ACC 646: Forensic financial statement Analysis and Valuation

Note to self: Consider either dropping valuation and adding another investigation case or shortening the analysis portion of the course.

Professor: Cindy Durtschi, PhD
Office: DPC 6038
Phone: 312-362-8789
Office Hours: I’m at the office every day (unless out of town on business), I can easily stay until 6pm if you want to visit prior to your other classes. I can also be contacted quickly via email.

Required Texts:


Easton, Wilde Halsey, McAnally, *Financial Accounting for MBA’s Modules 11 & 12 only*. (These two modules are compiled and available in the bookstore)

Required: Please bring a laptop to class. We will be working on the financial statement analysis and valuation homework assignments during class and you will also need them for the large Tampa Bay Sharks case

Course Description:
The objective of this course is to give students hands-on experience at financial statement analysis with the goal to detect fraud. In addition, we will learn the basics of valuing public and private companies. The course is case-based. Skills focused on in this course include

1) Financial Statement Analysis to detect fraud in financial statements
2) Valuation of a firm
3) Detection and investigation of fraud within the financial records of a firm
4) Interviewing suspects and witnesses

Professional Skills:

1. Analysis of financial information.
   a. Learning activities to support objective:
      i. Financial Statement Analysis Project

2. Valuation
   a. Learning activities to support Objective
      i. Valuation of a company

3. Investigating fraud:
   a. Learning activities to support the objective:
      i. Tampa Bay Shark case in fraud detection
      ii. Interviewing fraud suspects

Professional Values and Attitudes:

1. Increased professional skepticism
a. Learning activities to support objective:
   i. Analysis of financial statements of firms which have committed fraud
   ii. Case in which student practice fraud identification and investigation within a company setting

2. Interpersonal skills
   a. Learning activities to support objectives
      i. Experience in working within a forensic audit team
      ii. Interviewing

Course Schedule: suggested new one: Find 3 companies, figure out what analysis to do and do it… so there are set answers… work through one case in class. Have them do another as homework. Have the exam be a third case. … no teams until the final assignment. Same with the valuation.

<table>
<thead>
<tr>
<th>Date</th>
<th>Topic</th>
<th>Assignment Due</th>
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<tbody>
<tr>
<td>Mar 31</td>
<td>Fraud investigation: Case: follow the money</td>
<td>Readings: Schlitz Chaps 1-5</td>
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<td>Day 1</td>
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<td>Apr 7</td>
<td>FSA Part 1 &amp; 2</td>
<td>Readings: Schlitz Chaps 6-10</td>
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<td>Day 2</td>
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<td>Apr 14</td>
<td>FSA Part 3</td>
<td>Readings: Schlitz Chapters 11-16</td>
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<td>Day 3</td>
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<td>Apr 21</td>
<td>Exam I (FSA)</td>
<td>Due: FSA Case assignment</td>
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<td>Day 4</td>
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<td>Apr 28</td>
<td>Valuation: Part I</td>
<td>Readings: Easton Wild, Module 11</td>
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<td>Day 5</td>
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<td>May 5</td>
<td>Valuation: Part II</td>
<td>Readings: Easton, Wild, Module 12</td>
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<td>Day 6</td>
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<td>May 12</td>
<td>Intro Star Valley Confectioners (SVC)</td>
<td>Due: Valuation Models Assignment (line-by-line and valuation models)</td>
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<td>Day 7</td>
<td>Exam II (Valuation)</td>
<td>Due: Hypotheses for SVC (in class work)</td>
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<td>May 19</td>
<td>Interviews and Interrogations</td>
<td>Ongoing: Communication with TBS to acquire more information</td>
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<td>Day 8</td>
<td>Group Work SVC</td>
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<td>May 26</td>
<td>Group Work SVC</td>
<td>Ongoing: Communication with TBS to acquire more information</td>
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<td>Day 9</td>
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<td>Jun 6</td>
<td>Interviews of SVC Suspects</td>
<td>Due: Interviews with TBS Suspects</td>
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<td>Day 10</td>
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<td>No more new information available after interrogations</td>
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<td>Jun 9</td>
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<td>Due: Final TBS expert report</td>
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Graded Assignments:

1. **Financial Statement Analysis Project: (50 points)**
   - *Analysis of industry and firm background, description of fraud and perpetrators* (presented in class and included in your final report) 15 points (graded as group project)
   - *Financial Statement Analysis.* Do work individually, then combine your work into one group report: 35 points (graded as group project)

2. **Valuation of Financial Statement (60 points)**
   - Line by line I/S, B/S Statement of Cash Flows 20 points (graded individually)
     - Valuation of Fraudulent statements, DCF 10 points (graded individually)
     - Valuation of Fraudulent statements, ROPI 10 points (graded individually)
     - Valuation of Restated statements, DCF 10 points (graded individually)
     - Valuation of Restated statements, ROPI 10 points (graded individually)

3. **Tampa Bay Sharks (Group project) (80 points)**
   - a. Initial observations and hypotheses – written (10 points)
   - b. Interviews of suspects – detection of lies in oral communication (35 points)*
   - c. Final Investigative report – written (35 points)**

   *Success of the interviews is dependent on your team’s success during your investigation. Please note: This project is very time/labor intensive. There are only 3 weeks to work on the project prior to the suspect interviews, then one week to complete the expert report. Please plan your quarter accordingly.*

4. **2 Exams: Individual grade: 75 points each**

Grading:

- 95-100% A
- 90-94% A-
- 85-89% B+
- 80-84% B
- 75-79% B-
- 70-74% C+
- 65-69% C

Honor Code:

Students are expected to uphold the Academic Honor Code. The Academic Honor System is based on the premise that each student has the responsibility to 1) uphold the highest standards of academic integrity in the student’s own work, 2) to refuse to tolerate violations of academic integrity in the university community, and 3) to foster a high sense of integrity and social responsibility on the part of the university community.

**Students with disabilities** needing academic accommodation should 1) register with and provide documentation to the Office of Students with Disabilities, and 2) bring a letter to the instructor indicating the need for accommodation and what type. This should be done during the first week of class.
Description of Projects

Project 1: Financial Statement Analysis Project

Part I: Analysis of Fraud, Firm and Industry (Big Picture) (presented in class). (15 points)

Each team will be given some Accounting and Auditing Enforcement Releases (AAER) for a company indicted by the SEC for fraud. Assignment: Look for other AAERs, look to new sources to understand the fraud committed and the firm itself in relation to its industry.

Required (in class presentation and to be written up to be included in your final FSA project):

1. Describe the fraud and how the fraud was committed: Read the AAER’s, do an internet search for news items to gain an understanding of the fraud committed.
2. Look at your fraud firm’s competitive environment and summarize their position prior to the fraud being committed. Objective, can you pinpoint the pressure and rationalization for committing the fraud?) Things you can look for:
   1. Degree of Actual and Potential Competition focusing on such things as:
      a. Rivalry Among Existing Firms
      b. Threat of new Entrants
      c. Threat of Substitute Products
      d. Bargaining Power of Buyers
      e. Bargaining Power of Suppliers
   2. Sources of competitive advantage:
      a. Cost Leadership
      b. Differentiation
   3. Corporate Culture/Environment
      a. Was there any indication of a culture of corruption?
      b. Were there signs of executive/board personalities that indicate fraud?
      c. Were there performance pressures on those who committed the fraud?

Part II: (35 points) Financial Statement Analysis of the Fraud Firm.

Objective: To determine whether there were signs available within the financial statements which should have signaled to auditors that a fraud was being committed.

Deliverables:
Do a vertical and horizontal analysis of the firm and compare with self in non-fraud years, with others in their industry.
1. Do Ratio analysis of your firm
2. Turn in a written report that summarizes your findings for Parts I&II. The report should include:
   a. An Executive Summary
   b. A short analysis (no more than 1 page) of the relevant firm background information, (presented in class)
   c. A concise description of the fraud
d. The relevant financial analysis that you believe would have indicated that a fraud was being perpetrated (don’t show everything you tried, just the analysis that is relevant). Show the results of the numerical analysis as well as your interpretation of what you learned from the numerical analysis shown.
e. Your opinion as to whether or not someone who did the proper analysis should have found the fraud.
f. A sentence or two that details the outcome of the fraud (was someone prosecuted? Go to jail? Were financials restated?)

**Project #2: Valuation Project**

This project includes a valuation for your firm prior to the fraud being discovered and after the fraud was discovered. Use the financial statements that you used in your financial statement analysis project for this analysis as well as the restated financial statements if you have them (if there was no restatement, you can use the AAER description of the fraud to adjust the fraudulent financial statements).

Find the firm value, and the earnings per share for your firm using financial statements that included a fraud, then again using restated financial statements.

**Part I. Line by line forecast (20 points)**

Do a line by line forecast of both your income statement and Balance sheet for your firm.

**Deliverables**

1. Line by line forecast of 1) Income statement, 2) Balance Sheet and 3) Statement of Cash flows using the fraudulent numbers
3. Short summary highlighting the differences in your forecasts. Were there differences? How did those differences affect your forecasts?

**Part II. Valuation of firms (40 points)**

You will find a firm value for your fraud firm using two different valuation models to value your firm first using the fraudulent financials, then your fraudulent financials corrected for the fraud per the amounts shown to be fraudulent in the AAERs. The objective is to see the difference in price for the firm were the market have known about the fraud. NOTE: if valuation models are done correctly, the DCF and ROPI models in each instance (fraud and corrected) will match each other.

**Deliverables**

- Valuation of Fraudulent statements, DCF 10 points (graded individually)
- Valuation of Fraudulent statements, ROPI 10 points (graded individually)
- Valuation of Restated statements, DCF 10 points (graded individually)
- Valuation of Restated statements, ROPI 10 points (graded individually)
Project #3: Tampa Bay Sharks (TBS) Project

You will be given the books of a company and will be asked to find the frauds. Complete instructions will come with the project.

NOTE: This project requires a lot of time, thought and effort. Please plan your schedule accordingly

a. Initial observations and hypotheses – written (10 points)
b. Interviews of suspects – detection of lies in oral communication (35 points)*
c. Final Investigative report – written (35 points)**

Part I. Initial Observations and hypotheses (10 points)

Read the case and have a brainstorming session in which, just from reading the background of the company and employees, you make a guess as to:

a. Perpetrators
b. Weak or missing controls
c. Considering the possible perpetrators and the areas of weak or missing controls, what frauds are possible?

Deliverable:
A short written list of the fraud hypotheses you arrived at during your team brainstorming session

Part II. Interviews (35 points)

Once you have created initial hypotheses, you will begin to investigate these suspected frauds by determining what evidence you need, writing the person you believe can give you that information, then analyzing the information. The evidence you collect will be the basis for your interviews and expert report. If you have not done a thorough investigation, so you go into the interview unprepared, you will not obtain a confession, and not have proof that indicates a fraud has occurred, who committed the fraud and how they benefited. The importance of your investigation can not be overstated.

Deliverable:
Interviews with suspects. The interviews should be well organized, with a theme and plan. All team members should participate in a well-organized fashion, you should listen and evaluate responses looking for evidence of deception, you should have the evidence you collected during your investigation organized in such a way that you can show the person you are interviewing that they had opportunity, motive, intent and benefited from the crime.

Part III. Expert Report

At the conclusion of your investigation, after your interviews you will prepare a final expert report.
Deliverable:

Expert report: The report must include:
1. A brief statement of your conclusion (fraud or no fraud at TBS)
2. If a fraud or frauds have occurred, you state the following for each fraud:
   a. Identification of the perpetrator;
   b. Description of the fraud;
   c. Evidence of the pressure or motive the perpetrator had to commit the fraud;
   d. Evidence the perpetrator had the opportunity and knowledge to commit the fraud;
   e. Evidence of the perpetrator’s intent. That is, you must show that the perpetrator’s actions were not simply a mistake or ignorance that resulted in the fraud, but a deliberate action;
   f. Evidence of how the perpetrator benefited from the crime;
   g. The dollar amount of the fraud; and
   h. The perpetrator’s confession if you obtained one.
3. Include the evidence on which your conclusions were as appendices.
4. Organization, presentation, clarity, grammar, spelling and punctuation are also important and graded.

NOTE: This is a competitive exercise where your findings will be compared to the findings of other teams in your class. Therefore, it is imperative that your team keep your leads and solutions private, so unfair advantage is not given to other teams.

Finally, your team members will grade each other, so be certain you pull your weight in the case.