

Using Communication Theory to Teach SOX Reporting Requirements

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ABSTRACT: This paper presents an instructional resource and provides suggestions for its implementation. The resource demonstrates a method for teaching students how communication in required SOX Section 404 reports can impact stakeholders' perceptions of that organization. Students read portions of selected 10-K, 10-Q, and corporate annual reports in which management responds to disclosed internal control material weaknesses. Students then analyze these excerpts according to a well-known image restoration strategy. This assignment enhances written communication skills, analytical skills, research skills, and deepens students' understanding of Sarbanes-Oxley 404 requirements and of corporate image restoration strategies. The instructional resource would be beneficial in auditing, intermediate, or advanced accounting, as well as a graduate-level accounting course.

Keywords: Sarbanes-Oxley; communication theory; image restoration.

INTRODUCTION

Professors often tell their accounting students that good communication skills are essential in the business world, which explains why they assign writing projects, require class presentations, and evaluate student knowledge by using essay examinations. These means of stressing the importance of written and oral communication all involve assessing the content of accounting information, whether it entails answering essay questions about a particular audit standard, presenting literature on fraud, or preparing a research paper on the new codification standards. Such assignments and examinations are important because they help measure student learning; however, *how* we communicate professionally also deserves attention. In other words, “how we say it” can be just as important as “what we know.” This is especially true when a company’s reputation is tarnished by audit findings, including material weaknesses in internal controls.

Image restoration strategies are important for accounting professionals, as well as public relations experts. This paper provides a means of teaching audit students how communication in required SOX Section 404 reports can affect stakeholders’ perceptions of that organization. Students read excerpts of selected 10-K, 10-Q, and corporate annual reports where management

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provides responses to disclosed internal control material weaknesses. These excerpts are then analyzed according to a typology (Benoit 1995, 1997) used by communication scholars to evaluate responses to events that tarnish a company's image. The essay questions are written to be used in conjunction with chapters on internal control in an audit course, but may also be applicable in other upper-level financial accounting courses. Each exercise requires that a student demonstrate his/her knowledge about internal control weaknesses and SOX 404, identify the management communication strategies that were employed, and analyze any potential problems with those responses. Some exercises also ask the student to locate the annual reports of subsequent years in order to determine whether the material weaknesses were corrected. Additional questions and activities, including readings in academic and practitioner journals, are provided for use in an advanced undergraduate or a graduate-level course.

The remainder of the paper is organized as follows. First, we provide background material on Sarbanes-Oxley and Benoit's (1995, 1997) image restoration typology to be used in conjunction with the exercises. Following the background material, we provide a sample exercise and solution to be used for classroom discussion. Then, we provide three additional exercises for students to complete, with additional questions and readings for students in advanced undergraduate or graduate-level courses. The exercises are followed by learning objectives and implementation guidance. Suggested responses for each exercise are provided in the Teaching Notes.

BACKGROUND MATERIAL: SARBANES-OXLEY AND BENOIT'S IMAGE RESTORATION TYPOLOGY

Sarbanes-Oxley and Financial Reporting

The Public Accounting Reform and Investor Protection Act, also known as the Sarbanes-Oxley Act (SOX), requires the implementation of Section 404 (Enhanced Financial Disclosures, Management Assessment of Internal Control) that mandates management disclose the company's assessment of its internal controls and that a corresponding opinion by the firm's auditor be included. According to Section 404, any internal control weaknesses are disclosed and classified into three categories defined by auditing standards—control deficiencies, significant deficiencies (must be reported to the firm's auditor), and material weaknesses (must be disclosed to the auditor and to the public). These internal control deficiencies are assessed along two dimensions, the likelihood of misstatement and the significance of the potential misstatement, to determine their relative significance. When a deficiency results in more than a remote likelihood of a material error, the deficiency is classified as a material weakness.

Securities and Exchange Commission (SEC) rules require that companies report the following annually under Section 404 (Ramos 2004):

1. A statement of management's responsibilities for establishing and maintaining an adequate system.
2. The identification of a framework (such as COSO) used to evaluate the internal controls.
3. A statement as to whether the internal control system is effective as of year-end.
4. The disclosure of any material weaknesses in the internal control system.
5. A statement that the company's external auditors have issued an audit report on management's assessment of its internal controls.

When a company determines that material weaknesses in internal control exist at year-end, it must disclose this fact. A report of material weaknesses typically includes (Ramos 2004):

1. The fact that management has identified material weakness(es).
2. A definition of "material weakness."
3. The actions taken by the company (if any) to correct the weakness(es).

When a company reports internal control weaknesses under SOX 404, management's responses to the internal control weaknesses provide insight into how the company intends to change and improve internal controls. These responses also communicate the firm's image. Material internal control weaknesses can provide information about a potential pre-crisis situation in that a failure of the firm to correct the weaknesses can result in a loss of investor and creditor confidence in the firm's financial statements or even in business failure. Management must first acknowledge why material weaknesses exist before they can correct the weaknesses. By strategically managing the situation through reliable, credible, and transparent communication, a corporation addresses stakeholders' anxieties, manages its corporate image, and restores its reputation (Geppert and Lawrence 2008). By studying management responses to material weaknesses, we gain insight into how serious management is about taking the necessary actions to eliminate these weaknesses.

Benoit's Image Restoration Typology

Benoit's (1995, 1997) typology is the one used most often by communication researchers to analyze strategic responses to legitimacy issues. Benoit's (1995) five categories of image restoration include denial, evasion of responsibility, reducing the offensive act, taking corrective action, and mortification. The five categories include 14 unique communication (response) strategies, as shown in Table 1.

Denial can come in two forms, one of which is simple denial, which is an outright refutation that the organization had any part in the crisis or was responsible in any way. The other type of denial is shifting the blame, or asserting that someone (or something) else is responsible for the

TABLE 1
Benoit's Image Restoration Typology

Categories	Strategy	Description/example
Denial	1. Simple denial	1. Refuting outright that the organization had any part in the event
	2. Shifting the blame	2. Asserting that someone else is responsible
Evasion of responsibility	3. Scapegoating	3. Blaming the event on the provocation of another
	4. Defeasibility	4. Not knowing what to do; lacking knowledge to act properly
	5. Accident	5. Claiming the event was "accidental"
	6. Good intentions	6. Claiming the company had good intentions
Reducing the offensive act	7. Image bolstering	7. Using puffery to build image
	8. Minimization	8. Stating the crisis is not bad
	9. Differentiation	9. Indicating that this crisis is different from more offensive crises
	10. Transcendence	10. Asserting good acts far outweigh the damage of this one crisis
	11. Reducing the credibility	11. Maintaining the accuser lacks credibility
Taking corrective action	12. Compensation	12. Paying the victim; making restitution to set things to where they were before the event
	13. Corrective action	13. Taking measures to prevent event from reoccurring
Mortification	14. Mortification	14. Admitting guilt and apologizing

Source: Benoit (1995).

problem. Denial is the best strategy if the firm is truly blameless. If the firm uses a denial strategy and later is found responsible for the crisis, its reputation can be irreparably damaged.

If denial is not an appropriate strategy, the organization can choose to use one or more of four evasion of responsibility strategies. The first is scapegoating, which involves blaming the crisis on the provocation of another. Other evasion strategies include defeasibility (in which the organization did not know what to do or lacked the ability to act properly), claiming the crisis was accidental, or that the organization had good intentions and therefore should be exonerated. If a company cannot evade a responsibility that clearly exists, the company can reduce the offensiveness of the act, which can include image bolstering (puffery), minimization (the crisis is not very bad), differentiation (this crisis was different from more offensive crises), transcendence (the good we do as an organization far outweighs the damage done by this one crisis), reducing the credibility of the accuser, and victim compensation. In the case of material weaknesses, victim compensation is not possible because no known loss has yet occurred. A lack of internal control is a warning that possible losses can occur in the future if such weaknesses are not detected and corrected in a timely manner.

Corrective action is Benoit's (1995, 1997) fourth strategy, in which the organization tries to make amends for the wrong that was committed and takes measures to prevent the event from recurring. Corrective action is the most viable strategy because the firm addresses the source of the problem, explains how changes will eliminate future occurrences of the problem, and implements a remediation plan. When corrective action is used, management accepts its responsibility to eliminate problems before they can result in a crisis. The final strategy proposed by Benoit (1995, 1997) is mortification, in which the organization admits it was at fault and apologizes to the victims.

EXERCISES: CLASSROOM EXAMPLE AND ASSIGNMENTS

The following section contains an example from a company's 10-K report that illustrates various communication strategies managers use to respond to material weaknesses in internal control over financial reporting,¹ with an example of an analysis of these strategies according to Benoit's (1995) image restoration typology. This is followed by several exercises for students to complete. A list of questions follows each exercise. Additional questions/activities are provided for use in an advanced undergraduate course or in a graduate-level course.

Example for Classroom Illustration

Excerpt 1: Juniata Valley Financial Corporation: For Classroom Illustration

The first excerpt is from Juniata Valley Financial Corporation's Amended 10-K for the fiscal year ending 12-31-04:

ITEM 9A. CONTROLS AND PROCEDURES

(A) EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

The Corporation's Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of the Corporation's disclosure controls and procedures (as such term is defined in Rules

¹ In order to find examples of management responses to material weaknesses, we identified firms that reported material weaknesses in internal control in their 2004 and 2005 10-K and 10-Q SEC filings from two sources: (1) Compliance Week, and (2) EDGAR, by searching the keywords "material weakness" and "internal control" and collecting each firm's Section 404 report. These years were selected because this was the first time (after November 2004–2005 reporting year) SOX required that internal control weaknesses must be reported under Section 404.

13a–15(e) and 15d–15(e) under the Securities Exchange Act of 1934 (Exchange Act) as of the end of the period covered by this report, have concluded that, based on such evaluation, the Corporation's disclosure controls and procedures were not effective in reporting, on a timely basis, information required to be disclosed by the Corporation in the reports that the Corporation files or submits under the Exchange Act due to a deficiency in the Corporation's disclosure controls and procedures. The Corporation did not discover until the first quarter of 2005 that the Corporation is an accelerated filer and, as such, was required to file its Annual Report on Form 10-K within 75 days after the Corporation's December 31 year-end and was required to include in its Annual Report on Form 10-K a report by management and an attestation by the Corporation's independent registered public accounting firm on the adequacy of the Corporation's internal control over financial reporting. During the first quarter of 2005, we have implemented additional disclosure controls and procedures in order to remediate this deficiency and we are continuing to assess additional controls that may be required to remediate this deficiency.

(B) MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of the Corporation is responsible for establishing and maintaining adequate internal control over financial reporting. Management's internal control system was designed to provide reasonable assurance to the Corporation's management and Board of Directors regarding the preparation and fair presentation of published financial statements in accordance with U.S. generally accepted accounting principles. All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

An internal control material weakness is a significant deficiency (as defined in PCAOB Auditing Standard No. 2), or a combination of significant deficiencies, that results in there being more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected on a timely basis by management or employees in the normal course of performing their assigned functions.

In order to ensure that the Corporation's internal control over financial reporting is effective, management regularly assesses such controls and did so most recently for its financial reporting as of December 31, 2004. This assessment was based on criteria for effective internal control over financial reporting described in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). In performing this assessment, management has identified the material weaknesses in internal control over financial reporting listed below:

- Because the Corporation was not aware until the first quarter of 2005 that the Corporation is an accelerated filer, the Corporation was not able to complete its documentation and testing of its internal controls over financial reporting in a timely manner in order to permit our independent registered public accounting firm, Beard Miller Company, LLC (Beard Miller), sufficient time to perform its audit of management's assessment and its audit of effectiveness of the Corporation's internal control. Accordingly, Beard Miller has issued a disclaimer of opinion on both management's assessment and the effectiveness of the Corporation's internal control over financial reporting.

- The Corporation lacks sufficient personnel in the Finance Department to review information prepared by management and to assure that the information is calculated correctly and properly disclosed in the financial statements and related footnotes. Greater expertise is needed in certain complex areas of financial reporting, including the calculation of income taxes, stock options, and employee benefit plans.

As a result of these two material weaknesses in the Corporation's internal control over financial reporting, management has concluded that the Corporation's internal control over financial reporting, as of December 31, 2004, was not effective, based on the criteria set forth by COSO in Internal Control-Integrated Framework.

The Corporation is now aware of its accelerated filer status. In the future, it will allow sufficient time for completion of the appropriate documentation and testing of its internal control over financial reporting and for the accounting firm to perform its audit of management's assessment. The Corporation, therefore, believes that the first identified material weakness will not recur.

Management has developed a plan to resolve the material weakness relative to personnel in its Finance Department. Management has requested proposals from independent accounting firms for assistance in the review of financial information, particularly with respect to nonroutine, major, and complex financial transactions. Management will be interviewing independent accounting firms in the coming weeks in order to remedy this weakness at the earliest possible time. The Corporation notes that while there were weaknesses in its internal control, the consolidated financial statements for 2004 were prepared in accordance with generally accepted accounting principles, and our independent registered public accounting firm rendered an opinion that our financial statements presented fairly, in all material respects, the consolidated financial position of the Corporation as of December 31, 2004. (SEC)

To complete this exercise, the student will need the following materials:

1. Juniata Valley 10-K report for year-end 2005. Available at: <http://www.sec.gov/Archives/edgar/data/714712/000089322006000576/w18316e10vk.htm>.
2. For the additional questions, the student will need:
 - (a) Juniata's amended 10-K report for 2004, auditor's disclaimer. Available at: http://www.sec.gov/Archives/edgar/data/714712/000095015405000066/jvfc-10ka_57302.txt.
 - (b) Suchman, M. C. 1995. Managing legitimacy: Strategic and institutional approaches. *The Academy of Management Review* 20 (3): 571–610.
 - (c) Benoit, W. L. 1997. Image repair discourse and crisis communication. *Public Relations Review* 23 (2): 177–186.

Analysis

Write an essay that addresses the following issues:

1. Does Juniata disclose all of the required elements of a Section 404 report?

<u>Required Element</u>	<u>Yes</u>	<u>No</u>
Statement of management's responsibilities for establishing and maintaining an adequate system.		
Identification of a framework to evaluate internal controls.		
Which framework is used?		
Statement as to whether internal control system is effective as of year-end.		
Disclosure of material weaknesses.		
Statement that company's external auditors have issued an audit report on management's assessments of internal controls.		
Juniata Valley disclosed material weaknesses. Does the company report include the items below?		
The fact that management has identified material weaknesses.		
A definition of material weakness.		
Actions taken to correct the weakness.		
2. List Juniata Valley's material weaknesses. For each material weakness, discuss the image restoration strategies the firm uses to respond to the weakness. In your discussion, indicate words or phrases that help you determine the strategies the firm uses.		
3. Briefly critique the company's use of image restoration strategies in this excerpt.		
4. Find Juniata's 10-K for year ending 12-31-05. Were there any material weaknesses at the end of the 2005 fiscal year? If so, what are they? If not, how does Juniata address this in Item 9A?		

Additional Question(s) (Note: suggested solutions in Teaching Notes)

1. This example illustrates that a firm may not only respond to different material weaknesses using more than one strategy, but that it may also respond to a single material weakness with multiple strategies. Read Benoit (1997) and discuss Benoit's narrative concerning the use of multiple strategies to respond to a single event.
2. In this instance, the firm's auditor, Beard Miller, has issued a disclaimer of opinion on both management's assessment and the effectiveness of the corporation's internal control over financial reporting. Find the disclaimer in Juniata Financial's Amended 10-K dated 12-31-2004 and summarize the auditor's presentation of the disclaimer.
3. Image restoration has its roots in legitimacy theory. Read Suchman (1995) and write a summary of the paper. Include a definition of legitimacy, a description of the three types of organizational legitimacy, and a discussion of how firms manage legitimacy issues.

Sample Solution for Discussion

Juniata Valley discloses all of the required elements in its SOX 404 disclosure. Juniata Valley clearly lists two material weaknesses in internal control, the first of which is that it was not able to complete its documentation and testing of internal controls in a timely fashion. Management uses a defeasibility strategy (evasion of responsibility) to respond to this weakness when the company indicates it was not aware of its accelerated filer status. The firm combines the use of the defeasibility strategy with corrective action when the report states that the firm will allow sufficient time for documentation and testing of internal controls in the future.

The response to the second material weakness, related to the lack of sufficient personnel in the finance department, is a combination of scapegoating (evasion of responsibility) and corrective action. Though the company states that it has developed a plan to resolve the material weakness, it first places responsibility for the weakness on the Finance Department. In the last paragraph, management responds to the existence of material weaknesses with an image-bolstering strategy (reducing the offensive act) when it says that even though there were material weaknesses, the firm prepared its financial statements according to GAAP.

Perhaps the most interesting aspect of this response is that the company was not aware of its accelerated filer status. This is clearly an instance where the company is at fault and tries to evade its responsibility. The best response, in order to restore or maintain the company's image, would have been to admit it should have known its status and to state corrective action strategies (Benoit 1995; Erickson et al. 2009). In its 10-K for the year ended 12-31-05, management indicates that based on COSO criteria, the company's internal control over financial reporting was effective.

Additional Exercises

Exercise 1: IXYS: A Multi-Market Integrated Semiconductor Company

For this exercise the student will need the following materials:

1. IXYS' annual report dated March 31, 2005. Available at: <http://www.sec.gov/Archives/edgar/data/945699/000095013405012682/f09887e10vk.htm>. Item 9A: Controls and Procedures.
2. IXYS' annual report dated March 31, 2006. Available at: <http://www.sec.gov/Archives/edgar/data/945699/000095013406011966/f20992e10vk.htm>. Item 9A: Controls and Procedures.
3. For the additional questions, the student will need:
 - (a) Benoit, W. L. 1997. Image repair discourse and crisis communication. *Public Relations Review* 23 (2): 177–186.
 - (b) COSO Framework in Table 2.
 - (c) Perry, W., and H. Warner. 2005. A quantitative assessment of internal controls. *Internal Auditor* 2 (2): 51–55.

Analysis: Using the Information Gathered from the List Above, Complete the Following Exercises

Write an essay that addresses the following issues:

1. List IXYS' material weaknesses. For each material weakness, discuss the image restoration strategies the firm uses to respond to the weakness. In your discussion, indicate words or phrases that help you determine the strategies the firm uses.
2. In this excerpt, the company clearly blames the burden of Sarbanes-Oxley for its inability to perform its controls properly. Discuss the implications of this type of statement on the firm's credibility.
3. Briefly critique the company's use of image restoration strategies in this excerpt.
4. Find IXYS' annual report dated March 31, 2006. Does IXYS have any material weaknesses as of this date? If so, what are they? If not, how does IXYS address the remediation in Item 9A? Does the firm's ability to remediate a material weakness depend on the severity of the material weakness? Justify your answer.

Additional Question(s)

1. Benoit (1997) discusses the use of more than one type of corrective action to respond to problematic situations. Summarize Benoit's discussion.
2. Use the COSO framework outlined in Table 2 to classify each of IXYS' material weaknesses. Also, use IXYS' 10-K for 2005 to find the steps taken to remediate each material weakness. (Suggestion: use a table with column headings below.) Discuss the implications of these material weaknesses in terms of the discussion on page 53 of Perry and Warner (2005).

Material Weakness

Remediation

COSO Classification

TABLE 2
COSO's Components of Internal Control

Component	Description
Control environment	Tone of the organization Integrity and ethical values Management philosophy and operating style Organizational structure Assignment of authority and responsibility Human resource policies and procedures Board of directors and audit committee
Risk assessment	Company-wide objectives Process-level objectives Risk identification and analysis Technological developments Competition Economic changes Internal factors such as personnel quality, the nature of the entity's activities, and characteristics of information system processing
Control activities	Performance reviews and analysis of performance Segregation of duties Authorizing transactions Executing transactions Recording transactions Custody of assets Reviewing processes Performing reconciliations System controls Application controls that include entering and processing information as well as developing and maintaining application software General controls to restrict access to computers, software, data
Information and communication	Establishing procedures and records to initiate, record, process, and report the entity's process
Monitoring	Continual evaluation of the effectiveness of internal control process Reporting deficiencies

Source: Committee of Sponsoring Organizations (COSO 1992).

Exercise 2: Hypercom: A Global Provider of Electronic Payment and Transaction Services

For this exercise, the student will need the following materials:

1. CEO's letter to shareholders in the company's 2004 annual report. Available at: <http://ir.hypercom.com/annuals.cfm> (financial and accounting controls section).
2. Hypercom's 10-K filed on 3/16/2005. Available at: <http://www.sec.gov/Archives/edgar/data/1045769/000095012405001605/p70354e10vk.htm#113>.
3. Hypercom's 10-K filed on 3/16/2006. Available at: <http://www.sec.gov/Archives/edgar/data/1045769/000095015306000697/p72016e10vk.htm>.

4. For the additional questions, the student will need:
 - (a) Stephens, K., P. Malone, and C. Bailey. 2005. Communicating with stockholders during a crisis. *Journal of Business Communication* 42 (4): 390–419.
 - (b) Ulmer, R. R., and T. L. Sellnow. 2000. Consistent questions of ambiguity in organizational crisis communication: Jack in the Box as a case study. *Journal of Business Ethics* 25 (2): 143–155.
 - (c) CEO's letter to shareholders in Hypercom's 2005 annual report. Available at: <http://ir.hypercom.com/annuals.cfm>.

Analysis: Using the Information Gathered from the List Above, Complete the Following Exercises

Write an essay that addresses the following issues (be sure to answer this in light of the fact that there are two different responses):

1. Discuss the CEO's strategy for discussion of the company's material weaknesses (internal control deficiencies) in the letter to the shareholders. Why is the tone of the discussion different from in the excerpt from the company's 10-K report?
2. List Hypercom's material weaknesses. For each material weakness, discuss the image restoration strategies the firm uses to respond to the weakness. In your discussion, indicate words or phrases that help you determine the strategies the firm uses.
3. Briefly critique the company's use of image restoration strategies in this excerpt.
4. Find Hypercom's annual report dated December 31, 2005. Does Hypercom have any material weaknesses as of this date? If so what are they? If not, how does Hypercom address the remediation in Item 9A?

Additional Question(s)

1. This example from Hypercom illustrates that a company may use different strategies to respond to its material weaknesses in internal control in various types of publications. Read Stephens et al. (2005) and Ulmer and Sellnow (2000) and discuss their conflicting views on using consistent strategies in different publications.
2. Find the CEO's letter to shareholders in Hypercom's 2005 annual report; discuss the Benoit strategies management uses to report its remediation of the company's material weaknesses.

Exercise 3: China Energy Savings Technology

China Energy Savings is a developer, marketer, distributor, and manufacturer of energy-saving products for use in commercial and industrial settings.

For this exercise, the student will need the following materials:

1. China Energy Savings' 10-K for 2005 (use for 9A and audit opinion). Available at: http://www.sec.gov/Archives/edgar/data/1119601/000114420405040435/v031666_10ksb.htm.
2. SEC filing of fraud charges. Available at: <http://www.sec.gov/news/press/2006/2006-200.htm>.
3. For the additional questions, students will need the following:
 - (a) Pump and Dump charges. Available at: <http://www.sec.gov/answers/pumpdump.htm>; <http://www.sec.gov/litigation/litreleases/2009/lr21232.htm>; and <http://www.sec.gov/litigation/complaints/2009/comp21232.pdf>.
 - (b) Control Environment material weaknesses:
 - (i) McNally, S. 2005. Assessing company-level controls. *Journal of Accountancy* (June): 65–68.

- (ii) Perry, W., and H. Warner. 2005. A quantitative assessment of internal controls. *Internal Auditor* 2 (2): 51–55.
- (iii) Verschoor, C. 2007. 404 guidance: Real change or just window dressing? *Strategic Finance* 88 (8): 21–23.
- (iv) COSO. 2006. Internal Control over Financial Reporting: Guidance for Smaller Public Companies Executive Summary. Available at: http://www.coso.org/publications/erm_sb/SB_EXECUTIVE_SUMMARY.PDF.

Analysis: Using the Information Gathered from the List Above, Complete the Following Exercises

Write an essay that addresses the following issues:

1. List China Energy Savings Technology's material weaknesses. For each material weakness, discuss the image restoration strategies the firm uses to respond to the weakness. In your discussion, indicate words or phrases that help you determine the strategies the firm uses.
2. In this example from China Energy Savings Technology, the company discloses several very serious material weaknesses. Discuss why these weaknesses are very serious and why the company's remediation plan may be difficult to complete.
3. Briefly critique the company's use of image restoration strategies in this excerpt.
4. This 10-K was the last one filed by China Energy Savings Technology. In 2006, the SEC filed fraud charges against the company and trading of its stock was suspended. In this example, China Energy Savings discloses its material weaknesses and provides a remediation plan to correct the material weaknesses. In your opinion, did the provisions of Sarbanes-Oxley help the SEC uncover the company's fraudulent activities? Provide evidence to support your answer. Find the audit opinion in the 10-K. Did the auditor find any indications of fraudulent activities on the part of China Energy Savings? Summarize the auditor's findings.

Additional Question(s)

1. The SEC also filed a complaint against the company alleging a "pump and dump" scheme orchestrated by officers of the corporation. Read the SEC documentation and briefly summarize the charges brought against China Energy Savings.
2. China Energy Savings indicates a lack of an internal audit system, which is a control environment material weakness according to the COSO framework. Define control environment material weaknesses and discuss why these weaknesses can signal serious problems for the company. Use the sources listed above.

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CASE LEARNING OBJECTIVES AND IMPLEMENTATION GUIDANCE

The exercises in this instructional resource have several potential uses. An undergraduate audit course typically addresses the issues of Sarbanes-Oxley and internal controls, so these exercises would be appropriate in this course. The exercises could also be used in an intermediate or advanced accounting course if course coverage includes internal controls and/or corporate governance. We have also suggested additional questions to make the exercises more suitable for use in a graduate-level accounting course.

After completing the exercises and participating in related classroom discussion, students should be able to:

1. Understand Sarbanes-Oxley 404 requirements.
2. Identify material weaknesses in internal controls in corporate disclosures.
3. Understand image restoration and strategies used to maintain or restore corporate reputation.
4. Use Benoit's image restoration typology to analyze corporate material weakness disclosures.
5. Understand how communication in SOX reports can affect stakeholders' perceptions of the organization.
6. Appreciate the "real life" application of SOX requirements.

If the exercises are used in a graduate-level course, students should also be able to:

1. Incorporate information from academic and practitioner journal readings into discussion of SOX and image restoration.
2. Classify material weaknesses according to the COSO framework.
3. Demonstrate an in-depth understanding of legitimacy and image restoration.
4. Understand the implications of control environment material weaknesses.

Implementation Guidance and Teaching Methods

Instructors may use these exercises after discussion of Sarbanes-Oxley and internal controls. To supplement textbook materials on these topics, instructors who incorporate videos into their courses will find a large number of videos on these topics on YouTube.² There is a set of videos filmed at a luncheon held in July 2007 on the fifth anniversary of the enactment of Sarbanes-Oxley, where Senator Sarbanes, Representative Oxley, two former PCAOB chairmen, and SEC representatives discuss SOX and implementation to that date. A list below contains the URLs for these videos.

In addition to covering SOX and internal controls, instructors using one or more exercises from this resource will need to spend approximately 15–30 minutes of class time discussing corporate reputation management, image restoration strategies, and Benoit's image restoration typology. The material provided in the Background Materials section and in Table 1 can be used to present Benoit's typology to students. We strongly recommend that instructors read [Benoit \(1995\)](#) to prepare for this part of the discussion.

Once students have a grasp of the image restoration typology, the instructor spends an additional 15–30 minutes discussing one of the exercises in class—we use Juniata Valley Financial Corporation, but any of the exercises can be used to illustrate the use of communication theory to analyze corporate material weakness disclosures.

A number of strategies can be used to allow students to complete the remaining exercises. One strategy is to assign one exercise as an in-class group exercise, where students break into

² Careful screening of YouTube videos is necessary to ensure accuracy and appropriateness for classroom use.

small groups and discuss the excerpt and develop a response based on the discussion questions. These small group discussions are then followed by class-wide discussion. Then, one or more exercises can be assigned as an out-of-class, graded activity.

Alternatively, all of the excerpts may be used as in-class, group discussion assignments with class-wide discussion following. Or, after the initial in-class example is discussed, any combination of the remaining exercises may be used as out-of-class, graded assignments. When used as graded assignments, these essays can be used to improve students' written communication skills. The instructor may also require short oral presentations of student findings for each exercise. We cover the Juniata Valley example in class and assign one or two more exercises as graded homework.

Student preparation for the exercises should include: (1) understanding of Sarbanes-Oxley Section 404 (using either textbook materials or the information contained in the Background Materials section of this resource), (2) some familiarity with reputation management and Benoit's image restoration typology (using the information and table found in the Background Materials section of this resource and/or using excerpts from Benoit's 1995 book), (3) knowledge of the COSO framework, and (4) reading the exercises and analysis questions prior to class.

For undergraduate courses, we recommend that the instructor assign essays that address the analysis questions. The additional questions typically involve additional readings from academic and practitioner journals and are more appropriate for graduate-level courses, but instructors of advanced undergraduate courses may also choose to assign these questions as part of the analysis.

For additional or different excerpts from corporate reports, the instructor can go to <http://www.sec.gov> and search the EDGAR database using keywords "material weakness" and "internal control." The search can be conducted using the complete EDGAR database or by choosing SIC codes to find examples in certain industries.

Classroom Assessment

During fall semester 2009, 18 undergraduate senior accounting majors completed one in-class and one out-of-class exercise as part of their Audit I class. We administered a survey to students to measure their perceptions of the assignment. The survey questions and results are below.

Student responses indicated that the case helped reinforce their understanding of SOX 404 requirements (see Table 3). They also indicated that completing the case problems helped them understand image restoration strategies and how communication within SOX reports can affect stakeholder perceptions. Students also reported that they found the cases to be a useful addition to the textbook material and that the case should be used in the future. To a lesser degree, students felt that the case improved their written communication and critical thinking skills. We plan to emphasize the value of these outcomes when we use these exercises in the future by stressing that these types of cases should help to improve both written communication and critical thinking skills. Overall, students felt that completion of the case problems was a valuable experience that contributed to their understanding of SOX reporting requirements.

CONCLUSION

This paper presents an instructional resource and provides suggestions for its possible use in undergraduate and graduate accounting courses. This instructional resource provides a means of teaching students how communication in required SOX Section 404 reports can impact stakeholders' perceptions of that organization. Students read portions of selected 10-K, 10-Q, and corporate annual reports where management responds to disclosed internal control material weaknesses. Students then analyze these excerpts according to Benoit's image restoration strategies (Benoit 1995, 1997). This resource provides students an opportunity to increase their written communication skills, analytical skills, research skills, and to deepen their understanding of Sarbanes-Oxley

TABLE 3
Student Survey Questions and Frequency of Responses

	Strongly Agree 1	Agree 2	Neutral 3	Disagree 4	Strongly Disagree 5	Average Rating
Completing this case helped me understand SOX 404 requirements.	1	12	4	1	0	2.28
Completing this case helped me understand Image Restoration Strategies.	10	8	0	0	0	1.45
Completing this case helped me understand how communication in SOX reports can affect stakeholders' perceptions of the organization.	4	13	0	1	0	1.88
Completing this case helped me appreciate the "real life" application of SOX requirements.	1	11	5	1	0	2.33
Completing this case improved my written communication skills. ^a	0	5	10	2	0	2.67
Completing this case improved my critical thinking skills.	1	10	7	0	0	2.82
This case was a useful addition to the textbook material.	2	13	2	1	0	2.83
This case should continue to be used in the future.	3	12	3	0	0	2.00

^a One student did not respond to this item.
n = 18.

404 requirements and of image restoration strategies utilized in the corporate communication arena. The instructional resource would be beneficial in undergraduate courses such as auditing, intermediate accounting, or advanced accounting. The exercise can also be expanded for use in a graduate-level course by including additional reading and research requirements from practitioner and academic journals.

YOUTUBE VIDEOS

1. Rep. Michael Oxley: <http://www.youtube.com/watch?v=FOw22y-S6iE>.
2. PCAOB Chair Mark Olson: <http://www.youtube.com/watch?v=3tLzaesBI1g>.
3. Former PCAOB Chair Bill McDonough:
<http://www.youtube.com/watch?v=5gPV3rJPgIE&feature=related>.
4. Senator Paul Sarbanes:
<http://www.youtube.com/watch?v=19XAq7YMtmg&feature=related>.
5. Former SEC Chair Harvey Pitt:
<http://www.youtube.com/watch?v=uQWl8wMDqf0&feature=related>.
6. Cindy Fornelli: http://www.youtube.com/watch?v=dfdtwEK_oSU&feature=related.

TEACHING NOTES

Teaching Notes are available only to full-member subscribers to *Issues in Accounting Education* through the American Accounting Association's electronic publications system at

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