

CORNERSTONE RESEARCH

ECONOMIC AND FINANCIAL CONSULTING AND EXPERT TESTIMONY

# Accounting Class Action Filings and Settlements

2014 Review and Analysis



## TABLE OF CONTENTS

Highlights .....	1
Filings and Settlement Activity .....	2
Filings and Share of Accounting Cases .....	2
Filings and Market Capitalization Losses .....	3
Settlements and Share of Accounting Cases .....	4
Settlement Dollars and Share of Accounting Cases .....	5
Industry Sectors .....	6
Accounting Case Filings and Industry Sectors .....	6
Accounting Case Settlement Dollars and Industry Sectors .....	7
Accounting Restatements .....	8
Accounting Case Filings and Restatements .....	8
Market Reactions Surrounding Restatement Announcements .....	9
Disclosure Dollar Loss Index™ for Accounting Case Filings with Restatements .....	10
Accounting Case Settlements and Restatements .....	11
Internal Control Allegations .....	12
Accounting Case Filings and Allegations of Internal Control Weaknesses .....	12
Accounting Case Settlements and Allegations of Internal Control Weaknesses .....	13
Factors Affecting Accounting Case Settlements .....	14
Median “Estimated Damages” .....	14
Median Settlement Amounts .....	15
Median Settlement Amounts as a Percentage of “Estimated Damages” .....	16
Research Sample .....	17
Endnotes .....	18

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## TABLE OF FIGURES

Figure 1: Filings and Settlements Summary Statistics .....	1
Figure 2: Filings and Share of Accounting Cases .....	2
Figure 3: Case Filings Disclosure Dollar Loss Index™ .....	3
Figure 4: Settlements and Share of Accounting Cases .....	4
Figure 5: Settlement Dollars and Share of Accounting Cases .....	5
Figure 6: Accounting Case Filings by Industry Sector .....	6
Figure 7: Accounting Case Settlement Dollars by Industry Sector .....	7
Figure 8: Accounting Case Filings and Restatements .....	8
Figure 9: Market Reaction Surrounding Restatement Announcements by Percent Change in Share Price .....	9
Figure 10: Disclosure Dollar Loss Index™ for Accounting Case Filings with Restatements .....	10
Figure 11: Accounting Case Settlements and Restatements .....	11
Figure 12: Accounting Case Filings and Allegations of Internal Control Weaknesses .....	12
Figure 13: Accounting Case Settlements and Allegations of Internal Control Weaknesses .....	13
Figure 14: Median “Estimated Damages” .....	14
Figure 15: Median Settlement Amounts .....	15
Figure 16: Median Settlement Amounts as a Percentage of “Estimated Damages” .....	16

## HIGHLIGHTS

In 2014, the number of accounting case filings rose, returning to historical levels. This increase is consistent with the SEC's focus on accounting fraud and a heightened market reaction surrounding restatements. Accounting settlements once again represented the majority of the number and value of total settlements.

- Accounting case filings<sup>1</sup> during 2014 increased by 47 percent compared to 2013, despite little change in the overall level of securities class action filings. [\(page 2\)](#)
- More than one in four accounting case filings referred to an SEC inquiry or action—the highest level since Cornerstone Research began tracking this variable in 2010. [\(page 2\)](#)
- Accounting case filings involving restatements increased to their highest level in the last seven years; both in terms of the number of filings (29) and as a percentage of total accounting cases (42 percent). [\(page 8\)](#)
- In 2014, market capitalization losses for accounting cases comprised half of the Disclosure Dollar Losses for all filings. [\(page 3\)](#)
- The proportion of settlements with accounting allegations increased over the prior year and represented the vast majority of the total value of settlements approved in 2014. [\(pages 4 and 5\)](#)
- While accounting case settlements associated with firms in the Financial sector waned in 2014, settlements in the Energy sector grew—emerging as the highest contributor to total settlement value. [\(page 7\)](#)

**FIGURE 1: FILINGS AND SETTLEMENTS SUMMARY STATISTICS  
2013–2014**

	Accounting Cases		Non-Accounting Cases	
	2014	2013	2014	2013
<b>Filings Summary</b>				
Number of Filings	69	47	101	119
Total Disclosure Dollar Losses	\$28.9B	\$44.8B	\$28.4B	\$58.7B
<b>Settlements Summary</b>				
Number of Settlements	44	44	19	22
Median Settlement	\$5.8M	\$4.3M	\$6.5M	\$17.7M
Average Settlement	\$20.6M	\$27.2M	\$8.6M	\$166.0M
Total Settlement Value	\$907.8M	\$1,212.0M	\$160.2M	\$3,636.0M

Note: In 2013 the majority of the total settlement value for non-accounting cases is represented by one large settlement. Without this case, the total value for non-accounting cases is \$1,171.7 million, and the median and average are \$15.5 million and \$56.6 million, respectively. Settlement dollars adjusted for inflation; 2014 dollar equivalent figures used.

## FILINGS AND SETTLEMENT ACTIVITY

### FILINGS AND SHARE OF ACCOUNTING CASES

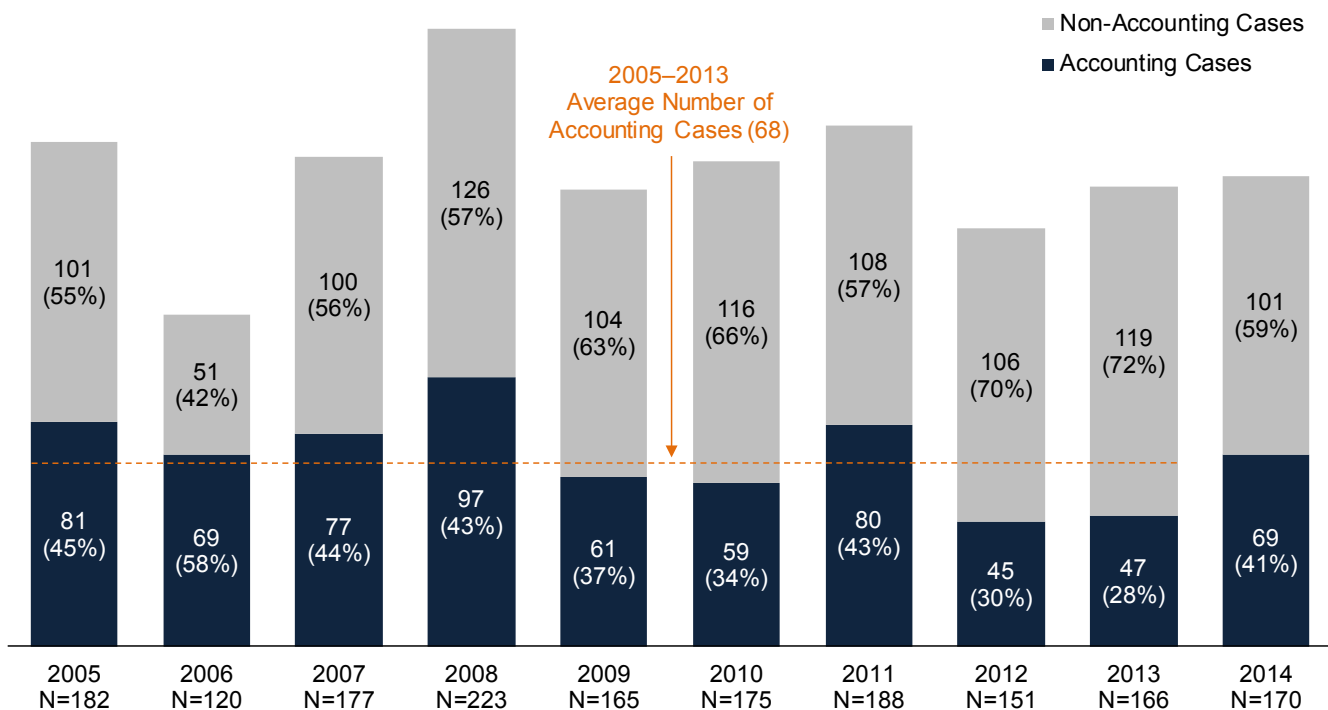
- There were 69 accounting case filings in 2014, compared with 47 in 2013—a 47 percent increase.
- The increase in accounting case filings occurred against the backdrop of a year marked by essentially no change in overall securities class action filing activity and the absence of new types of securities class actions, such as those that involve Chinese reverse mergers.<sup>2</sup>
- Consistent with the SEC’s increased focus on identifying accounting-related fraud, cases involving an SEC inquiry or action reached their highest level, both in terms of the number and percent of accounting case filings, since Cornerstone Research began tracking this variable in 2010.<sup>3</sup>

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In 2014, 18 accounting case filings referred to an SEC inquiry or action, compared to 5 in 2013.

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**FIGURE 2: FILINGS AND SHARE OF ACCOUNTING CASES 2005–2014**



## FILINGS AND MARKET CAPITALIZATION LOSSES

### Disclosure Dollar Loss (DDL) Index™

This index measures the aggregate DDL for all filings over a period of time. DDL is the dollar value change in the defendant firm’s market capitalization between the trading day immediately preceding the end of the class period and the trading day immediately following the end of the class period. DDL should not be considered an indicator of liability or measure of potential damages.

- The DDL Index for accounting case filings has fluctuated significantly over the past 10 years.
- The DDL Index declined significantly for all securities class action filings in 2014. However, the decline for accounting cases (35 percent) was less severe than the decline for non-accounting cases (52 percent).
- In 2014, accounting cases amounted to 50 percent of the DDL Index even though only 41 percent of all securities class actions filed were accounting cases.

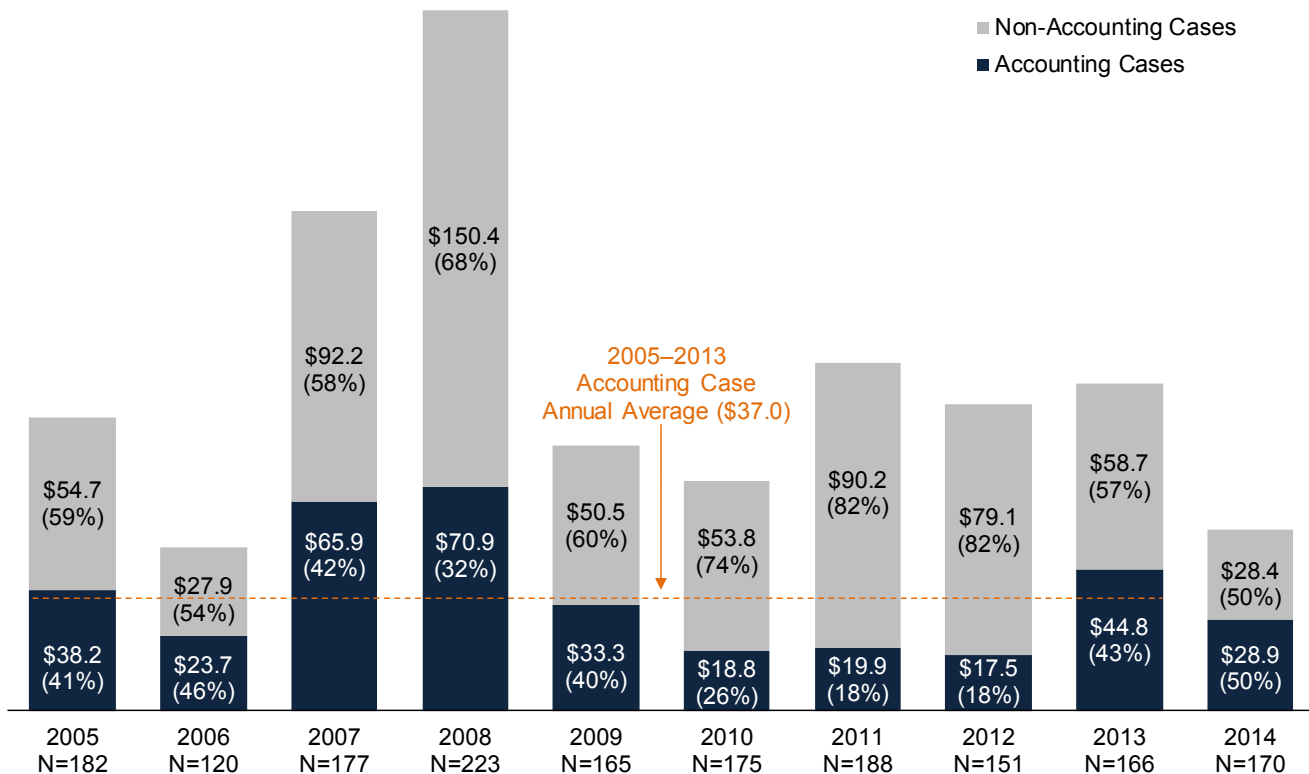
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For the first time in 10 years, the DDL Index for accounting case filings equaled that of non-accounting case filings.

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**FIGURE 3: CASE FILINGS DISCLOSURE DOLLAR LOSS INDEX™**  
**2005–2014**

(Dollars in Billions)



## SETTLEMENTS AND SHARE OF ACCOUNTING CASES

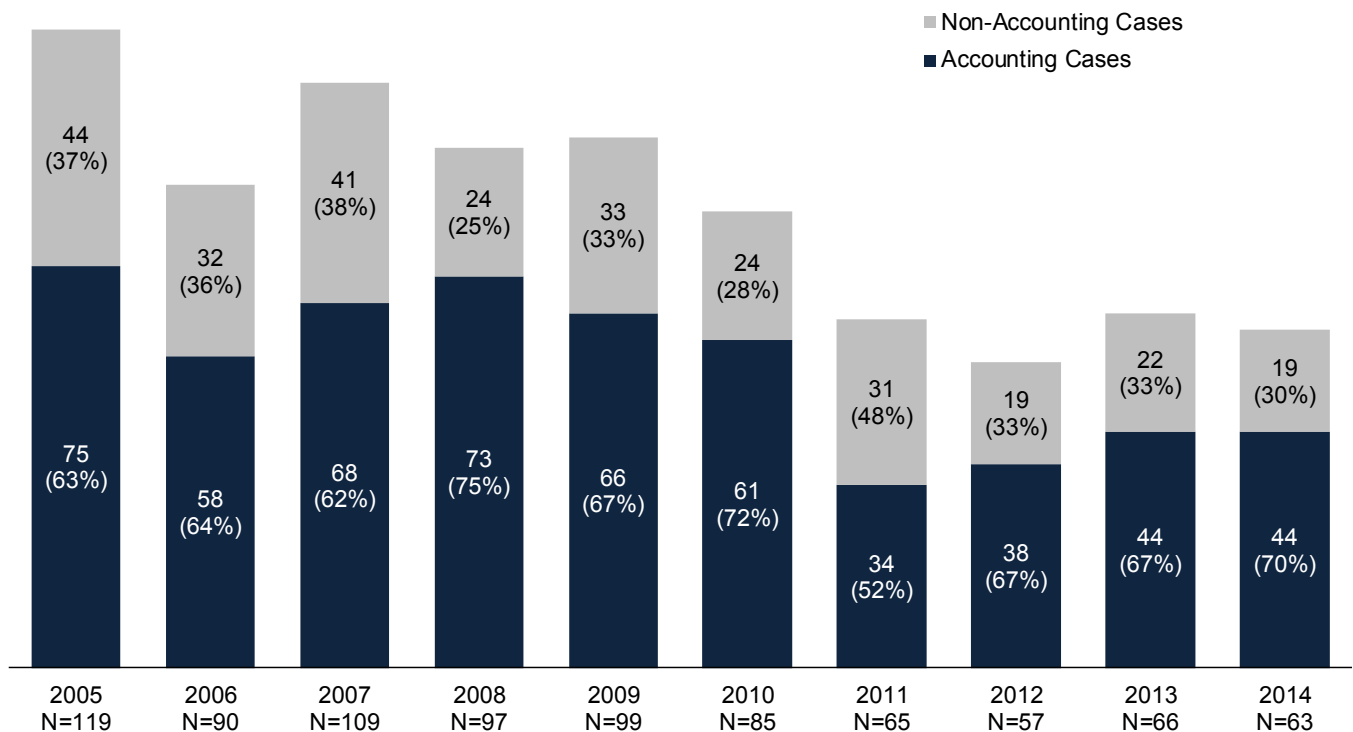
- In 2014, the proportion of settlements involving accounting cases reached its highest level since 2010.
- Despite the increase in the proportion of accounting case settlements, overall, the number of accounting case settlements has remained relatively low particularly compared to 2005–2010.
- In 2014, six settlements were for Chinese reverse merger cases,<sup>4</sup> all of which involved accounting allegations. This represents a decrease from 14 settlements in 2013, consistent with the dramatic decline of these cases in the last few years.

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The number of accounting case settlements has risen almost 30 percent since the decade’s low level in 2011.

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**FIGURE 4: SETTLEMENTS AND SHARE OF ACCOUNTING CASES 2005–2014**



## SETTLEMENT DOLLARS AND SHARE OF ACCOUNTING CASES

- Historically, accounting cases have represented the majority of the total value of cases settled. Following an unusual dip in 2013, this ratio returned to a more typical level in 2014—85 percent of the total value of settlements was associated with accounting cases.
- While the proportion of accounting case settlements increased, the total value of all securities class action settlements in 2014 reached a 16-year low.<sup>5</sup> As a result, the total value of accounting case settlements remained relatively low, and was comparable to the total value in 2013.

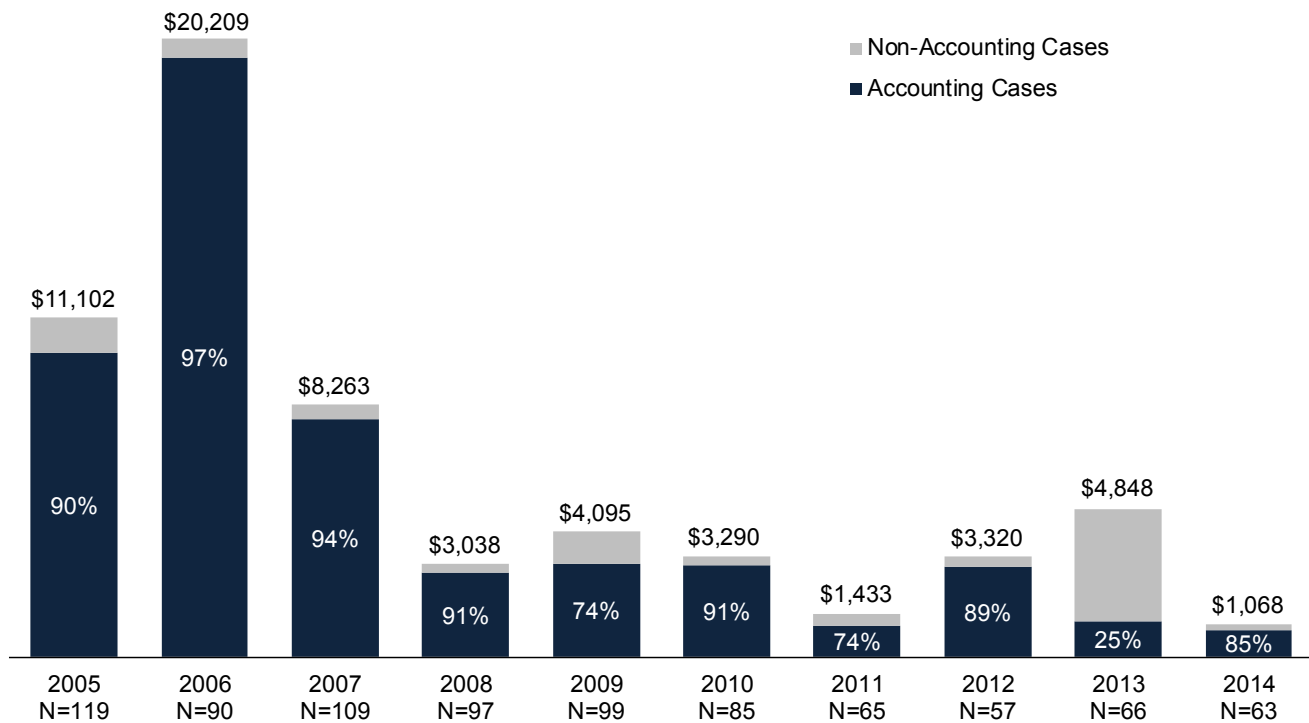
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The proportion of total settlement value attributable to accounting cases increased compared to 2013.

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**FIGURE 5: SETTLEMENT DOLLARS AND SHARE OF ACCOUNTING CASES 2005–2014**

(Dollars in Millions)



Note: Settlement dollars adjusted for inflation; 2014 dollar equivalent figures used.



## INDUSTRY SECTORS

### ACCOUNTING CASE FILINGS AND INDUSTRY SECTORS

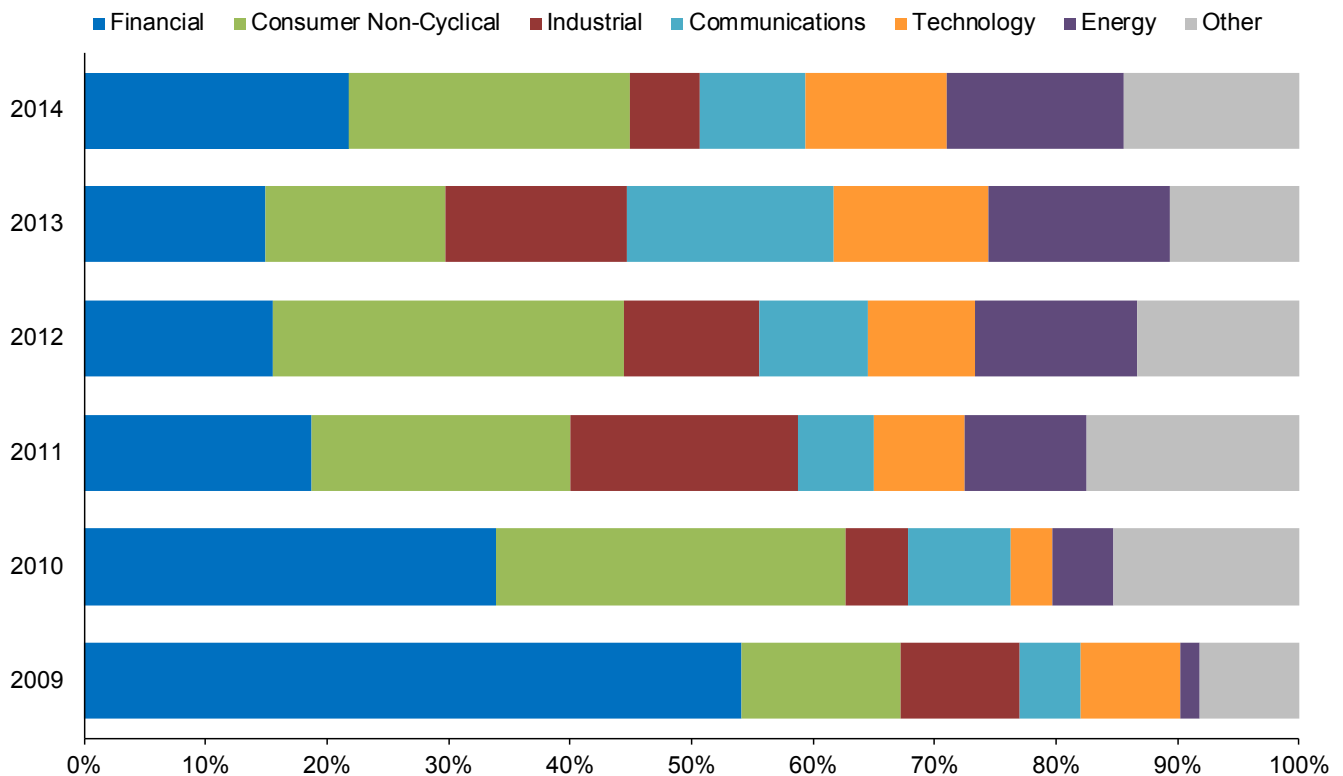
- After four years of declines, the number of accounting case filings against companies in the Financial sector more than doubled in 2014.
- The number of accounting case filings against companies in the Consumer sector also more than doubled in 2014, returning to historical levels.
- Of the 29 accounting case filings with restatements, 15 (52 percent) involved the Financial and Consumer sectors.

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More than half of accounting case filings with restatements involved the Financial and Consumer sectors.

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**FIGURE 6: ACCOUNTING CASE FILINGS BY INDUSTRY SECTOR 2009–2014**



## ACCOUNTING CASE SETTLEMENT DOLLARS AND INDUSTRY SECTORS

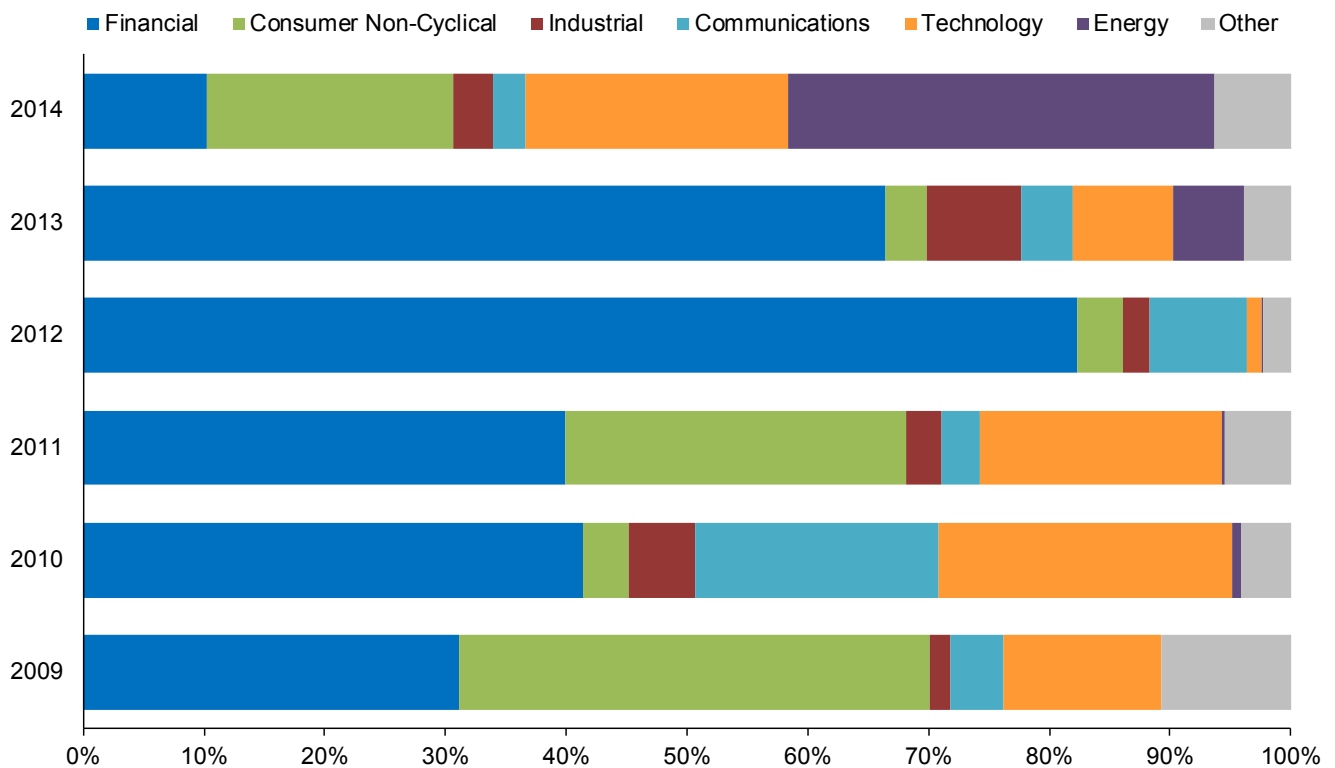
- The industry sectors contributing most to total accounting case settlement dollars have shifted over time. For a number of years, cases in the Technology sector constituted the largest portion of settlement dollars. Later, as a result of the credit crisis, the Financial sector grew to contribute the majority of accounting case settlement dollars.
- The substantial decrease in settlement dollars associated with the Financial sector in 2014 reflects the fact that the majority of credit-crisis cases were resolved in prior years.
- The increase in the value of settled Energy sector cases is primarily due to the presence of two large settlements in 2014, comprising 30 percent of the total value of accounting case settlements.

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For the first time, the Energy sector emerged as the largest contributor to accounting case settlement value.

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**FIGURE 7: ACCOUNTING CASE SETTLEMENT DOLLARS BY INDUSTRY SECTOR 2009–2014**



## ACCOUNTING RESTATEMENTS

### ACCOUNTING CASE FILINGS AND RESTATEMENTS

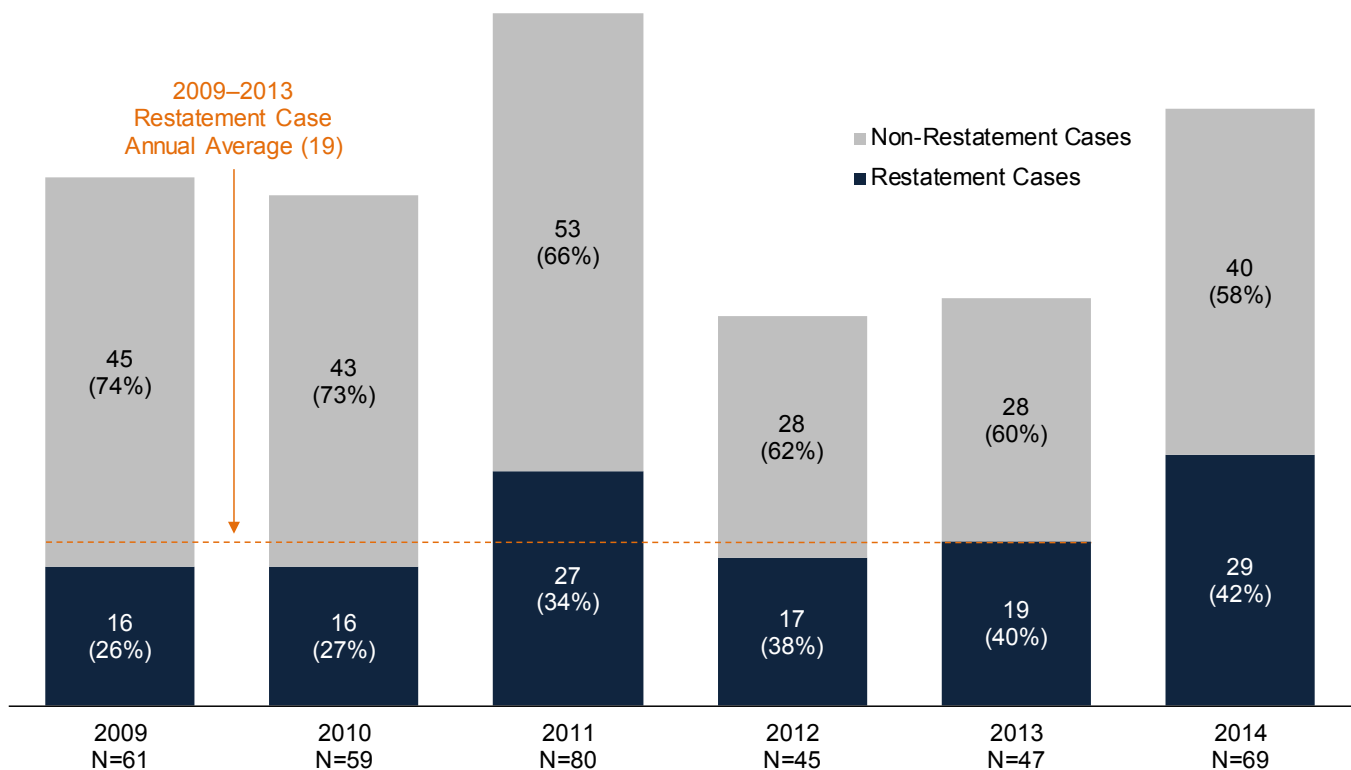
- Both the number (29) and percentage (42 percent) of accounting case filings with restatements increased in 2014.
- The increase in accounting case filings is consistent with data showing that the number of restatements by accelerated filers (i.e., large companies that are heavily targeted in securities class actions) has increased in recent years.<sup>6</sup>

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Accounting case filings with restatements increased to the highest level in the last 7 years.

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**FIGURE 8: ACCOUNTING CASE FILINGS AND RESTATEMENTS 2009–2014**



## MARKET REACTIONS SURROUNDING RESTATEMENT ANNOUNCEMENTS

Research through 2012 shows that stock market reactions in response to announcements of financial statement restatements peaked in 2009, with declines in subsequent years.<sup>7</sup> Possible contributors to the reduced responses include a change in the nature of restatements (considered more benign by investors), as well as reduced stock market volatility. New analysis included in this year’s report extends prior research to include 2013 and 2014, and finds a rebound in the severity of stock price drops surrounding restatements in 2014.<sup>8</sup>

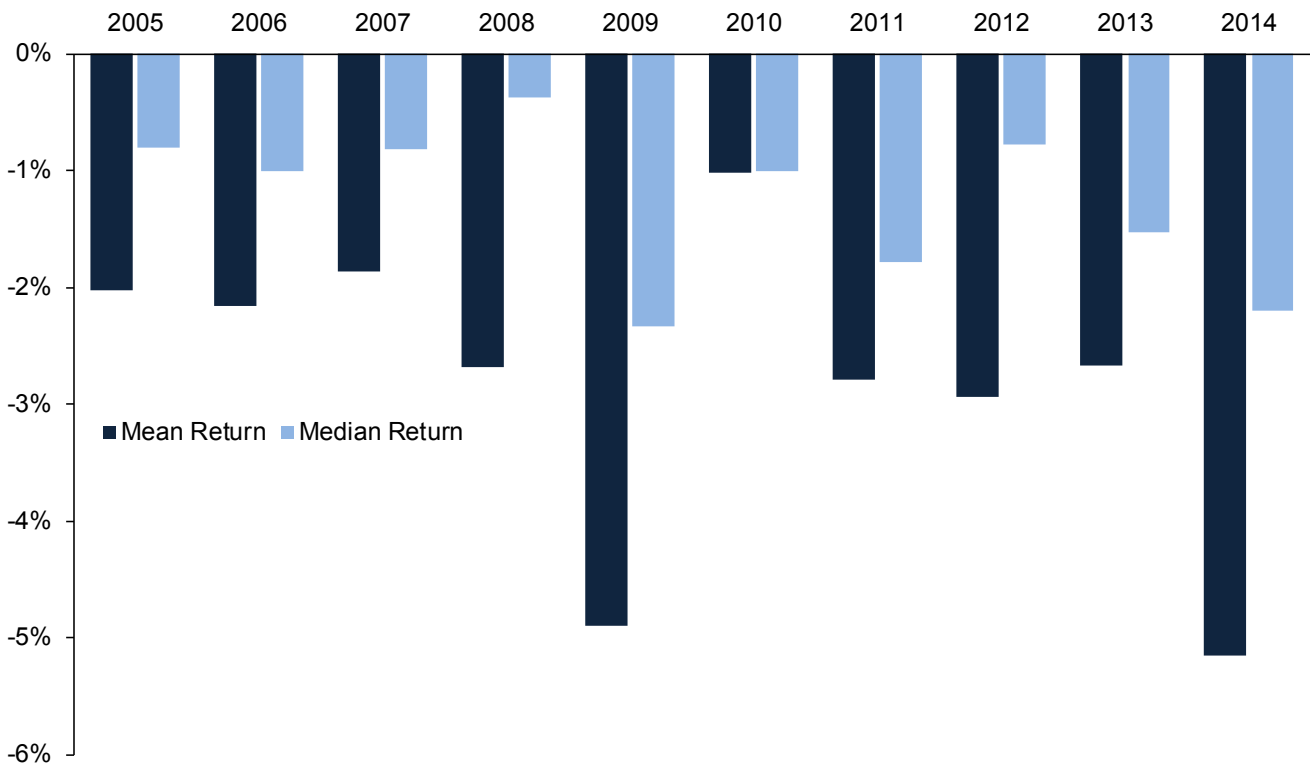
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In 2014, the mean stock price drop surrounding announcements of restatements was the most severe in the last 10 years.

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- The median stock price drop surrounding announcements of financial statement restatements was the second highest in the last 10 years.
- The substantial negative stock price movement surrounding financial statement restatement announcements in 2014 is consistent with the relatively high DDL associated with filings of restatement cases in 2014 (discussed on the following page).

**FIGURE 9: MARKET REACTION SURROUNDING RESTATEMENT ANNOUNCEMENTS BY PERCENT CHANGE IN SHARE PRICE 2005–2014**



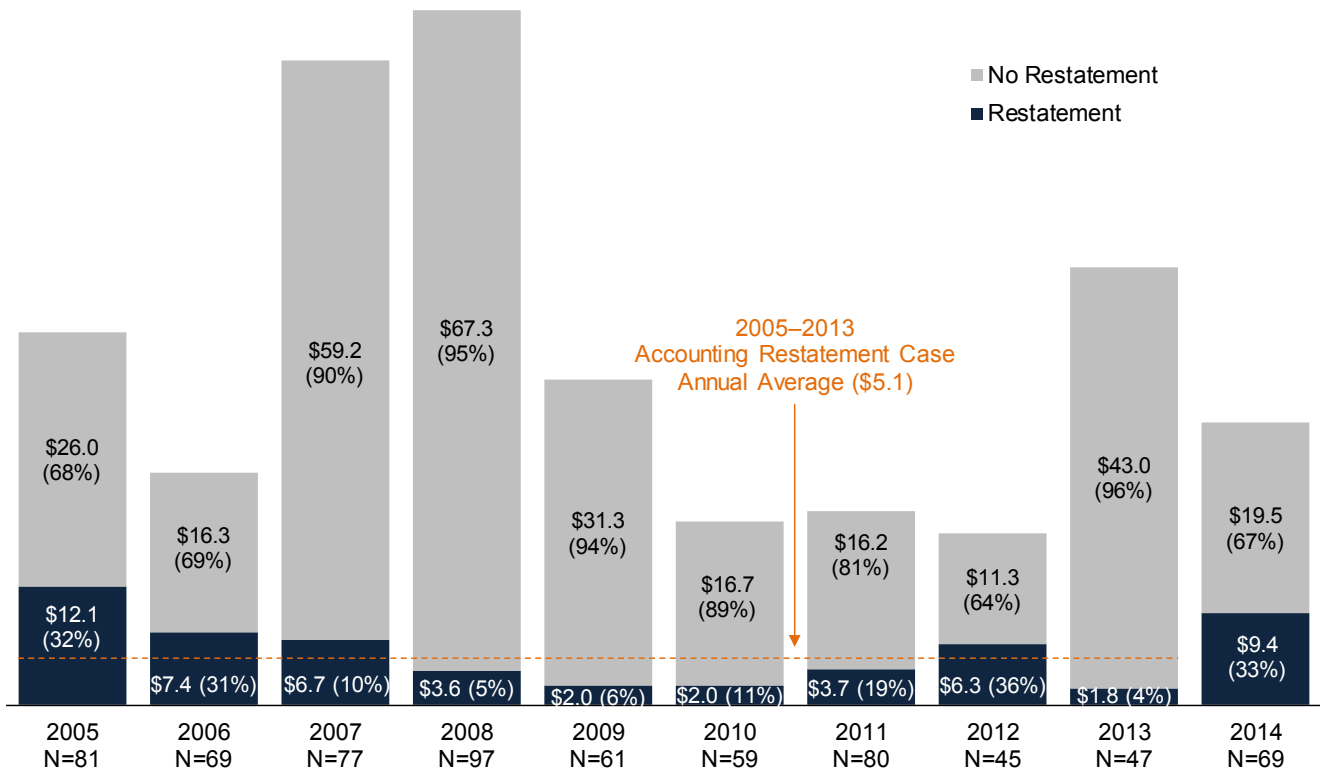
Note: Limited to financial statement restatements that required an 8-K filing with the SEC (i.e., Item 4.02 restatements).

**DISCLOSURE DOLLAR LOSS INDEX™  
FOR ACCOUNTING CASE FILINGS WITH RESTATEMENTS**

- The DDL Index for accounting case filings with restatements in 2014 was over 80 percent greater than the average between 2005 and 2013.
- The higher DDL for these cases was likely a function of not only the increased number of accounting case filings involving restatements, but the more severe market reaction surrounding restatement announcements in 2014 discussed on the previous page.

The DDL Index for accounting case filings with restatements increased to its highest dollar level since 2005.

**FIGURE 10: DISCLOSURE DOLLAR LOSS INDEX™  
FOR ACCOUNTING CASE FILINGS WITH RESTATEMENTS  
2005–2014**  
(Dollars in Billions)



## ACCOUNTING CASE SETTLEMENTS AND RESTATEMENTS

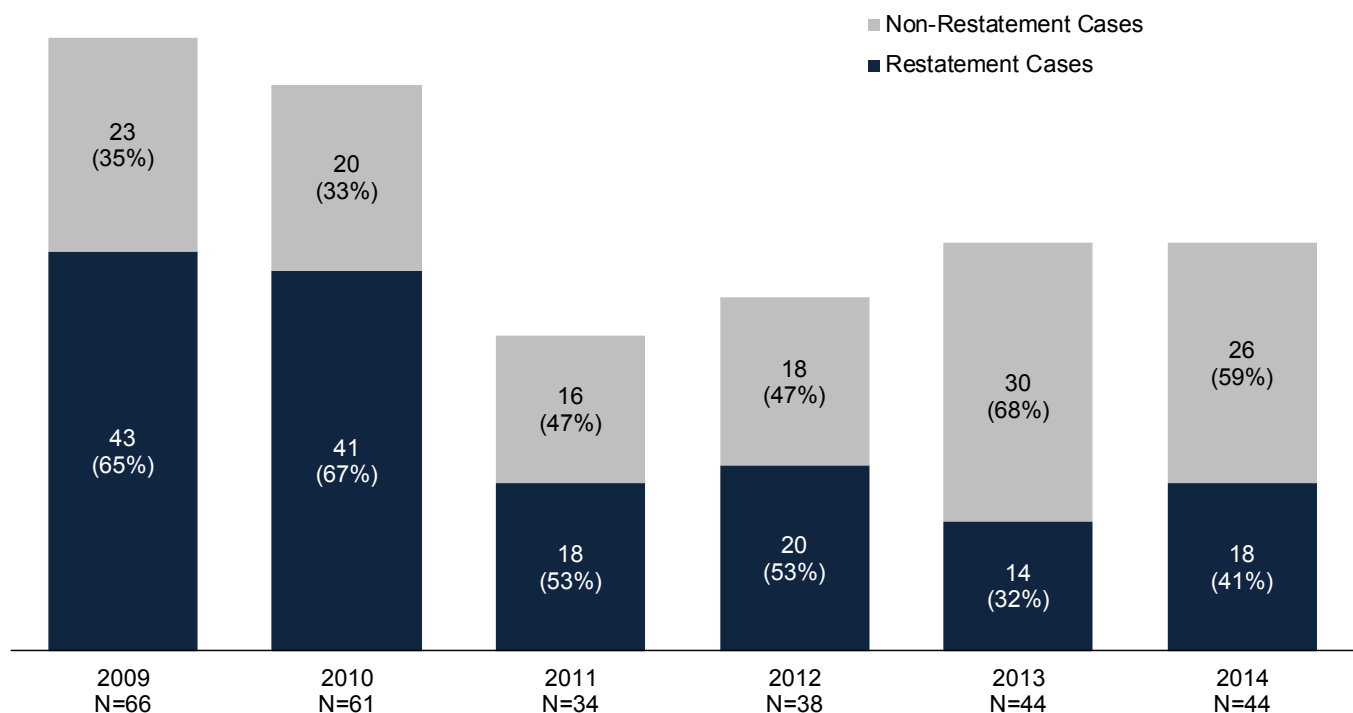
- In 2014, the number (18) and proportion (41 percent) of accounting case settlements involving restatements increased compared with 2013, but remained low relative to the previous decade.
- The current-year increase in case filings involving financial statement restatements has not yet resulted in an increase in settlements involving these issues, since cases often take several years to reach a settlement.
- Of the cases that were settled in 2014 involving restatements, two-thirds were filed in 2011 and 2012. This is consistent with the typical time to reach settlement (two to four years) and the higher proportion of case filings in 2011 and 2012 involving restatements compared to 2009 and 2010 (Figure 8).

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The proportion of accounting case settlements involving restatements increased in 2014.

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FIGURE 11: ACCOUNTING CASE SETTLEMENTS AND RESTATEMENTS  
2009–2014



## INTERNAL CONTROL ALLEGATIONS

### ACCOUNTING CASE FILINGS AND ALLEGATIONS OF INTERNAL CONTROL WEAKNESSES

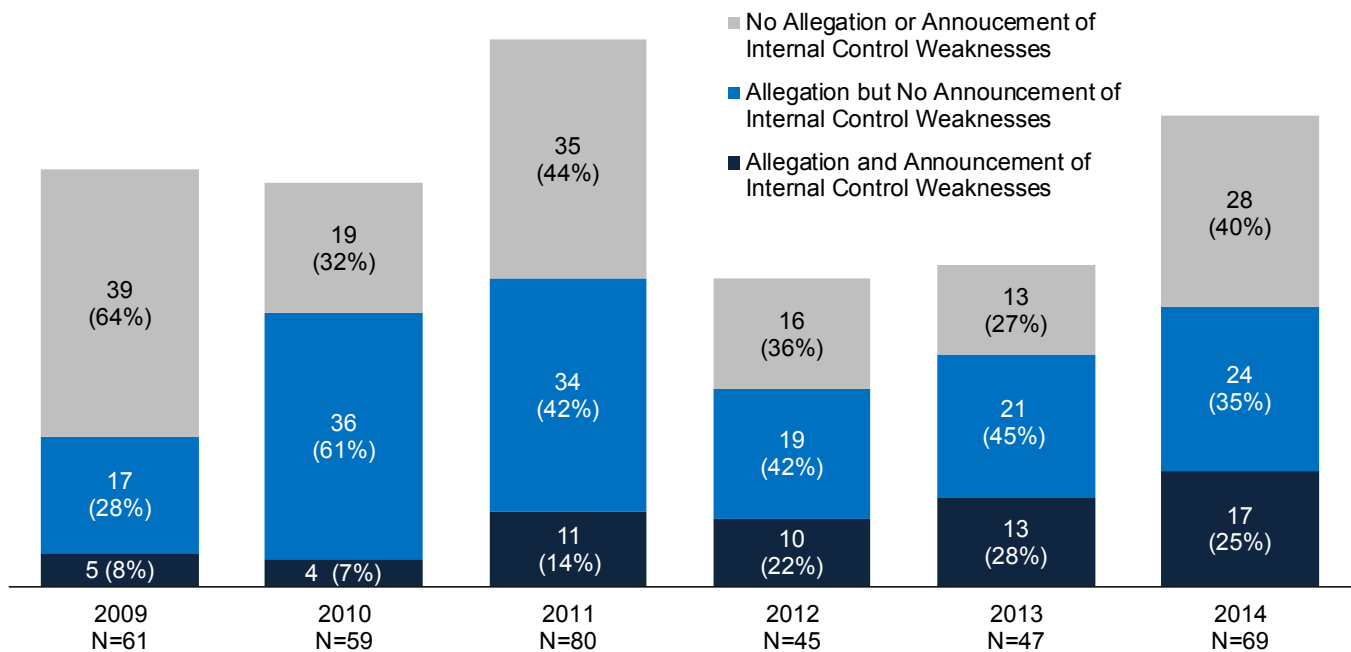
- Since 2010, the majority of accounting case filings have included allegations of internal control weaknesses. This trend continued in 2014, with 60 percent of accounting case filings involving these allegations.
- For the past two years, the number of accounting case filings involving allegations of internal control weaknesses has increased.
- Of the 29 accounting case filings that included a restatement, two in three also included allegations of weaknesses in internal controls.

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The number of accounting case filings with announcements of internal control weaknesses was higher than any of the previous 5 years.

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**FIGURE 12: ACCOUNTING CASE FILINGS AND ALLEGATIONS OF INTERNAL CONTROL WEAKNESSES 2009–2014**



## ACCOUNTING CASE SETTLEMENTS AND ALLEGATIONS OF INTERNAL CONTROL WEAKNESSES

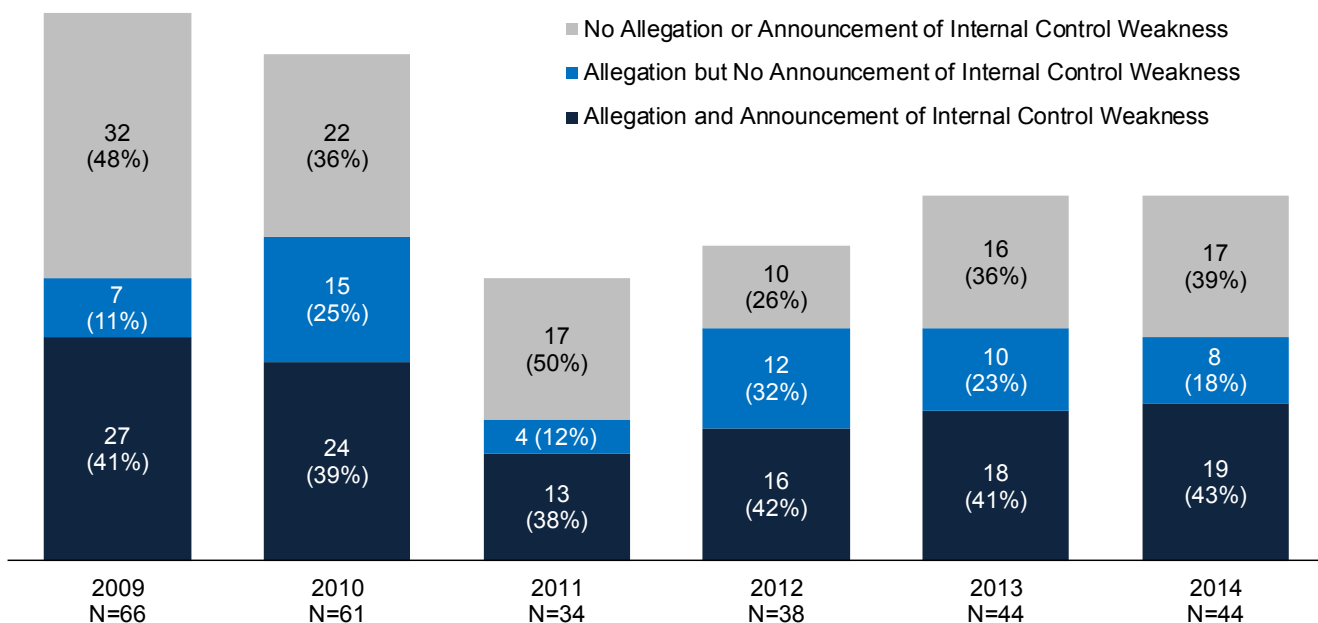
- In 2014, the proportion of accounting case settlements involving internal control allegations remained relatively consistent with the last two years.
- The proportion of settlements involving company announcements of an internal control weakness has fluctuated within a narrow range of 38 to 43 percent. In contrast, the proportion of settled cases in which plaintiffs alleged internal control weaknesses without the presence of company announcements acknowledging any weaknesses shows more variation (11 to 32 percent).
- On average, settlements as a percentage of “estimated damages” (described on the following page) for cases involving both allegations and company announcements of internal control weaknesses have been over 60 percent greater than the percentage for cases with these allegations but without an announcement.

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**27 settlements in 2014 involved allegations of internal control weaknesses.**

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**FIGURE 13: ACCOUNTING CASE SETTLEMENTS AND ALLEGATIONS OF INTERNAL CONTROL WEAKNESSES 2009–2014**





## FACTORS AFFECTING ACCOUNTING CASE SETTLEMENTS

### MEDIAN “ESTIMATED DAMAGES”

This section examines case attributes across different types of allegations and accounting issues, with comparisons to non-accounting cases.<sup>9</sup> The measure “estimated damages” is discussed in detail in [Securities Class Action Settlements—2014 Review and Analysis](#) and is the most important factor in predicting settlement amounts. As a brief overview, this measure is a simplified calculation of shareholder losses measured consistently across years; thus, it is not intended to represent alleged damages incurred by shareholders but enables the identification and analysis of potential trends.<sup>10</sup>

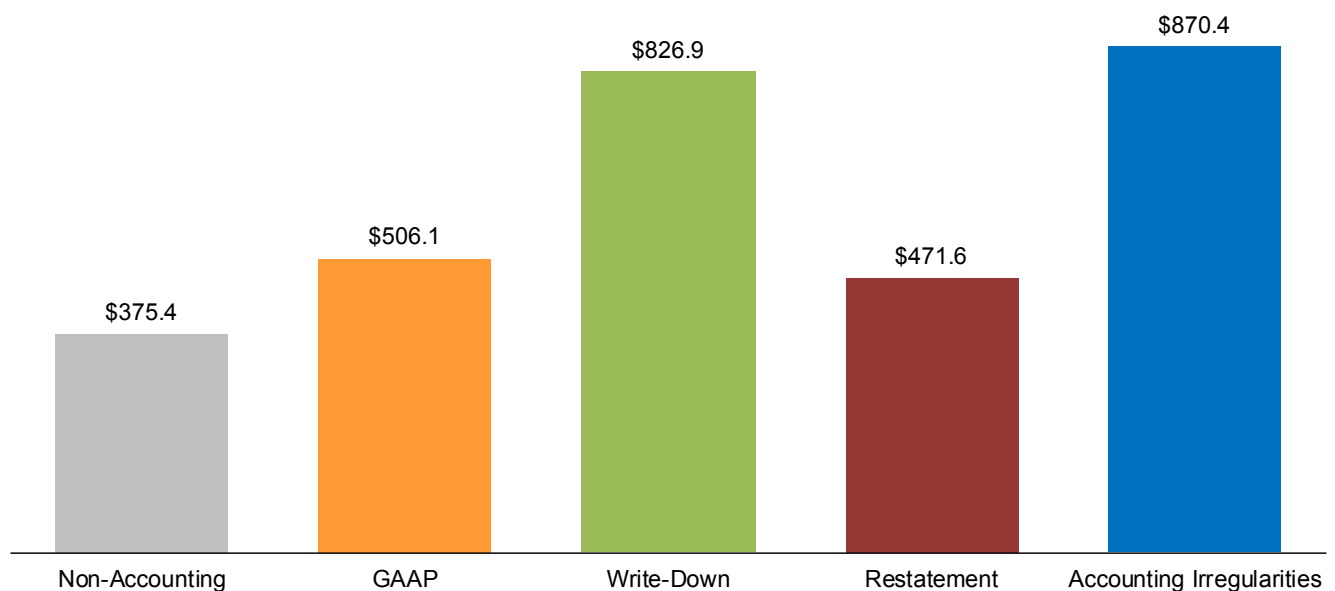
- The trend of accounting cases generally involving higher “estimated damages” continued in 2014.
- While cases involving reported accounting irregularities are relatively infrequent (five such cases in 2014), they are associated with the highest median “estimated damages.”
- Cases involving allegations of asset write-downs continued to rank a close second in median “estimated damages,” driven in part by the fact that these cases often have involved large financial institutions (larger firms tend to be associated with higher “estimated damages”).

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Accounting cases typically involve higher median “estimated damages” than cases without accounting-related allegations.

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**FIGURE 14: MEDIAN “ESTIMATED DAMAGES”**  
**2009–2014**  
*(Dollars in Millions)*



Note: “Estimated Damages” are adjusted for inflation based on class period end dates. Allegations of write-downs, restatements, and accounting irregularities are subsets of GAAP.

## MEDIAN SETTLEMENT AMOUNTS

- Consistent with their higher median “estimated damages,” cases involving accounting irregularities have settled for the highest amounts, with write-downs the second highest, compared to accounting cases not involving these allegations.
- Although median settlement amounts for restatement cases are only slightly higher than GAAP cases not involving restatements, regression analyses (which allow multiple factors to be examined simultaneously) reveal that the presence of a restatement is a significant factor in explaining higher settlement amounts.<sup>11</sup>
- Cases involving accounting issues tend to be associated with accompanying SEC actions and accompanying derivative actions, both of which are also associated with higher median settlement amounts.

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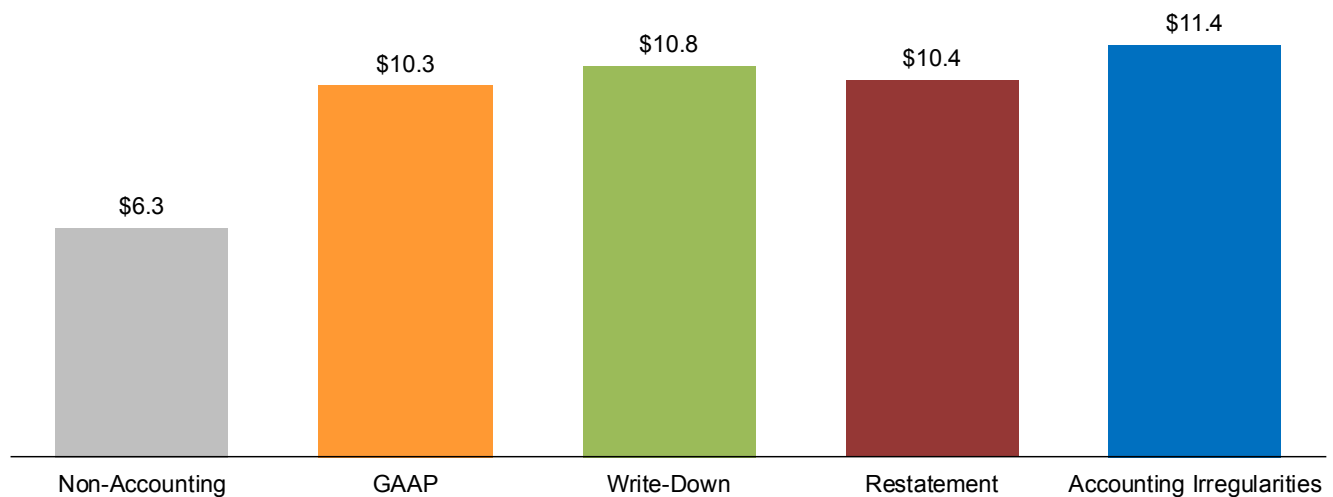
Overall, the median settlement amount for accounting cases has been higher than for non-accounting cases.

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**FIGURE 15: MEDIAN SETTLEMENT AMOUNTS**

**2009–2014**

*(Dollars in Millions)*



Note: Settlement dollars adjusted for inflation; 2014 dollar equivalent figures used. Allegations of write-downs, restatements, and accounting irregularities are subsets of GAAP.

## MEDIAN SETTLEMENT AMOUNTS AS A PERCENTAGE OF “ESTIMATED DAMAGES”

Since settlement amounts are largely driven by shareholder losses, it is useful to consider settlement amounts in relation to “estimated damages.”

- Across the different types of accounting allegations, median settlements as a percentage of “estimated damages” show more variation than median settlement amounts.
- Overall, cases with lower “estimated damages” tend to have higher settlements as a percentage of “estimated damages.” Since restatement cases usually have lower “estimated damages” than other types of accounting cases, their settlements as a percentage of “estimated damages” tend to be higher. Similarly, cases involving write-downs have settled for the smallest proportion of “estimated damages,” reflecting the fact that they tend to have relatively high “estimated damages.”
- Write-downs involve estimates such as asset impairments and reserve increases. These items are inherently more subjective, potentially making it more difficult for plaintiffs to substantiate claims of wrongdoing in these cases.

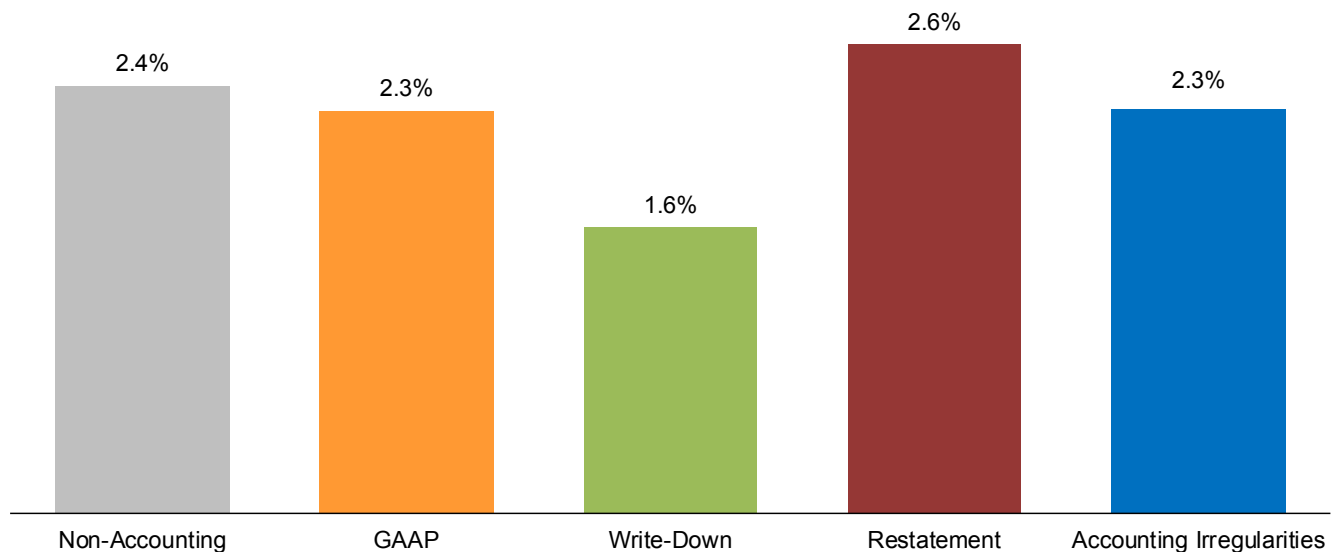
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Cases involving restatements have settled for the highest percentage of “estimated damages.”

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**FIGURE 16: MEDIAN SETTLEMENT AMOUNTS AS A PERCENTAGE OF “ESTIMATED DAMAGES”**

**2009–2014**



Note: Allegations of write-downs, restatements, and accounting irregularities are subsets of GAAP.

## RESEARCH SAMPLE

This report utilizes the databases described in [Securities Class Action Filings—2014 Year in Review](#) and [Securities Class Action Settlements—2014 Review and Analysis](#).

## ENDNOTES

- <sup>1</sup> For purposes of this research, cases are considered “accounting cases” if they include allegations related to Generally Accepted Accounting Principles (GAAP) violations, auditing violations, or weaknesses in internal control over financial reporting. In some cases, plaintiff(s) may not have expressly referenced GAAP; however, the allegations, if true, would represent GAAP violations.
- <sup>2</sup> See [Securities Class Action Filings—2014 Year in Review](#), Cornerstone Research.
- <sup>3</sup> Last year’s report observed the emergence of increased SEC enforcement efforts directed toward the identification of accounting-related fraud, as made apparent by SEC public statements, as well as the formation of the Financial Reporting and Audit Task Force in July 2013. These efforts were expected not only to ultimately result in increased SEC enforcement actions but to potentially impact the volume of private securities class actions involving accounting issues. See [Accounting Class Action Filings and Settlements—2013 Review and Analysis](#), Cornerstone Research, 2014.
- <sup>4</sup> See [Investigations and Litigation Related to Chinese Reverse Merger Companies](#), Cornerstone Research, 2011.
- <sup>5</sup> See [Securities Class Action Settlements—2014 Review and Analysis](#), Cornerstone Research, 2015.
- <sup>6</sup> See *2013 Financial Restatements: A Thirteen Year Comparison*, Audit Analytics, April 2014.
- <sup>7</sup> See Susan Scholz, *Financial Restatement Trends in the United States: 2003–2012*, Center for Audit Quality, 2014.
- <sup>8</sup> Analysis is based on the percentage change in stock price net of overall market returns calculated over a two-day window including the announcement day and the following day, as identified by data provided by Audit Analytics. The analysis is limited to firms for which stock price data were available from the Center for Research in Security Prices (CRSP) during the relevant time period (e.g., excludes firms that traded over-the-counter or were delisted).
- <sup>9</sup> The accounting allegations and issues analyzed are: (1) GAAP—cases with allegations of GAAP violations; (2) Write-Down—cases with allegations involving an asset write-down or reserve increase; (3) Restatement—cases involving a restatement (or announcement of a restatement) of financial statements; and (4) Accounting Irregularities—cases in which the defendant has reported the occurrence of accounting irregularities (intentional misstatements or omissions) in its financial statements.
- <sup>10</sup> As described in [Securities Class Action Settlements—2014 Review and Analysis](#), “estimated damages” are not necessarily linked to the allegations included in the associated court pleadings. Accordingly, damages estimates presented in this report are not intended to be indicative of alleged economic damages incurred by shareholders.
- <sup>11</sup> See [Securities Class Action Settlements—2014 Review and Analysis](#), Cornerstone Research, 2015.

Please reference Cornerstone Research in any reprint of the figures or findings included in this report.

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