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## **FINANCIAL FRAUD AT U.S. PUBLIC COMPANIES OFTEN RESULTS IN BANKRUPTCY OR FAILURE, WITH SIGNIFICANT IMMEDIATE LOSSES FOR SHAREHOLDERS AND PENALTIES FOR EXECUTIVES**

**Altamonte Springs, Fla.** – According to a new study by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), fraudulent financial reporting by U.S. public companies has significant negative consequences for investors and executives.

The COSO study, which examined financial statement fraud allegations investigated by the U.S. Securities and Exchange Commission over a ten-year period, found that news of an alleged fraud resulted in an average 16.7 percent abnormal stock price decline in the two days surrounding the announcement. Companies engaged in fraud often experienced bankruptcy, delisting from a stock exchange, or asset sale, and in nine out of ten cases the SEC named the CEO and/or CFO for alleged involvement.

COSO Chairman David Landsittel said the study's in-depth analysis of the nature, extent, and characteristics of accounting frauds provides helpful insights regarding new and ongoing issues that need to be addressed. "All parties involved in the financial reporting process need to continue to focus on ways to prevent, deter, and detect fraudulent financial reporting," Landsittel said. "COSO plans to sponsor additional research on fraudulent financial reporting, as well as the development of further internal control-related guidance to assist those involved in the financial reporting process."

The study, *Fraudulent Financial Reporting: 1998-2007*, examines nearly 350 alleged accounting fraud cases investigated by the SEC. It shows:

- Financial fraud affects companies of all sizes, with the median company having assets and revenues just under \$100 million.
- The median fraud was \$12.1 million. More than 30 of the fraud cases each involved misstatements/misappropriations of \$500 million or more.
- The SEC named the CEO and/or CFO for involvement in 89 percent of the fraud cases. Within two years of the completion of the SEC investigation, about 20 percent of CEOs/CFOs had been indicted. Over 60 percent of those indicted were convicted.
- Revenue frauds accounted for over 60 percent of the cases.
- Many of the commonly observed board of director and audit committee characteristics such as size, meeting frequency, composition, and experience do not differ meaningfully between fraud and no-fraud companies. Recent corporate governance regulatory efforts appear to have reduced variation in observable board-related governance characteristics.
- Twenty-six percent of the firms engaged in fraud changed auditors during the period examined compared to a 12 percent rate for no-fraud firms.
- Initial news in the press of an alleged fraud resulted in an average 16.7 percent abnormal stock price decline for the fraud company in the two days surrounding the announcement.
- News of an SEC or Department of Justice investigation resulted in an average 7.3 percent abnormal stock price decline.
- Companies engaged in fraud often experienced bankruptcy, delisting from a stock exchange, or material asset sales at rates much higher than those experienced by no-fraud firms.

The COSO study was conducted by four accounting professors: Mark S. Beasley of North Carolina State University, Joseph V. Carcello of the University of Tennessee, Dana R. Hermanson of Kennesaw State University, and Terry L. Neal of the University of Tennessee. The study updates a previous COSO study issued in 1999, *Fraudulent Financial Reporting: 1987-1997*.

Beasley, who is a COSO board member in addition to being one of the study's authors, noted that additional research is needed to better understand differences in processes surrounding the board of directors and audit committee. "We need to determine if there are certain board-related processes that strengthen the board's oversight of risks affecting financial reporting," he said. "In addition, given the small number of frauds examined in this study that involve time periods subsequent to the issuance of the

Sarbanes-Oxley Act of 2002 and related implementation of Section 404, further research is needed before any conclusions can be reached about the impact of SOX in reducing fraudulent financial reporting.”

COSO is hosting a Webcast highlighting the key findings and insights on Wed., May 26, 2010 from 2:00 – 4:00 p.m. Eastern time. Those interested in participating in the live Webcast may register at [www.CPA2Biz.com](http://www.CPA2Biz.com). (Click on Web events by date.) The full text of the study is available at the COSO website: <http://www.coso.org>.

### **About COSO**

Originally formed in 1985, COSO is a voluntary private sector organization dedicated to improving organizational performance and governance through effective internal control, enterprise risk management and fraud deterrence. COSO is jointly sponsored by the American Accounting Association (AAA), the American Institute of Certified Public Accountants (AICPA), Financial Executives International (FEI), the Institute of Management Accountants (IMA), and The Institute of Internal Auditors (IIA).

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