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PwC Probably Did Celebrate When It Helped Mattel Cover Up an Accounting Error

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By now you guys have probably read the [Wall Street Journal article](#) yesterday that explains what Mattel and PwC did to bury accounting issues related to the value of the *Thomas & Friends* show for kids.

If for some reason you've been too busy to surf the web or dick around on Reddit in the last day or so, [here's what happened in a nutshell](#):

The accounting error had to do with Mattel's ownership of "Thomas & Friends," an animated children's show. The error was tied to a \$562 million valuation allowance that Mattel created against its deferred tax assets in September 2017. Ultimately, the allowance was reduced by \$109 million, which came from deferred tax liabilities related to Mattel's acquisition of HIT Entertainment in 2011. Reducing this allowance lowered Mattel's loss during the quarter.

The finance team, according to the Journal, had discussed fixing the error and then restating its earnings, but Mattel would need to admit that there were shortcomings in its accounting and reporting procedures.

Brett Whitaker, who was Mattel's director of tax reporting at that time, told the Journal that the finance execs and PwC decided to change the accounting treatment of the Thomas asset and not tell Mattel's then-chief executive or its board.

This whole Mattel/PwC saga just confirms the accuracy of research presented in August at the **American Accounting Association's annual meeting in San Francisco**, which, as [Adrienne reported](#), reiterated that audit firms are greatly discouraged from making important disclosures that would make their client look bad.

An auditor's issuance of an ICMW [internal control material weakness] indicates that the auditor conducted the audit sufficiently well to identify a weakness and then communicated that valuable information to the public. Thus, to the extent that clients value providing useful information to users of financial statements, the issuance of an ICMW should neither impair the issuing auditor's reputation for quality, nor deter clients from selecting auditors with a history of issuing ICMWs. However, ICMWs signal poor internal financial reporting quality that research has found damages client reputations. Thus, the implications of an ICMW diverge for the auditor and client (negative for the client and neutral or positive for the auditor).

Of course PwC was going to do whatever it took to help conceal that accounting error because Mattel had been a client of PwC's for 45 years. PwC didn't want to disclose the material weakness and have Mattel's reputation be damaged.

This doesn't seem to be an "honest mistake," as a PwC spokesperson told the WSJ. Nah, this was PwC taking a "we need to do something so we don't lose a longtime client" approach.

As Whitaker told the WSJ:

"It was known within Mattel that if we took this approach, at worst we might get a slap on the wrist from the Securities and Exchange Commission," Whitaker told the Journal. He stepped down from his post in March 2018. "But if the company disclosed a material weakness, a senior executive said to me it would be 'the kiss of death.'"

So when Whitaker told the WSJ that he remembered seeing one PwC employee “walking down the hall, high-fiving people, after this decision was made” to not disclose the mistake, I believe him. I bet there was a lot of celebrating behind closed doors too. PwC denied that any emotion was shown by any of its employees after it helped Mattel cover up the error.

And it looks like the fall guy is Los Angeles-based PwC partner Joshua Abrahams, who led the Mattel audit team. He’s been placed on administrative leave and isn’t expected to work for PwC much longer. He won’t be out of work long. He’s got “future KPMG audit partner” written all over him.