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Required Disclosures Under Accounting Standards

ESI Team

A Financial Accounting Standards Board (FASB) update in effect for plan year ends beginning December 2012 would have made it necessary for ESOP companies that have annual plan audits to disclose on their Form 5500 filing sensitive information such as:

1. The weighted average cost of capital used in a discounted cash flow method
2. Pricing multiples applied
3. Operating margins
4. Long-term revenue growth rates
5. Other sensitive information

These disclosures may have allowed the public, along with competitors, customers, suppliers, private-equity groups, and others the ability to recreate the financial picture of the company. This may have proved detrimental to the company, its managers, and its employee-owners.

On April 10, 2013, however, the FASB decided to indefinitely defer the implementation of the "quantitative" requirements of the Fair Value Disclosure for retirement plans that hold privately held stock.

This means that audited ESOP financial statements (required for plans with 100+ participants) must still disclose in footnotes the generic methodology by which companies' valuations were determined, as well as a basic description of the inputs. However, no numbers will need to be disclosed.

The decision follows a request from prominent ESOP groups for private, employee-owned companies to be excluded from the new reporting requirements.

ESI recommends that you work with your auditor to determine the best way for your company to disclose the information required. ESI will be happy to assist in this matter as well. ■

Sandy Paavola Earns ABAR Credential

ESI Team

S. Paavola, CVA, ABAR

ESI's COO/Vice President/Principal, Sandy Paavola recently earned the Accredited in Business Appraisal Review (ABAR) credential from the National Association of Certified Valuators and Analysts (NACVA) and the newly merged Institute of Business Appraisers (IBA).

This advanced designation, the valuation profession's only credential certifying the competence in the review of valuation reports and analysis performed by others, is specifically designed for highly specialized professionals.

> "An ABAR opinion can assist fiduciaries as part of their due diligence requirements involving valuation issues."
>
> —Sandy Paavola

Sandy has been involved in the valuation of hundreds of companies for a variety of purposes, including ESOPs, fairness opinions, estate and gift tax reporting, buy-sell agreements, mergers & acquisitions, and general corporate planning. The ABAR credential adds to Sandy's broad spectrum of expertise and demonstrates her commitment to continuous improvement. ■

Trust Survey

Adapted from the Employee Ownership Report

A recent survey of ESOP employees measured how much they trusted their supervisors and upper management. Also, the survey calculated how much job satisfaction, company fairness, problem solving, and pride in ownership influenced the numbers.

The conclusion was that supervisors and upper management are trusted almost equally, but trust in supervisors has a stronger relationship to pride in ownership and job satisfaction, while trust in upper management was more closely associated with company fairness and problem solving. ■

Adding an Incentive Plan

Adapted from the ESOP Report

An incentive plan can help employee-owners to see and feel the impact of their efforts more quickly (and more often) than their ESOPs will. While an ESOP on its own does provide an incentive, the long-term nature of the investment can make the results seem rather intangible to employees.

It is true that many incentive plans have not worked, but that is usually due to the plan either being overly complex, or failing to give the employees the necessary means to drive the plan.

A good plan will be easy to understand, and will provide the tools for employees to make it *their* plan, not managements'. In order to create a usable plan, several elements are necessary:

a) Tie pay to one key performance indicator that every employee will have an impact on, such as profits before tax.
b) Set a minimum threshold so that all necessary expenses (taxes, payments toward debt, etc.) are paid before bonuses.
c) Make the payout an amount that is meaningful to the employees, but that will not risk ESOP value. A good level is 8% to 12% of wages in a company that is performing well.
d) Include business literacy training, key performance indicator identification training, scoreboards, forecasting training, and rapid improvement plans. These will allow employees to actively fund the incentive plan—making it *theirs*.

Of course there are other considerations such as whether you will pay equal portions or according to wage earnings, whether or not you will cap the amount that can be earned, and how often payouts will be made.

The ultimate goal of a successful incentive plan is that it will shape the employees' behavior in a way that will improve the financial performance of the company. Additionally, the ownership culture will be strong because it is rewarded in a more immediately tangible way. ■

Pro-ESOP Bill Introduced

Adapted from the ESOP Report

In February of this year, Senator Kelly Ayotte (R-NH) introduced S. 273, a bill that will modify the definition of fiduciary under the Employee Retirement Income Security Act of 1974 to exclude appraisers of ESOPs. The bill was introduced in response to the DOL's proposed anti-ESOP legislation mandating that all private ESOP company appraisers be ERISA fiduciaries.

Although the DOL withdrew its initial proposal, leaders at the DOL stated that a new proposal would be issued in July 2013; the proposed regulation's mandate that all appraisers of ESOP stock act as ERISA fiduciaries is not expected to be altered. There is, however, the possibility that the reissuance of the proposal will be postponed due to the DOL's lack of data for a cost-benefit analysis.

Any regulation that makes ESOP appraisers ERISA fiduciaries will cause confusion as to whether the appraiser, the trustee(s), or other current fiduciaries make the decisions about the acquisition of shares on behalf of average pay employees.

Additionally, current tax law requires ESOP appraisers to be independent, while the DOL proposal would require the appraisers to act solely in the best interest of the ESOP participants. The two criteria are at odds with one another, causing a conflict of interest. Such a change would leave ESOP companies open to lawsuits by aggressive class action trial lawyers.

Senator Ayotte has a history of strong support for ESOPs. She introduced a similar bill in 2011 (S.1232) shortly after the DOL's initial attempt to change the definition of fiduciary to include ESOP appraisers.

The status of Senator Ayotte's current bill may be followed at:

http://beta.congress.gov/bill/113th-congress/senate-bill/273. ■

"The greatest challenge to any thinker is stating the problem in a way that will allow a solution."

~Bertrand Russell