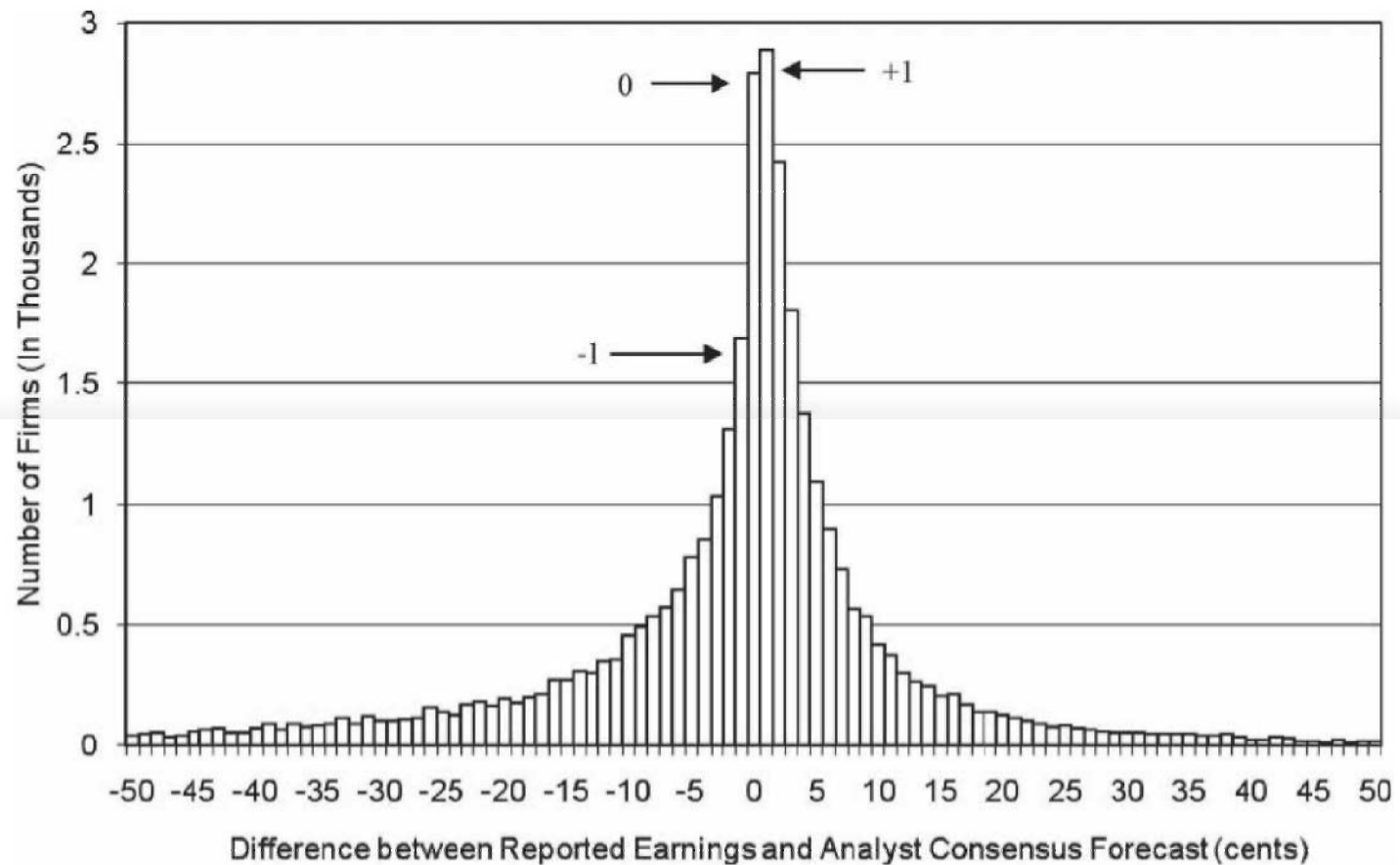


Meeting Analyst Forecasts

- Research has shown that announcing net income less than the earnings forecast by analysts results in a **significant drop in stock price**.
- Companies have an incentive to manage earnings to make sure that the announced number is **at least equal to** the earnings **forecast** by analysts.

Meeting Analyst Forecasts

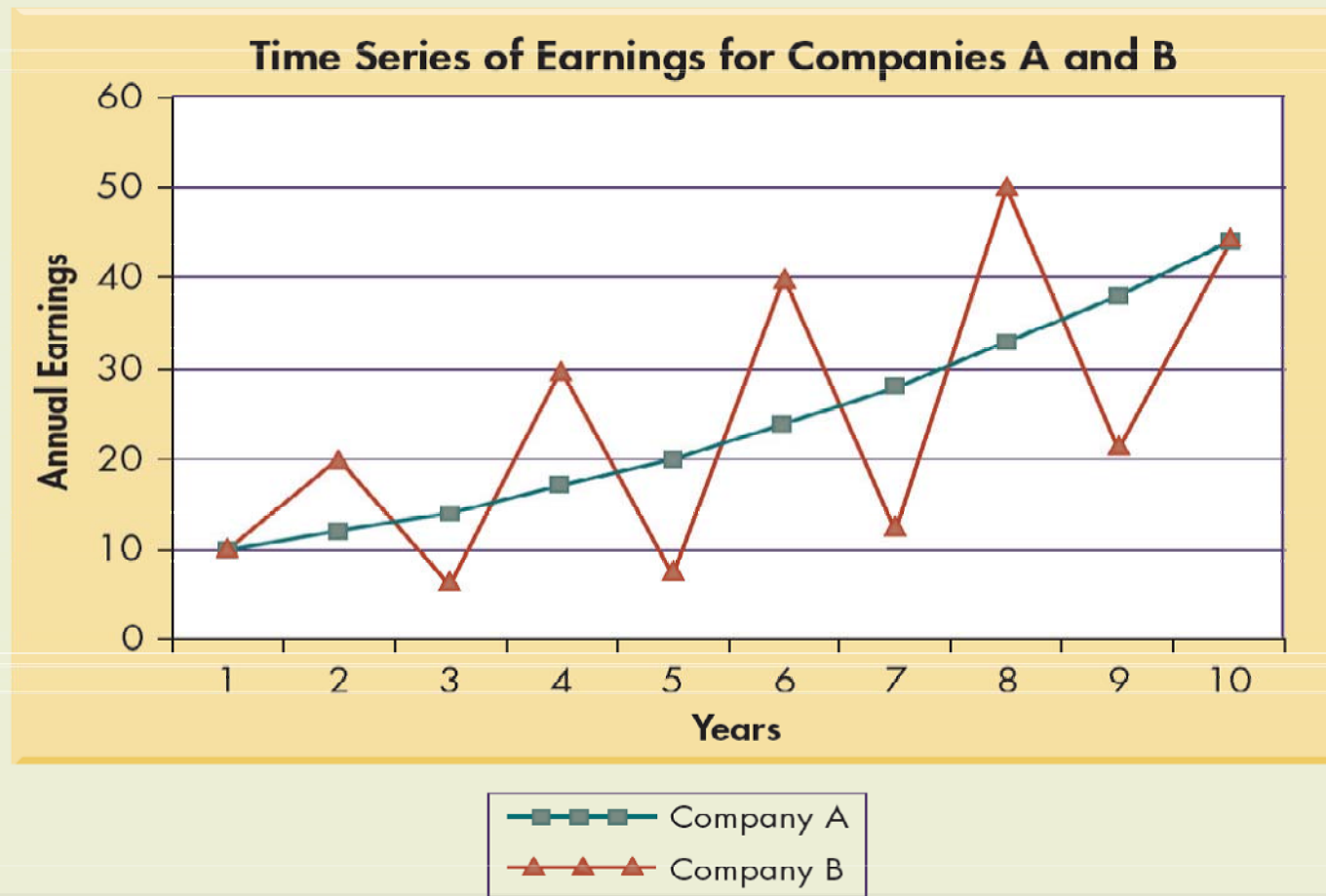
Figure 5b. Frequency distributions of excess earnings in 1988–2006
(Source: Figure 2 of Bhojraj et al 2009)



Excess earnings defined as earnings surprises relative to analysts' consensus forecast (in cents)

Cookie Jar Accounting

EX 6-3 INCOME SMOOTHING



Cookie Jar Accounting

- An accounting practice to **create reserves** in periods of **good** financial results in order to **shore up profits in bad years**
 - e.g., through **reversals of over-estimated expenses** in prior years
 - used by some companies to **smooth income over time** so that certain earnings targets could be met consistently

Common Inventory-related Fraud Schemes

- Double counting
 - e.g., **move** inventory already counted at one **location** to another not yet counted
- Consigned inventory
 - if consigned inventory is incorrectly counted as owned by the company holding the goods, its inventory is overstated

Short Case – Laramie Wire Manufacturing

	2011	2010
Sales	\$ 8,350,000	\$ 8,050,000
Cost of Sales	\$ 6,142,500	\$ 5,980,000
Finished Goods Inventory (Approx. 250 million ft. in 2011)	\$ 1,554,500	\$ 1,075,500
Copper Rod Inventory (Approx. 5.5 million lbs. In 2011)	\$ 2,525,000	\$ 1,550,000
Plastics Inventory (Approx. 1 million lbs. 2011)	\$ 214,500	\$ 172,000
Accounts Payable (for raw materials purchases)	\$ 440,000	\$ 415,000
Days in Accounts Payable	25.4 days	27.1 days
Days in Accounts Receivable	55.8 days	47.9 days
Market Price of Insulated Wire (per foot)	\$ 0.007	\$ 0.009
Market Price of Copper Rod (per lb.)	\$ 0.470	\$ 0.470
Market Price of Plastics (per lb.)	\$ 0.130	\$ 0.190

