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**Corporate Earnings Management and Cookie Jar Accounting**

Any earnings management device can only temporarily improve financial statement performance. All ethics aside, cookie jar accounting can be a highly effective method of reducing operating expenses in order to improve low profit quarters. Management can rationalize the decision as good for earnings, the company, and for investors alike. The strategy, however, can only buy time in most cases. If revenue does not continually increase, the company will have trouble to make earnings goals, even with cookie jar accounting.

In theory, this method could be very effective for a company that has increasing sales and profits overtime, only at sporadic intervals. Thus, a company could smooth earnings and show consistent earnings growth each quarter. Bank is happy, investors are happy, and Wall Street is happy. Only the SEC would appear as the “wet blanket” of the party with its regulatory devices. The reality of such methods though, is that if you give management a cookie (continuing with the metaphor) they will want a glass of milk.[[1]](#footnote-1) Mangers would likely abuse accounting tactics further for their own gain. Accounting rules are just that, rules to be followed. In order to maintain the predictive value and feedback value of financial statements, rules must be enforced under all conditions.

Cookie jar accounting is clearly effective at reducing operating expenses in low-profit quarters in order to meet earnings forecasts. Such a strategy, however, only can work long term if a company has increasing sales and profits overtime, only at sporadic intervals. In such a scenario, the cookie jar could be “replenished” has needed. So long as hot quality cookies are being produced and bought at ever increasing rates, the jar can increase and decrease, but never empty. If the company earnings do not continually to increase, however, the firm will be on borrowed time before it must realize a loss even greater than it would have had it reported earnings correctly in the first place.

Even in the scenario of ever increasing sales, management should not attempt to manipulate earnings. Should the company report increasing earnings at amazingly consistent rates, market expectation will continue to increase. Under the cookie jar scenario, Management would effectively signing the company up for a task that is impossible to accomplish long term. One quarter of slow growth could break the back of the cookie jar.

“Stuffing the Channels” to increase sales is clearly a temporary fix. In the case of Bristel-Myers Squib Co. (BMS), persuading wholesalers to accept excess inventory cannot continue forever. Like most accounting schemes, earnings will be bolstered only temporally. As soon as vendors are at maximum capacity or consumer demand drops, the scheme is over. Buying time using accounting methods will eventually compound if management continues to meet or exceed earnings targets overtime due to the increase in expectation that is created. Such a house of cards scenario inevitably leads to collapse, as witnessed with Enron, WorldCom and Lehman brothers.

1. Numeroff, Laura J. Bond, Felicia (illustrator). If You Give A Mouse A Cookie. ( 1985) [↑](#footnote-ref-1)