


Common Sense CFO

Balance Sheet Walk Through to Understand and Build Value


Written by
Bob Mims
CPA



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About the Author



Bob Mims, CPA, is an entrepreneur and accounting/management executive based in Memphis, TN. He has served as a CFO and CPO across various industries in the role of planning, modeling and accounting capacities. Bob has had the privilege of serving as chair on an AICPA committee and on two FASB advisory committees. During his ten years with the accounting firm KPMG, he was selected national instructor of the year on three occasions.

Bob graduated from the University of Mississippi, and enjoys outdoor sports with his wife, 5 children, 2 service dogs, and a 20-pound cat named 'Squirt'.



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Doing Everything Right?



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Polling Question
What is Your Favorite FASB?

- a) FAS 5 is probably it,
- b) FAS 87 because it's frozen,
- c) FAS 144 is one I'm evaluating,
- d) FAS 115/116 is what I'm investing in,
- e) The next one, or
- f) I prefer the recodification to license plate numbers.

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What are Assets?

Asset
 [a-set]

A resource with economic value that an individual, corporation, or country owns or controls with the expectation that it will provide a future benefit.

- Assets are cash and things you invest in so that thing can produce more cash through the P&L

Investopedia
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What About Assets? And Why?

- Cash
- Inventory
- Investments
- Accounts receivable
- PPE
- Other

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Accounting Judgement With Cash

- Debit: Cash \$1Million
- Credit: ???? \$1Million

Rule of thumb to follow:

If you debit cash for any amount of money, your credit is?

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Accounting Judgement With Cash

- Debit: Cash \$1Million
- Credit: ???? \$1Million

Rule of thumb to follow:

If you debit cash for any amount of money, your credit is?

WHO CARES?

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Cash Is King



Cash Is King
[kash iz 'kɪŋ]

A slang term reflecting the belief that money (cash) is more valuable than any other form of investment tools, such as stocks or bonds.

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How We Wish We Were Viewed

THE FAR SIDE By GARY LARSON

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A Word on the Balance Sheet

Assets		Liabilities	
Current Assets		Current Liabilities	
Cash	32,800	Accounts Payable	49,000
Accounts Receivable	300	Accrued Expenses	450
Prepaid Rent	1,000	Unearned Revenue	<u>1,000</u>
Inventory	<u>39,800</u>	Total Current Liabilities	50,450
Total Current Assets	73,900	Long-term Liabilities	<u>99,500</u>
		Total Liabilities	149,950
Long-term Assets		Owner's Equity	
Leasehold Improvements	100,000	Owner's Equity	
Accumulated Depreciation	<u>(2,000)</u>	Retained Earnings	11,950
Total Long-term Assets	98,000	Common Stock	<u>10,000</u>
Total Assets:	171,900	Total Owner's Equity	21,950
		Total Liabilities and Owner's Equity	171,900

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A Word on the Balance Sheet

Liabilities	
Current Liabilities	
Accounts Payable	49,000
Accrued Expenses	450
Unearned Revenue	<u>1,000</u>
Total Current Liabilities	50,450
Long-term Liabilities	<u>99,500</u>
Total Liabilities	149,950
Owner's Equity	
Owner's Equity	
Retained Earnings	11,950
Common Stock	<u>10,000</u>
Total Owner's Equity	21,950
Total Liabilities and Owner's Equity	171,900

- Cost of payables is likely 0-2%
- Cost of debt and working capital is 5 to 10%
- Cost of imputed equity is usually 20 to 25%
- Blended cost of capital = 9%

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A Word on the Balance Sheet

Can these assets earn you net revenue that beats your blended cost of liabilities?

Assets	
Current Assets	
Cash	32,800
Accounts Receivable	300
Prepaid Rent	1,000
InVENTORY	39,800
Total Current Assets	73,900
Long-term Assets	
Leasehold Improvements	100,000
Accumulated Depreciation	(2,000)
Total Long-term Assets	98,000
Total Assets:	171,900

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Inventory

Types of Inventory

 Raw Materials	 Components	 Work In Progress (WIP)	 Finished Goods	 Maintenance, Repair and Operations (MRO) Goods	 Packing and Packaging Materials
 Safety Stock and Anticipation Stock	 Decoupling Inventory	 Cycle Inventory	 Service Inventory	 Transit Inventory	 Theoretical Inventory
		 Excess Inventory			

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Inventory - GAAP vs IFRS

- Companies in the United States operate under the generally accepted accounting principles (GAAP), while most other countries use the International Financial Reporting Standards (IFRS).
- GAAP permits the use of all three of the most common methods for inventory accountability so long as the inventory is stated at lower of cost or market; the IFRS forbids the use of the LIFO method.
- IFRS requires that inventory is carried at the lower of cost or net realizable value; U.S. GAAP requires that inventory is carried at the lower of cost or market value.
- IFRS allows for some inventory reversal write-downs; GAAP does not.

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Inventory Valuation

- GAAP = Lower of cost or net asset value
- IFRS = Lower of cost or net realizable value
- Banks/lenders:
 - a) Typically, 80% of raw materials,
 - b) Plus 0% of work in process,
 - c) Plus 75% of finished goods.

Why would we have a value in WIP?

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IFRS/GAAP?

IFRS	vs	GAAP
Principles-based system.	APPROACH	Rules-based system.
Allows more flexibility in interpretations.	FLEXIBILITY	More rigid with specific guidelines.
Emphasizes fair value accounting.	VALUATION	Focuses on historical cost.
Used internationally in 140+ countries.	GEOGRAPHIC USE	Primarily used in the U.S.
Less detailed disclosures required.	DISCLOSURE REQUIREMENTS	Requires more detailed disclosures.
Revenue recognized when control transfers.	REVENUE RECOGNITION	Revenue recognized when risks/rewards transfer.
Development costs can be capitalized.	INTANGIBLE ASSETS	Development costs are usually expensed.
The LIFO method is not allowed.	INVENTORY VALUATION	The LIFO method is allowed.
Allows revaluation of fixed assets.	FIXED ASSETS	Revaluation of fixed assets is not required.
Financial statements presented differently.	FINANCIAL STATEMENT	Specific format and line items required.

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Accounting for Investments

How liquid are different assets?

MOST LIQUID	FAIRLY LIQUID	LEAST LIQUID
Cash	Stocks and ETFs	Cryptocurrency
Bank accounts	Corporate bonds	Real estate
CDs	Foreign currencies	Bullion
US Treasuries	Mutual funds	Art and antiques

BUSINESS INSIDER

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Case #1
The Illiquid Investment

Kramerica Industries produces VHS tapes of every Seinfeld episode. Kramerica acquires a 10% interest in Vandelay Industries (a privately held marine biologist company) for \$1M. During the year Vandelay posts a \$100k net profit and issues dividends of \$20k.

a) What is Kramerica's investment entry?
 b) What is the dividend entry?
 c) How does Kramerica handle their investment at year end?

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Case #1
The Illiquid Investment (cont.)

- Entry to record the investment:
 - Debit: Investment in Vandelay \$1M
 - Credit: Cash \$1M
- Entry to record the dividends
 - Debit: Cash \$2k
 - Credit: Revenue (or who cares?) \$2k
- Entry to record investment at year end
 - Likely none, or if known to be impaired it may be written down

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Investments at Market

- How to value an asset at market
 - Orderly transaction
 - Sales to a third party
 - Active market valuation
 - Other
 - Market approach
 - Cost approach

Valuation Approaches
Reliable methods under U.S. GAAP and FASB

1) **Market Approach** Uses relevant information as well as market prices to dictate its transactions 

2) **Income Approach** Converts future amounts that include cash flows or earnings to one discounted amount when measuring fair value 

3) **Cost Approach** Use current replacement costs when measuring an assets fair value (e.g. replacement cost) 

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Levels of Investments

Fair Value Hierarchy of Inputs

Level 1: Unadjusted quoted prices on active markets for identical assets or liabilities. **Stock prices on NYSE**

Level 2: Inputs outside of those from quoted market prices. Can be identical or similar. **Municipal Bonds**

Level 3: Unobservable inputs for an asset or liability. Use best estimate. **Complex Derivatives**


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Polling Question

What Level Investor Are You?

- a) Level 1,
- b) Level 2,
- c) Level 3,
- d) Crypto and NFTs, or
- e) Just my 401k.



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The Case of Investments at Market

- Risky Business Inc. invests exclusively in Crypto and NFT's.
- Risky Business Inc. purchased 100 coins of a cryptocurrency called "M-coin", which is highly volatile at a price of \$10
- At year-end Dec 31, M-coin is worth \$100.
- On February 28th of the following year, M-coin is worth \$1 per coin

• How do you value the investment at year end (Dec 31)?

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Accounts Receivable

For profit organizations

- Invoicing errors
- Late paying customers
- Discrepancy between billed and received
- Lack of understanding at c-suite of revenue not equaling cash

Nonprofits

- Present value and discount rates on pledges
- Writing off pledges from donors without collections

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Accounts Receivable Collections



**GETTING PAID
IN REAL LIFE**

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Fixed Asset Accounting Issues

- Inaccurate valuation
- Ignoring accumulated depreciation
- Misclassifying repairs and maintenance
- Wrong depreciation computations
- Lack of regular revaluation (or inventory of PPE)
- Ignoring impairment issues
- Not accounting for disposals
- Not accounting for salvage value

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What's My PPE Value?

Defining Fixed Assets and Their Useful Life

- 1 Industry Standards
- 2 Physical Wear and Tear
- 3 Technological Advancements
- 4 Economic Obsolescence
- 5 Depreciation Methods

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The Dreaded Other Assets

Other Current Assets (OCA)

[ə-ˈθər ˈkʌr-ənt ˈɑː-sɛts]

A category of things of value that a company owns, benefits from, or uses to generate income that can be converted into cash within one business cycle.

Investopedia

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Polling Question

What is in Your Other Assets?

- a) Stamps,
- b) Antiques,
- c) Art,
- d) Baseball cards or collectibles,
- e) Crypto and NFT's,
- f) Items that should have been written off long ago, but *someone* does not want to take the P&L hit, or
- g) Other investments.

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Intangible Assets

- 1) Identify
- 2) Recognize
- 3) Measure
- 4) Amortize
- 5) Impair
- 6) Disclose
- 7) Annually update inventory
- 8) Repeat

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Year End Review Steps


- 1) Schedule your annual review of assets
- 2) Pick the right team to evaluate
- 3) Have more than accountants involved
- 4) Make it a fun meeting to recognize company value
- 5) Understand what is impaired

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Discussion of XYZ Corp's Intangibles

- XYZ Corp purchases a zipper patent for \$200k, which has a legal life of 20 years and economic benefits for 10 years
- How would you account for the patent?
 - Identify
 - Recognize
 - Measure
 - Amortize
 - Impairment?



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Long Lived Assets

What really matters?

- An impairment loss is recognized on a long-lived asset if it is carrying amount is not recoverable and exceeds its fair value.

Intentionally illegible



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Case #2a

Explaining the New Accounting?

Assume a new, revised accounting standard for “**unrecorded assets**” is being considered and will be issued in twelve months and effective in two years. This will impact the income statement roughly 6% to 100%.

- What if you do nothing?
- Who needs to know the implications?
- How will you explain it to them?
- When do to inform them? Where?
- What is your plan or plans?

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Case #2b

Explaining the New Accounting?

Assume that a new, revised accounting standard for cryptocurrency accounting is being considered by FASB and will be issued in twelve months and effective in two years. What would you do?


- What if you do nothing?
- Who needs to know the implications?
- How will you explain it to them?
- When do to inform them? Where?
- What is your plan or plans?

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Economics vs GAAP

- How many of you work (or used to work) in an office building?
- How many work in an office building fully depreciated (over 40 years old)?
- Does anyone see a problem here?



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How Will Things Be Repurposed?

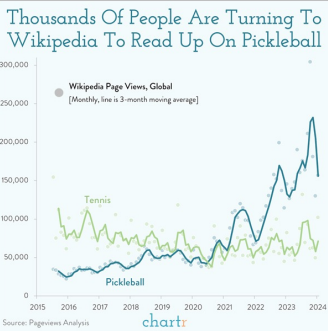


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Watch Trends

Thousands Of People Are Turning To Wikipedia To Read Up On Pickleball

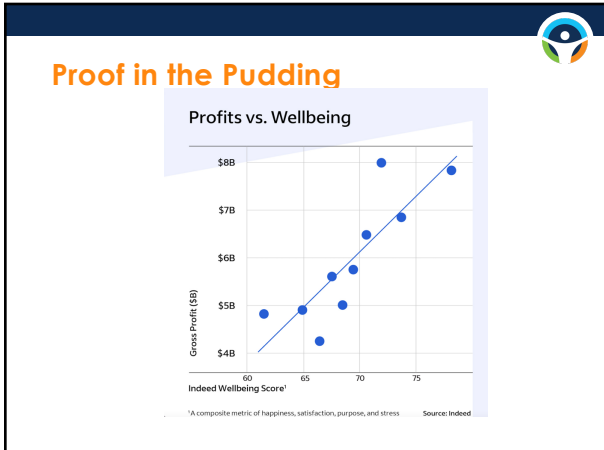


Year	Tennis	Pickleball
2015	~80,000	~30,000
2016	~80,000	~30,000
2017	~80,000	~30,000
2018	~80,000	~30,000
2019	~80,000	~30,000
2020	~80,000	~30,000
2021	~80,000	~30,000
2022	~80,000	~30,000
2023	~80,000	~30,000
2024	~80,000	~30,000

Source: Pageviews Analysis chart

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Case Discussion
Retail Survival?

Method	GEN Z	GEN Y	GEN X
High Street	58%	40%	48%
Online (Laptop/PC)	33%	40%	40%
Other (Tablet/Outlet)	9%	20%	12%

First Insight

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Case of the Long-Lived Asset

- Transaction: Nonprofit receives in-kind gift in the form of an “easement” restriction placed on property
- Facts:
 - Donation helps fulfill the mission of the nonprofit
 - Easement must be held by nonprofit in perpetuity
 - Nonprofit must monitor (look at it annually) the easement to ensure there is no infringement/development on the property in future years

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Questions We Need To Answer


- Is it an asset?
- Is it a liability?
- How will it build value?
- How will it provide a return? How much?
- What are the short-term and long-term implications?
- Who cares about the transaction? Who will be impacted?

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Case of the Long-Lived Asset

- TNC: Book as asset and record revenue for donation
- DU: Book as revenue and expense
- TPL: Book as revenue and expense and record add'l liability for monitoring costs in the future



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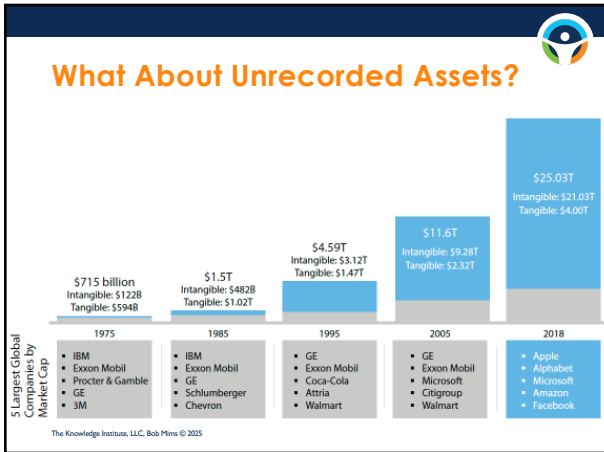
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Other Long-Lived Examples

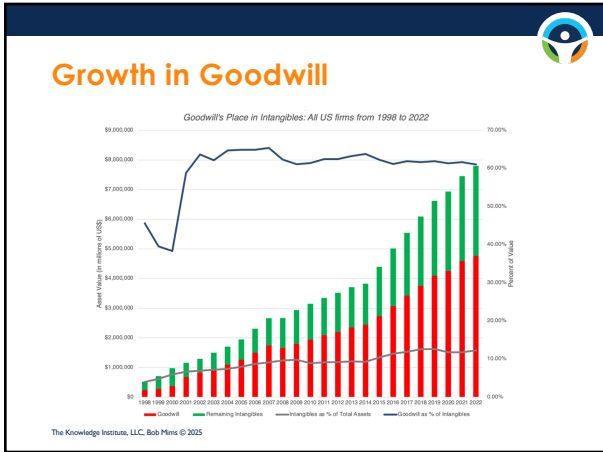
- Anything called "other"
- Goodwill
- Long-lived inventory
- Capitalized costs with no value
- Patents
- Trademarks
- Anything lasting longer than a year
- Anything on the books for more than one year – with no schedule to write off/down

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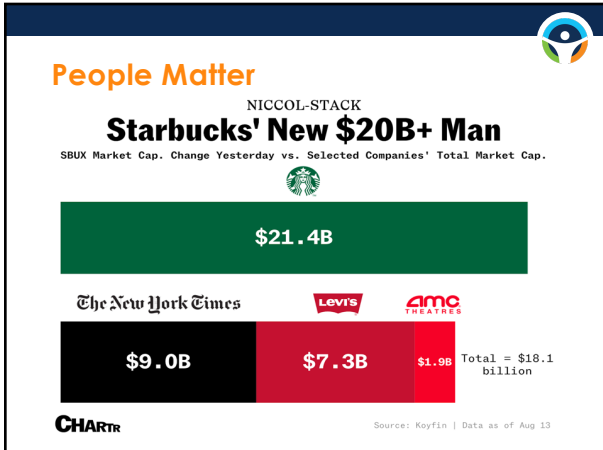
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What is Your Most Important Asset?

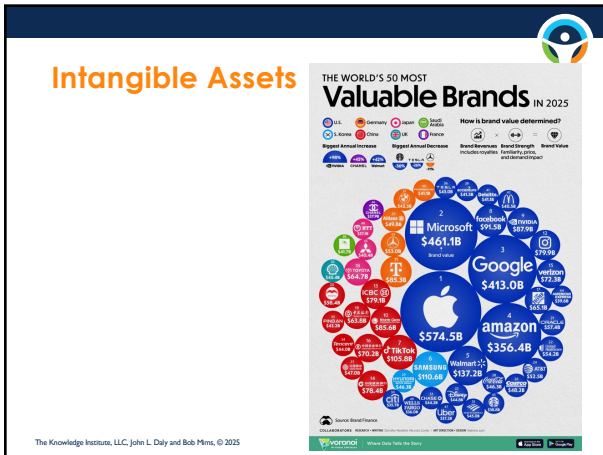
"...IN TODAY'S KNOWLEDGE-BASED ECONOMY, THERE IS NO QUESTION THAT EMPLOYEES ARE THE MOST IMPORTANT ASSET OF AN ORGANIZATION."

marcuslemons.com/business/business-assets-employees

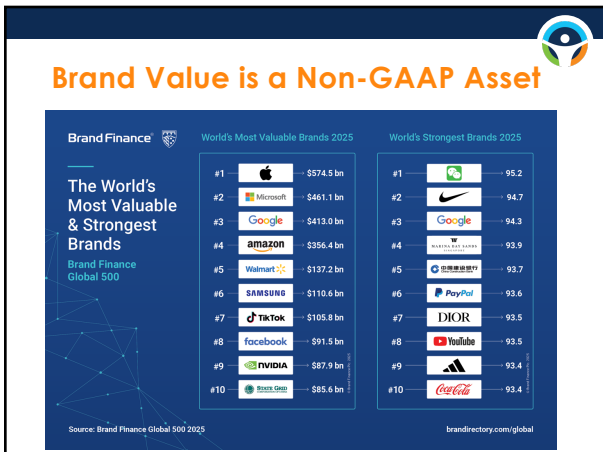
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Polling Question
Which Company Had a Large Brand Value When You Were a Teenager?

- a) Sears
- b) Coke
- c) Blockbuster
- d) Netflix
- e) Dogecoin

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Big Value

AMERICA'S **MOST VALUABLE COMPANY**
 EVERY YEAR SINCE 1995

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Intangible Value

The Inconvenient Truth about Accounting
 The true value of intangible assets worth a lot more than the book value

Year	% Intangible Assets	% Tangible Assets
1975	17%	83%
1985	32%	68%
1995	69%	31%
2005	80%	20%
2018	84%	16%
2020*	90%	10%

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The Real Value of Companies



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Invisible Intangible Assets




Company ABC (in MUSD)	Book Value	Market Value	Remarks
Total Assets	60	100	Premium 40 MUSD
Invisible Assets	0	40	Not in the Balance Sheet
Intangible Assets	40	40	In the Balance Sheet at Book Value
Tangible Assets	20	20	In the Balance Sheet at Book Value

Book Value vs Market Value



Book Value




Market Value

■ Tangible Assets ■ Intangible Assets ■ Invisible Assets

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Change in Values



INTANGIBLE ASSETS

They account for 80% of the value of the S&P 500, which equals 21 T USD.

Year	Tangible Assets	Intangible Assets
1973	83%	17%
1985	68%	32%
1995	32%	68%
2005	20%	80%
2015	16%	84%
2020	10%	90%

Today, there are two ways to generate these assets

Intellectual & Industrial Property

- Patents
- Brand equity
- Consumer data
- Software

Reputation, ESG Criteria

- Environmental
- Social
- Governance

An intangible asset is an identifiable asset of a non-monetary nature and without physical appearance, that is held for use in the manufacture or supply of goods and services.

Source: Grant Thornton, 4/16, 10/18

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Details Usually Matter

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Unrecorded Liabilities

- ? Understanding
- ? Types
- ? Causes
- ? Impact
- ? Mitigating them

Common Examples of Unrecorded Liabilities

Employee Benefits		Warranty Claims
Legal Claims		Environmental Liabilities
Deferred Revenue		

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Unrecorded Liabilities

Real-Life Examples of Unrecorded Liabilities

Enron

WorldCom

Tesco

Lehman Brothers

Volkswagen

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Polling Question
What Are Your Unrecorded Liabilities?

- a) Upcoming wedding(s)
- b) Braces
- c) College tuition
- d) Kids
- e) Caring for parents/relatives
- f) Grandkids
- g) Retirement

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Tale of \$1 Million Liabilities



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Invisible Assets and Liabilities



Off-Balance Sheet (OBS)
['of-'ba-lan(t)s 'shet]

A term for assets or liabilities that do not appear on a company's balance sheet.


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Polling Question
What Makes Sense?

- a) Animals don't drive cars
- b) My mom is older than me
- c) Debits must equal credits
- d) Don't breathe under water
- e) Go to doctor if sick
- f) Pigs do not fly



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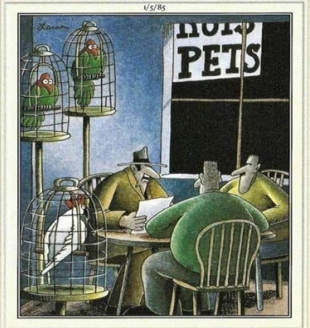
What Does Not Make Sense?



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Think Ahead



4/5/85

NO PETS

"Okay, listen up! The cops are closing in on this place, so here's our new hideout: 455 Elm Street. ... Let's all say it together about a hundred times so there'll be no screw-ups."

Far Side

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Who is Our Audience?



V alue	Understand how value is created for customers and organisation
A ccountability	Be accountable for value creation
L anguage	Use the language of value creation and of business
U nderstanding	Scale the understanding of value creation inc financial literacy Understand current CFO relationship and collaborate
E vidence	Have an evidence based mindset and use value based metrics

BRANDEQUITY
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The EPB Institute

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Do We Think of Our Audience?

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Instagram

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Deciphering Accounting Issues

- Network
 - at CPE, lunch, business development, peers, etc.
- Stay current
 - Read *Accounting Today* (<https://www.accountingtoday.com/>)
 - Reddit has an accounting sub-reddit
- Talk to your auditor
- Brainstorm with former colleagues
- Peers in your industry
 - Your state CPA Society can provide referrals
- Educate your audience

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Network to Keep Current

CPE events

- Is live better than virtual?
- Are we here to learn or here to earn?
- Ever consider bringing your issues to discuss with colleagues?
- Build relationships live and online

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Reading to Keep Current

What to read?

- FASB pronouncements?
- Google/Reddit/AI?
- Industry information on issues?

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Relationships to Keep Current

Active relationships


- Building accounting friendships
- Benchmarking data?
- How about your relationship with your audit partner?
- Linked in?

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Summary

- Use common sense
- Translate economic and GAAP issues for your entity
- Stay current
- Educate your audience




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Why Was I Here?

- The imperative to use common sense in evaluating the balance sheet
- Bridge the gap between the books and real value
- Keeping current for ourselves and our audience



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Optional Video "Words to Avoid"



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Thank You!
Please share your thoughts and comments.

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You can also connect with us on LinkedIn, or call us at 704-942-0413

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