A70511 probes issues central to audit failure: earnings management, the restatements that earnings management can drive, and the litigation that may follow. The course unfolds in four modules:

I  Audit Risk & Earnings Management
II  Strategic Lenses, Value Drivers & Understanding a Business
III  Restatement & Fraud
IV  Securities Litigation

Learning Objectives

Following completion of A70511, students will understand:

- The role of risk in audit practice and the means to accomplish earnings management. For example, how do companies smooth earnings and detract from the quality of earnings?
- The lenses through which auditors see engagement risk and engagement strategies. For example, how have auditors approached managements’ assertions traditionally?
- An accountant’s role in–and an auditor’s responsibility for– financial restatements. For example, how do restatements play out in practice?
- An accountant’s role in securities litigation. For example, how do GAAP violations map to negotiated damage settlements?

Materials

Discussion Outlines, Cases, Class Notes, and Readings:
Available electronically on Sakai

Grading

Individual Case & Paper:

Judgment in the Face of Contradictory Evidence
Wednesday, September 10 50

Mid Term Exam
Wednesday, October 29 100

Group Paper & Presentation:

Strategies, Earnings Management & Risk*
November 10 100

Paper
Presentation November 10, 12

Final Exam 100

In-Class Performance** 50

400
* **Group Paper & Presentation** (Three-Person Teams)

A brief description follows. (I’ll distribute detailed instructions following Module II.)

Select a public company.

- Using public (e.g., EDGAR: www.sec.gov) and private (your internship firm?) sources, construct for the company, and discuss, a *Client Strategy Template*.
- Identify and discuss risks of potential *earnings management* and *fraud*.
- Identify and discuss actual or potential *adverse influences* and *economic shocks* affecting the company.

Present your findings in a bullet-point memo to the instructor, and orally in class to students, as if you were presenting to the client services executive team of your firm. In your memo, and in class, demonstrate understanding and insight that transcends the trivial and the obvious, makes clear to the executive team that you've digested the client's strategies fully, and wins the executive team's complete confidence.

**In-Class Performance**

Be prepared to discuss in detail assigned articles and cases and to participate fully in class discussion.

### Pre-Class Reading/Case Assignments

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<thead>
<tr>
<th>Week of</th>
<th>Module I</th>
<th>Pre-Class Reading/ Case Assignment</th>
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<tr>
<td>8/25</td>
<td>1</td>
<td>Blackwell, et al., <em>Journal of Accounting Research</em>, Sections 1, 2, 3.2-3.3, 5</td>
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<td>2</td>
<td>Chaney &amp; Philipich, <em>Journal of Accounting Research</em>, Sections 1, 3.1, 5.3 &amp; Table 8</td>
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<tr>
<td>9/01</td>
<td>Case</td>
<td><em>Accounting for Contingencies: FAS 5, FIN 14 &amp; Litigation Reserve Disclosures</em></td>
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<td>3</td>
<td>Leone, CFO.com</td>
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<td>Hulbert <em>The New York Times</em></td>
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<td>Morgenson <em>The New York Times</em></td>
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<td>Greenberg <em>Wall Street Journal</em></td>
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<td>7</td>
<td>Magrath &amp; Weld, <em>The CPA Journal</em></td>
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<td>9/08</td>
<td>8</td>
<td><em>ASC 450-20, “Loss Contingencies”</em></td>
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<td>9</td>
<td>Bogoslaw, <em>Business Week</em></td>
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<td>10</td>
<td>Colter, <em>Wall Street Journal</em></td>
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<td>Case</td>
<td><em>Judgment in the Face of Contradictory Evidence</em></td>
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<td>Case</td>
<td><em>Revenue Recognition &amp; Earnings Management</em></td>
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<td>9/15</td>
<td>Module II</td>
<td>1 Peecher et al. <em>Accounting Organizations &amp; Society</em></td>
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<td>9/22</td>
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<td>2 Ricchiute, <em>Understanding a Client’s Strategies and Business</em></td>
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<tr>
<td>9/29</td>
<td>Module III</td>
<td>1 <em>ASC 250, “Accounting Changes and Error Corrections”</em></td>
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Each student is responsible to uphold the Mendoza College of Business Graduate Academic Code of Honor.

Module Objectives, Key Questions, Readings & Cases

Module I: Audit Risk & Earnings Management

Objective
- To explain the role of risk in practice and the means to accomplish earnings management.

Key Questions
- How does audit risk play out in practice?
- Do financial statement audits add value?
- How do companies manage earnings, financial position, and cash flows?
- Are financial statements relevant in the information age?
• How are entity relationships changing in the information age?

Reading

Discussion Cases
• Accounting for Contingencies: *FAS 5, FIN 14* & Litigation Reserve Disclosures
• Judgment in the Face of Contradictory Evidence: When is a Contingent Liability Both Probable and Reasonable Estimable?

Quick Cases
• The Value of an Audit
• Financial Statements in the Information Age

Module II: Strategic Lens, Value Drivers & Understanding a Business

Objective
• To introduce strategic lenses through which to see engagement risks and engagement strategies.

Key Questions
• How have auditors approached managements' assertions traditionally?
• Why are transaction lenses problematic?
• How have auditors responded to economic shock traditionally?
• What approaches do contemporary auditors use to supplant the transaction lens?
• What are the advantages of strategic lenses & balanced scorecards over the transactions lens?

Reading
2. Ricchiute, D.N. “Understanding a Client’s Strategies and Business”

Quick Cases
• Testing Management's Assertions
• Merger and a Combined Firm's Corporate Vision
Module III: Restatement & Fraud

**Objective**
- To introduce an accountant's role in, and an auditor's responsibility for, financial-statement restatements.

**Key Questions**
- How do restatements unfold in practice?
- Can restatement lead to securities litigation?
- What is the SEC’s enforcement process?
- What is an auditor's responsibility for fraud?

**Reading**

**Restatement**
1. *ASC 250-10-45,* “Accounting Changes and Error Corrections,” Stamford, CT: FASB.
2. *ASC 855-10,* “Subsequent Events,” Stamford, CT: FASB.
3. *AU Sec 561,* “Subsequent Discovery of Facts Existing at the Date of the Auditor’s Report.”

**Fraud**

**Quick Cases**
- Incentives, Opportunity & Rationalization at Global Crossing
- Applying SAS No. 99 to Sunbeam & Global Crossing
- The Decision to Restate Financial Statements

Module IV: Securities Litigation

**Objective**
- To introduce an accountant's role in litigation that can follow restatement and fraud.

**Key Questions**
- What is management's and an auditor's liability under common and statutory law?
- What are the issues, tasks, and standards in litigation support services?
- How do GAAP violations map to Rule 10b-5 actions and to negotiated damage settlements? The case of Waste Management Inc.
- How do GAAS violations map to Rule 10b-5 actions? The case of Datronic Equipment Income Funds
Reading
1. Ricchiute, D.N. “Auditor Liability.”

Quick Cases
• Controlling Legal Liability: Engagement Letters and Litigation Settlements
• Oracle Systems and Backward Induction
• 10b-5 Damages and the Private Securities Litigation Reform Act’s 90 day Lookback Period