Online Appendix
Sample AAERs

Sample AAERs related to financial statement fraud – one related to Income Statement fraud and another related to Balance Sheet fraud. Information which reveals that financial statement fraud occurred, the year it began, and whether the Income Statement or the Balance Sheet is in bold.

AAER 2631 – Income Statement Fraud

U.S. SECURITIES AND EXCHANGE COMMISSION

Litigation Release No. 20178 / July 2, 2007

Accounting and Auditing Enforcement Release No. 2631 / July 2, 2007

SEC v. Mark Leslie, Kenneth E. Lonchar, Paul A. Sallaberry, Michael M. Cully and Douglas S. Newton, Civil Action No. C 07-3444 (JF) (N.D. Cal.)

SEC Charges Five Former Officers of Veritas Software Corporation with Participating in Accounting Fraud Scheme

On July 2, 2007, the Securities and Exchange Commission filed civil fraud charges in the United States District Court for the Northern District of California against five former officers of Veritas Software Corporation. The SEC's complaint alleges that the defendants artificially inflated and/or intentionally manipulated and distorted Veritas' reported financial results and misled Veritas' independent auditors. **The complaint alleges that, as a result of this misconduct, Veritas filed false and misleading financial statements from 2000 through 2002.**

The individuals charged in the complaint are Mark Leslie, former chairman and chief executive officer, Kenneth E. Lonchar, former chief financial officer, Paul A. Sallaberry, former head of sales, Michael M. Cully, former controller, and Douglas S. Newton, former assistant controller. **According to the complaint, Leslie, Lonchar and Sallaberry knowingly participated in a fraudulent scheme by artificially inflating Veritas' publicly reported revenues and earnings through an improper round-trip transaction with America Online, Inc. and by lying to Veritas' independent auditors.** In addition, Lonchar, with the participation and assistance of Cully and Newton, intentionally manipulated and distorted Veritas' reported financial results from 2000 through 2002. Lonchar, Cully and Newton also misled Veritas' independent auditors.

Cully and Newton have agreed to settle the Commission's charges. Cully agreed to be permanently enjoined from violating Section 17(a) of the Securities Act of 1933 (the "Securities Act"), Sections 10(b) and 13(b)(5) of the Securities Exchange Act of 1934 (the "Exchange Act") and Exchange Act Rules 10b-5, 13b2-1 and 13b2-2 and from aiding and abetting **violations of Sections 13(a), 13(b)(2)(A)** and 13(b)(2)(B) of the Exchange Act and Exchange Act Rules 12b-20, 13a-1, 13a-11 and 13a-13, to be barred from serving as an officer or director of a public company for five years, to pay disgorgement and prejudgment interest of $181,470.67 and a civil penalty of $35,000. Newton agreed to be permanently enjoined from violating Section 13(b)(5) of the Exchange Act and Exchange Act Rules 13b2-1 and 13b2-2 and from aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Exchange Act

Rules 12b-20, 13a-1, 13a-11 and 13a-13, to pay disgorgement and prejudgment interest of $37,263.36 and a civil penalty of $25,000. The settlements by Cully and Newton are subject to court approval.

The Commission's complaint charges Leslie, Lonchar and Sallaberry with committing violations of Section 17(a) of the Securities Act, Sections 10(b) and 13(b)(5) of the Exchange Act and Exchange Act Rules 10b-5, 13b2-1 and 13b2-2 and aiding and abetting violations of Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Exchange Act Rules 12b-20, 13a-1, 13a-13 and 13b2-1. Lonchar is also charged with aiding and abetting violations of Section 13(b)(2)(B) of the Exchange Act. The complaint seeks injunctive relief, disgorgement of ill-gotten gains plus prejudgment interest, civil monetary penalties and officer and director bars against each of them.

http://www.sec.gov/litigation/litreleases/2007/lr20178.htm

AAER 3176 – Balance Sheet Fraud

U.S. SECURITIES AND EXCHANGE COMMISSION

Litigation Release No. 62773 / August 26, 2010

Accounting and Auditing Enforcement Release No. 3176 / August 26, 2010

In the Matter of Stephen D. Chanslor (CPA)

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Chanslor, age 59, was a certified public accountant licensed to practice in the State of Texas until his license expired in June 1996. In January 1997, the Texas State Board of Public Accountancy issued an order suspending Chanslor's license based on his failure to fulfill continuing professional education requirements, and in January 2000, Chanslor's license was statutorily revoked. He served as Chief Financial Officer of Geotec, Inc. from April 2005 until October 2005.

2. Geotec was, at all relevant times, headquartered in Delray Beach, Florida. At all relevant times, Geotec's common stock was registered with the Commission and quoted in the Pink Sheets operated by Pink OTC Markets Inc.

3. In June 2009, the Commission filed a complaint against Chanslor in SEC v. Geotec, Inc., et al. (Civil Action No. 09-CV-80986). On July 28, 2010, the Court entered an order permanently enjoining Chanslor, by consent, from future violations of Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13a-14 and 13b2-1 thereunder, and aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder. The Court also imposed an officer-and-director bar and a civil penalty of $25,000 against Chanslor.

4. The Commission's complaint alleged, among other things, that **Chanslor engaged in a fraudulent scheme which resulted in Geotec falsely reporting in its Commission filings that it had acquired millions of tons of coal. Chanslor signed Geotec's Form 10-QSB for the quarter ended March 31, 2005 and Form 10-QSB for the quarter ended June 30, 2005. In both filings, Geotec falsely represented it had acquired 3.7 million tons of coal and a permit had been obtained for the coal, and improperly recorded**

the coal as an $18.9 million asset. Geotec omitted to disclose that the coal was under a state receivership, rendering its claimed ownership tenuous at best, and Chanslor signed these filings, knowing they falsely stated there was a permit. The Securities and Exchange Commission announced today that it filed civil fraud charges against Stansbury Holdings Corporation, a mining company, and two former officers, as well as aiding and abetting charges against the company's auditors. In the suit, filed in federal court in the District of Colorado, the Commission alleges that former chief executive officer Aldine J. Coffman, Jr. of Denver, Colorado; former chief financial officer Dennis R. Staal of Chadron, Nebraska; and Richard E. Sellers and Sellers & Associates P.C. of Henderson, Nevada, Stansbury's auditors, caused Stansbury to overstate its assets in numerous periodic filings and in offering documents.

Appendix Table 1
Survival Analysis - Macro Variables

$$IS|BS_{i,t} = \beta_1 \, PE \, MKT_t + \beta_2 DEFAULT \, RISK_t + \beta_3 GDP_t + \beta_4 SURPRISE_t + \beta_5 SEC_t + \beta_6 IS|BS \, DETECT_t + \beta_7 IPOS_t + \varepsilon_{i,t}$$

	INCOME STATEMENT	BALANCE SHEET
PE MKT	1.054***	1.004
	(3.76)	(0.35)
DEFAULT RISK	1.059	1.496***
	(0.48)	(2.63)
GDP	1.016**	1.008
	(2.47)	(0.74)
SURPRISE	0.982*	0.998
	(-1.92)	(-0.14)
SEC	0.934	0.830
	(-0.96)	(-1.64)
IS DETECT	1.016	
	(0.05)	
BS DETECT		0.803
		(-1.13)
IPOS	1.282***	0.787**
	(3.06)	(-2.17)
OBSERVATIONS	117,483	117,483
FAILURES	161	68
R-SQUARED	0.24	0.19

Appendix Table 1 presents the results of Cox proportional hazards models estimating variants of equations (2) and (3). Equations (2) and (3) estimate the relation between IS and BS fraud respectively and macro and firm-level determinants; only macro variables are analyzed in this table. The first column models Income Statement fraud; the second column models Balance Sheet fraud. *PE MKT* is the value-weighted annual market price-earnings ratio; *DEFAULT RISK* is the difference between the long term BAA corporate bond rate and the 10 year treasury bill rate; *GDP* is gross domestic product (inflation adjusted and expressed in 2005 $100s of billions) detrended using the Hodrick and Prescot [1997] filter; *SURPRISE* is the difference between actual GDP and expected GDP; SEC is the SEC's annual budget appropriation; *IS DETECT* is the average time to detect IS frauds initiated in the current year; *BS DETECT* is the average time to detect BS frauds initiated in the current year; *IPOS* is the number of IPOs in the current year. Z-statistics appear in parentheses. ***, **, and * denote significance at the .01, .05, and .10 levels respectively.

Appendix Table 2
Survival Analysis - Fraud Firms Only

$$IS|BS_{i,t} = \beta_1 PE\ MKT_t + \beta_2 DEFAULT\ RISK_t + \beta_3 GDP_t + \beta_4 SURPRISE_t + \beta_5 SEC_t + \beta_6 IS|BS\ DETECT_t + \beta_7 EARN\ SEN_{i,t-1} + \beta_8 KZ_{i,t-1} + \beta_9 AB\ RET_{i,t-1} + \beta_{10} SIZE_{i,t-1} + \beta_{11} ROA_{i-t-1} + \beta_{12} IPO_{i,t} + \varepsilon_{i,t}$$

	INCOME STATEMENT	BALANCE SHEET
PE MKT	1.038***	1.018
	(3.39)	(1.14)
DEFAULT RISK	0.947	1.633***
	(-0.32)	(3.75)
GDP	1.005	1.004
	(0.83)	(0.39)
SURPRISE	0.976***	0.995
	(-3.74)	(-0.41)
SEC	1.023	1.199**
	(0.42)	(2.12)
IS DETECT	0.764	
	(-1.30)	
BS DETECT		1.005
		(0.02)
IPOS	1.137**	0.838**
	(2.26)	(-2.01)
EARN SEN	1.004***	0.996*
	(3.75)	(-1.74)
KZ	0.924***	1.083***
	(-2.57)	(2.79)
AB RET	1.220***	0.655**
	(2.66)	(-2.08)
SIZE	1.093**	0.946
	(2.32)	(-0.86)
ROA	0.533	1.530
	(-1.41)	(0.48)
IPO	1.965**	0.526
	(2.55)	(-1.35)
OBSERVATIONS	2,059	2,059
FAILURES	161	68
R-SQUARED	0.30	0.35

Appendix Table 2 presents the results of Cox proportional hazards models estimating variants of equations (2) and (3). Equations (2) and (3) estimate the relation between IS and BS fraud respectively and macro and firm-level determinants. The first column models Income Statement fraud and the second column models Balance Sheet fraud. *PE MKT* is the value-weighted annual market price-earnings ratio; *DEFAULT RISK* is the difference between the long term BAA corporate bond rate and the 10 year treasury bill rate; *GDP* is gross domestic product (inflation adjusted and expressed in 2005 $10s of billions) detrended using the Hodrick and Prescot [1997] filter; *SURPRISE* is the difference between actual GDP and expected GDP; *SEC* is the SEC's annual budget appropriation; *IS DETECT* is the average time to detect IS frauds initiated in the current year; *BS DETECT* is the average time to detect BS frauds initiated in the current year; *IPOS* is the number of IPOs during the year. *EARN SEN* is the difference between the firm's price-earnings ratio and its predicted price-earnings ratio from the annual regression of equation (1); *KZ* is the financial constraint proxy developed by Kaplan and Zingales [1997]; *AB RET* is the firm's annual abnormal return; *SIZE* is the natural logarithm of the firm's market capitalization; *ROA* is the firm's operating income after depreciation scaled by average total assets; *IPO* is an indicator that equals 1 if the firm made an initial public offering in the current or preceding two years and 0 otherwise. Z-statistics appear in parentheses. ***, **, and * denote significance at the .01, .05, and .10 levels respectively.

Appendix Table 3
Survival Analysis - Non-Fraud AAERs

$$NFAAER_{i,t} = \beta_1 PE\ MKT_t + \beta_2 DEFAULT\ RISK_t + \beta_3 GDP_t + \beta_4 SURPRISE_t + \beta_5 SEC_t + \beta_6 NF\ DETECT_t + \beta_7 EARN\ SEN_{i,t-1} + \beta_8 KZ_{i,t-1} + \beta_9 AB\ RET_{i,t-1} + \beta_{10} SIZE_{i,t-1} + \beta_{11} ROA_{i,t-1} + \beta_{12} IPO_{i,t} + \varepsilon_{i,t}$$

	NON-FRAUD
PE MKT	1.013
	(0.91)
DEFAULT RISK	0.867
	(-0.74)
GDP	1.016**
	(2.17)
SURPRISE	1.002
	(0.16)
SEC	0.943
	(-0.55)
NF DETECT	0.673
	(-1.31)
IPOS	0.999
	(-0.57)
EARN SEN	1.001
	(1.10)
KZ	0.991
	(-0.10)
AB RET	1.266*
	(1.69)
SIZE	1.411***
	(5.93)
ROA	1.588
	(0.81)
IPO	0.588
	(-1.16)
OBSERVATIONS	117,483
FAILURES	78
R-SQUARED	0.28

Appendix Table 3 presents the results of Cox proportional hazards models estimating a variant of equation (2) where the dependent variable is replaced by *NFAAER,* which equals 1 in the period a non-fraud violation begins and 0 otherwise. *PE MKT* is the value-weighted annual market price-earnings ratio; *DEFAULT RISK* is the difference between the long term BAA corporate bond rate and the 10 year treasury bill rate; *GDP* is gross domestic product (inflation adjusted and expressed in 2005 $10s of billions) detrended using the Hodrick and Prescot [1997] filter; *SURPRISE* is the difference between actual GDP and expected GDP; *SEC* is the SEC's annual budget appropriation; *NF DETECT* is the average time to detect non-fraud violations initiated in the current year; *IPOS* is the number of IPOs during the year. *EARN SEN* is the difference between the firm's price-earnings ratio and its predicted price-earnings ratio from the annual regression of equation (1); *KZ* is the financial constraint proxy developed by Kaplan and Zingales [1997]; *AB RET* is the firm's annual abnormal return; *SIZE* is the natural logarithm of the firm's market capitalization; *ROA* is the firm's operating income after depreciation scaled by average total assets; *IPO* is an indicator that equals 1 if the firm made an initial public offering in the current or preceding two years and 0 otherwise. Z-statistics appear in parentheses. ***, **, and * denote significance at the .01, .05, and .10 levels respectively.

Appendix Table 4
Rare Events Logit - Income Statement and Balance Sheet Fraud

$$IS|BS_{i,t} = \beta_1 PE\ MKT_t + \beta_2 DEFAULT\ RISK_t + \beta_3 GDP_t + \beta_4 SURPRISE_t + \beta_5 SEC_t +$$
$$\beta_6 IS|BS\ DETECT_t\ + \beta_7 EARN\ SEN_{i,t-1} + \beta_8 KZ_{i,t-1} + \beta_9 AB\ RET_{i,t-1} + \beta_{10} SIZE_{i,t-1} +$$
$$\beta_{11} ROA_{i-t-1} + \beta_{12} IPO_{i,t} + \varepsilon_{i,t}$$

	INCOME STATEMENT	BALANCE SHEET
PE MKT	0.048***	0.009
	(4.01)	(0.81)
DEFAULT RISK	-0.013	0.357***
	(-0.07)	(3.24)
GDP	0.014**	0.001
	(2.25)	(0.06)
SURPRISE	-0.017**	-0.013
	(-2.47)	(-1.10)
SEC	-0.127*	-0.215**
	(-1.92)	(-2.24)
IS DETECT	0.141	
	(0.55)	
BS DETECT		-0.001
		(-0.01)
IPOS	0.197**	-0.176*
	(2.56)	(-1.97)
EARN SEN	0.001***	-0.001***
	(5.99)	(-18.59)
KZ	-0.009	0.113***
	(-0.44)	(7.77)
AB RET	0.284***	-0.337
	(3.95)	(-1.39)
SIZE	0.213***	0.144**
	(4.93)	(2.12)
ROA	0.232	0.940
	(0.50)	(1.64)
IPO	0.693***	0.074
	(3.87)	(0.26)
INTERCEPT	-9.858***	-7.933***
	(-7.22)	(-7.12)
OBSERVATIONS	117,483	117,483
FAILURES	161	68

Appendix Table 4 presents the results of Cox proportional hazards models estimating variants of equations (2) and (3). Equations (2) and (3) estimate the relation between IS and BS fraud respectively and macro and firm-level determinants. The first column models Income Statement fraud and the second column models Balance Sheet fraud. *PE MKT* is the value-weighted annual market price-earnings ratio; *DEFAULT RISK* is the difference between the long term BAA corporate bond rate and the 10 year treasury bill rate; *GDP* is gross domestic product (inflation adjusted and expressed in 2005 $10s of billions) detrended using the Hodrick and Prescot [1997] filter; *SURPRISE* is the difference between actual GDP and expected GDP; *SEC* is the SEC's annual budget appropriation; *IS DETECT* is the average time to detect IS frauds initiated in the current year; *BS DETECT* is the average time to detect BS frauds initiated in the current year; *IPOS* is the number of IPOs during the year. *EARN SEN* is the difference between the firm's price-earnings ratio and its predicted price-earnings ratio from the annual regression of equation (1); *KZ* is the financial constraint proxy developed by Kaplan and Zingales [1997]; *AB RET* is the firm's annual abnormal return; *SIZE* is the natural logarithm of the firm's market capitalization; *ROA* is the firm's operating income after depreciation scaled by average total assets; *IPO* is an indicator that equals 1 if the firm made an initial public offering in the current or preceding two years and 0 otherwise. Z-statistics appear in parentheses. ***, **, and * denote significance at the .01, .05, and .10 levels respectively.

Appendix Table 5
Penalized Maximum Likelihood Analysis

$$IS|BS_{i,t} = \beta_1\,PE\,MKT_t + \beta_2 DEFAULT\,RISK_t + \beta_3 GDP_t + \beta_4 SURPRISE_t + \beta_5 SEC_t + \beta_6 IS|BS\,DETECT_t + \beta_7 IPOS_t + \varepsilon_{i,t}$$

	INCOME STATEMENT	BALANCE SHEET
PE MKT	0.055***	0.017
	(6.84)	(1.49)
DEFAULT RISK	-0.037	0.305***
	(-0.30)	(2.80)
GDP	0.023***	-0.003
	(4.40)	(-0.49)
SURPRISE	-0.010*	-0.014*
	(-1.74)	(-1.73)
SEC	-0.044	-0.156**
	(-0.95)	(-2.19)
IS DETECT	0.126	
	(0.71)	
BS DETECT		-0.056
		(-0.36)
IPOS	0.229***	-0.133
	(3.97)	(-1.64)
INTERCEPT	-9.337***	-7.942***
	(-10.96)	(-9.20)
OBSERVATIONS	269,309	269,309
FAILURES	234	92

Appendix Table 5 presents the results of penalized maximum likelihood models estimating variants of equations (2) and (3). Equations (2) and (3) estimate the relation between IS and BS fraud respectively and macro and firm-level determinants; only macro variables are analyzed in this table. The first column models Income Statement fraud; the second column models Balance Sheet fraud. *PE MKT* is the value-weighted annual market price-earnings ratio; *DEFAULT RISK* is the difference between the long term BAA corporate bond rate and the 10 year treasury bill rate; *GDP* is gross domestic product (inflation adjusted and expressed in 2005 $10s of billions) detrended using the Hodrick and Prescot [1997] filter; *SURPRISE* is the difference between actual GDP and expected GDP; SEC is the SEC's annual budget appropriation; *IS DETECT* is the average time to detect IS frauds initiated in the current year; *BS DETECT* is the average time to detect BS frauds initiated in the current year; *IPOS* is the number of IPOs in the current year. Z-statistics appear in parentheses. ***, **, and * denote significance at the .01, .05, and .10 levels respectively.