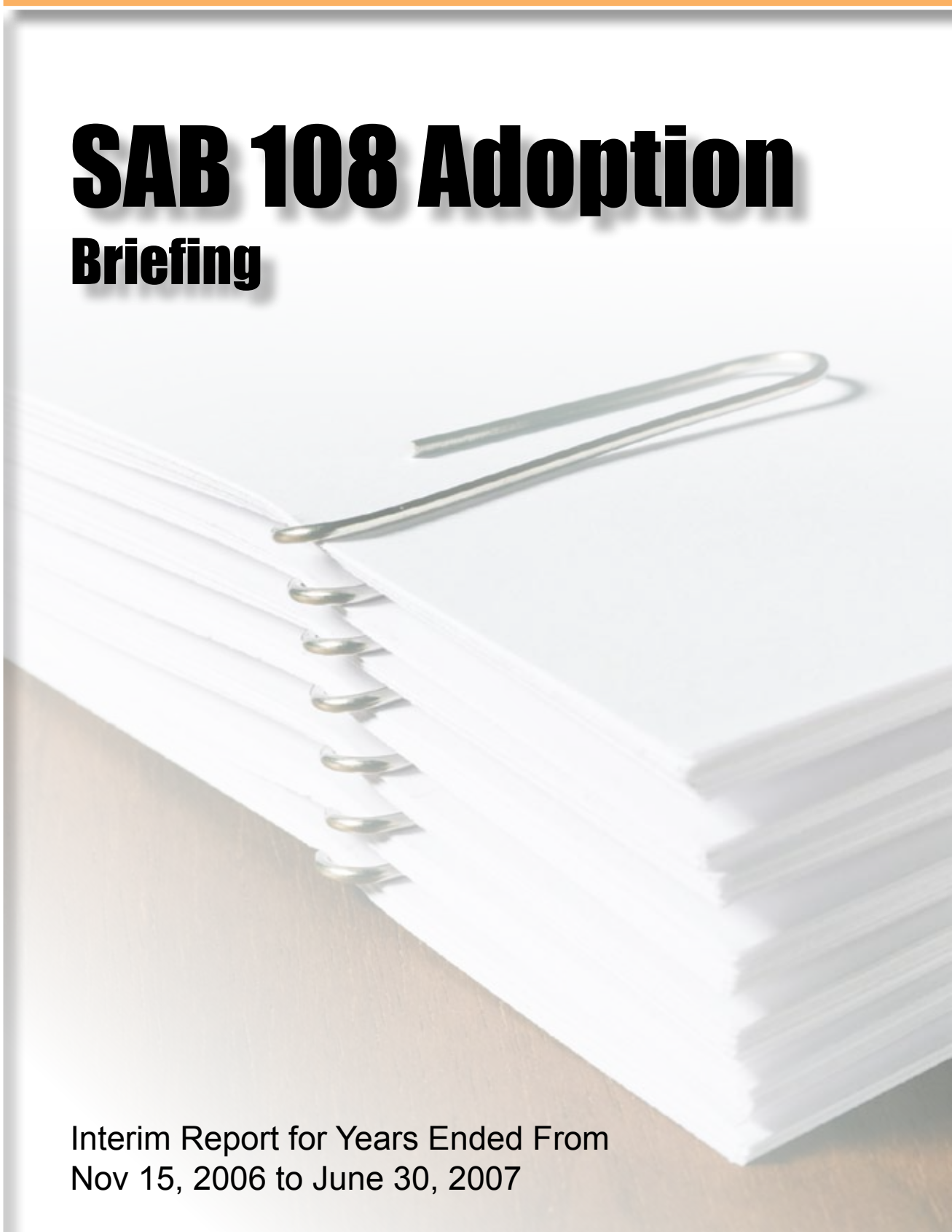


SAB 108 Adoption

Briefing



Interim Report for Years Ended From
Nov 15, 2006 to June 30, 2007

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Introduction

In September 2006, the SEC issued “Staff Accounting Bulletin N. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements”. The major objective of SAB 108 was to eliminate inconsistencies in the treatment of historical accounting errors. SAB 108 is effective for the fiscal years ending after November 15, 2006 and should be applied in the first year thereafter. Contained within SAB 108 was one controversial requirement: that any previously uncorrected errors could be entered, on a one time basis only in the year of adoption, directly into beginning retained earnings. In short, these errors could be corrected without ever appearing on an income statement. This feature of SAB 108 brings with it issues associated with historical comparability of financial results.

Executive Summary

1. Registrant adoptions of SAB 108, through the first eight months of application, totaled 296¹, representing 4.71% of all registrants² and \$630 billion of market capitalization.
2. KPMG clients made up by far the largest number of adoptees (114), making up 38.5% of all SAB 108 filers and 13.73% of their own client base. By comparison among the Big Four PricewaterhouseCoopers clients made up the fewest number of SAB 108 adoptees (26) of all SAB 108 filers and Ernst & Young had the lowest percentage (2.40%) of their client base.
3. Among the eight largest accounting firms, relative to their total number of public company clients, Crowe Chizek client adoptions make up the highest percentage (21.98%).
4. Financial Services company adoptees make up the most significant number of industry filers utilizing SAB 108, making up 28.7 % of all companies and 6.13% of this industry’s companies. Information industry companies made up the highest percentage (8.5%).
5. Errors affecting liabilities and reserves accounts made up the most significant number and percentage of total SAB 108 restatements totaling 108 and 36.49% respectively³.
6. Tax accounting error corrections comprised the second most significant number and percentage totaling 97 and 32.77% respectively. During this past year there had been some speculation that some companies would seek to include tax accounting error corrections in their SAB 108 filings as opposed to FIN 48 adoptions. By doing so, certain companies could avoid the threatened scrutiny by tax regulatory authorities of FIN 48 adoptions. The relatively high number of tax accounting error corrections in SAB 108s leaves open this possibility.
7. A review of the ten largest positive and negative error correction changes (by dollar amount) reveals that for most of these companies the effect on current net income, if such adjustment had been recorded in the most recent year, would have been material. In 13.5% of the time a company that filed a SAB 108 adjustment, also filed a regular restatement during the year prior to and during the SAB 108 adoption period.

¹ The population of SAB 108 restatements is based on September 30, 2007 download and include analysis of 10-K’s only.

² This analysis examines SAB 108 adjustments from 10K filers only, with the one exception that REIT filers have been added back. It has not looked at 10KSB, 20F, 40F, Fund filers or early adoptions for such adjustments.

³ A significant number of companies reported multiple accounting issue errors in their SAB 108 filings.

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Background

Prior to the adoption of SAB 108, companies used either the iron curtain (balance sheet) approach or the rollover (income statement) method when accounting for errors. Under the SAB 108 provision, companies have to use both approaches to evaluate the cumulative impact of a misstatement. If issues that were previously considered immaterial appear to be material under one of these approaches, companies are required to record adjustments to carrying values of assets and liabilities, with offsetting adjustments recorded to the opening balance of retained earnings.

This briefing presents an overview of SAB 108 restatements filed on form 10-K only. Most of the SAB 108 restatements have been associated with companies that initially used the rollover method of error quantification.

Since the SAB 108 provision requires companies to record misstatements that were previously considered immaterial in a given year, it was unknown how many entities would take advantage of the SAB 108 provision to correct previous errors into beginning retained earnings. As of September 30, 2007 we have found only 296 10K filers that have restated their beginning retained earnings balances under SAB 108. Of note is that this regulation seems to have come into effect after three straight years of record numbers of financial restatements including 1,876 in 2006 alone (as presented by Audit Analytics, 2006 Financial restatements, a Six Year Comparison). SAB 108 adjustments are supposed to be small mistakes that are accumulated over years. Companies that identified material misstatements prior to adopting SAB 108 and as a result filed amended financial statements were likely to identify those immaterial issues during the restatement preparation process and record the additional charge as part of a regular restatement adjustment. As shown on figure 7, most of the companies that adjusted retained earnings under the SAB 108 provision did not have any regular restatements in either 2006 or 2007.

One of the unique features of the SAB 108 restatements is the high ratio of restatements that had positive impact on retained earnings. Out of 296 total SAB 108 restatements, 192 had a negative historical impact and 104 had a positive historical impact on retained earnings. That ratio - about 35% positively impacted restatements - is much higher than that of regular positively impacted restatements (approximately 10% in 2006). This difference gives credence to the assertion that SAB 108 adjustments were more likely to derive from random errors, as opposed to seemingly less random forces that affect traditional restatement disclosures.

Figures 1 and 2 describe the 10 largest positive and the 10 largest negative SAB 108 restatements. These charts give the reader an idea of the materiality, with respect to companies' most recent years' net income, of the 20 largest SAB 108 restatements.

As evident from Figure 3, clients of the 8 largest audit firms account for more than 85% of SAB 108 restatements, with KPMG alone accounting for almost 40% of the total. On a percentage basis, Crowe Chizek clients exhibit the highest rate of SAB 108 restatements. One possible explanation of these results is that both KPMG and Crowe Chizek have historically encouraged their clients to use the rollover method of accounting for errors. Other possible explanations may exist.

Figure 8 describes total counts of the accounting error issues disclosed in SAB 108 restatements. Out of a total 625 issues disclosed, 408 appear in restatements with a negative impact on retained earnings, and 217 - in restatements with a positive impact. Some of the categories, such as taxes and liabilities, appeared in approximately a third of SAB 108 restatements.

Another point to consider is the uneven distribution of SAB 108 restatements among industries. Due to the immaterial nature of SAB 108 mistakes, it would be expected that they would be spread more or less equally among sectors. However, as is evident from the Figure 9, five industries account for more than 80% of all SAB 108 restatements, with Financial Services industry alone accounting for almost a third of the restatements. One of the possible explanations is that those industries had fewer regular restatements in the past few years.

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Figure 1 – SAB 108 restatements analysis

10 largest **negative** restatements

Company	Decrease in retained earnings	Net Income	Effect on Net Income of charge to Beginning Retained Earnings (overstates NI)
Home Depot Inc	-257,000,000	5,761,000,000	4.46%
Crown Castle International Corp	-83,895,000	-41,893,000	200.26%
Bed Bath & Beyond Inc	-72,612,000	594,244,000	12.22%
Echostar Communications Corp	-62,345,000	608,272,000	10.25%
Marshall & Isley Corp/WI	-61,178,000	807,838,000	7.57%
Sprint Nextel Corp	-50,000,000	1,329,000,000	3.76%
Symantec Corp	-33,788,000	404,380,000	8.36%
Smurfit Stone Container Corp	-28,000,000	-59,000,000	47.46%
Lincare Holdings Inc	-27,616,000	212,981,000	12.97%
Interpublic Group of Companies	-26,400,000	-31,700,000	83.28%

- Net income for the most current fiscal year on file

- All amounts are in US dollars

Column 2 reflects the amount that historical retained earnings was reduced from the net effect of SAB 108 restatements. To give some perspective we have compared this number to the most recent years net income. From the column on the far right one can observe net income effects ranging from 3.76% to 200.26 %. These comparisons do not give insight into how these SAB 108 restatements would have been distributed between multiple years and to what extent they might have been material in previous years.

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Figure 2 – SAB 108 restatements analysis

10 largest **positive** restatements

Company	Increase in retained earnings	Net Income	Effect on Net Income of credit to Beginning Retained Earnings (understates NI)
Aflac Inc	139,000,000	1,483,000,000	9.37%
Cablevision Systems Corp/NY	121,668,000	-126,465,000	96.21%
Sara Lee Corp	53,000,000	504,000,000	10.52%
Automatic Data Processing Inc	44,300,000	1,138,700,000	3.89%
Citizens Communications Co	36,392,000	344,555,000	10.56%
Sealed Air Corp/DE	31,800,000	274,100,000	11.60%
Bard C R Inc/NJ	26,500,000	272,100,000	9.74%
Estee Lauder Companies Inc	24,200,000	449,200,000	5.39%
GATX Corp	19,200,000	111,700,000	17.19%
Blockbuster Inc	18,400,000	54,700,000	33.64%

- Net income for the most current fiscal year on file

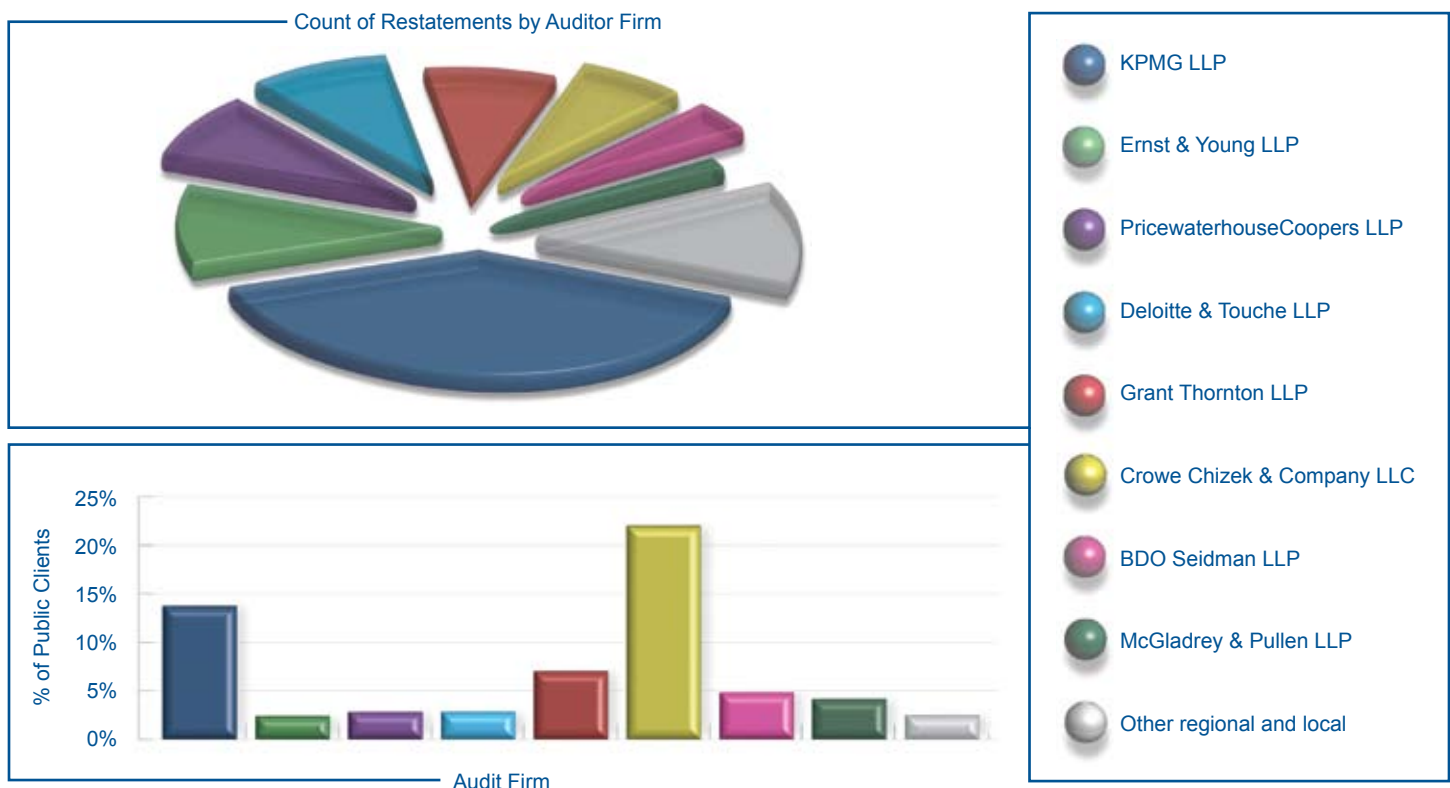
- All amounts are in US dollars

The above represents the ten largest SAB 108 increases to historical retained earnings that will never be reflected in any net income or earnings statements.

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Figure 3 – SAB 108 restatements analysis
by auditor firm

Auditor	Number of SAB 108 restatements	Decrease in retained earnings, negative restatements	Increase in retained earnings, positive restatements	% of the auditors public clients
KPMG LLP	114	-837,991,504	520,171,000	13.73%
Ernst & Young LLP	30	-120,330,000	48,929,000	2.40%
PricewaterhouseCoopers LLP	26	-82,480,156	86,464,564	2.83%
Deloitte & Touche LLP	27	-176,353,000	64,438,000	2.86%
Grant Thornton LLP	24	-32,711,911	4,807,000	7.04%
Crowe Chizek & Company LLC	20	-4,311,413	5,775,582	21.98%
BDO Seidman LLP	12	-14,170,000	13,667,000	4.84%
McGladrey & Pullen LLP	4	-1,692,000	2,480,000	4.17%
Other regional and local	39	-24,945,285	9,939,924	2.49%
Total	296	-1,294,985,269	756,672,070	4.71%



The above charts represent the breakdown by major accounting firm client base of the SAB 108 restatements.

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Figure 4 – SAB 108 restatements analysis
count by exchange type

Exchange	Number of SAB 108 restatements
Amex	16
Nasdaq National Market	125
Nasdaq Small Cap Market	10
Nyse	84
OTCBB	25
Other	36
Total	296

Figure 5 – SAB 108 restatements analysis
count by filer type

Type	Number of SAB 108 restatements
Accelerated filer	222
Non-accelerated filer	73
Not disclosed	1
Total	296

The above charts breakdown the SAB 108 filers by size and trading exchange. Clearly the largest segment of SAB 108 filers are both accelerated filers and traded on the Nasdaq.

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Figure 6 – SAB 108 restatements analysis

count by impact on retained earnings

Type	Number of SAB 108 restatements	Impact on retained earnings
Negative	192	-1,294,985,269
Positive	104	756,672,070
Total	296	-538,313,199

The above chart provides a breakdown of SAB 108 restatements by whether they positively or negatively impacted prior years retained earnings.

Figure 7 – SAB 108 restatements analysis

count by % of SAB 108 filers with no restatements in years 2006 or 2007

	Number of SAB 108 restatements
Total registrants adoptions of SAB 108	296
Registrants with no regular restatements in either 2006 or 2007	256
% of total registrants with no regular restatements in either 2006 or 2007	86.49%

The above chart identifies all SAB 108 filers who also have filed a regular restatement during the period of 2006 and 2007, with the exception of Cash Flow Statement, Income Statement reclassifications and Segment restatements that are specifically excluded from SAB 108 adjustments.

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Figure 8 – SAB 108 restatements analysis
count by issue and % of total restatements

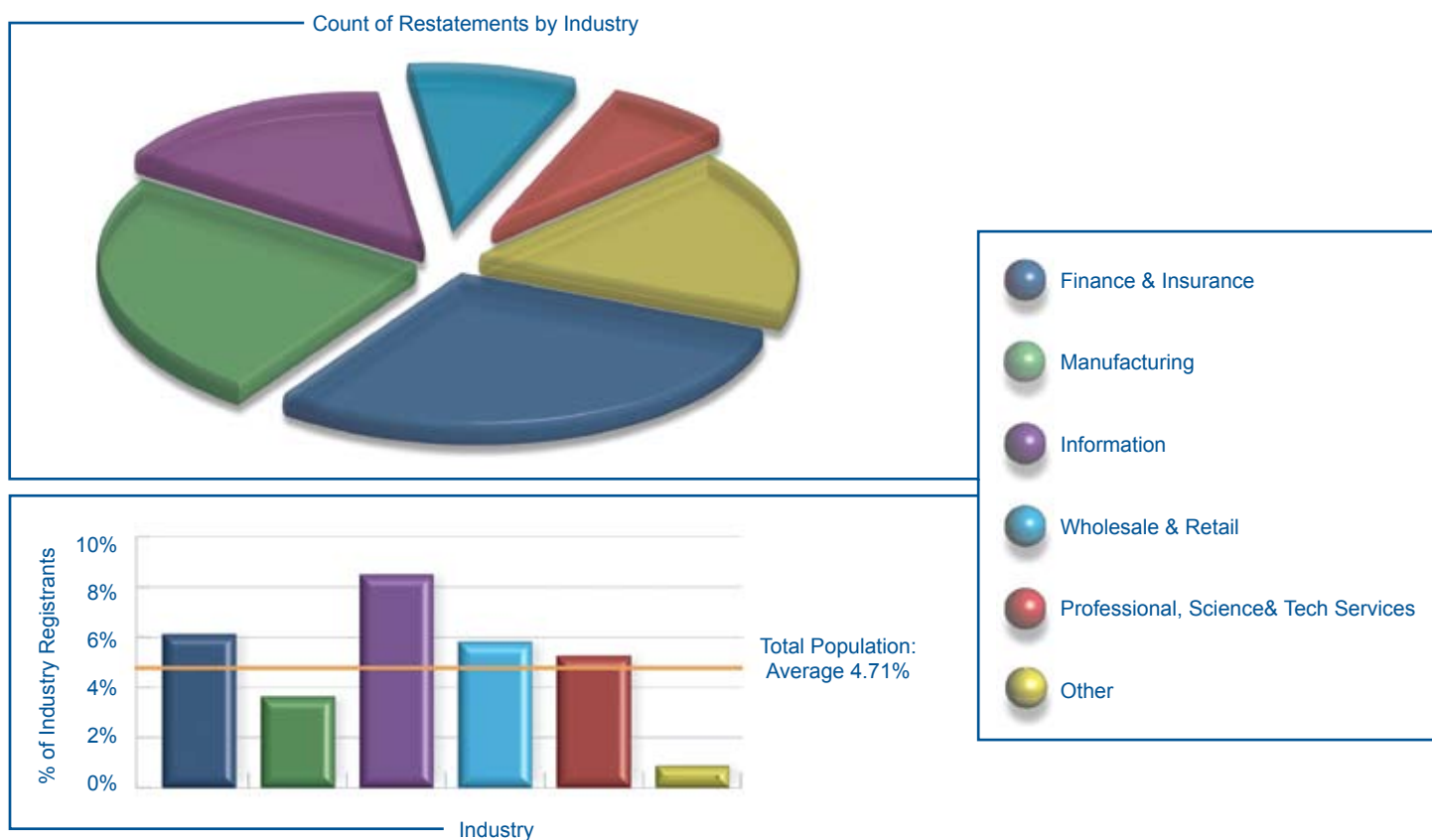
Category	Negative	Positive	Total	% of total SAB 108 restatements
Liabilities, payables, reserves and accrual estimate failures	69	39	108	36.49%
Tax expense/benefit/deferral/other (FAS 109) issues	50	47	97	32.77%
Lease, SFAS 5, legal, contingency and commitment issues	49	11	60	20.27%
Revenue recognition issues	34	21	55	18.58%
Depreciation, depletion or amortization errors	29	11	40	13.51%
Accounts/loans receivable, investments & cash issues	23	14	37	12.50%
Inventory, vendor and/or cost of sales issues	23	13	36	12.16%
PPE intangible or fixed asset (value/diminution) issues	25	11	36	12.16%
Deferred, stock-based and/or executive comp issues	27	4	31	10.47%
Acquisitions, mergers, disposals, re-org acct issues	17	13	30	10.14%
Consolidation issues including Fin 46 variable interest & off-B/S	13	8	21	7.09%
Capitalization of expenditures issues	7	9	16	5.41%
Intercompany, investment in subs./affiliate issues	12	1	13	4.39%
Foreign, related party, affiliated, or subsidiary issues	9	3	12	4.05%
Gain or loss recognition issues	6	4	10	3.38%
Debt, quasi-debt, warrants & equity (BCF) security issues	5	2	7	2.36%
Expense (payroll, SGA, other) recording issues	2	2	4	1.35%
Financial derivatives/hedging (FAS 133) acct issues	2	2	4	1.35%
Cash flow statement (SFAS 95) classification errors	2	1	3	1.01%
Comprehensive income issues	1	1	2	0.68%
Balance sheet classification of assets issues	1	0	1	0.34%
GAAP - Changes in Acct Principles FASB/EITF or Foreign GAAP	1	0	1	0.34%
Material Weakness - Section 404 or 302 issues identified	1	0	1	0.34%
Total	408	217	625	

The above chart identifies the area of SAB 108 mistakes by type of accounting area. As noted above certain areas of accounting failures being corrected in a SAB 108 adjustment are far more prevalent than others. The most prevalent are liabilities, taxes, lease and revenue recognition.

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Figure 9 – SAB 108 restatements analysis
count by industry

Company	Number of SAB 108 restatements	% of industry registrants
Finance & Insurance	85	6.13%
Manufacturing	75	3.63%
Information	42	8.50%
Wholesale & Retail	25	5.81%
Professional, Science & Tech Services	19	5.26%
Other	50	0.87%
Total	296	4.71%



- Industries are as defined by US census bureau

The above charts break out the SAB 108 restatements by industry.

Contacting Audit Analytics®

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