

Case Study 8	Earnings management
Outline of the case	
<p><i>You are the Financial Controller in a family business, though in reality you would be considered to be the Finance Director. After some financial difficulties a bank and a venture capitalist have invested and acquired over 33% of the shares*, but no Board seats. The continuing support of the Bank and Venture Capitalist are dependent on performance figures being achieved. You have been told that if you put in the “right” figures you will get a large bonus and 1% share option.</i></p> <p><i>The company is secretive and as little information as possible being given to the auditors and the investors. You believe that some figures may be being ‘massaged’. You have tentatively raised your concerns with the father and son Chairman and Chief Executive. You have been told that if you pursue the matter and/ or fail to put in the right figures you will lose the bonus and share option.</i></p>	
Key fundamental principles	
<p>Integrity – <i>Can you support the business without being involved in potentially misleading information?</i></p> <p>Objectivity - <i>How can you avoid your financial interest* influencing your professional judgement?</i></p> <p>Professional Behaviour - <i>How will you manage relationships with the affected parties?</i></p>	
Discussion	
<p><i>Identify relevant facts: Consider the business’ policies, procedures and guidelines, accounting standards, applicable laws and regulations. Double check your facts, including forecast figures and the assumptions underlying them. Consider whether the culture of secrecy means that you are not in possession of material facts and challenge the management if necessary.</i></p> <p><i>Identify affected parties: Key parties are you, the family, professional advisers, bankers and venture capitalists. Other possible affected parties are your family, the Institute and the profession.</i></p> <p><i>Who should be involved in resolution: Consider not just whom you should involve, but also why and when. Are there trusted colleagues or friends with whom you can discuss your position? Can your Institute provide advice and assistance? Have you discussed the matter with your family?</i></p>	
Possible course of action	
<p><i>Discount the short-term financial benefits on offer. Prepare a range of forecasts for the family, and impress on them the implications of short-term manipulation in the long term. Encourage the family to focus on the underlying business issues, and address them to enhance long term value. Draw up realistic figures for presentation, and explain how your professional standing demands that these be presented. Do not become involved in manipulation, and do not allow your name to be associated</i></p>	

with figures not prepared by you. Consider whether the values of the organisation are consistent with your own, and if necessary your employment options.

During the resolution process, it may be helpful to document the substance of the discussions held, who was involved, what decisions were made and why, and your involvement.