INTERNATIONAL SOCIETY OF BUSINESS ANALYSTS
ISBA

ISBA Network News

March 2010

In This Issue

Part 2: Partners In The World Of Valuation: The Appraiser, The Accountant And The Auditor

Kweku Boison, MSA, CPA, CSBA, CMEA

APPRAISERS, ACCOUNTANTS AND AUDITORS - PARTNERS IN THE FINANCIAL REPORTING WORLD

The general purpose of accounting is to provide financial information to users for decision-making purposes. The financial information among other considerations has to be relevant. How relevant are historical assets (costs) values? The profession has long recognized this and the Financial Accounting Standards Board (FASB) has since the latter half of the 1980s with an increasing accelerated pace in recent years put forward standards pushing the profession to improve the relevance and representational faithfulness of financial statements.

Providing users of financial statements with relevant information. The role of the Plant, Machinery and Equipment Appraiser.

It has been the practice in financial reporting that plant, property and equipment are reported at cost which is often the fair market value of the acquisition. The cost is allocated (depreciated) over the period of the use of the asset. However, through to when the assets are fully depreciated, how representational are the cost less accumulated depreciation of the fair market values of the assets? The accounting profession has struggled with this issue.

Beginning in 1986 the FASB began a concerted push for the disclosure of the fair value of assets on the financial statements. This effort started with a focus on financial instruments. Starting from SFAS 105, SFAS 107 through SFAS 141, SFAS 144, SFAS 157 to SFAS 166. (SFAS - Statements of Financial Accounting Standards). The ultimate objective was to get to a point where the financial statements and

ISBA Connect

ISBA Connect is a LIST SERVE email service that we have purchased for the members of ISBA.

What will ISBA Connect enable you to do and why do you want to participate? Answer: It will keep you connected to close to 700 ISBA members who may need your services! Also, one of your clients may need their services. Now you know where to go when a client requests information that you may not have. Through ISBA Connect, you can email out an inquiry and wait for the responses! It's a win/win/win. In most professional industries, you may be able to work out a referral fee from the ISBA member.

Each ISBA member is automatically a participant and will receive ISBA Connect ListServe emails.

INSTRUCTIONS:

To email the ISBA Connect membership, click the link below!

Email ISBA Connect

If you want to opt-out and not receive any ISBA Network Connection emails, click the link below

ISBA Connect Opt-Out

Questions?

Call (866) 290-2284 for further instructions.

disclosures reflected as close to current values as could be obtained. Of this range of standards it is SFAS 141 and SFAS 157 which focus directly on physical assets, namely plant, machinery and equipment. Under SFAS 141 Revised FASB provides the following guidance for measuring identifiable assets in paragraph 20;

"The acquirer shall measure the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at their acquisition date fair values."[i]

For accountants to be able to meet these requirements in, for example, the reporting of mergers and acquisitions, the expertise of a plant, machinery and equipment appraiser is needed. Accountants who resort to the use of book values or unsubstantiated estimates are not only misrepresenting the financial statements but also putting the clients and themselves at legal risk not to mention professional jeopardy.

SFAS 157 among other things establishes the definition of fair value and the framework for measuring fair value in generally accepted accounting principles. The definition of fair value focuses on "....the price that would be received to sell the asset or paid to transfer the liability (an exit price), not the price that would be paid to acquire the asset or received to assume the liability (an entry price).

This Statement emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, this Statement establishes a fair value hierarchy that distinguishes between (1) market participant assumptions developed based on market data obtained from sources independent of the reporting entity (observable inputs) and (2) the reporting entity's own assumptions about market participant assumptions developed, based on the best information available in the circumstances (unobservable inputs). The notion of unobservable inputs is intended to allow for situations in which there is little, if any, market activity for the asset or liability at the measurement date. In those situations, the reporting entity need not undertake all possible efforts to obtain information about market participant assumptions. However, the reporting entity must not ignore information about market participant assumptions that is reasonably available without undue cost and effort...."[ii]

The appraiser, through the systematic process of valuation is best equipped to provide answers to the accountants' questions about value and value-related issues both in and out of the market place. The goal of the process of valuation is to produce a well supported opinion of value showing that the appraiser has considered all factors that materially affect the value of the assets being appraised.[iii]   It is submitted that though SFAS 157 is written for the guidance of the accounting profession, to effectively and efficiently implement the reporting requirements of the standard, the accountant would have to depend on the "qualified appraiser". The role of the "qualified appraiser" during the financial statement preparation is to provide the CPA with all relevant information and to provide a fair value of the subject assets, which enables the CPA to make decisions on the most appropriate accounting treatment and to account for different assets used in the client company in a manner consistent with the standards. The "qualified appraisal" report provides the documentation the CPA needs to support the values reported for physical assets.

Section 404 of the Sarbanes-Oxley Act requires CEOs and CFOs of public companies to report on the completeness and accuracy of the information contained in the financial reports as well as the effectiveness of underlying internal controls. In addition the CEOs and CFO are required to give assurance that adequate disclosures, controls and procedures are maintained. For capital-intensive companies, the fixed-asset investment is often the largest portion of the asset side of the balance sheet. The income and cash flow statements are significantly impacted by the annual depreciation charges for these assets.

It so happens that often the property records of businesses are not in sync with the physical assets. For example physical assets may no longer be on the premises as the record reports them; obsolete assets are retained and depreciated as though they are contributing to the earning capacity of the entity; assets retired are not properly reflected in the books resulting in a distortion of total assets and return on investment and return on assets measurements.

The CEO or CFO signing the Sarbanes Oxley certification should do so with the full knowledge of when physical assets were last verified against the assets records; whether the assets records are burdened by obsolete non-performing assets. It falls on the CFO to ensure that the appropriate values are assigned to the company's physical assets. The appraisers are best trained to review the physical assets of companies for appropriate value assignments and value impairments by way of obsolescence.

When it comes to liquidating physical assets of companies, the services of the appraiser can be employed in the planning and determination of the effective and profitable approach to liquidate the assets.

The recent developments in the world of CPAs - Impact on the Financial Reporting partnership.

On July 1, 2009 FASB unveiled the Accounting Standards Codification. This is now the authoritative source of U.S. GAAP for non-governmental entities. The codification does not change U.S. GAAP. It only restructures the way the GAAP is organized. The unique feature of the new codification is the election by the board to make it online based. The document therefore has the following benefits; it provides access to all FASB standards and other authoritative literature related to a topic in one place; it reduces the amount of time and effort required to research accounting standards; it diminishes the risk of noncompliance with standards through improved usability and it provides accurate information with real-time updates.

CPAs can now turn to U.S. GAAP Codification of Accounting Standards - Codification Topic 360: Property, Plant and Equipment for all the authoritative pronouncements affecting physical assets.

Alongside the evolution of the SFAS has been the development of the International Financial Reporting Standards, IFRS. The IFRS is a set of accounting standards developed by the International Accounting Standards Board, IASB, an independent accounting standards body based in London.

The globalization of business and finance has led more than 12,000 companies in more than 100 countries to adopt IFRS. In 2005, the European Union (EU) began requiring companies incorporated in its member states whose securities are listed on an EU-regulated stock exchange to prepare their consolidated financial statements in accordance with IFRS1. Australia, New Zealand and Israel have essentially adopted IFRS as their national standards. Canada, which previously planned convergence with the U.S. Generally Accepted Accounting Principles (GAAP) now plans to require IFRS for publicly accountable entities in 2011. The Accounting Standards Board of Japan (ASBJ) and the International Accounting Standards Board (IASB) plan convergence by 2011. On November 11, 2008, Mexico announced it would adopt IFRS for all listed entities starting in 2012.[iv] There is a growing acceptance of International Financial Reporting Standards (IFRS) as a basis for U.S. financial reporting. This represents a fundamental change for the U.S. accounting profession. On November 14, 2008, the Securities and Exchange Commission ,SEC released for public comment a proposed roadmap with a timeline and key milestones for adopting IFRS beginning in 2014. [v]

THE ERA OF ECONOMIC AND MARKET UNCERTAINTY

The economic melt down of the past year, if anything, emphasizes on the need for relevance and representational faithfulness of financial statements. In a broad sense at the core of the financial melt down was the problem of valuation. The value of the assets represented on the books could not be supported in reality hence the fall of the institutions holding these assets and the need for government intervention to prevent a total collapse of the economy. At the company level there is the need for CPAs to be alert to the presence of obsolete and worthless assets on the books of their clients. This calls for the institution of a program of periodic revaluation of the physicals assets. The frequency of revaluations depends upon the movements in the fair values of the items of property, plant and equipment being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is necessary. Some items of property, plant and equipment may experience significant and volatile movements in fair value, thus necessitating annual revaluation.

Such frequent revaluations are unnecessary for items of property, plant and equipment with only insignificant movements in fair value. Instead, revaluation every three or five years may be sufficient[i]

The article has examined the need for collaboration between the Plant, Machinery and Equipment Appraiser and the Accounting profession. The coming changes to the accounting profession points to urgency and proactive planning. It is the hope that CPAs will enjoin in this partnership effort.

[i] IPSAS 17 - Property Plant and Equipment International Accounting Standards Board.
[i] Financial Accounting Series. Statement of Financial Accounting Standards No. 141 (Revised 2007). Business Combinations. Financial Accounting Standards Board of the Financial Accounting Foundation.
[ii] Financial Accounting Series. Statement of Financial Accounting Standards No. 157 (Amended). Fair Value Measurements. Financial Accounting Standards Board of the Financial Accounting Foundation.
[iii] Valuing Machinery and Equipment, The Fundamentals of Appraising Machinery and Technical Assets by Machinery and Technical Specialties Committee of the American Society of Appraisers. (2000) page 9.
[iv] http.www.ifrs.com/backgrounder_worldwide.html as of October 27, 2009.
[v] http.www.ifrs.com/backgrounder_Get_Ready.html as of October 27, 2009.

Kweku Boison MSA, CPA, CSBA, CMEA, Principal, Valuation and Assets Services LLC; a firm providing Plant, Machinery and Equipment Appraisal services, Business Appraisal Services and Cost Segregation Studies nationwide. He received a Master of Science, Accounting degree from James Madison University. He is qualified as a Certified Public Accountant. He has been qualified by the National Equipment and Business Brokers Institute as Certified Machinery and Equipment Appraiser and also a Certified Senior Business Analyst of the Society of Business Analysts. Please direct all questions to Kweku Boison at 301-646-4119 or projects@valuationandassets.com

Thank you for your valued membership in the International Society of Business Analysts. We are continually looking for new opportunities to expand your knowledge and bring value and success to your business.

Sincerely,

John Harris
International Society Of Business Analysts
866-290-2284