%
Consolidation issues incl Fin 46 variable interest & off-B/S	62	28	45.2%	34	54.8%
Tax expense/benefit/deferral/other (FAS 109) issues	91	37	40.7%	54	59.3%
Acquisitions, mergers, disposals, re-org acct issues	103	39	37.9%	64	62.1%
Inventory, vendor and/or cost of sales issues	49	18	36.7%	31	63.3%
Revenue recognition issues	98	34	34.7%	64	65.3%
Depreciation, depletion or amortization errors	30	10	33.3%	20	66.7%
Lease, SFAS 5, legal, contingency and commitment issues	15	5	33.3%	10	66.7%
Foreign, related party, affiliated, or subsidiary issues	30	8	26.7%	22	73.3%
Financial derivatives/hedging (FAS 133) acct issues	19	3	15.8%	16	84.2%

Notes:

¹ The research is based on SEC filings as of December 31, 2008 (database download of January 5, 2009).

² This research is a supplemental analysis of Audit Analytics Restatement Report published in February 2008 (See Audit Analytics, 2008 Financial Restatements, An Eight Year Comparison, February 2009).

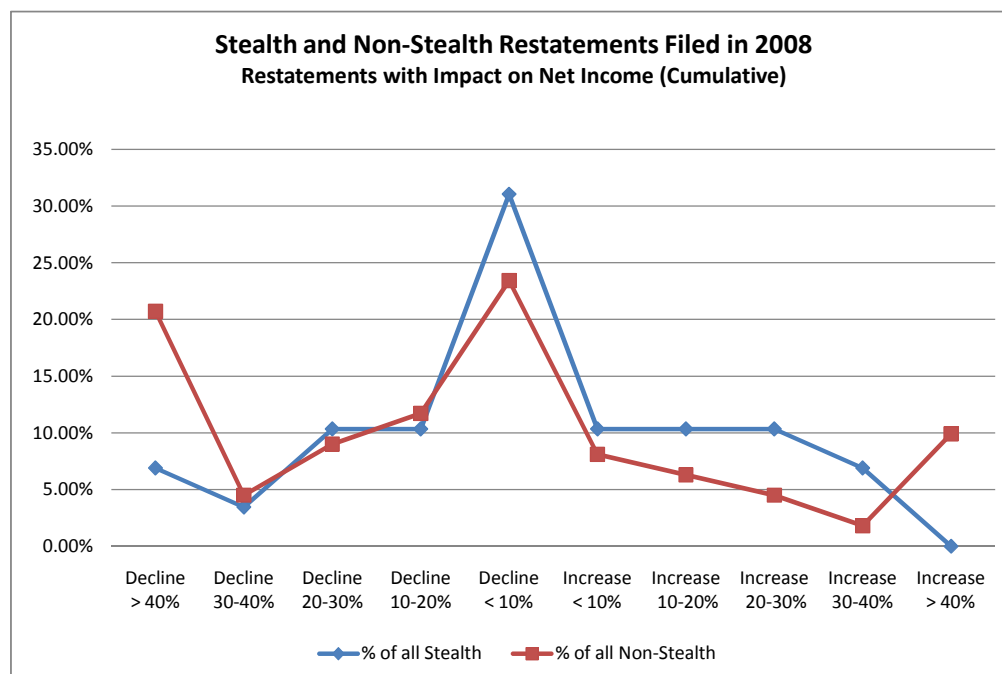
³ The percentages above are based on restatements filed in 2008 by publicly traded companies.

Stealth vs. Non-Stealth Restatements

Impact Distribution of Restatements Filed in 2008

Based on Percent of Cumulative Impact on Net Income

Publicly Traded Companies that Disclosed Initial Cumulative Net Income



Degree of Impact on Income Statement	Stealth		Non-Stealth	
	#	%	#	%
Decrease of more than 40%	2	6.90%	23	20.72%
Decrease of 30-40%	1	3.45%	5	4.50%
Decrease of 20-30%	3	10.34%	10	9.01%
Decrease of 10-20%	3	10.34%	13	11.71%
Decrease of 0-10%	9	31.03%	26	23.42%
Increase of 0-10%	3	10.34%	9	8.11%
Increase of 10-20%	3	10.34%	7	6.31%
Increase of 20-30%	3	10.34%	5	4.50%
Increase of 30-40%	2	6.90%	2	1.80%
Increase greater than 40%	0	0.00%	11	9.91%
Total	29	100%	111	100%

Additional Refinement of Low Impact Filings to Show 5% Breakdown

Degree of Impact on Income Statement	Stealth		Non-Stealth	
	#	%	#	%
Decrease of 5-10%	4	13.79%	13	11.71%
Decrease of less than 5%	5	17.24%	13	11.71%
Increase of less than 5%	2	6.90%	5	4.50%
Increase of 5-10%	1	3.45%	4	3.60%

Notes:

¹ The research is based on SEC filings as of December 31, 2008 (database download of January 5, 2009).

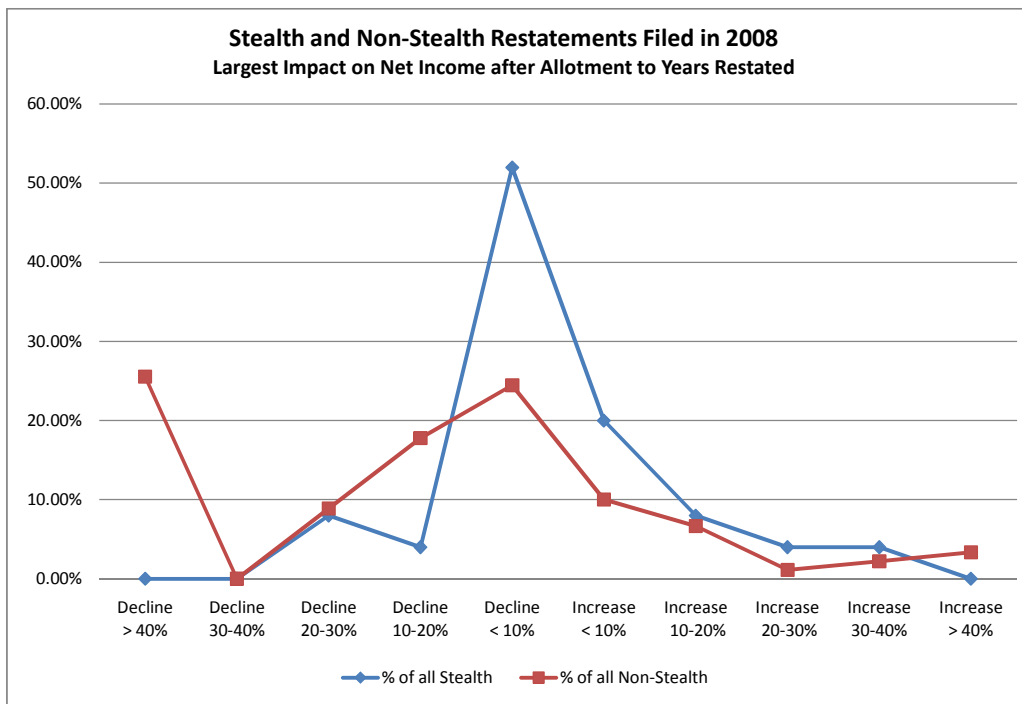
² This research is a supplemental analysis of Audit Analytics Restatement Report published in February 2008 (See Audit Analytics, 2008 Financial Restatements, An Eight Year Comparison, February 2009).

³ The percentages of Stealth and Non-Stealth restatements shown above are based on the cumulative impact (the aggregate of all the years restated) on net income. The restatements analyzed are those restatements (annual and quarterly) filed in 2008 by publicly traded companies (listed in Amex, NASDAQ or NYSE) that disclosed their initial cumulative net income. In 2008, a total of 197 restatements from publicly traded disclosed an impact on net income: 51 stealth restatements and 146 non-stealth. Of those restatements, a total of 140 companies disclosed their initial cumulative net income: 29 stealth restatements and 111 non-stealth.

Stealth vs. Non-Stealth Restatements

Impact Distribution of Restatements Filed in 2008

Based on Percent of Impact on Net Income with Impact Allotted to Each Year Restated and Largest Impact Presented



Degree of Impact on Income Statement	Stealth		Non-Stealth	
	#	%	#	%
Decrease of more than 40%	0	0.00%	23	25.56%
Decrease of 30-40%	0	0.00%	0	0.00%
Decrease of 20-30%	2	8.00%	8	8.89%
Decrease of 10-20%	1	4.00%	16	17.78%
Decrease of less than 10%	13	52.00%	22	24.44%
Increase of less than 10%	5	20.00%	9	10.00%
Increase of 10-20%	2	8.00%	6	6.67%
Increase of 20-30%	1	4.00%	1	1.11%
Increase of 30-40%	1	4.00%	2	2.22%
Increase of more than 40%	0	0.00%	3	3.33%
Total	25	100.00%	90	100.00%

Additional Refinement of Low Impact Filings to Show 5% Breakdown

Degree of Impact on Income Statement	Stealth		Non-Stealth	
	#	%	#	%
Decrease of 5-10%	6	24.00%	13	14.44%
Decrease of less than 5%	7	28.00%	9	10.00%
Increase of less than 5%	3	12.00%	5	5.56%
Increase of 5-10%	2	8.00%	4	4.44%

Notes:

¹ The research is based on SEC filings as of December 31, 2008 (database download of January 5, 2009).

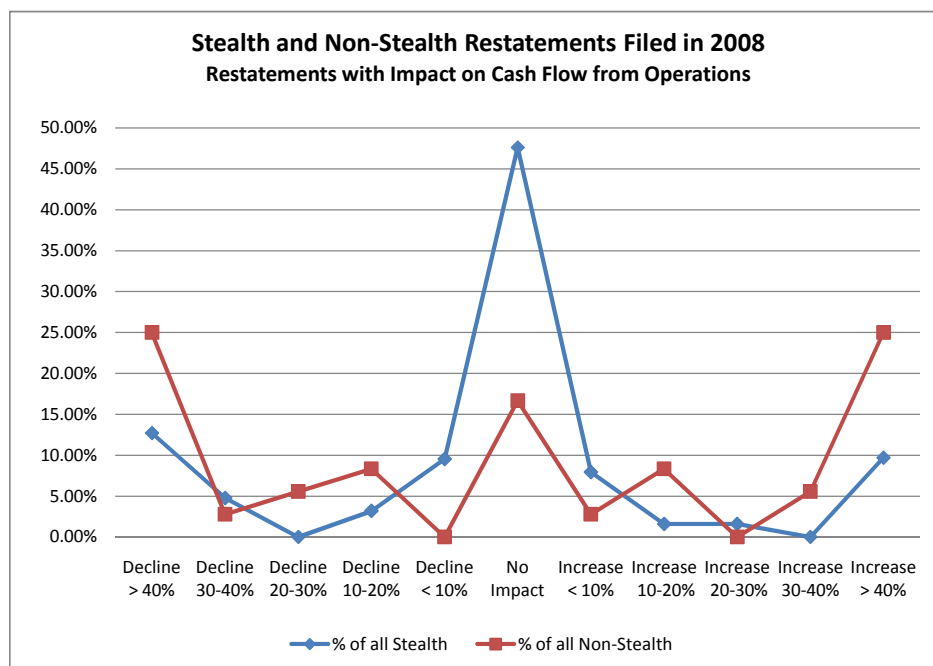
² This research is a supplemental analysis of Audit Analytics Restatement Report published in February 2008 (See Audit Analytics, 2008 Financial Restatements, An Eight Year Comparison, February 2009).

³ The percentages of Stealth and Non-Stealth restatements shown above are based on the largest adverse impact on net income experienced by a particular year after determining the impact on each year restated (instead of using the cumulative impact of the restatement). The restatements analyzed are those annual restatements filed in 2008 by publicly traded companies (listed in Amex, NASDAQ or NYSE) that disclosed their initial cumulative net income and the year to year breakdown. In 2008, a total of 197 restatements from publicly traded companies disclosed an impact on net income: 51 stealth restatements and 146 non-stealth. Of those restatements, a total of 115 companies disclosed its the yearly breakdown net income adjustments: 25 stealth restatements and 90 non-stealth.

Stealth vs. Non-Stealth Restatements

Impact Distribution of Restatements Filed in 2008

Restatements with an Impact on Cash Flow from Operations



Degree of Impact on Cash Flow Statement	Stealth		Non-Stealth	
	#	%	#	%
Decrease of More than 40%	8	12.90%	9	25.00%
Decrease of 30-40%	3	4.84%	1	2.78%
Decrease of 20-30%	0	0.00%	2	5.56%
Decrease of 10-20%	2	3.23%	3	8.33%
Decrease of Less than 10%	6	9.68%	0	0.00%
No Impact on Cash from Operations	30	48.39%	6	16.67%
Increase of Less than 10%	5	8.06%	1	2.78%
Increase of 10-20%	1	1.61%	3	8.33%
Increase of 20-30%	1	1.61%	0	0.00%
Increase of 30-40%	0	0.00%	2	5.56%
Increase of More than 40%	6	9.68%	9	25.00%
Total	62	100.00%	36	100.00%

Additional Refinement of Low Impact Filings to Show 5% Breakdown

Degree of Impact on Income Statement	Stealth		Non-Stealth	
	#	%	#	%
Decrease of 5-10%	4	6.35%	0	0.00%
Decrease of Less than 5%	2	3.17%	0	0.00%
No Impact on Cash from Operations	30	47.62%	6	16.67%
Increase of Less than 5%	4	6.35%	1	2.78%
Increase of 5-10%	1	1.59%	0	0.00%

Notes:

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³ The percentages above are based on restatements filed in 2008 by publicly traded companies (listed in Amex, NASDAQ or NYSE).

Stealth vs. Non-Stealth Restatements

Auditor Breakdown of Restatements Filed in 2008

Restatements with an Impact on Cash Flow from Operations

Degree of Impact on Cash Flow Statement	Stealth						Non-stealth					
	Total	E&Y	D&T	KPMG	PwC	Other Auditor	Total	E&Y	D&T	KPMG	PwC	Other Auditor
Decrease of More than 40%	8	0	0	0	0	8	9	2	3	0	0	4
Decrease of 30-40%	3	0	0	0	0	3	1	0	0	0	0	1
Decrease of 20-30%	0	0	0	0	0	0	2	0	2	0	0	0
Decrease of 10-20%	2	0	0	0	0	2	3	0	2	0	1	0
Decrease of 5-10%	4	0	3	1	0	0	0	0	0	0	0	0
Decrease of Less than 5%	2	0	0	0	1	1	0	0	0	0	0	0
No Impact on Cash from Operations	30	4	5	1	1	19	6	0	3	0	1	2
Increase of Less than 5%	4	1	0	0	0	3	1	0	0	0	0	1
Increase of 5-10%	1	0	0	1	0	0	0	0	0	0	0	0
Increase of 10-20%	1	0	1	0	0	0	3	0	2	1	0	0
Increase of 20-30%	1	0	0	0	0	1	0	0	0	0	0	0
Increase of 30-40%	0	0	0	0	0	0	2	0	2	0	0	0
Increase of More than 40%	6	0	1	0	0	5	9	0	4	0	0	5
Total	62	5	10	3	2	42	36	2	18	1	2	13

Notes:

¹ The research is based on SEC filings as of December 31, 2008 (database download of January 5, 2009).

² This research is a supplemental analysis of Audit Analytics Restatement Report published in February 2008 (See Audit Analytics, 2008 Financial Restatements, An Eight Year Comparison, February 2009).

³ The percentages above are based on restatements filed in 2008 by publicly traded companies (listed in Amex, NASDAQ or NYSE).

⁴ If there was an auditor change during the restated period, this analysis counted the auditor that signed the last restated annual report.

AUDIT ANALYTICS® - PUBLIC COMPANY MARKET INTELLIGENCE

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