ACC 646: Forensic Financial Statement Analysis and Valuation

Professor: Cindy Durtschi, PhD
Office: DPC 6038
Phone: 312-362-8789
Office Hours: I’m at the office every day and can easily stay until 6pm if you want to visit prior another class. An appointment can assure I’m not in a meeting. 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

Course Schedule:

<table>
<thead>
<tr>
<th>Date</th>
<th>Topic</th>
<th>Assignment Due</th>
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<tbody>
<tr>
<td>Jan 6</td>
<td>Intro and Financial Statement Analysis (FSA) Part I:</td>
<td>Readings: Schilit Chaps 1-5</td>
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</table>
| Day 1    | FSA Part II                              | Readings: Schilit Chaps 6-10
<p>|          |                                         | Due: short group presentation about your fraud/firm background |
| Jan 20   | FSA Part III                             | Readings: Schilit Chapters 11-16                |
| Day 3    | Exam I (FSA)                             | Due: FSA Assignment                              |
|          | Fraud Investigation                      |                                                 |
| Jan 27   | Valuation: Part I                        | Readings: Easton Wild, Module 11                |
| Day 4    |                                        |                                                 |
| Feb 3    | Valuation: Part II                       | Due: Line by line forecast of IS/BS &amp; SCF       |
| Day 5    |                                        | Readings: Easton, Wild, Module 12               |
| Feb 17   | Intro Tampa Bay Sharks (TBS)             | Due: Valuation Models Assignment                |
| Day 7    | Exam II (Valuation)                      | Due: Hypotheses for TBS (in class work)         |</p>
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<thead>
<tr>
<th>Date</th>
<th>Event</th>
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<tbody>
<tr>
<td>Feb 24</td>
<td>Interviews and Interrogations</td>
<td>Ongoing: Ongoing: Communication with TBS to acquire more information</td>
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<td></td>
<td>Group Work TBS</td>
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<tr>
<td>Mar 2</td>
<td>Group Work TBS</td>
<td>Ongoing: Communication with TBS to acquire more information</td>
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<td>Day 9</td>
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<tr>
<td>Mar 9</td>
<td>Interviews of TBS 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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<tr>
<td>Mar 16</td>
<td>Expert report due, brief debriefing on the TBS case</td>
<td>Due: Final TBS expert report due PRIOR TO CLASS</td>
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Graded Assignments:

1. **Financial Statement Analysis Project: (50 points total)**
   - *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 total)**
   - 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 total)**
   - 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 Oral Presentation (5-10 minutes, all group members must participate):**
1. What is your company’s business? (Who are they, what do they do, when are we talking about?
2. Who are the main competitors (What is their competitive environment, what is their industry like?
3. What was the fraud? (brief description or the highlights)
4. Did you find any interesting news tidbits about the firm or the main fraudsters?

**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 first in the fraudulent financial statements, then again after you have adjusted your financials for the fraud. You can either use the firm’s restatement or correct your fraudulent financials per the information given in the AAERs.

Objective: To see how fraud affects the value of the firm.

Part I. Line by line forecast (20 points). Note: While graded individually, it helps to compare to your group members. Your results often differ because you do not all need to use the same assumptions of revenue growth (in fact, it is often interesting to vary the forecasts to see the different outcomes).

Deliverables
1. Line by line forecast (based on the fraudulent numbers) of
   1) Income statement,
   2) Balance Sheet and
   3) Statement of Cash flows using the fraudulent numbers

Part II. Valuation of firms (40 points)

You will find a firm value (total and earnings per share) for your firm using two different valuation models, (DCF and ROPI models)

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)
- Note: DCF and ROPI models should be equal in each set (i.e., fraud statements should match each other and Restated valuations should match each other… but your Restated set should be lower than your fraudulent valuation set

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 quarter schedule accordingly

- Initial observations and hypotheses – written (10 points)
- Interviews of suspects – detection of lies in oral communication (35 points)*
- 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 an educated guess as to:

a. Perpetrator(s) .. anyone with a motive/rationalization?
b. Weak or missing controls
c. Consider the possible perpetrators and the areas of weak or missing controls, if a possible perpetrator has access to an area with weak controls, what frauds might he/she commit?

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

**Part II. Investigations/ 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, and 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.