# Elbit Imaging and Accounting Fraud

By

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Abstract

Accounting Fraud has come under scrutiny of regulators and received interest amongst researchers due to several accounting scandals in the past 2 decades. These frauds have often occurred due to management greed, internal control weaknesses or other factors such as financial statements manipulation, misappropriation of assets, bribery, and corruption. This study analyzes Elbit Imaging, following their accounting fraud and the SEC order. The results clearly show the existence of problems due to revenue recognition, manipulation of financial statements and asset misappropriation as indicated in our analysis.

## Introduction:

Accounting scandals such as Enron and WorldCom are caused because of manipulation of the financial statements or accounting records by the top management, board of directors, and those responsible for presentation and disclosure of financial statements. These scandals can also involve auditors as was seen in the Enron scandal when their auditor Arthur Anderson was involved. The fallout of these scandals has been increased regulations. These regulations have led to changes in requirements for disclosures, financial reporting, auditing and other regulatory requirements. The regulations have been more in developed countries such as the USA. This is because the Securities and Exchange Commission (SEC) has stringent requirements for publicly listed firms in the USA regarding presentation of their financial statements and filing forms annually with the SEC such as the 10-K besides quarterly filings such as the 10-Q. SEC also has certain requirements for foreign firms wanting to list on the US stock exchanges such as form 20-F. Due to these requirements, there is greater regulation in the US (Rezaee, 2005) and greater level of investor protection as compared to other countries.

The stringent requirements by the SEC regarding disclosures have led to reduced incentives for top management in USA to commit financial statement fraud but the jurisdiction of the SEC is limited to US firms and foreign firms listed on the US stock exchanges. Thus, non-USA firms where the top management may not be under strict supervision would still have the incentive to commit fraud. This can also be seen in the various accounting frauds that have occurred in international companies outside USA in the last decade such as the scandals involving Parmalat in 2003, Satyam in 2009, Biovali in 2009, Toshiba in 2015, Alberta Motor Association in 2016.

A similar case of accounting violations has been observed in Elbit Imaging. Elbit was in the news because of an order from the Securities and Exchange Commission on March 9, 2018 requiring Elbit Imaging to pay civil damages for its improper accounting violations and book keeping by Elbit Imaging and its subsidiaries. Additionally, a study by Gerety and Lehn (1997) showed that at the start of accounting fraud the stock performance increases but investors revise their expectations after the announcement of the SEC order. Another study by Karpoff et. al (2006) shows the extent of loss for companies that were targeted by the SEC enforcements from 1978-2002. Their analysis of 585 firms showed that firms lose the inflated money once the misconduct is revealed and must pay an additional loss of three times for every dollar inflated. Also SEC enforcements lead to increased borrowings costs for the firm (Dechow et. Al, 1996). This indicates that SEC orders can have a strong negative impact on the firm. Additionally, the top management is also vary of the press (Miller, 2006) because the negative publicity of the company would lead to a decline in its firm performance and stock price.  Such negative publicity regarding fraud would also lead to loss of confidence in the firm and losses to its investors and creditors (Shizhong and Jianming, 2002).

Recently, Elbit was also in the news because its board of directors announced a new buyback plan for the company's Series H notes which are traded on the Tel Aviv Stock Exchange

(Accesswire, 2018). It would be interesting to analyze the impact of the accounting fraud and the SEC order on the performance of Elbit as it is a foreign firm listed on the US stock exchange. The next section of this paper gives a brief history of the company. This is followed by a section describing the accounting fraud of the company, then a brief review of the literature, data analysis and a conclusion of the paper.

## History

Elbit Imaging is an Israeli firm established in 1996 with headquarters in Petach Tikva. The company deals with different real estate segments such as hotels (Radisson and Park Inn) and commercial centers through Plaza, its subsidiary from Netherlands besides offering medical services through InSightec and land plots in India. Insightec contributes to 30% of the business of Elbit while Gamida Cell and Plaza Centers contribute about 23% and 45% of the business of Elbit (Elbit, n.d). The corporate debt of the company was restructured in 2014 with unsecured financial creditors using a majority of the share capital. The two major shareholders are York Capital and Davidson-Kampner. Elbit Imaging also has a Code of Ethics and Business Conduct which is applicable to the top management and the employees of the company and has whistleblower policies and procedures in place to ensure that any fraud detected can be conveyed using the whistleblower policies to the appropriate authorities.

## Accounting Fraud

The Whistleblower procedures and the Code of Ethics and Business Conduct stated above have not be able to prevent accounting fraud in Elbit Imaging primarily due to improper documentation and lack of control procedures. Elbit Imaging and its subsidiary, Plaza were involved in a series of violations since 2006. This section gives a brief discussion of the different violations that have occurred in Elbit Imaging.

Casa Radio Project

The problem arose because Plaza entered into different contracts since 2006-2007 with third parties for the Casa Radio Project however, Plaza failed to maintain any proper documentation regarding these transactions and the consulting companies involved did not provide any of the required services. The improper documentation by Plaza was again observed in 2011 when it hired another consultant for the Casa Radio Project. The consultant was supposed to help Plaza obtain approvals from the Romanian government besides also purchasing a 15% interest in the project from the Romanian government. However, the consultant failed to perform any of the duties that were assigned. Also, Plaza failed to maintain any accurate documentation or evidence regarding the matter.

Real Estate Portfolio Sale Agency Contract

Elbit and Plaza together were involved in another problematic sales contract. The sale consisted of a combination of 47 shopping center real estate assets within USA. They signed a contract with a third party offshore entity, Sales Agent A with the order from Executive A. This contract was again executed by Elbit and Plaza without any proper due diligence procedures. The problems began when Sales Agent A gave a subcontract to Sales Agent B and it was later observed that Sales Agent B was owned by Executive A. Later, in June 2012, Elbit and Plaza paid Sales Agent A, around $ 13 million for commissions and expenses even though there was no documentation to support the matter. Additionally, after Sales Agent A received the money, he paid Sales Agent B $ 12.75 million.

## SEC order

The improper accounting records and financial books led to certain violations by Elbit Imaging under the SEC, Exchange Act Section 13(b)(2)(A) and Section 13(b)(2)(B). The Securities and Exchange Commission considered the remedial procedures adopted by Elbit Imaging and the company's cooperation with the commission during the investigation and limited the civil penalty of the company to $ 500,000. Additionally, the company is required to make the payment within 14 days of this order. This order was passed on March 9, 2018. Elbit has recently accepted the offer of the SEC (Accesswire, 2018b)

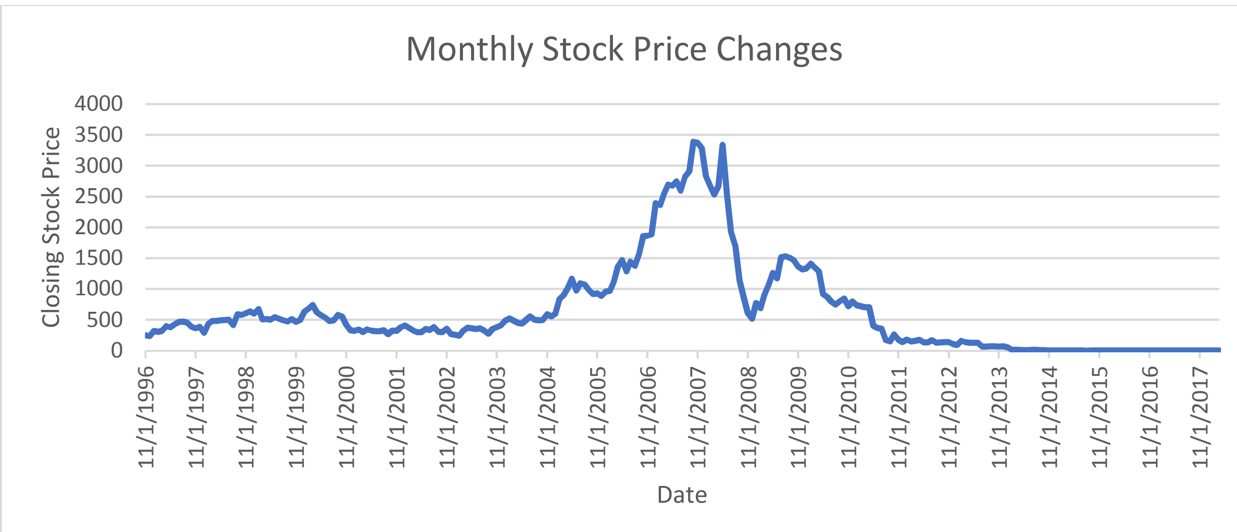
## Literature Review

The nature of accounting fraud and its impact on the company financials and accounting policies has received tremendous attention in the academic literature. A strand of literature shows that SOX has led to reduced risk taking by publicly listed firms in USA (Bargeron et al, 2010; Dey 2010), their CEOs (Cohen et. al, 2007; Cohen and Dey, 2013), and led to improved quality of financial reporting (Auburt and Grudnitski, 2014). However, Bargeron et. al (2010) also show that these results are not consistent with the non-US firms. This indicates that despite the accounting scandals and the losses sustained by the companies worldwide, non-US firms are still reluctant to impose stricter guidelines for preventing fraud and don't discourage risk taking by their top management. The case of Elbit Imaging regarding its internal control weakness and accounting violations described above is an interesting one because such a significant weakness would have a direct impact on the perception of investors and would affect the financial performance of the company. Hence it would be interesting to analyze the impact of these violations and the SEC order on the performance of Elbit Imaging.

Company Financials

Elbit Imaging is a publicly listed company. It operates in the domestic market where its stock is listed on the Tel Aviv Stock Exchange and it also operates in the foreign market as it is listed on the NASDAQ. It has around 470 full time employees. Elbit Imaging has a total market capitalization of $ 24.87 million and appropriately 9.19 million shares outstanding. The following figure shows the monthly changes in the stock price of the firm since its inception in 1996 until March 2018.

**Figure 1** Monthly Stock Price Changes of Elbit Imaging.




As shown in Figure 1 above, the stock price increased tremendously around April 2005 and was at an all-time high of 3390 in October 2007 before reducing drastically around the end of 2007. This can be attributed to the financial crisis of 2007-2008 which was responsible for the global decline in the stock price around that time. The peak stock price of 3390 in October 2007 would be due to the real estate bubble that had sent most of the prices of real estate souring around that time. Additionally, as Elbit Imaging conducts its business in real estate and land deals, the peaking of the stock price prior to the burst of the real estate bubble is understandable.

Table 1 below shows the Income Statement of the company for the years 2013-2016. As shown in the income statement, the Gross Profit of the company has been fluctuating in the past 4 years. This is due to the changes in the Cost of Revenue as compared to the Revenue. These changes can be seen in the Gross Profit Margin. The Gross Profit Margin for the year 2016 was 59787000/328275000 = 18.21% while the Gross Margin in 2015, 2014 and 2013 was 5.06%, 10.93% and 10.92%. Due to the low Gross Profit in 2016, the company recorded a loss, this loss is due to the increased operating expenses. During 2015 and 2013 also, the company recorded an overall loss due to the high interest expense in these years while there was a gain in 2014 due to the income that it received.

**Table 1**: Income Statement of Elbit Imaging

| Items (000s) | 12/31/2016 | 12/31/2015 | 12/31/2013 |
|---|---|---|---|
| Total Revenue | 85,296 | 112,701 | 653 |
| Cost of Revenue | 71,499 | 107,223 | - |
| Gross Profit | 13,798 | 5,478 | 653 |
| Operating Expenses | | | |
| Research Development | - | - | - |
| Selling General and Administrative | 1,962 | 5,686 | 16,988 |
| Non Recurring | - | - | - |
| Others | - | - | - |
| Total Operating Expenses | - | - | - |
| Operating Income or Loss | 11,836 | -208 | -16,335 |
| Income from Continuing Operations | | | |
| Total Other Income/Expenses Net | -40,641 | -9,289 | 583 |
| Earnings Before Interest and Taxes | -42,917 | -20,528 | -15,753 |
| Interest Expense | 37,413 | 60,726 | 33,885 |
| Income Before Tax | -80,330 | -81,254 | -49,638 |
| Income Tax Expense | 755 | 1,447 | 1,814 |
| Minority Interest | 35,624 | 73,188 | 73,188 |
| Net Income From Continuing Ops | -81,085 | -82,702 | -333,950 |
| Non-recurring Events | | | |
| Discontinued Operations | - | 1,767 | 1,007 |
| Extraordinary Items | - | - | - |
| Effect Of Accounting Changes | - | - | - |
| Other Items | - | - | - |
| Net Income | | | |

| | | | |
|---|---|---|---|
| **Net Income** | -81,085 | -80,935 | -332,943 |
| **Preferred Stock And Other Adjustments** | - | - | - |
| **Net Income Applicable To Common Shares** | -81,085 | -80,935 | -332,943 |

Adopted from Yahoo Finance

Table 2 below shows the Balance Sheet of the company on December 31, 2013, December 31, 2014, December 31, 2015 and December 31, 2016. As shown below the ratio of total liabilities contributed to 97.8% of the sum of liabilities and equity while the stockholders equity contributed the remaining 2.2% in 2016. The figures for 2013-2015 show that the total liabilities contributed to 88.75% in 2015, 80.51% in 2014 and 108.95%. The percentage contribution of 2013 is more than 100% because the equity section consisted only of common stock which appears to be bought back.

**Table 2**: Balance Sheet of Elbit Imaging

| Items (000's) | 12/31/2016 | 12/31/2015 | 12/31/2013 |
|---|---|---|---|
| **Current Assets** | Current Assets | Current Assets | Current Assets |
| **Cash And Cash Equivalents** | 23,304 | 40,568 | 34,711 |
| **Short Term Investments** | 10,270 | 7,729 | 3,343 |
| **Net Receivables** | 12,345 | 7,080 | 2,685 |
| **Inventory** | 485 | 532 | - |
| **Other Current Assets** | - | - | - |
| **Total Current Assets** | - | - | - |
| **Long Term Investments** | 347,524 | 452,305 | 480,838 |
| **Property Plant and Equipment** | 187,503 | 180,971 | 1,597 |
| **Goodwill** | - | - | - |
| **Intangible Assets** | - | - | - |
| **Accumulated Amortization** | - | - | - |
| **Other Assets** | 6,102 | 5,628 | 4,630 |
| **Deferred Long Term Asset Charges** | - | - | 27 |
| **Total Assets** | 587,533 | 694,813 | 527,830 |
| **Current Liabilities** | Current Liabilities | Current Liabilities | Current Liabilities |
| **Accounts Payable** | 8,876 | 4,037 | - |
| **Short/Current Long Term Debt** | 293,289 | 186,778 | 760,382 |
| **Other Current Liabilities** | - | - | - |
| **Total Current Liabilities** | - | - | - |
| **Long Term Debt** | 221,602 | 371,087 | - |

| | | | |
|---|---|---|---|
| **Other Liabilities** | 26,985 | 33,490 | 64,953 |
| **Deferred Long Term Liability Charges** | 24,149 | 21,276 | - |
| **Minority Interest** | 35,624 | 73,188 | - |
| **Negative Goodwill** | - | - | - |
| **Total Liabilities** | 610,525 | 689,856 | 825,335 |
| **Stockholders' Equity** | Stockholders' Equity | Stockholders' Equity | Stockholders' Equity |
| **Misc. Stocks Options Warrants** | - | - | - |
| **Redeemable Preferred Stock** | - | - | - |
| **Preferred Stock** | - | - | - |
| **Common Stock** | 287,367 | 284,235 | 267,136 |
| **Retained Earnings** | -105,673 | -57,731 | -313,117 |
| **Treasury Stock** | - | - | -48,551 |
| **Capital Surplus** | - | - | - |
| **Other Stockholder Equity** | -204,686 | -221,548 | -202,973 |
| **Total Stockholder Equity** | -22,992 | 4,957 | -297,505 |
| **Net Tangible Assets** | -22,992 | 4,957 | -297,505 |

Adopted from Yahoo Finance

Table 3 below shows the vertical analysis of the balance sheet of Elbit Imaging for the years 2016, 2015 and 2013. As shown in the table below long term investments had an highest contribution of more than 59% in 2016, more than 65% in 2015 and more than 91% in 2013. Additionally, Property Plant and Equipment had the second highest contribution of more than 30% in 2016 and more than 25% in 2015. The distinguishing feature about this analysis is that most of their contributions to assets are from long term investments. The vertical analysis of assets is also shown in pie charts in Figure 2, Figure 3, and Figure 4 respectively. The vertical analysis of the liabilities and equity sections will indicate that the short term debt contributed to around half of debt and equity in 2016 and around 1.4 times of debt and equity in 2013 while long term debt contributed more than half in 2015. Also, the stockholders equity is negative in the year 2016 and 2013 due to the company having a net loss in 2013 and 2016. This net loss or negative net income is reflected in retained earnings and stockholders' equity section.

**Table 3**: Vertical Analysis Balance Sheet

| Period Ending | 12/31/2016 | Vertical Analysis | 12/31/2015 | Vertical Analysis | 12/31/2013 | Vertical Analysis |
|---|---|---|---|---|---|---|
| **Current Assets** | | | | | | |
| **Cash And Cash Equivalents** | 23,304 | 3.97 | 40,568 | 5.84 | 34,711 | 6.58 |
| **Short Term Investments** | 10,270 | 1.75 | 7,729 | 1.11 | 3,343 | 0.63 |
| **Net Receivables** | 12,345 | 2.10 | 7,080 | 1.02 | 2,685 | 0.51 |
| **Inventory** | 485 | 0.08 | 532 | 0.08 | - | |
| **Other Current Assets** | - | | - | | - | |
| **Total Current Assets** | - | | - | | - | |
| **Long Term Investments** | 347,524 | 59.15 | 452,305 | 65.10 | 480,838 | 91.10 |
| **Property Plant and Equipment** | 187,503 | 31.91 | 180,971 | 26.05 | 1,597 | 0.30 |
| **Goodwill** | - | | - | | - | |
| **Intangible Assets** | - | | - | | - | |
| **Accumulated Amortization** | - | | - | | - | |
| **Other Assets** | 6,102 | 1.04 | 5,628 | 0.81 | 4,630 | 0.88 |
| **Deferred Long Term Asset Charges** | - | | - | | 27 | 0.01 |
| **Total Assets** | 587,533 | 100.00 | 694,813 | 100.00 | 527,830 | 100.00 |
| **Current Liabilities** | | | | | | |
| **Accounts Payable** | 8,876 | 1.51 | 4,037 | 0.58 | - | |
| **Short/Current L/T Debt** | 293,289 | 49.92 | 186,778 | 26.88 | 760,382 | 144.06 |
| **Other Current Liabilities** | - | | - | | - | |
| **Total Current Liabilities** | - | | - | | - | |
| **Long Term Debt** | 221,602 | 37.72 | 371,087 | 53.41 | - | |
| **Other Liabilities** | 26,985 | 4.59 | 33,490 | 4.82 | 64,953 | 12.31 |
| **Deferred L/T Liability Charges** | 24,149 | 4.11 | 21,276 | 3.06 | - | |
| **Minority Interest** | 35,624 | 6.06 | 73,188 | 10.53 | - | |
| **Negative Goodwill** | - | | - | | - | |
| **Total Liabilities** | 610,525 | 103.91 | 689,856 | 99.29 | 825,335 | 156.36 |
| **Stockholders' Equity** | | | | | | |
| **Misc. Stocks Options Warrants** | - | | - | | - | |
| **Redeemable Preferred Stock** | - | | - | | - | |
| **Preferred Stock** | - | | - | | - | |
| **Common Stock** | 287,367 | 48.91 | 284,235 | 40.91 | 267,136 | 50.61 |
| **Retained Earnings** | -105,673 | -17.99 | -57,731 | -8.31 | -313,117 | -59.32 |
| **Treasury Stock** | - | | - | | -48,551 | -9.20 |
| **Capital Surplus** | - | | - | | - | |
| **Other Stockholder Equity** | -204,686 | -34.84 | -221,548 | -31.89 | -202,973 | -38.45 |
| **Total Stockholder Equity** | -22,992 | -3.91 | 4,957 | 0.71 | -297,505 | -56.36 |
| **Net Tangible Assets** | -22,992 | | 4,957 | | -297,505 | |

**Figure 2:** Proportion of Assets in 2016

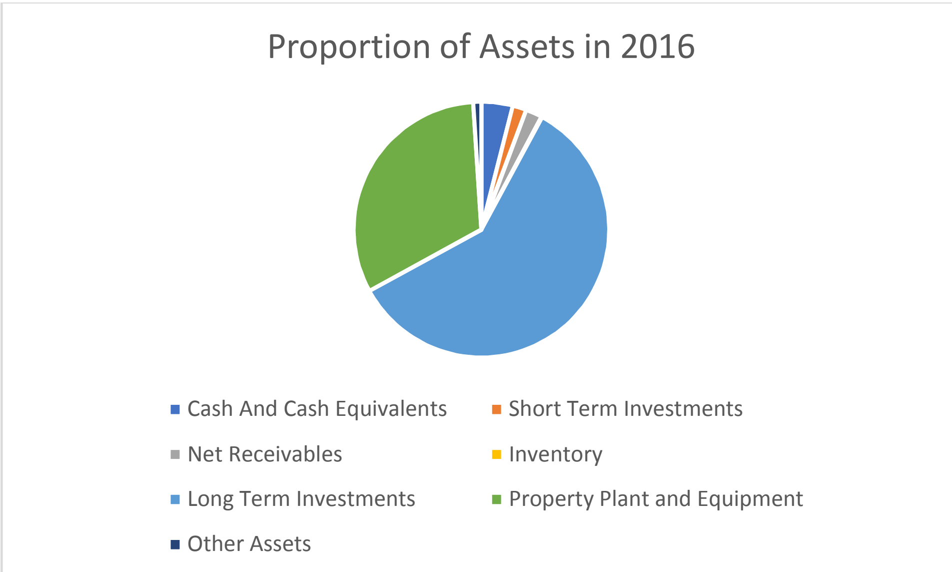



**Figure 3:** Proportion of Assets in 2015

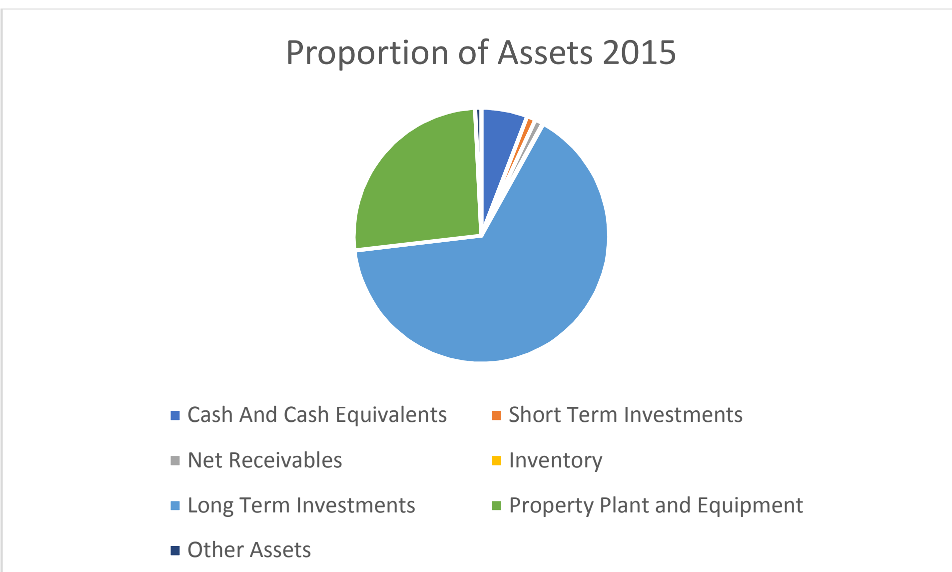
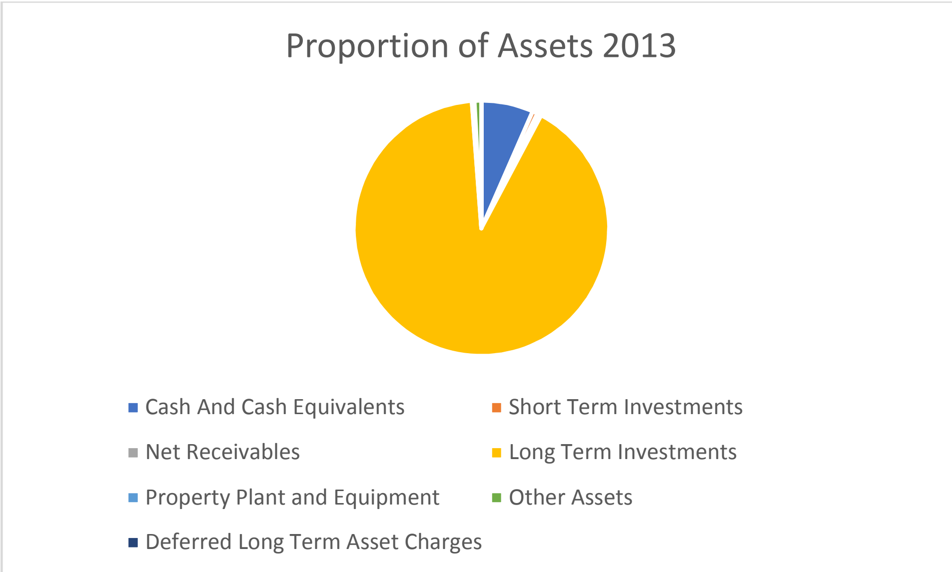



**Figure 4**: Proportion of Assets 2013



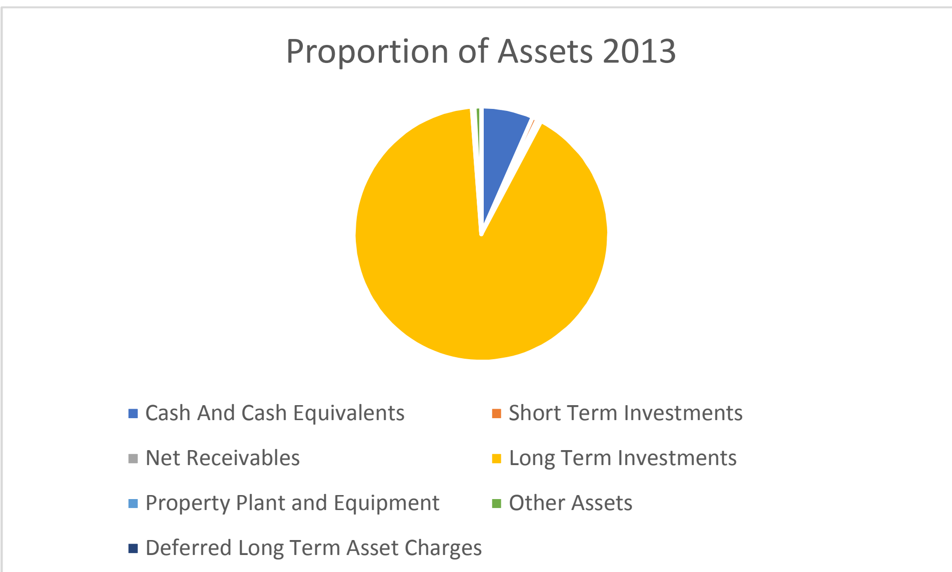




Table 4 below shows the horizontal analysis of the Balance Sheet for the years 2016, 2015 and 2013 respectively. The horizontal analysis shows that there was a 74% increase in the Net Accounts Receivables from 2015 to 2016 while the cash and cash equivalents and the long term investments reduced during this period. When we compare the figures of 2015 to 2013 we can see that the short term investments and the net accounts receivables increased around 1.3

times and 1.6 times in this period. Also there was a tremendous increase in the investment in Property Plant and Equipment during the years 2013-2015.

Table 4 also shows the horizontal analysis of the liabilities and equity section. The horizontal analysis of the liabilities and the stockholders equity section indicate that the accounts payables increased by 1.2 times from 2015 to 2016 while the long term debt declined by 40% and minority interest declined by 51% in this period. The retained earnings also reduced further by more than 80% and became more negative because of the increased net loss or the negative net income for the company. The change from 2013-2015 indicates that the retained earnings fell by 81% in this period and the short term debt reduced by 75% in this period.

**Table 4:** Horizontal Analysis Balance Sheet

| | | | Horizontal Analysis | | | Horizontal Analysis | |
|---|---|---|---|---|---|---|---|
| **Period Ending** | 12/31/2016 | 12/31/2015 | Change | % change | 12/31/2013 | Change | % change |
| **Current Assets** | | | | | | | |
| **Cash And Cash Equiv.** | 23,304 | 40,568 | -17264 | -42.56 | 34,711 | 5857 | 16.87 |
| **Short Term Investments** | 10,270 | 7,729 | 2541 | 32.88 | 3,343 | 4386 | 131.20 |
| **Net Receivables** | 12,345 | 7,080 | 5265 | 74.36 | 2,685 | 4395 | 163.69 |
| **Inventory** | 485 | 532 | -47 | -8.83 | - | | |
| **Other Current Assets** | - | - | | | - | | |
| **Total Current Assets** | - | - | | | - | | |
| **Long Term Investments** | 347,524 | 452,305 | -104781 | -23.17 | 480,838 | -28533 | -5.93 |
| **PP&E** | 187,503 | 180,971 | 6532 | 3.61 | 1,597 | 179374 | 11231.93 |
| **Goodwill** | - | - | | | - | | |
| **Intangible Assets** | - | - | | | - | | |
| **Accum. Amortization** | - | - | | | - | | |
| **Other Assets** | 6,102 | 5,628 | 474 | 8.42 | 4,630 | 998 | 21.56 |
| **Deferred Long Term Asset Charges** | - | - | | | 27 | | 0.00 |
| **Total Assets** | 587,533 | 694,813 | -107280 | -15.44 | 527,830 | 166983 | 31.64 |
| **Current Liabilities** | | | | | | | |
| **Accounts Payable** | 8,876 | 4,037 | 4839 | 119.87 | - | | |
| **Short/Current Long Term Debt** | 293,289 | 186,778 | 106511 | 57.03 | 760,382 | -573604 | -75.44 |
| **Other Current Liabilities** | - | - | | | - | | |
| **Total Current Liabilities** | - | - | | | - | | |
| **Long Term Debt** | 221,602 | 371,087 | -149485 | -40.28 | - | | |
| **Other Liabilities** | 26,985 | 33,490 | -6505 | -19.42 | 64,953 | -31463 | -48.44 |
| **Deferred Long Term Liability Charges** | 24,149 | 21,276 | 2873 | 13.50 | - | | |
| **Minority Interest** | 35,624 | 73,188 | -37564 | -51.33 | - | | |
| **Negative Goodwill** | - | - | | | - | | |
| **Total Liabilities** | 610,525 | 689,856 | -79331 | -11.50 | 825,335 | -135479 | -16.42 |
| **Stockholders' Equity** | | | | | | | |
| **Misc. Stocks Options Warrants** | - | - | | | - | | |
| **Redeemable Pref. Stock** | - | - | | | - | | |
| **Preferred Stock** | - | - | | | - | | |
| **Common Stock** | 287,367 | 284,235 | 3132 | 1.10 | 267,136 | 17099 | 6.40 |
| **Retained Earnings** | -105,673 | -57,731 | -47942 | 83.04 | -313,117 | 255386 | -81.56 |
| **Treasury Stock** | - | - | | | -48,551 | | 0.00 |
| **Capital Surplus** | - | - | | | - | | |
| **Other Stockholder Equity** | -204,686 | -221,548 | 16862 | -7.61 | -202,973 | -18575 | 9.15 |
| **Total Stockholder Equity** | -22,992 | 4,957 | -27949 | -563.83 | -297,505 | 302462 | -101.67 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Net Tangible Assets** | -22,992 | 4,957 | -27949 | -563.83 | -297,505 | 302462 | -101.67 |

Table 5 below shows the horizontal analysis of the income statement. The results indicate that the sales declined by 24% from 2015 to 2016 while they increased drastically from 2013 to 2015. The gross profit increased 1.5 times from 2015 to 2016 while it increased 7.3 times from 2013 to 2015. Selling and Administrative Expenses have been declining since 2013 and the decline has been steady in the 2013-2015 period and the 2015-2016 period. Operating income has also decreased from 20132 to 2015 but suddenly increased in 2016. Net Income increased by 19% from 2015 to 2016 but declined by 75% from 2013 to 2015.

**Table 5:** Horizontal Analysis Income Statement

| Revenue | 12/31/2016 | 12/31/2015 | Change | %Change | 12/31/2013 | Change | %Change |
|---|---|---|---|---|---|---|---|
| **Total Revenue** | 85,296 | 112,701 | -27405 | -24.32 | 653 | 112048 | 17158.96 |
| **Cost of Revenue** | 71,499 | 107,223 | -35724 | -33.32 | - | 107223 | |
| **Gross Profit** | 13,798 | 5,478 | 8320 | 151.88 | 653 | 4825 | 738.90 |
| **Operating Expenses** | | | | | | | |
| **Research Development** | - | - | | | - | | |
| **Selling General and Administrative** | 1,962 | 5,686 | -3724 | -65.49 | 16,988 | -11302 | -66.53 |
| **Non Recurring** | - | - | | | - | - | |
| **Others** | - | - | | | - | | |
| **Total Operating Expenses** | - | - | | | - | | |
| **Operating Income or Loss** | 11,836 | -208 | 12044 | -5790.38 | -16,335 | 16127 | -98.73 |
| **Income from Continuing Operations** | | | | | | 0 | |
| **Total Other Income/Expenses Net** | -40,641 | -9,289 | -31352 | 337.52 | 583 | | 0.00 |
| **Earnings Before Interest and Taxes** | -42,917 | -20,528 | -22389 | 109.07 | -15,753 | | 0.00 |
| **Interest Expense** | 37,413 | 60,726 | -23313 | -38.39 | 33,885 | 26841 | 79.21 |
| **Income Before Tax** | -80,330 | -81,254 | 924 | -1.14 | -49,638 | -31616 | 63.69 |
| **Income Tax Expense** | 755 | 1,447 | -692 | -47.82 | 1,814 | | 0.00 |
| **Minority Interest** | 35,624 | 73,188 | -37564 | -51.33 | 73,188 | | 0.00 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Net Income From Continuing Ops** | -81,085 | -82,702 | 1617 | -1.96 | -333,950 | 251248 | -75.24 |
| **Non-recurring Events** | | | | | | | |
| **Discontinued Operations** | - | 1,767 | | 0.00 | 1,007 | | 0.00 |
| **Extraordinary Items** | - | - | | | - | | |
| **Effect Of Accounting Changes** | - | - | | | - | | |
| **Other Items** | - | - | | | - | | |
| **Net Income** | | | | | | | |
| **Net Income** | -81,085 | -80,935 | -150 | 0.19 | -332,943 | 252008 | -75.69 |
| **Preferred Stock And Other Adjustments** | - | - | | | - | | |
| **Net Income Applicable To Common Shares** | -81,085 | -80,935 | -150 | 0.19 | -332,943 | 252008 | -75.69 |

Table 6 below shows the vertical analysis of the income statement. The results indicate that the Gross Profit contributed to 16% of the revenue in 2016 but just around 5% in 2015 and 100% in 2013. The company spent a gigantic amount of money on the selling, general and administrative expenses in 2013 compared to its revenue in 2013 and hence had an operating loss. The company has been spending more on expenses in 2016 and 2015 too compared to its revenue and has thus recorded a net loss or a negative net income in 2016, 2015 and 2013.

**Table 6:** Vertical Analysis Income Statement

| Revenue | 12/31/2016 | Vertical Analysis | 12/31/2015 | Vertical Analysis | 12/31/2013 | Vertical Analysis |
|---|---|---|---|---|---|---|
| **Total Revenue** | 85,296 | 100.00 | 112,701 | 100.00 | 653 | 100.00 |
| **Cost of Revenue** | 71,499 | 83.82 | 107,223 | 95.14 | - | |
| **Gross Profit** | 13,798 | 16.18 | 5,478 | 4.86 | 653 | 100.00 |
| **Operating Expenses** | | | | | | |
| **R&D** | - | | - | | - | |
| **SG&A** | 1,962 | 2.30 | 5,686 | 5.05 | 16,988 | 2601.53 |
| **Non Recurring** | - | | - | | - | |
| **Others** | - | | - | | - | |
| **Total Operating Expenses** | - | | - | | - | |

| | | | | | | |
|---|---|---|---|---|---|---|
| **Operating Income or Loss** | 11,836 | 13.88 | -208 | -0.18 | -16,335 | -2501.53 |
| **Income from Continuing Ops** | | | | | | |
| **Total Other Inc/Exp Net** | -40,641 | -47.65 | -9,289 | -8.24 | 583 | 89.28 |
| **Earnings Before Interest and Taxes** | -42,917 | -50.32 | -20,528 | -18.21 | -15,753 | -2412.40 |
| **Interest Expense** | 37,413 | 43.86 | 60,726 | 53.88 | 33,885 | 5189.13 |
| **Income Before Tax** | -80,330 | -94.18 | -81,254 | -72.10 | -49,638 | -7601.53 |
| **Income Tax Expense** | 755 | 0.89 | 1,447 | 1.28 | 1,814 | 277.79 |
| **Minority Interest** | 35,624 | 41.77 | 73,188 | 64.94 | 73,188 | 11207.96 |
| **Net Income From Continuing Ops** | -81,085 | -95.06 | -82,702 | -73.38 | -333,950 | -51140.89 |
| **Non-recurring Events** | | | | | | |
| **Discontinued Ops** | - | | 1,767 | 1.57 | 1,007 | 154.21 |
| **Extraord. Items** | - | | - | | - | |
| **Effect Of Acc. Changes** | - | | - | | - | |
| **Other Items** | - | | - | | - | |
| **Net Income** | | | | | | |
| **Net Income** | -81,085 | -95.06 | -80,935 | -71.81 | -332,943 | -50986.68 |
| **Preferred Stock And Other Adj.** | - | | - | | - | |
| **Net Income Applicable To Common Shares** | -81,085 | -95.06 | -80,935 | -71.81 | -332,943 | -50986.68 |

Table 7 below shows the ratio analysis of the company in the years 2016, 2015 and 2013. As shown below current ratio is very low because most of the assets are long term investments. Similarly quick ratio is also very low. This indicates that the company does not have enough liquidity to pay off its obligations in the short term compared to its short term liabilities and this could be due to fraud or accounting problems that the company is facing. The accounts receivable turnover ratio is also fluctuating drastically and is very low in 2013 and very high in

2015 before reducing again in 2016. This fluctuation can also be seen in the Days in Receivables ratio. The receivables percentage ratio is nearly constant. The inventory turnover ratio is changing because of the change in the cost of goods sold. As the cost of goods sold was 0 in 2013 the inventory turnover ratio was 0 and the days in inventory was infinite. Thus, the gross profit margin was 100% in 2013 and fell to 5% in 2015 before increasing again in 2016. Net Profit Margin has been negative due to the net loss of the company. The debt to equity ratio has increased significantly in 2015 indicating the use of more debt to pay off its obligations.

**Table 7:** Ratio Analysis

| Ratio | Formula | 2016 | 2015 | 2013 |
|---|---|---|---|---|
| Current Ratio | Current Assets/Current Liabilities | 0.15 | 0.29 | 0.05 |
| Quick Ratio | (Cash+Accounts Receivables)/Current Liabilities | 0.12 | 0.25 | 0.05 |
| Accounts Receivable Turnover | Sales/Average Accounts Receivables | 8.78 | 23.08 | 0.24 |
| Days in Receivable | 365/Receivables Turnover | 41.56 | 15.81 | 1520.83 |
| Receivable Percentage | Accounts Receivables/Total Assets | 0.02 | 0.01 | 0.01 |
| Inventory Turnover | Cost of Goods Sold/Average Inventory | 140.61 | 403.10 | 0 |
| Days in Inventory | 365/Inventory Turnover | 2.60 | 0.91 | Infinite |
| Gross Profit Margin | Gross Profit/Sales | 0.16 | 0.05 | 1.00 |
| Profit Margin | Net Income/Sales | -0.95 | -0.72 | -509.80 |
| Debt to Equity, Leverage | Total Liabilities/Stockholders Equity | -26.55 | 123.03 | -2.78 |

The horizontal and vertical analysis and the ratio analysis discussed above clearly indicates that the existence of fraud. The major red flags which can be seen are the sudden decline in the revenue in 2013 compared to its expenses which could indicate problems of revenue recognition. Additionally, the absence of cost of goods sold in 2013 is a serious accounting error that could be due to manipulation of financial statements. Alternatively, the increased expenses and their ability to meet the short term obligations as can be seen from the current and the quick ratio is a grave concern for the company. Elbit should focus on meeting its short term obligations and have enough liquidity failing which it may be liable for bankruptcy.

Conclusion

Accounting and financial fraud has gained importance since the past two decades. This has resulted in tremendous losses for the companies, their investors, creditors and their CEOs. While the developed countries such as USA took immediate steps with the help of the SEC to enact regulations seeking to prevent such frauds in the future, the developing countries where corporate governance structure is not very strong have still to enact stronger regulations. Hence, the top management of firms headquartered in foreign countries can have the incentive to commit fraudulent acts. Additionally, the top managements of such companies can also be careless regarding the documentation while making contracts with third party vendors.

This study analyzed Elbit Imaging, an Israeli company that had received a civil penalty from SEC regarding its internal control weakness, improper documentation and contracts with third party in the last decade. The results of the analysis clearly indicate the existence of fraud as can be seen in the sudden changes in the revenue probably due to revenue recognition fraud as well as the absence of the cost of goods sold in 2013. Also the drastically low current and quick ratios indicate the inability of the company to meet its short term obligations even when they are going into net loss every year. This clearly indicates the existence of misappropriation of assets or fraudulent activities on the part of the management for which the SEC enforced the order.

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