Helecom Communications:
Considering Fraud Risk on an Engagement Before and After Analyzing A Key Business Process

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**HELECOM COMMUNICATIONS:**

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**ABSTRACT**

Helecom Communications is a fictitious public company in the cable industry, founded by its current Chairman and CEO, Jefferson Means. For this case, students assume the role of an associate auditor in an international accounting firm that has just acquired this client. Students are provided with background information on the company and its environment in Part 1 of the case and provided with information related to a critical business process, subscriber management, in Part 2 of the case.

This case involves considering fraud risk of an organization in a competitive, regulated, and volatile industry. For this case, the established criterion is AICPA Statement of Auditing Standards No. 99, *Consideration of Fraud in a Financial Statement Audit* (SAS No.99). While many of the facts in the case are adapted from fraud risks and actions that occurred at actual organizations, the company is fictitious to enable the case to place students in the role of the auditor evaluating the organization for fraud risks both before and after analyzing a key business process. By performing the requirements in this case, students are exposed the key aspects of SAS No.99, which should be maintained and possibly expanded pursuant to consideration by the Public Company Accounting Oversight Board (PCAOB), within the context of audit approaches being used to some extent by all international accounting firms (e.g., Lemon et al. 2000).
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INTRODUCTION

You work as an associate for an international public accounting firm that has just been engaged to conduct the financial statement audit for Helecom Communications. The Company is led by Chairman and CEO, Jefferson Means, who is the founder. One of his sons, Jefferson Means, Jr., is the CFO, and served as chair of the audit committee prior to passage of the Sarbanes-Oxley Act of 2002, was instrumental in your firm being chosen as the auditor (the engagement partner from your firm knew Jefferson Jr. from their days at Georgia A&M). This engagement was available because the firm that had been auditing Helecom was dissolved during the prior year, meaning that a new auditor had to be selected and that no communications with the prior auditor were possible. To compound the challenges associated with performing a first-year audit, Statement of Auditing Standards No. 99, Consideration of Fraud in a Financial Statement Audit (AICPA 2002), has recently been issued, and this is your first client on which to implement the new standard. As part of your responsibilities on the engagement, you learn that you will be performing the business process analysis of subscriber management, although you will be helped by the manager on the engagement because of the importance of the process as it relates to revenue recognition for the client.
PART I: CONSIDERING FRAUD RISK PRIOR TO ANALYZING
A KEY BUSINESS PROCESS

Background

Telcommunications Industry

**A brief history.** The telecommunications industry experienced unprecedented, rapid growth in the mid-1990s, introducing an array of services and competitors to an industry once known only for home phone service and the industry giant AT&T. The changes resulted from antitrust sentiment waged against the Baby Bell local phone companies (formerly pieces of the divested AT&T) and the passage of the Telecommunications Act of 1996. The Act dissolved the monopolies held by the Baby Bells on local phone services and opened the market to a variety of competitors, including cable companies, network broadcasters, and wireless service operators. The Baby Bells were required to make their infrastructures (i.e. cables) available to competitors. In return for their sacrifice, the Bells were allowed to enter into new markets such as cable and TV services, equipment, and long distance. With a more level playing field, telecommunications has evolved into a highly competitive industry.

**Products.** Firms competing in the telecom industry can be sorted into various market niches, though several large industry players offer products in all niches. Products offered by the telecommunications industry can be categorized as phone-related, television-related, or Internet-related. In each of these product divisions, there are firms that produce the telecommunications equipment (e.g. coaxial cable and cable boxes) for wholesale to service providers and firms that provide the actual services and equipment to consumers.

Phone-related products historically included local and long distance phone services using copper lines as a communications medium. In the mid to late 1980s, long distance carriers such
as MCI and Bell Atlantic began constructing fiber optic cable networks, made from glass rather than copper, that were purported to be a significant improvement over copper lines due to much greater bandwidth (the capacity for data transmission). One of the most recognizable long-distance service ad campaigns was launched by MCI, who claimed that on their fiber-optic cable, one could “hear a pin drop.” Fiber optics hasn’t replaced copper as of yet, likely due to the vast existing infrastructure of copper cable that would require a massive investment to replace. Some market participants think that copper will eventually be displaced by wireless capabilities rather than by fiber optics. Indeed, wireless services via analog and digital media already represent a large market niche in telecommunications and Plunkett Research predicts continued growth in wireless communications (Plunkett Research 2002).¹

Firms in the television products market have capitalized on “broadband” transmission methods. Using broadband, multiple transmissions share a common communications path. Thus, cable television providers are able to offer high-speed Internet access in addition to digital video and audio for the TV across the same cable. Broadband also includes satellite delivery or DBS (direct broadcast satellite), which is competitive with cable firms’ digital TV but not so much with Internet access. Phone companies also have gained from new transmission methods by introducing high-speed Internet access via digital subscriber lines (or DSL), but they also trail broadband cable firms for market share. A growing industry trend is to “bundle” cable television, telephone, Internet, and wireless services for consumers.

**Recent industry threats.** Forbes reports that $1.3 trillion has been contributed to the industry by investors since the passage of the 1996 Act, much of it during the technology boom of the late 1990s. A majority of the capital has been used by telecom firms to purchase wireless

¹ The regulatory changes in late 2003 that enable consumers to switch their home phone numbers to wireless phones and to maintain phone numbers when switching carriers has been widely reported as an indicator that wireless technology might replace wired technology.
bandwidth or construct cable networks. *Hoover’s Online* reports that much of the approximately 90 million miles of cable that has been constructed is still unused, and has caused the wholesale price of network capacity to plummet (Hamerly 2002). The driver of this excessive construction was a statistic provided in 1997 by Michael O’Dell, then chief scientist of UUNet, that estimated Internet traffic would double every 100 days, or about 1000% per year. The hypothesized statistic spread quickly throughout the industry. Unfortunately, actual demand is now believed to have only grown by 100% per year and has grown at declining rates since that time (Dreazen 2002).

A compounding problem is that most telecommunications firms suffered dramatically when the technology bubble burst in 2000—largely due to the aforementioned overstated demand. Telecommunications historically has been an industry with a high level of merger and acquisition activity. Larger firms frequently acquire smaller firms for their capacity or existing customer revenue streams. In the late 1990s, however, the acquiring firms’ share prices began to tumble as the purchased capacity could not be turned into revenue. Soaring predictions from industry analysts and unrealistic shareholder expectations led several firms to falsify accounting figures to satisfy constituencies. Various frauds and restatements within the telecom industry have hit the news in recent times. Notable examples include Qwest, AOL, and Worldcom. In the latter, a fraudulent accounting scheme perpetrated over years 1999 to 2001 directly reduced expenses and inflated reported net income by approximately $7 billion, and resulted in the firm re-naming itself MCI in 2003. The scheme was relatively basic. Some of the firm’s largest costs were fraudulently classified as capital expenditures (Markon 2002). The industry has witnessed the falter of worthy competitors, such as 360Networks and McLeod, Inc. Taken in sum, investor confidence in the telecom industry has been shaken.
The Story of Helecom Communications

Humble beginning. Jefferson Means, CEO and founder of Helecom, was born in 1938 in Helena, Alabama, and was the youngest of five children. William and Opal Means instilled in their children a strong sense of family values, as well as the belief that hard work, a little business sense, and attention to customer relationships could build or maintain a successful business. William was sure to involve all of the children, to some degree, in the day-to-day business of the family-owned Helena Feed & Seed.

After his father died and his older siblings assumed the family business, Jefferson decided to become the first in his family to go to college. He was easily accepted to Georgia Agricultural & Mechanical Institute where he earned good grades in his engineering curriculum. While at Georgia A&M, Jefferson discovered his natural ability to build and wire just about anything.

After graduating in 1960, Jefferson married Lilly, his high school sweetheart, and moved to a small city about seventy miles north of Birmingham, called Gadsden. The town’s livelihood was dependent on two factories—Republic Steel and The Goodyear Tire and Rubber Company—and Jefferson had taken an engineering job with the latter. Jefferson and Lilly enjoyed living in Gadsden. One of their favorite things about the town was that the Coosa River ran right through the heart of it. Jefferson and Lilly decided to investigate buying a piece of waterfront property in the nearby town of Hokes Bluff that had been placed on the market by a financially distressed family. Unfortunately, the steep grade of the land made it a poor choice for building. However, there was something on the land that was much more interesting to Jefferson than the lot’s suitability for a house—an 18-foot tall antenna. The current owner liked to tinker
with radio and explained that he’d lost interest in the antenna before ever “getting the kinks worked out.” To Lilly’s dismay (after seeing the lot), Jefferson offered $700 on the spot and the owner accepted. The wheels in Jefferson’s mind were turning.

Jefferson put his wiring skills to use and convinced nearby residents to let him string some wires to their television sets. They agreed out of sheer curiosity. Soon Jefferson was urging the rest of Hokes Bluff to trade their rabbit ears for wires to his antenna, making Jefferson an early pioneer of the cable television industry.

Over the next several years, Jefferson acquired other plots of land in neighboring towns—Glencoe, Cedar Bluff, Centre, Piedmont—and built more antennas and strung more wires. One week after quitting his job with Goodyear, he went into the First National Bank of Gadsden to borrow $45,000 to purchase the failing cable franchise in Gadsden. When the bank said no, Jefferson convinced several local businessmen to contribute $25,000. Prodded by one of those businessmen, the bank president agreed to lend the remaining $20,000. Jefferson told Lilly that they would “either make a mint or go broke.” Lilly had no idea that Jefferson would make that claim many more times in the future.

By the late 1960s, Jefferson’s cable business was doing well and he purchased a 60-acre river-front property in Hokes Bluff and built a beautiful 8,200-square-foot home for Lilly and his two sons, Jefferson, Jr. (Junior), and George. Jefferson and Lilly were easily the most “successful” residents in the history of Hokes Bluff, and the more successful they became, the less popular they became. As in most small towns, all 2,900 townspeople in Hokes Bluff were at about the same socioeconomic level, at least until Jefferson’s success. Jefferson and Lilly wanted to feel at home in Hokes Bluff and tried everything to earn acceptance in the town. Jefferson ran for a position on the school board—and lost. He hosted barbeques at his home—
few came, and those mostly out of curiosity over the estate. He went as far as attending the church preferred by the mayor, which differed from his religious denomination. Finally, in 1975, his goal to be accepted in the community was realized when he was invited to sit on the board of the local bank. Not only was this a great personal triumph but he foresaw needing a loan from time to time.

**Growing Pains.** Jefferson continued to operate his cable business out of his garage with the help of a secretary and two linemen. As his ambition grew, he took significant risks and leveraged the company in order to acquire and develop more rural cable systems in Alabama and Georgia. Often, he was only one step ahead of creditors. He constantly told Lilly and the boys, “We’ll either make a mint or go broke.”

Jefferson pushed Junior and George to be overachievers. Both lettered in a sport. Lilly drove them into Gadsden once a week for piano lessons. Junior, the older of the two, graduated as Valedictorian among his 52 classmates, and George graduated as Salutatorian two years later. After graduating from Georgia A&M, both sons returned to Hokes Bluff to work for their father. Jefferson built a large cinderblock warehouse to house his headquarters and hired a secretary for each son. People wondered why so few employees needed such a large space, but they were unaware of the deal that Jefferson had made, growing his subscriber base from 28,000 to 90,000 overnight. Other large acquisitions followed. By the mid 1980s, the company had 160,000 subscribers and 250 employees. Based on his financial management strategy, there was not a bank within a 200-mile radius with which Jefferson did not have debt. Frankly, he and the boys had borrowed about as much as they could. Over a plate of Lilly’s meatloaf one fall evening in 1987, they decided to go public. Upon Junior’s suggestion, Means’ Cable became Helecom Communications.
Current status. By the late 1990s, Helecom was among the 10 largest cable companies in the country, with over 25,000,000 subscribers. The public offering had given Jefferson the cash needed to take the company to the next level. Although the greatest cluster of subscribers was in the Southeast, Jefferson had developed other clusters in the Midwest. George Means developed the strategy of clustering subscribers in geographic areas, which was lauded by analysts. Clustering helped to keep operating costs low and gave Helecom a much greater cash margin than its competitors.

George invested in new technologies, such as wireless and digital services, and pushed to become industry leader. Like his father, he was always looking for a profitable deal in these new service lines. He had identified several targets in the wireless market in 1995 that had been beneficial acquisitions for Helecom. However, there were a couple of targets for which his “business case” had been less appealing to Jefferson and Junior, one in home security and one in cellular. George could not persuade Jefferson that entry into the home security line would be profitable, so that particular deal never came to pass. Jefferson also was cautious of the wireless target, as it had some formidable obstacles to overcome (hence its discount) and was located in an area far from Helecom’s other clusters. Neo Wireless, a new cellular company in rural Southern California, was in the midst of a lawsuit with the FCC over a disputed tie bid for a wireless spectrum (the Federal Communications Commission auctions wireless “airspace” to wireless companies). George believed that although Neo was much smaller than the other tie-bidder, Neo would eventually come out of the suit with the spectrum and would be a profitable company with high growth potential. George wanted to create a new cluster in the Southwest. Jefferson went against his better judgment and agreed to purchase Neo to appease George. He
was adamant, however, that Neo would not become part of Helecom. Instead, Neo would be a stand-alone entity, and a personal project for George.

Based on age, experience, and interests, the top of Helecom’s governance hierarchy was structured with Jefferson as Chief Executive Officer (CEO), George as Chief Operating Officer (COO), and Jefferson, Jr., as Chief Financial Officer (CFO) and Chair of the Audit Committee.\(^2\) Jefferson and Junior designed the IPO such that Class A shares with one vote each were issued. The Means retained all Class B shares, with five votes per share, giving the Means final word on who would hold board seats. Most other members of the Board of Directors were good friends of Jefferson’s, from days at A&M, Goodyear, and the local bank. Lilly’s cousin from Helena also held a seat. Coincidentally, these were about the only shareholders willing to travel to Small-town, USA, for board meetings or annual shareholder meetings (which were held at the Gadsden Country Club with a round of golf following). Board and shareholder meetings alike were mostly informational where Jefferson shared with those present about the company’s recent victories and the deals put together by the boys and him.

Outside of the boardroom, the Means’ continued to run the business just as they always had—at the dinner table over Lilly’s home cooking—with little thought to investors, analysts, or other stakeholders. Jefferson continued to make the deals that had made Helecom successful. He sought smaller competitors within geographic clusters for acquisition, most of which had unused capacity that could be developed by George to further expand Helecom’s subscriber base. In November, 2000, Jefferson had six to eight deals on the table, most with commitments to purchase stock at some agreed upon price. Jefferson’s deal-making required him to keep Helecom highly leveraged. But, in his mind, he had mastered that art and he knew that

\(^2\) Based on the requirements in The Sarbanes-Oxley Act of 2002, Jefferson, Jr. resigned from the Audit Committee, and the President of the Hokes Bluff Bank, Johnny Kinsey, took Jefferson’s place as Chair.
Helecom’s goal to become industry giant depended on it! At times, Helecom’s debt was 10 times its market capitalization, and 10 times that of any competitor. However, annual revenues approached $2.5 billion, and the stock price continued to climb in the late 1990s. Jefferson, George, and Junior increased their ownership by purchasing a large volume of stock. Jefferson had faith that the company would continue to prosper, enabling him to divest some of his shares upon retirement.

Jefferson also had established various privately-owned businesses over the years. He insisted upon keeping his salary from Helecom at a conservative amount (e.g., Jefferson’s average salary over the years 1996 to 2002 was $800,000 per year) and these businesses allowed him to subsidize his personal income. One of the businesses, MediaMarket LLC, was an advertising company that focused primarily on telemarketing services. It had several small Gadsden-area clients and Helecom. MediaMarket handled the majority of Helecom’s marketing to potential subscribers for services in areas where it had services available. Jefferson also created Service Link LLC, a customer service outsourcing agency. Its primary revenue stream was from Helecom, but other clients included the local Hokes Bluff bank and two other banks from surrounding towns. Both MediaMarket and Service Link were located in Helecom’s office building. Lilly and George’s wife, Emily, also operated a florist and home interiors business. The two hospitals and the funeral home in Gadsden provided sources of demand for the florist, and the Gadsden country club provided demand for the interiors business. Often, Jefferson would redecorate Helecom’s offices to provide business for Lilly and Emily. Jefferson could see the value in his small companies. MediaMarket and Service Link lowered Helecom’s operating costs and both of the companies received professional management fees from Helecom.

Jefferson insisted that Junior and George also draw modest salaries, the former earning an average of $550,000 and the latter, an average of $400,000 per year.
By 2001, the sentiment toward the Means family was warm. After all, the Means treated folks in Hokes Bluff like extended family. They built youth recreation facilities, sponsored an annual fair, and built a library and seniors’ center. Jefferson was rumored to have never turned away anyone who came to him in financial difficulty. Further, townsfolk were often invited as personal guests of the Means to Altanta Eagles pro football games and shows at the historic Antebellum Theatre. (They had acquired both in the 1990s.) Jefferson was finally admired by all and wealthy beyond belief. He had realized his dreams—those for his company and for himself.

**Required**

1. Based on the information provided about Helecom in the case and external research on the industry, document issues that increase the risk of fraud at Helecom. These are issues that you will make sure are discussed during the initial audit team fraud risk meeting (that is required by SAS No.99).

2. For each of the three dimensions of fraud (a.k.a., the fraud triangle)—incentives/pressures, opportunities, and attitudes/rationalizations—document what you believe to be factors that increase the risk of fraud at Helecom.

3. Based on your initial understanding of the entity and its environment, what issues suggest that revenue could be misstated due to fraud?

4. Based on your general understanding of the entity and its environment, document any concerns about the possibility for management to override controls to perpetrate fraud.

5. Given your responses to Requirements 1 through 4 above, what initial inquiries of senior management and the audit committee do you believe are needed to help better formulate your assessment of the risk of fraud?
6. At this stage of the engagement, based on your evaluation of questions 1 through 5, how should your understanding of fraud risk for Helecom influence your approach to this audit?

PART II: CONSIDERING FRAUD RISK AFTER ANALYZING A BUSINESS PROCESS

Information Related to Subscriber Management

According to Jefferson, the heart of his business is the acquisition of new subscribers and the retention of existing subscribers. The subscriber management process is the key link in Helecom’s value chain and has the overall objective of increasing the revenue growth per household. Subscribers for Helecom’s cable services are acquired in one of two ways—through marketing and sales or through the acquisition of another cable company. Retention of existing subscribers is achieved through high-quality customer service and improvement in services available. Figure 1 illustrates the activities in the subscriber management process.

---------Insert Figure 1 About Here----------

Acquisition of Subscribers through Sales and Marketing

In a typical locale, the cable service provider has a monopoly. Instead of competing with other cable providers, Helecom competes with other forms of service, such as direct broadcast satellite (DBS), broadcast television (household use of a traditional “air-wave” antenna), or digital subscriber line (DSL) Internet technology. Therefore, one objective of subscriber management is to acquire those subscribers currently using another form of service or no service at all. Helecom also strives to move “basic” subscribers up the service ladder. Helecom offers three levels of cable service: basic (20 analog channels) for an average of $15 per month, expanded (all analog channels; no digital movie, pay-per-view, or music) for an average of $35 per month, and premium (all available analog and digital channels) for an average of $60 per
In order to meet these two objectives, Helecom formed a strategic alliance with MediaMarket (MM) to conduct various targeted marketing techniques, including television and radio advertising and e-marketing (methods using the Internet as a medium). Helecom must constantly monitor the competition, customers’ product preferences, and general responsiveness to marketing campaigns. Figure 2 lists details about how the alliance between Helecom and MM operates.

--- Insert Figure 2 About Here ---

Helecom also has recently entered into strategic alliances with various television retailers who sell Helecom’s cable services to customers, at a promotional rate, when they purchase a television. The retailer bills Helecom a monthly sales services fee for each cable package sold (according to cable service level). Helecom requests that the retailers also report the number of television units sold on the monthly bill to aid in evaluating the efficacy of the venture.

Helecom has experienced a good return on its marketing endeavors over the period of 2000 to 2002. On average, Helecom has grown the number of new subscribers by an average of 16% per year through marketing activities. Jefferson attributes this kind of revenue growth to competitive pricing of services (compared to available DBS) and effective contact with existing and potential customers.

Notwithstanding Helecom’s marketing success, Jefferson’s preferred method to increase the subscriber base is to acquire other cable companies. He calls it the “Voila! effect.” Find a cable company with a reasonable number of subscribers, sufficient unused cable capacity, and shares trading at a discount. Then, buy it and voila! However, an immediate, significant increase in number of subscribers and capacity that can be developed for sales to new subscribers

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4 Helecom’s cable product rates vary slightly by geographic area. Furthermore, rates are regulated by the 1992 Cable Act which essentially limits increases in rates in areas where there is a lack of “effective competition.”
is needed to justify the acquisition. Jefferson and Junior believed that they made several great
buys in 2001 and 2002. One deal in particular involved the ninth largest cable company in the
US, Tribex Communications. With the 2002 purchase of Tribex, headquartered in Columbus,
Ohio, Helecom acquired a large cluster in the Midwest and increased its subscriber base by 26%.
Further, Tribex had a large proportion of subscribers at the high end of its service offerings; thus,
Helecom was able to acquire those subscribers into its premium service level. Because of this
acquisition, 2002 marked the first year that the premium service level represented the majority of
subscribers. Furthermore, it made Helecom the third largest cable company in the US.

Jefferson, Jr., uses various indicators to gauge performance in the area of customer
acquisition, all of which are reported to shareholders and regulators in the 10-K and annual
report. Indicators include the number of (and percentage change in) cable subscribers, by level,
and the number of (and percentage change in) new cable subscribers, by level. Total
subscribers are computed using the number of subscribers of Helecom, including cable and
Internet (Neo). To account for new subscribers, Helecom adds the total number of subscribers
from acquired companies and reported by alliance partners. Annual subscriber counts for the
years 2000 through 2002 are shown in Table 1. These figures are required by the SEC and are
tracked by analysts.

---------Insert Table 1 About Here---------

Retention of Subscribers

Another element of the subscriber management process is subscriber retention. Helecom
views retention along two dimensions: absolute retention and level-of-service retention. The
primary focus is on absolute retention of the subscriber. Each subscriber has the ability to cancel

5 This indicator is broken down to show both “new” as a subscriber and “new” to the service level (from changes in
service level.)
cable service in favor of another form of service (e.g., DBS such as DirecTV). The customer service mission requires that whenever subscribers cancel service, representatives are to make reasonable concessions to retain the customers.

The secondary objective of subscriber retention is minimizing the loss of a current subscriber to a lower level of service. Subscribers at the premium level of service are most likely to opt for a lesser service level based on the high subscriber cost for the premium level. Subscribers at the expanded level of service also are at risk of being lost to the basic level. Whenever subscribers opt downward, representatives are first to attempt retaining them at their current level, and second, to attempt allowing only one level of service reduction.

Helecom attempts to combat absolute subscriber loss by continuously updating home equipment (e.g., the receiver box) and promptly responding to technical difficulties and outages utilizing its alliance partner, Service Link (SL). Absolute loss and level-of-service loss can be reduced by periodically adding new features and channels (e.g., on-screen menu functionality and additional channels). Figure 3 lists details about how the alliance between Helecom and SL Operates.

---------Insert Figure 3 About Here---------

Jefferson and George meet with sales managers from Helecom and SL monthly to review indicators related to subscriber retention. The performance indicators include number of cable subscribers canceling service, number of cable subscribers reduced to a lower level of service, ratio of subscribers canceling services to number of incoming customer service calls, and dollar amount of SL service fees per incoming customer service calls. They also review changes in overall subscriber counts and counts according to level of service. As with subscriber acquisition, George reports the indicators in the 10-K and annual report.
Overall, subscriber management has been an effective process for Helecom, making it one of the company’s strongest competitive advantages. Analysts generally have been impressed by Helecom’s subscriber management process. Reports consistently laud Helecom’s ability to grow its subscriber base and note its impressive margins earned per subscriber and the percentage of subscribers relative to total residents within its market.

**Required**

1. Your manager has partially completed a business process analysis for subscriber management (see Figure 4). Complete the remainder of the process analysis using information contained in the case and reasonable inferences.

2. Based on your understanding of the subscriber management process, how would you update your responses associated with the fraud risk assessment in Part 1 of the case?

3. What analytical tests related to revenue recognition would you perform? How would you ensure that the source information for your tests is reliable?

4. What fraud risk inquiries do you anticipate making of management relating to the fraud risk associated with subscriber management and any other business processes impacted by subscriber management?

5. What additional evidence gathering procedures for the transactions listed under Requirement 1 would you plan to perform based on the anticipated management responses to your inquiries?

--------Insert Figure 4 About Here--------
CASE LEARNING OBJECTIVES AND IMPLEMENTATION GUIDANCE

ABSTRACT

This case involves considering fraud risk by applying guidance under Statement of Auditing Standards No. 99, *Consideration of Fraud in a Financial Statement Audit* (SAS No.99), to a fictitious organization in the cable (telecommunications) industry. While many of the facts in the case are adapted from fraud risks and actions that occurred at actual organizations, the company is fictitious to enable the case to place students in the role of the auditor evaluating the organization for fraud risks both before and after analyzing a key business process. The information needed to perform a process analysis generally is not public, making the use of information from an actual client difficult, particularly when fraud risks are present.

Students perform this two-part case by first reading background information on the cable industry and Helecom Communications. Part 1 of the case requires students to address the key components of SAS No.99, including an engagement team discussion, fraud triangle assessments, unpredictable audit tests, revenue recognition issues, and management control override opportunities. Students are next given more detailed company information related to a key business process, subscriber management. Part 2 of the case requires students to perform basic components of a business process analysis of subscriber management. Finally, they are asked to update their responses to Part 1 based on the result of the process analysis. This case illustrates how fraud risk is considered continuously throughout an engagement and how a deep understanding about a business and industry help in considering fraud risk.
CASE LEARNING OBJECTIVES AND IMPLEMENTATION GUIDANCE

Learning Objectives

There are several learning objectives associated with each part of the case, although the overriding objective is to provide students an opportunity to apply SAS No.99 in a task setting for a public company being audited by an international firm. Depending on the audience and case usage, these objectives can be modified. However, we believe that the fundamental objectives are similar across audiences, so we present a general set of objectives that can be adapted as desired by instructors. The Learning Objectives for each part of the case are presented in Figure 5.⁶

Suggested Audiences

This case has been designed for courses at the undergraduate or graduate level that feature an emphasis on fraud risk assessments or assurance. To be most effective, we recommend that the two parts of the case be assigned and discussed separately. Depending on the depth of classroom discussion desired, we believe that discussion of each part should not require more than 40 minutes or so of each classroom session. However, if class time is too limited, one of the parts (likely Part 2) may be performed completely outside of class. The learning objectives and usage of the case can vary depending on the specific audience utilized. Here, we discuss several possibilities for using the case; however, other options might be equally effective.

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⁶ Pursuant to the formation of the Public Company Accounting Oversight Board (PCAOB), the specific procedures performed to assess fraud risk might change. However, the procedures performed in this case are expected to be required under any new standard. Additional procedures also might be required, which can be added to the case requirements by instructors if so desired.
**Introductory Assurance Courses.** This case should be useful within an introductory assurance course, particularly if it features business-risk oriented audit approaches being utilized to some extent at all of the Big Four international firms (e.g., Lemon et al. 2000). Most importantly for introductory courses, the case provides students with practice identifying elements of the fraud risk triangle (i.e., opportunities, incentives, and rationalization) and allows discussion of the interactivity of the fraud risk elements. Students are also provided with a context in which to study requirements of SAS No.99. Instructors might wish to discuss client acceptance issues in conjunction with the fraud risk analysis, after students have developed initial findings in Part 1.

Because students might prefer to make inferences based on discussion with others (i.e., other audit team members) or perform outside research on the industry, this case might be most effective for introductory courses if assigned to teams of students for work done outside of class, after discussing requirements together as a class. One useful approach that we have taken is to have the instructor perform the role of engagement partner and utilize the classroom discussion for Part 1 as the engagement team discussion of the risk of material misstatement due to fraud that is required under SAS No.99 (i.e., the brainstorming session). Utilizing the case in this manner enhances the spirit of SAS No.99 and provides a realistic audit team meeting.

**Advanced Assurance Courses.** The case should be a good fit with most advanced assurance courses, particularly those that segregate a significant portion of the course to assessing fraud or utilizing business risk-oriented audit approaches. Because students in advanced courses should have sufficient knowledge structures in place, we recommend that students prepare at least Part 1 on their own prior to participating in a group discussion or completing a more comprehensive report on the case (which might be effective if completed by
teams). If students have not been exposed to business risk-oriented audit approaches in introductory courses, completion of Part 2 of the case might be effective if assigned to teams of students outside of class or if the requirements are discussed together as a class. If teams are utilized to complete either of the parts, we recommend utilizing group presentations. Such presentations can involve having groups present their results to the class in the form of an engagement team meeting or a quality review report to the Public Company Accounting Oversight Board (as mandated under the Sarbanes-Oxley Act of 2002).

**Fraud/Forensic Accounting Courses.** Even though this case focuses on a financial statement auditor’s assessments and responses to the risk of material misstatement due to fraud, instructors of courses that feature fraud/forensic accounting might find that this case helps achieve learning objectives other than those described in Figure 5. Instructors who utilize the case in this type of environment might want to modify the listed requirements to enable other learning objectives to be achieved. The primary reason that we are suggesting this case for a fraud/forensic course is that it involves fraud risk characteristics found at public companies that committed actual fraud and enables students to assess the risk of fraud using components of the fraud triangle, which has traditionally been utilized in fraud/forensic accounting courses (e.g., Albrecht 2003). As a suggested alteration to the requirements of this case, students could identify aspects of the case that impact each aspect of the fraud triangle—both overall and for subscriber management—and suggest fraud investigation techniques that could be utilized to address the students’ concerns. Instructors in fraud/forensic courses might also place the students in the role of an expert witness and require them to develop litigation support materials for the case. Students could be assigned as either plaintiff or defense witnesses and provide their oral testimonies in class, in the form of a mock trial.
Uniqueness of Context

The case provides a rich context for students to consider the risk of fraud and its impact on the auditor. The company in the case is a long-time family-owned business that is newly public. Even after the company becomes public, it maintains much of its family-owned philosophies, such as its highly-centralized organizational structure and informal, ad hoc control system. Because students are provided with information from throughout the life of the company, they are able to consider the “new” accountability to shareholders and regulators and the ability of management to adapt. The company also demonstrates, in a real context, the significance of related-party transactions.

Student Evaluation of the Case

To gauge the effectiveness of the requirements of each part of the case in achieving the associated learning objectives, this case was pilot tested within both undergraduate and graduate assurance courses that include coverage of risk assessments. Across pilot tests, the case was assigned in various formats—both parts discussed in class, only part 1 discussed in class, neither of the parts discussed in class—both as team and individual assignments. The format that was evaluated by instructors as being the most efficient and effective was the option of having students prepare individually for an in-class mock “brainstorming session” (as called for by SAS No.99) after being provided only with information from Part I. Then, following the in-class brainstorming exercise, students were organized into auditing teams, provided with Part II of the case, and required to complete working papers for the Subscriber Management Process. Working papers included planned analytical procedures and inquiries. Student comments about the case experience, which were submitted anonymously after completion of the case, were positive and included comments such as:
• “The brainstorming session reflected a real-world meeting setting and offered valuable insight for participant on how skepticism is important in the mind of a public accountant.”

• “Designing analytical procedures for the case was tough, but applying our theoretical knowledge from the Auditing course did bring some closure on real-world necessity for such procedures.”

• “It is important not only to consider a client’s attitude about his/her business but also his/her attitude and relationships with family members, local businesses, competitors, and the community.”

• “Helecom made me more aware of the existence of various types of frauds and how to react to suspicions of various frauds in an audit.”

• “I specifically learned about SAS 99 and all of its components and was able to apply it in a real-world example.”

• “Working on the Helecom case forced me to work through the details of a new auditing standard—which I might not have done otherwise.”

• “I learned how difficult it is to determine what controls are in place and how they link to specific fraud implications within an organization. The case helped me to practice figuring that out.”

The only negative comments received from students were regarding the limited information of the case scenario. We believe that the case information must necessarily be limited for manageability of the case; however, we also understand that wanting to know additional facts while attempting to solve a case is natural.

The case was also utilized as part of two continuing professional education courses on fraud and SAS No.99 for practicing CPAs. For CPAs, information in Part I of the case was used for a mock “brainstorming session,” then Part II of the case was disclosed and the implications of the new information for the audit was discussed. Verbal comments of practitioners regarding the effectiveness of the case for illustrating the use of SAS No. 99 in practice were positive and several practitioners commented that the case was interesting to read.
TEACHING NOTES

Teaching Notes are available through the American Accounting Association’s new electronic publishing system at http://aaahq.org/ic/browse.htm. Full members can use their personalized usernames and passwords for entry into the system where the Teaching Notes can be reviewed and printed.

If you are a full member of AAA and have any trouble accessing this material, please contact the AAA headquarters at office@aaahq.org or (941) 921-7747.
REFERENCES


Figure 1

Activities of the Subscriber Management Process

- Identify target subscribers (MM)
- Market cable services to target subscribers (MM)
- Assess service level of subscribers (MM)
- Market higher service level to current subscribers (MM)
- Set subscriber count goals
- Identify target cable companies
- Research & Negotiate Acquisition
- Deliberate solutions for subscriber’s technical difficulties & outages (SL)
- Deliver solutions for subscriber’s desired change in service level (SL)
- Monitor changes in subscriber count—overall and by service level (SL)
- Provide customer service to subscribers (SL)
- Deliver solutions for subscriber’s desired cancellation of service (SL)
- Report & evaluate against goals using key indicators

MM: Activity performed by alliance partner, Media Market
SL: Activity performed by alliance partner, Service Link
Figure 2

Information About the Alliance between Helecom and MediaMarket

To more effectively acquire new subscribers and shift subscribers at lower levels of service to higher levels, Helecom utilizes a strategic alliance with MediaMarket (MM). Policies and procedures related to this component of subscriber management and the alliance are provided below:

- MM targets subscribers using: (a) new resident data provided by Chambers of Commerce in service localities, (b) analysis of service localities to determine addresses not listed in Helecom’s customer database, (c) records of former (i.e. lost) subscribers provided by Helecom, and (d) records of current subscribers not at the premium service level provided by Helecom.

- Target subscriber reports are either generated by MM or provided by Helecom according to the categories of target subscribers listed above.

- Before initiating a sales call to any former subscriber, MM personnel log into Helecom’s system and view the former subscriber’s “account notes” file to determine the nature of the subscriber’s cancellation.

- MM personnel document the nature and outcome of the sales call in the “target subscriber” file according to a target subscriber number present on the target subscriber report.

- A new subscriber discount package is offered by MM for purposes of acquiring new subscribers.

- MM personnel log into Helecom’s customer database to enter new subscribers’ customer information and make service level changes to current subscribers.

- New subscribers are sent a Welcome Package containing a “personal letter” from Jefferson, documentation explaining their selected level of service, and a discount coupon for upgrade (if at the basic or expanded service level).

- MM charges Helecom a fee based on each subscriber acquired/upgraded. Because of economies of scale, the fee per customer charged is significantly reduced at an increasing rate as the number of subscribers increases. Helecom records its payments to MM as part of its customer service expense, which is netted against subscriber revenue to compute gross margin.
The majority of subscriber retention issues are addressed by Service Link under a strategic alliance with Helecom. Policies and procedures related to subscriber retention and Service Link (SL) include:

- SL personnel provide solutions to subscribers’ technical difficulties when possible. If difficulties cannot be solved, subscribers are forwarded to Helecom technicians.

- SL verifies a subscriber-reported cable outage through a series of questions. Information on actual outages is forwarded to a Helecom technical manager.

- SL personnel provide approximate time of response to subscribers for cable outage.

- SL personnel use currently-approved, new subscriber discounts to dissuade subscribers from reducing current level of service or canceling service.

- SL personnel transfer subscribers to a customer service manager for consultation and authorization before a downward level of service change order or cancellation order is entered into Helecom’s system.

- SL personnel utilize Helecom’s billing system to provide solutions to subscribers’ billing questions when possible. If the billing questions cannot be addressed, subscribers are forwarded to Helecom’s billing department.

- SL bills Helecom a fee based on the total number of subscribers serviced. Because of economies of scale, the expense per customer is significantly reduced at an increasing rate as the number of subscribers increases. Helecom records its payments to SL as part of its customer service expense, which is netted against subscriber revenue to compute gross margin.
Figure 4

Business Process Analysis for Subscriber Management

Process Objectives

- Package product offerings to promote the sale of multiple premium services
- Provide an attractive price/value relationship to customers to enable greater opportunity for entertainment and information services
- Increase the number of residential consumers who subscribe to digital service, enabling them to receive a greater variety of television channels and interactive services
- Educate customers about the advantages offered by advanced products and services
- Target marketing opportunities based on demographic data and past purchasing behavior
- Employ Telecom branding of products to promote customer awareness and loyalty

Activities

MM: Activity performed by alliance partner, Media Market
SL: Activity performed by alliance partner, Service Link

MM: Activity performed by alliance partner, Media Market
SL: Activity performed by alliance partner, Service Link
Figure 4 (Continued)

Business Process Analysis for Subscriber Management

Information Inputs

- Subscriber targets (e.g., total subscribers, subscriber percentage in market area, etc.)
- Population within market areas
- Due diligence of targeted companies
- Total number of televisions sold by retail alliance partners
- Laws and regulations associated with offering cable services in exclusive areas
- Regulatory reporting requirements
- Competitor offerings and prices (including cable providers in peer zones and satellite offerings within market areas)
- Customer preferences for offerings
- Availability of technology for services
- Alliance opportunities
- Operational budgets
- Marketing budgets

Information Outputs

- Basic service sales
- Premium service sales, including digital
- Fees to alliance partners
- Reports on subscriber data (e.g., total subscribers)
- Acquisition of cable companies
- Marketing campaigns
- Reports on customer satisfaction
- Reports on reasons for canceling service

Accounting Impact of Activities [To Be Completed by Associate Auditor]

Routine Transactions

Nonroutine Transactions

Accounting Estimates
## Internal Threat Analysis for Subscriber Management Process

[To Be Completed by Associate Auditor]

<table>
<thead>
<tr>
<th>Risks that Threaten Objectives</th>
<th>Controls Linked to Risks</th>
<th>Performance Measures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subscriber count goals are unrealistic</td>
<td>•</td>
<td></td>
</tr>
<tr>
<td>Target subscribers not identified appropriately</td>
<td>•</td>
<td></td>
</tr>
<tr>
<td>Inappropriate regulatory reporting</td>
<td>•</td>
<td></td>
</tr>
<tr>
<td>Cable company acquisitions are poor</td>
<td>•</td>
<td></td>
</tr>
<tr>
<td>Ineffective marketing of cable services to targeted consumers</td>
<td>•</td>
<td></td>
</tr>
<tr>
<td>Fee structure not optimal for either alliance partner</td>
<td>•</td>
<td></td>
</tr>
<tr>
<td>Inability to market higher service levels to existing customers</td>
<td>•</td>
<td></td>
</tr>
<tr>
<td>Poor customer service to existing customers by alliance partner</td>
<td>•</td>
<td></td>
</tr>
<tr>
<td>Violation of laws or regulations related to service exclusive markets</td>
<td>•</td>
<td></td>
</tr>
<tr>
<td>High numbers of cancellations for substitute services (e.g., satellite)</td>
<td>•</td>
<td></td>
</tr>
</tbody>
</table>
Figure 5

Learning Objectives for Each Part of Case Exercises

**Part 1: Considering Fraud Risk Prior to Analyzing a Key Business Process**

This module of the case is designed to expose students to SAS No.99 in a setting that emulates actual conditions at a client of an international accounting firm. Specifically, students are able to utilize external industry and internal control environment information:

- To consider how each element of the fraud triangle—opportunities, incentives, and rationalization—might be present in a publicly-traded client
- To identify information that should be relevant to include in a brainstorming session among engagement personnel regarding the risks of material misstatements due to fraud
- To formulate inquiries of management to better assess the risks of material misstatements due to fraud
- To focus on revenue recognition issues that might increase the risk of material misstatements due to fraud
- To identify opportunities existing at this organization in which management might override existing controls
- To gain experience integrating various information and judgments to reach an overall assessment of the risk of material misstatements due to fraud.

**Part 2: Considering Fraud Risk After Analyzing a Key Business Process**

This module of the case is designed to expose students to two important aspects of SAS No.99, maintaining professional skepticism throughout the audit and updating assessments of the risk of material misstatement due to fraud. Specifically, students are able to utilize the information about the business process:

- To gain experience completing a process analysis similar to what is performed by international accounting firms
- To be exposed to how areas in an organization outside of accounting play a key role in assessing the risk of material misstatement due to fraud
- To utilize the understanding gained from completing a process analysis to update the planned responses to fraud risk assessments made in Part 1.
- To develop analytical tests for revenue recognition based on the expectations developed in completing the business process analysis
- To consider the reliability of source information used in performing analytical tests of revenue recognition
- To formulate fraud risk inquires of management relating to the subscriber management business process and any other business processes impacted by subscriber management
- To identify additional evidence gathering procedures needed in response to anticipated management responses to inquiries.
Table 1

Annual Subscriber Count

<table>
<thead>
<tr>
<th>Subscriber Service Level</th>
<th>Actual 2002</th>
<th>ProForma 2001*</th>
<th>ProForma 2000*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic</td>
<td>4,986,000</td>
<td>5,967,000</td>
<td>6,184,000</td>
</tr>
<tr>
<td>Expanded</td>
<td>9,862,000</td>
<td>8,624,000</td>
<td>7,398,000</td>
</tr>
<tr>
<td>Premium</td>
<td>10,983,000</td>
<td>7,677,000</td>
<td>5,615,000</td>
</tr>
<tr>
<td>Total</td>
<td>25,831,000</td>
<td>22,268,000</td>
<td>19,197,000</td>
</tr>
</tbody>
</table>

*Years 2001 and 2000 are shown ProForma to account for highly material acquisitions made in 2001