University of Washington
ACCTG 523: Advanced Financial Analysis
Professor Terry Shevlin
Tuesday/Thursday 8.30-10.20am: Balmer 313

Professor Terry Shevlin	Office: 262
University of Washington Business School	Office hours: 10.30 –11.30 T/Thurs or by appointment
Mackenzie Hall	Phone: 206-543-7223
Seattle, WA 98195	Email: shevlin@u.washington.edu

This pre-assignment packet contains the course syllabus and the first class day of course materials, which are listed on the "Topic and Assignment Schedule" in the included syllabus.

PRE-ASSIGNMENT FOR CLASS MEETING ON THURSDAY, SEPTEMBER 29, 2005

Please read the following:
1. Course syllabus–I will briefly summarize it in class, and answer any questions.
2. Lecture notes of session 1 and case 1.
3. Prepare for the case, FastComm Communications. Please bring a written response to the questions on FastComm. The assignment is worth 5% of your grade.

Please make note of the following:
Your course-pack will be available at the Balmer Copy Center on the first day of class.

The contents of this pre-assignment pack include the following:

Syllabus

The Audit Report
Audit Report Notes
FastComm Communications (CASE#1)

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Course Overview

This course is designed to increase your ability to extract and interpret information in financial statements. Extracting the information will develop your accounting analysis skills. After taking this course, you should improve your ability to use the disclosures in a firm's annual or quarterly report to determine its accounting policy for a particular type of transaction and to determine how that policy choice affects its primary financial statements. Interpreting the information will develop your skills in assessing the relation between the accounting report and the underlying economics of the firm. After taking this course, you should improve your ability to use an accounting report as part of an overall assessment of the firm's strategy and the potential rewards and risks of dealing with the firm (as an investor, creditor, supplier, employee, etc.). You should also improve your ability to assess how the firm's stated strategy corresponds to its actual strategy and how the firm's stated accounting results correspond to its true economic results.

Ultimately, the course is about two things: a) becoming “footnote” literate: increasing your ability to extract and interpret information in financial footnotes; and b) appreciating how managers use/abuse accounting discretion to achieve strategic reporting objectives.

The course adopts a user perspective of accounting by illustrating specific accounting issues in various decision contexts. The course assumes a solid understanding of financial accounting.

Course Materials

Required

Accounting 523 Course Pack

Revsine, L., D. Collins and W.B. Johnson 2004. **Financial Reporting and Analysis (3rd edition).**

This text is a good reference on accounting and disclosure topics. It also contains explanations of most of the financial statement analysis issues we address. Copies of the text are available on reserve at the Foster Library. (ISBN is 0-13-143021-1).

Course downloads, announcements, and hand-outs

I will generally make announcements in class, but may on occasion, make them via e-mail to the list of registered students. Finally, some materials will also be provided via email or through in-class handouts.

Course Structure, Grading, and Examination Policies

Your grade for the course will be determined as follows:

First day case write-up	5%
Case write-ups (team)	50%
Final (individual)	30%
Class participation (individual)	10%

First day case-write up: The first day case write-up is to be done individually, without discussion with anyone else and without making use of the suggested case solution.

Case write-ups: You are required to write-up, in detail, as a group, **12 assigned cases** in the schedule that follows. In some situations, the case may represent your first exposure to a particular issue or problem; in such instances, you are expected to read ahead and work through the case questions to the best of your group's ability. *The intent of structuring the cases in this fashion is to stimulate, rather than solidify, your thinking and our class discussion.* You should be prepared to discuss *each* case in the designated class discussion; this includes cases that have write-ups and those do not. Students will gain points by providing benefits to others through their participation in class. Benefits to others arise from asking questions and making good comments. For "write-up" cases, your group must turn in a brief (no more than 2-3 page) typed analysis of the case. Case write-ups are due at the end of the class period when assigned.

You should work through each case in your group, and then turn in one write-up, representing the group's work. You may use the case questions to structure these write-ups, but you should not feel constrained by the questions. All members of the group should bring a copy of the case to class, for use in the case discussion. Names of all individuals in the group should be noted on a title page accompanying the write-up. You may discuss the case with other students or me prior to class, but you may not make use of suggested solutions to either the assigned case or to other accounting cases covering the same company. In addition, you must turn in your own group's write-up. In other words, you cannot copy any other group's write-up. Making use of suggested case solutions or copying the case write-up of any other group will constitute cheating and will result in all group members receiving a grade of F for the course!

I expect that you will attend class regularly and on time, having prepared beforehand all assignments and readings. I expect that you will be actively involved in all class discussions, including asking questions and sharing your knowledge and experiences with the rest of the class. If you are unable to attend class on a given day (and this should not be a regular occurrence), you will not be make-up that participation in some other way.

Groupwork

Case assignments are to be prepared in groups. Group size must be at least four but not more six persons. Because you will assess the contribution of group members at the end of the course, group membership must be maintained through out the course. You may select your group from persons registered in the same section of the class.

On the last day of the course, you will asked to assess (using a peer evaluation form) the level of contribution of the members of your group. This information will be used in determining case analysis and final project grades

Final Examination: The examination will be open book, open notes take-home exam. It will cover the cumulative set of materials to that point in the course.

Topic and Assignment Schedule

Note: RCJ refers to Revsine, Collins and Johnson
CP refers to the pack by me, Shiva Rajgopal.

1 Thurs 29 Sep Course Overview and The Audit Report
Reading: CP Course Syllabus, and CP Ch. 1
Assignment: CASE #1: FASTCOMM COMMUNICATIONS for everyone

2 Tues 4 Oct Deferred Taxes – Day 1
Reading: CP Ch. 2; RCJ Ch. 13 pp. 687-718
Assignment: MDC Manufacturing Problem

3 Thurs 6 Oct Deferred Taxes – Day 2
Reading: CP Ch. 2; RCJ Ch. 13 pp. 687-718
Assignment: CASE #2: MONTEREY PASTA (write-up due)

4 Tues 11 Oct Deferred Taxes – Day 2.5
Reading: CP Ch. 2; RCJ Ch. 13 pp. 687-718
Assignment: Spill over from the previous class, if any

Revenue Recognition
Reading: CP Ch. 3; RCJ Ch. 2 pp.43-51, RCJ Ch.3 pp.107-125
Assignment: None

5 Thurs 13 Oct Revenue Recognition (continued)
Reading: CP Ch. 3; RCJ Ch. 8 pp. 383-392
Assignment: CASE #3: PATTEN CORP (write-up due)

6 Tues 18 Oct Capitalization and Write-offs
Reading: CP Ch. 4; RCJ Ch. 10 pp. 527-530, Ch.3 pp.128-9
Assignment: CASE #4: McCORMICK AND CO (write-up due)

7 Thurs 20 Oct Capitalization and Write-offs (continued)
Reading: CP Ch. 4; RCJ Ch. 10 pp. 520-527
Assignment: CASE #5: AMERICA ONLINE INC (write-up due)

8 Tues 25 Oct Inter-corporate Investments
Reading: CP Ch.5; RCJ Ch.16 pp. 885-908
Assignment: None

9 Thurs 27 Oct Inter-corporate Investments

Reading: CP Ch.5
Assignment: CASE #6: COCA-COLA ENTERPRISES (write-up due)

10 Tues 1 Nov Inventory
Reading: CP Ch.6; RCJ Ch. 9 pp. 437-472
Assignment: CASE #7: TOKHEIM CORPORATION

11 Thurs 3 Nov Analysis of Earnings Quality
Reading: CP Ch.7
Assignment: CASE #8: WIRED WANDA (write-up due)

12 Tues 8 Nov Accounting and Organizational Form
Reading: CP Ch.8
Assignment: CASE #9: SOUTHERN LAND (write-up due)

13 Thurs 10 Nov Accounting Method Changes and Changes in Estimates
Reading: CP Ch. 9; RCJ Ch.2, pp.64-69
Assignment: CASE #10: TELE-METROPOLE (write-up due)

14 Tues 15 Nov Pensions and Other Post Retirement Obligations
Reading: CP Ch.10; RCJ Ch. 14
Assignment: Pensions (An Illustrative example)

15 Thurs 18 Nov Pensions and Other Post Retirement Obligations
Reading: CP Ch.10; RCJ Ch. 10
Assignment: CASE # 11: PEPSICO (write-up due)

16 Tues 22 Nov Long-Term Debt Application
Reading: CP Ch. 11; RCJ Ch. 11 pp. 561-584
Assignment: none
Stock option questionnaire

17 Thurs 24 Nov **Thanksgiving break**

18 Tues 29 Nov Long-Term Debt Overview
Reading: CP Ch. 11; RCJ Ch. 11 pp. 561-584
Assignment: CASE #12: MGM (write-up due)

19 Thurs 1 Dec Lease Accounting Overview
Reading: CP Ch. 12; RCJ Ch. 12 pp. 631-668
Assignment: CASE #13: GIANT FOODS INC.

20	Tues	6	Dec	Capital Leases - Lessor	
				Reading:	CP Ch. 12; RCJ Ch. 12 pp. 631-668
				Assignment:	CASE #14: CRIME CONTROL (write-up due)
21	Thurs	8	Dec	Employee Stock Options, Earnings Per Share Calculations and Comprehensive Income	
				Reading:	CP Ch. 13; RCJ Ch. 15 pp. 842-853 Ch. 15, pp. 836-842
				Assignment:	CASE #15: MICROSOFT (write-up due)

Comprehensive Take-Home Final Exam (Due Tuesday Dec 13, 10.00 a.m. in my mailbox).

1a. The Audit Report

I. Role of the Auditor
  A. Auditors <u>attest</u> to the <u>financial statements</u> which are prepared by <u>management</u>.
    1. Auditors do not attest to the quality of the firm as an investment.
    2. Audits are not designed solely to detect fraud.
  B. Who Audits the Auditors?
    1. Auditors can be held liable for negligence.
    2. The value of an auditor to a client is based upon the auditor's reputation. Thus, auditors desire to maintain the value of their reputation by avoiding signing off on statements that are subsequently revealed to be faulty.

II. The Audit Report
  A. The Standard Report -- 3 paragraphs
    1. Paragraph 1 -- What statements have been audited? Who is ultimately responsible for the statements? What responsibility is the auditor assuming?
    2. Paragraph 2 -- What is the basis for the auditors opinion? What work was done?
    3. Paragraph 3 -- The auditors opinion regarding the financial statements.
      a. unqualified -- statements in conformity with GAAP
      b. qualified -- statements in conformity with GAAP except for some particular items
        1. scope of the audit was limited -- statement of what balances were not audited
        2. inadequate disclosure regarding some balances or events -- audit report usually supplements the disclosure
        3. GAAP violation regarding some balances -- audit report usually quantifies magnitude of the violation
      c. disclaimer of opinion -- scope of audit too limited to warrant an opinion
      d. adverse -- deviations from GAAP are to extensive that a qualified opinion is not even possible (extremely rare)
  B. Additional Paragraphs
    1. uncertainties highlighted
    2. changes in accounting policy highlighted
    3. emphasis of matter -- auditor wants to highlight a particular issue for the reader
    4. going concern -- auditor wants to express doubt regarding the firm's ability to continue for the next fiscal year

The Audit Report
Auditor Changes -- Some Observations

> On average, auditor changes, have not been consistently associated with significant negative abnormal returns. (See, for example, Johnson and Lys (1990))

> If switches are partitioned into those that occurred after a disagreement disclosed in an 8K filing and those that reported no such disagreement, then the following average results are attained. (See, for example, Dhaliwal, Schatzberg, and Trombley (1993))

- Negative abnormal returns are observed for the disagreement subsample around the 8K filing and positive abnormal returns are observed for the remaining subsample. The magnitude of the negative abnormal return is larger.

- The disagreement subsample exhibited poorer financial performance and increasing leverage before and deteriorating financial performance and increasing leverage after the disagreement relative to the remaining subsample.

- The disagreement subsample had positive abnormal returns in the 12 months after the disclosure (greater than 15%) while the remaining subsample exhibited slightly positive abnormal returns over the same period.

The Audit Report
Summary

1. Auditor reports are useful because they contain information regarding the following.

   - What information was audited?
   - Highlight accounting issues the auditor deems important.
   - Highlight other information the auditor deems important.
   - Identify the auditor and allow the reader to infer auditor changes.

2. Analyze auditor changes and attempt to assess the reasons for auditor changes.

CASE #1 FastComm Communications

1. The auditor's report for the 1992 financial statements of FastComm Communications is on page 10 of the case. Notes referred to in the 1992 auditor's report follow on page 11.

   a. What information relevant to users of FastComm's financial statements is contained in the 1992 auditor's report?

   b. How does the 1992 audit report depart from the standard audit report? What is the purpose served by these departures?

2. The auditor's report for the 1993 financial statements of FastComm Communications is on the page 12. A note referred to in the 1993 auditor's report is on page 13. The auditor's report for the 1994 financial statements of FastComm Communications is on page 14. Repeat questions a and b for the 1993 and 1994 audit reports.

3. A mandatory disclosure from FastComm Communications 10K report is on pages 15 and 16 of the case. Why does the SEC require such a disclosure? How is it useful? How might it be deficient?

4. A story from the Washington Post is on page 18 of the case. Does this article provide information regarding the resignation of Deloitte and Touche that is not in the disclosures cited in question 3?

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To FastComm Communications Corporation:

We have audited the accompanying consolidated balance sheet of FastComm Communications Corporation (a Virginia corporation) and Subsidiary as of April 30, 1992, and the related consolidated statements of operations, changes in stockholders' equity and cash flows for each of the two years in the period ended April 30, 1992. These financial statements and the schedule referred to below are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and schedule based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of FastComm Communications Corporation and Subsidiary as of April 30, 1992, and the results of their operations and their cash flows for each of the two years in the period ended April 30, 1992, in conformity with generally accepted accounting principles.

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. As discussed further in Note 12, as of April 30, 1992, the Company was in violation of certain loan covenants that give the lender the right to demand immediate repayment of all outstanding borrowings. This fact, among others, as described in Note 12, creates a substantial doubt about the Company's ability to continue as a going concern. The accompanying financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should the Company be unable to continue as a going concern.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedule listed in the index of financial statements is presented for purposes of complying with the Securities and Exchange Commission's rules and is not part of the basic financial statements. The schedule has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, fairly states, in all material respects, the financial data required to be set forth therein in relation to the basic financial statements taken as a whole.

ARTHUR ANDERSON & CO.

Washington, DC
July 2, 1992

12. SIGNIFICANT RISK AND RECENT OPERATIONS

The company operates in a high technology industry which is currently characterized by vigorous competition. The Company competes with companies that are significantly larger and have greater engineering and development, marketing, manufacturing, financial, personnel and other resources than the Company. The high technology industry is also characterized by a rapid rate of technological change. Accordingly, the Company's ability to compete successfully depends, in part, on its ability to anticipate and respond to changing technology. The Company's products are not patented and may be rendered obsolete by changing technology. There are no assurances that new competitive technologies will not emerge and adversely affect the Company's ability to market its products or that the Company will be able to compete successfully in the markets it has targeted.

The success of the Company's operations will depend, to a large extent, on a small number of key technical, marketing and managerial personnel. The loss of any of these key individuals could have a material adverse effect on the Company's operations. In addition, as a company operating in a complex and highly competitive field, the success of the Company will also be dependent upon its ability to hire and retain additional key technical personnel. If qualified personnel cannot be hired in a timely fashion and retained, the Company's business may be adversely affected.

During 1992, the Company purchased certain assets of Sigma Research and of Watch Hill Research. The combined effect of these transactions was to increase fixed costs significantly in fiscal 1992, with no offsetting increase in revenues. Additionally, the Company has experienced a decline in sales of its traditional products, resulting in a significant loss from operations in the current year. Successful future operations are dependent upon the Company's ability to reduce expenses and increase sales including sales of its new products of which there is no assurance.

The negative developments described above have resulted in a severe liquidity problem which the Company is addressing on an urgent basis. The Company has significant past due payables. While deferred or delayed payment terms have been negotiated with certain vendors, it can be expected that some vendors will require COD payment terms, thereby further restricting the Company's cash flow and operations. The Company's options are limited to reducing overhead, obtaining outside financing, accelerating payments of accounts receivable, and increasing sales. In January 1992, the Company imposed across-the-board salary reductions on all of its employees and commenced layoffs of certain employees. The Company is also attempting to accelerate payments of accounts receivable by offering discount incentives for early payment.

The Company has discussed, on a preliminary basis, the infusion of capital from investors to fund short-term capital requirements. The availability and amounts of any such investments is unknown at this time, and no assurance can be given that any such amounts will be available from investors.

The Company's liquidity position will remain extremely difficult. Further, as described in Note 4, although the bank has expressed no intention to demand repayment of its loans, it could do so at any time. In the event that the bank were to exercise its right to demand repayment, the need for additional capital would be critical, and the Company may be required to cease operations if it is unable to obtain capital sufficient to repay the bank.

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders of
FastComm Communications Corporation

We have audited the accompanying consolidated balance sheet of FastComm Communications Corporation and its subsidiary (the Company) as of April 30, 1993, and the related consolidated statements of operations, stockholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Company as of April 30, 1992 and for the two years then ended were audited by other auditors whose report, dated July 2, 1992, expressed an unqualified opinion on those statements and included an explanatory paragraph that described a going concern uncertainty discussed in Note 11 to the financial statements.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 1993 consolidated financial statements present fairly, in all material respects, the financial position of the Company as of April 30, 1993, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles. Also, in our opinion, such financial statement schedule for the year ended April 30, 1993, when considered in relation to the consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

DELOITTE & TOUCHE

Washington, DC
July 16, 1993

11. BUSINESS RISK

The Company operates in a high technology industry that is currently characterized by vigorous competition. The Company competes with companies that are significantly larger and have greater engineering and development, marketing, manufacturing, financial, personnel, and other resources than the Company. The high technology industry is also characterized by a rapid rate of technological change. Accordingly, the Company's ability to compete successfully depends, in part, on its ability to anticipate and respond to changing technology. The Company's products are not patented and may be rendered obsolete by changing technology. There are no assurances that new competitive technologies will not emerge and adversely affect the Company's ability to market its products or that the Company will be able to compete successfully in the markets it has targeted.

The success of the Company's operations will depend, to a large extent, on a small number of key technical, marketing, and managerial personnel. The loss of any of these key individuals could have an adverse effect on the Company's operations. In addition, as a company operating in a complex and highly competitive field, the success of the Company will also be dependent upon its ability to hire and retain additional key technical personnel. If qualified personnel cannot be hired in a timely fashion and retained, the Company's business may be adversely affected.

During 1992, the Company purchased certain assets of Sigma Research and of Watch Hill Research. The combined effect of these transactions was to increase fixed costs significantly in 1992 with no offsetting increase in revenues. Additionally, the Company experienced a decline in sales of its traditional products, resulting in a significant loss from operations in 1992. Successful future operations are dependent upon the Company's ability to reduce expenses and increase sales, including sales of its new products of which there is no assurance.

The negative developments described above resulted in a severe liquidity problem for the Company. The Company had significant past due payables and deferred or delayed payment terms with certain vendors. These events affected the Company's cash flow and operations. In January 1992, the Company imposed across-the-board salary reductions and commenced layoffs of certain employees.

During 1993, the Company took actions to improve its liquidity and operations. These actions included replacing executive management, refinancing the Company's line-of-credit and term loan agreements which were in violation of debt covenants at April 30, 1992, and issuance of additional common stock through a private placement, which contributed $ 2.2 million in cash to the Company. Additionally, holders of common stock options and warrants exercised their stock purchase rights during 1993 which contributed an additional $ 1.3 million in cash to the Company. The Company also increased its network of dealers and distributors, both in the United States and internationally, which improved sales over 1992 results.

As a result of the above, at April 30, 1993, the Company's current assets exceeded its current liabilities by a ratio of 5 to 1. The Company had approximately $ 2 million in cash and cash equivalents at April 30, 1993. The term loan, which refinanced the prior line-of-credit and term loan, is collateralized by an investment in treasury bills.

Management believes the Company has sufficient working capital and liquidity to remain as a going concern through April 30, 1994.

Report of Independent Certified Public Accountants

Board of Directors and Stockholders
FastComm Communications Corporation

We have audited the accompany balance sheet of FastComm Communications Corporation (the Company) as of April 30, 1994 and the related statements of operations, stockholders' equity, and cash flows for the year then ended. We have also audited the schedules listed in the accompanying index. These financial statements and schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedules based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements and schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements and schedules. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 1994 financial statements referred to above present fairly, in all material respects, the financial position of FastComm Communications Corporation at April 30, 1994, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

Also, in our opinion, the schedules present fairly, in all material respects, the information set forth therein.

BDO SEIDMAN

Washington, D.C.
July 29, 1994

Changes In and Disagreements with Accountants on Accounting and Financial Disclosure.

On November 20, 1992, Arthur Andersen & Co. ("AA"), the independent certified public accountants for the Company at the time, resigned. By action taken effective November 20, 1992, the Board of Directors of the Company accepted the resignation of AA and authorized senior management to seek to engage an accounting firm as independent certified public accountants for the Company for the fiscal year ended April 30, 1993.

During the Company's two fiscal years ended April 30, 1991 and 1992, and during the interim period from April 30, 1992 to November 20, 1992, there were no disagreements with AA on any matter of accounting principles or practices, financial statement disclosure, auditing scope or procedure or any reportable events. The reports of AA on the financial statements of the Company for the fiscal years ended April 30, 1991 and April 30, 1992 contained no adverse opinion or disclaimer of opinion, nor were they qualified or modified as to audit scope or accounting principles; however, the report for the 1991 fiscal year did contain an explanatory paragraph as to a "going concern" as follows:

"As discussed further in Note 10, subsequent to June 19, 1991, the date of our original report, based on unaudited financial statements, the Company incurred losses of $322,000 during the six months ended October 31, 1991, and as of that date, the Company was in violation of certain loan covenants that give the lender the right to demand immediate repayment of all outstanding borrowings. Unaudited information indicates that losses have continued since October 31, 1991. These factors, among others, as described in Note 10, create a substantial doubt about the Company's ability to continue as a going concern and an uncertainty as to the recoverability and classification of recorded asset amounts and the amounts and classification of liabilities that might result should the Company be unable to continue as a going concern.

In addition, the report for the 1992 fiscal year also contained an explanatory paragraph as to a "going concern" as follows:

"The accompanying financial statements have been prepared assuming the Company will continue as a going concern. As discussed further in Note 12, as of April 30, 1992, the Company was in violation of certain loan covenants that give the lender the right to demand immediate repayment of all outstanding borrowings. This fact, among others, as described in Note 12, creates a substantial doubt about the Company's ability to continue as a going concern. The accompanying financial statements do not include any adjustments relating to the recoverability and classification of asset carrying amounts or the amount and classification of liabilities that might result should the Company be unable to continue as a going concern."

On March 19, 1993, the Company engaged Deloitte & Touche ("D&T") as its independent certified public accountants for the fiscal year ended April 30, 1993. On May 18, D&T resigned.

By action taken effective May 18, 1994, the Board of Directors of the Company accepted the resignation of D&T and authorized senior management to seek to engage an accounting firm and independent certified public accountants for the Company for the fical year ended April 30, 1994.

Changes In and Disagreements with Accountants on Accounting and Financial Disclosure (continued):

In March 1993 D&T was initially engaged to audit the financial statements of the Company for the year ended April 30, 1993. During the audit for the fiscal year ended April 30, 1993, and during the interim period from May 1, 1993 to May 18, 1994, there were no disagreements with D&T on any matter of accounting principles or practices, financial statement disclosure or auditing scope or procedure.

D&T advised the Company in its management letter dated July 16, 1993 of certain of its concerns, including weaknesses in internal accounting controls. Additionally, D&T advised the Company of its concerns in the following matters, which had not been resolved prior to D&T's resignation and which are considered by D&T to be reportable events under applicable regulations:

a. Sales cut off at April 30, 1994. Although all product was packed prior to midnight of April 30, 1994, an immaterial portion was placed with a common carrier between midnight of April 30, 1994 and 1:30 a.m. of the following morning (May 1, 1994).

b. Allowance for sales returns and bad debts relating to past due balances in accounts receivable, potential returns and/or bad debts.

c. The policy and disclosure regarding the dates of fiscal quarter ends.

The Company has authorized D&T to respond fully to the successor accountant concerning the subject matter of each of the above.

The report of D&T on the financial statements of the Company for the fiscal year ended April 30, 1993 contained no adverse opinion or disclaimer of opinion, nor was it qualified or modified as to audit scope or accounting principles; however, such report of D&T noted that the financial statements of the Company for the fiscal year ended April 30, 1992, were audited by other auditors whose report, dated July 2, 1992, expressed an unqualified opinion on those statements and included an explanatory paragraph which described a going concern uncertainty.

Effective June 3, 1994, the firm of BDO Seidman was engaged by the Company to serve as its independent public accountants to audit the financial statements of the Company commencing with the fiscal year ended April 30, 1994.

HEADLINE: FastComm auditors quit, cite concerns

Washington Post, June 2, 1994

FastComm Communications president and chief executive Peter Madsen said Deloitte & Touche stepped down because it could not make a profit auditing a company as small as FastComm.

"We don't fit their profile," Madsen said. Deloitte is more interested in the Fortune 1000 companies where they can make more money." FastComm, which has assets of $ 8million, makes telecommunications equipment that enables consumers to use desktop computers and telephones to plug into large telecommunications networks.

Phillip Callif, a partner in Deloitte's District office, said he would not respond to that comment specifically, but noted that more than 80 percent of Deloitte's customers nationwide are small firms and that "we are actively seeking small businesses as clients.

The resignation by Deloitte & Touche, one of the six biggest accounting firms in the country, took effect May 18 and was made public in a filing last week with the Securities and Exchange Commission, the federal agency that regulates publicly traded companies.

Callif said that Deloitte had no comment on the resignation beyond what was in the SEC filing. The filing listed concerns about FastComm's having shipped inventory after midnight on April 30, the cutoff for the company's fourth quarter; about how the company recorded returned products and bad debts and about its policy and disclosure of the date that its fiscal quarters end.

Madsen said those concerns were "not big problems" and were written by someone "higher up the chain" at Deloitte from Callif who "doesn't know" FastComm. He said they expected to hire a new accounting firm in the next few days and would release fourth-quarter results in July.

FastComm, one of the region's hottest stocks last year, has watched its per-share price fall from $ 18.25 a share last summer to less than $ 7. The stock price plunge resulted in part from three money-losing quarters, Madsen said. He said it also stems from rumors among Wall Street traders about bookkeeping irregularities. Madsen said the rumors have been generated by speculators who stand to profit if the company's stock price falls.

Yesterday FastComm stock closed at $ 6.75 share, down $ 1 in trading on the Nasdaq stock market. The company lost $ 30,000 on revenue of $ 1.7 million for the third quarter, which ended Jan. 31.