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Graeber Companies, Inc.: Examining Impairment of Equity-Owned Investments

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ABSTRACT: The Graeber Companies, Inc. case illustrates the implications of the Fair Value Measurements Standard (FASB ASC 820 or IFRS 13) and the Fair Value Option for Financial Assets and Financial Liabilities (FASB ASC 825 or IAS 39) on the accounting and auditing issues regarding fair value accounting. Based on an actual company's experience, the case provides an application of the new standards on fair value measurement, which is one major achievement of the FASB/IASB convergence project. Graeber Companies, Inc. is a 100-year-old financial boutique firm that, through its wholly owned and partially owned subsidiaries, is engaged in financial service activities. One of Graeber's proprietary investments is an equity investment in Advisor Group, Inc. (AGI)—an early stage development company. Students evaluate AGI's financial performance and strategic activities, including operating losses, issuance of preferred stock and proposed acquisitions by another investor company relative to its materiality, and potential impairment of Graeber Companies' equity-owned investment. The case study requires a determination of materiality of the equity investment and introduces students to the different valuation techniques such as Discounted Cash Flow Analysis, Public Market Analysis, Precedent Transaction Analysis, and the waterfall schedule method. The usefulness of these methods is then analyzed in determining the fair value of an investment in the situation where there have been no recent market transactions. Through analysis of the financial statements, relevant footnotes, and obtaining/obtained fair market value using different valuation approaches, students make a recommendation on materiality and on the fairness of the Graeber Companies management conclusion that no impairment of its investment in Advisor Group has taken place.

Keywords: materiality; fair value of equity investment; impairment test; equity-owned investment; discounted cash flows; public market analysis; precedent transaction analysis; waterfall schedule method.

INTRODUCTION

This case explores the difficulties and professional judgments involved in auditing an impairment test of an equity-owned investment when there have been no recent market transactions to suggest a fair value for the investment. In this exercise, which is based on an

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The author thanks the management, especially the CFO, of the company on which this case is based for providing access to data and documents for the case as well as reading and providing input to various drafts. Further, the author appreciates the input of colleagues and students in the School of Accountancy at DePaul University provided throughout the development and testing of this case in the Lang Student Case Competitions.

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actual valuation case, students are asked to assume the role of independent auditors who must determine the materiality of the equity investment and evaluate the reasonableness of Graeber management's position that the investment is not impaired.

Graeber Companies, Inc. (Investing Company)

Graeber Companies, Inc. is a 100-year-old financial boutique firm that, through its wholly owned and partially owned subsidiaries (collectively referred to as Graeber), is engaged in financial services activities. These activities are conducted through four operating segments:

1. Capital Markets, which is primarily involved in underwriting fixed income securities to finance senior living facilities, healthcare providers, religious institutions, and private schools.
2. Asset Management, which manages investments, including a series of mutual funds.
3. Wealth Management, which provides brokerage services to the public through retail locations.
4. Proprietary Investments, which makes investments on behalf of the company.

Advisor Group, Inc. (Investee Company)

One of Graeber's proprietary investments is an equity investment in Advisor Group, Inc. (AGI). AGI is a non-public, technology-based asset management company that is in the process of growing its business and has the ultimate goal of becoming one of the premier fee-based investment advising companies in the market. AGI's mission is to utilize advanced technology and practice management solutions that will allow investment advisors to achieve a competitive advantage. AGI combines its employees' investment management skills with state-of-the-art technology to assist advisors in meeting the demands of clients. AGI is well qualified to provide the following:

- Innovative investment analysis and access to leading asset managers.
- Proven investment management expertise.
- Portfolio construction, implementation, and monitoring.
- Online reporting and account access for advisors and clients.
- Customized marketing support and private-labeled websites.

With over $15 billion of assets under its management, more than 70,000 investor accounts, and access to over 100 asset managers, AGI is the first integrated provider of a unified model for fee-based solutions. AGI's client groups include leading registered investment advisors, CPAs, broker/dealer firms, banks, and trust companies. A sample of AGI's client list includes Ernst & Young LLP, Northern Trust, ING, TD Waterhouse, Standard & Poor's, AIG SunAmerica, MassMutual, PricewaterhouseCoopers LLP, Thomas Weisel Partners, U.S. Bank, and NFP.

AGI's strategy to achieve its goal of becoming the leading platform for independent advisors is focused on three areas:

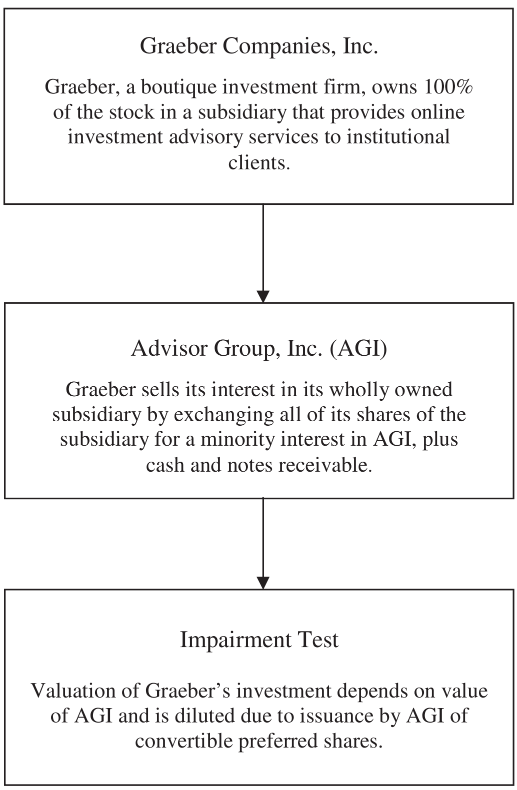
- Distribution: Build distribution strength within RIA, independent broker/dealer, and insurance broker/dealer channels to seize market share across the firm's entire practice.
- Product Focus: Develop a complete and integrated fee-based product offering differentiated by distribution channels.
- Cost Leadership: Increase scale in order to become a unit cost leader.

As there have been no recent market transactions to reflect a readily determinable value of AGI stock, Graeber's auditor has asked for an assessment of potential impairment of its investment in AGI. Graeber's financial statements and the portion of the notes to the financial statements related to the AGI investment appear in Appendices A and B.

Background of Graeber's Investment in AGI

The acquisition of Graeber's present investment in AGI is illustrated in Figure 1. Graeber acquired a minority interest in AGI on August 31, 2009, when it exchanged all of its stock in a wholly owned subsidiary for 9,681,784 shares of AGI's common stock. In addition to Graeber receiving the stock from AGI, the transaction also included a cash payment of $3,500,000 and notes receivable of $4,500,000 payable to Graeber. The notes have subsequently been repaid. Thus, the only part of the investment that remains is the shares of AGI stock. At the date of the acquisition, AGI was an early stage development company and there was not an active market for its common stock. Since Graeber acquired the shares, AGI has engaged in several capital-raising efforts that have been necessary to cover monthly operating deficits, as AGI has yet to achieve a positive cash flow in its month-to-month operations as originally projected. AGI's status as an early stage company that is not yet profitable forced the company to issue shares of convertible preferred stock to entice investment. As a result, the structure of AGI ownership equity now includes a substantial number of these convertible preferred shares, with rights and liquidation preferences superior to the rights of the common shareholders. The preferred shareholders have the right to receive preferred dividends that have accumulated at an increasing rate. Preferred shareholders also have primary claim to assets in the event of the sale or liquidation of AGI.

FIGURE 1
The Acquisition of Graeber's Investment in AGI



Graeber has maintained its minority ownership in AGI, and thus the value of this investment depends on AGI's operating results and its ability to generate a positive operating cash flow. AGI has not yet achieved a positive cash flow in its month-to-month operations at December 31, 2011.

As a result of AGI's issuance of convertible preferred stock, Graeber's original investment in AGI common stock has been diluted and subordinated to securities with preferential rights. Due to continuing losses, AGI has not paid any preferred dividends to date. These preferred dividends, which are cumulative, are an increasing obligation that could weigh on the profitability of AGI.

Other Information

In 2011, AGI obtained an independent appraisal of PMC International, Inc. (PMC), a subsidiary of AGI, as of March 31, 2011. The appraisal resulted in an $8.9 million write-down of AGI's goodwill related to PMC. The goodwill write-down was related to revenue losses by PMC in 2010, 2009, and 2008. Half of these losses were transferred from PMC to its parent company, AGI.

In the second quarter of 2011, AGI re-priced most of the incentive options held by its management to purchase its shares to 30 cents per share in a negotiated transaction between AGI executives and its board of directors. The board felt that the options had initially been issued at a strike price that was below market value.

In late 2011, another piece of information came to Graeber's attention. Graeber learned that AGI is in negotiations with a major investor regarding the potential acquisition of a 5 percent stake in AGI. AGI did not indicate that a final deal was imminent, but the investor's valuation of $120 million was leaked to Graeber. This information was taken into account by Graeber as part of the impairment analysis.

The Impairment Test

On December 30, 2011, a conference call transpired that included the CFO of Graeber and the engagement partner from the audit firm of White, Johnson & Turner LLC. The purpose of the call was to discuss the 2011 year-end valuation of Graeber's holdings in AGI. The participants of the conference call agreed on a procedure for estimating the fair value of Graeber's common stock holdings in AGI. The procedure includes the following steps:

1. Obtain a year-end enterprise valuation of AGI from Valuation Associates (VA), a firm with extensive experience in firm valuations. The study performed by VA would derive an approximate enterprise value of AGI based on three valuation methods. The Company Valuation Summary is presented in Exhibit 2 and summarizes the findings of VA's valuation study. In its analysis, VA utilizes the following three methods to arrive at an estimate of AGI's fair value:

   Method 1—Discounted Cash Flow Analysis, which includes:

   - A review of cash flow projections, adjusted to include forecasts for revenue growth and expenditures.
   - Selection of terminal values based on similar deal comparisons and industry trading characteristics.
   - Selection of a discount rate using the capital asset pricing model (CAPM) and comparable companies.

   Method 2—Public Market Analysis, which includes:

   - A comparative review of similar publicly traded companies.

   Method 3—Precedent Transaction Analysis, which includes:

- An analysis of previous transactions within the target industry as well as other relevant industries.
- Use of the collective judgment of merger professionals regarding the relevance and comparability of transactions.

2. Estimate the fair value of the AGI common stock (expressed on a per share basis) using a waterfall schedule prepared by AGI. Exhibit 3 presents the waterfall schedule that was prepared by AGI's COO. This schedule outlines Graeber's percentage claim to AGI's valuation. The waterfall schedule takes into account all conversion rights, preferences, and unpaid, cumulative preferred stock dividends. The computations included in the waterfall schedule apply the going concern and liquidation approaches described below and produce a per-share value of the common stock under each method. The fair value of the stock will be the lesser of the amounts determined using the following two approaches:

   - Going Concern Approach: This approach assumes that all of the preferred shares (along with the cumulative, unpaid dividends) are converted into common stock. Once this preliminary step is completed, the valuation of AGI obtained from VA is divided by the total common shares outstanding (including the shares that resulted from the assumed conversions) at year-end to determine the relevant per share fair value.
   - Liquidation Approach: This approach begins with the firm valuation obtained from VA and reduces it by the cumulative, unpaid dividends. The residual amount is then divided by the number of common shares outstanding at year-end to arrive at the fair value of the AGI shares.

Management's Summary and Conclusions

Using the procedures described above, Graeber's management analyzed the investment in AGI and concluded that the net carrying value of $0.49 per share at December 31, 2011 is reasonable and that the investment is not impaired. The full text of Graeber's analysis and conclusion regarding the impairment issue appear in a memorandum shown in Exhibit 1. This memo was prepared by Graeber's CEO, Mr. Cary A. Martin, and addressed to Samuel T. White, the engagement partner representing White, Johnson & Turner LLC.

REQUIREMENTS

You are to assume the role of members of the White, Johnson & Turner LLC audit team that have been assigned to the Graeber Companies, Inc. engagement. You have been provided with the narrative above as well as the aforementioned exhibits. In addition, you have access to the firm's financial statements and relevant footnotes. This latter information can be found in Appendices A and B. Please read through all of the information and complete the following:

1. Define and discuss the concept of materiality as set forth in FASB Statement of Financial Accounting Concepts No. 8, *Qualitative Characteristics of Useful Financial Information*. Determine an overall materiality level for Graeber and assess whether the equity investment in AGI is material to Graeber's financial statements.
2. Research and summarize FASB Accounting Standards Codification Topics 820 and 825 (section on Fair Value Options only). What are the implications of the standard on the accounting and auditing issues regarding fair value accounting as it applies to equity-owned investments? Be sure to cite the specific information in the standard.

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3. Analyze and evaluate the relevant information you have been provided in this case. Write a brief paragraph on each of the following topics. Be sure to include a case for and against impairment for each topic.

   a. AGI's Persistent Operating Losses
   b. AGI's Issuance of Preferred Stock
   c. The Proposed Acquisition of AGI by an Investor Company

4. Review and evaluate each valuation method used in the case. Write a brief paragraph on each method that indicates why each method is useful in determining the fair value of an investment.

   a. Discounted Cash Flow Analysis
   b. Public Market Analysis
   c. Precedent Transaction Analysis
   d. Waterfall Schedule

5. Prepare a memo that includes your recommendation as to whether to accept management's conclusion that no impairment has occurred. If you do not accept this conclusion, include the reasons why you believe that impairment has occurred. Regardless of your conclusion, provide support for your recommendation.

EXHIBIT 1: Valuation Memorandum

Memorandum

Date: January 30, 2012
To: Samuel T. White—Audit Partner, White, Johnson & Turner LLC
From: Cary A. Martin
Title/Location: Chief Financial Officer, Graeber Companies, Inc.
Subject: 2011 Year-End Valuation of Graeber's Investment in AGI Group, Inc.

The purpose of this memo is to document the relevant information concerning the 2011 year-end valuation of Graeber Companies, Inc.'s investment in Advisor Group, Inc. ("AGI").

Advisor Group, Inc.

Our consolidated balance sheet at December 31, 2011 includes an investment in the common stock of AGI with a gross carrying value of $9.5 million. All notes receivable resulting from the investment in AGI have been fully collected. There is currently a $4.8 million deferred gain in a valuation account that acts as a reserve and offsets the equity investment. Thus, our gross carrying value of AGI's common stock was $0.98 per share while its carrying value net of the reserve was $0.49 per share at that date (we hold 9,681,784 shares of AGI's common stock). With respect to our equity position in AGI, we have identified two possible indications of impairment during 2011. The first potential indicator was an $8.9 million write-down of AGI's goodwill in PMC International, Inc. ("PMC"), a subsidiary of AGI, resulting from an independent appraisal of PMC. The majority of the goodwill write-down was related to revenue losses by PMC in 2010, 2009, and 2008. The second potential indicator of impairment was the re-pricing of many of AGI's incentive options held by the firm's management to a strike price of $0.30 per share. Despite these two occurrences, we believe that our investment in AGI, net of the reserve, remains fairly stated. A summary of the relevant issues and our assessment of the overall situation follows:

2010 Events

In 2010, equity markets continued their steady decline in value, a trend that started around the time we acquired the investment, and did not shows signs of subsiding until the third quarter. This reduced the value of AGI's assets under administration and delayed the successful completion of the company's drive to profitability.

By the fourth quarter of 2010, AGI was in a low cash position. In December 2010, AGI embarked on an effort to raise new funds for its operations. At this time, I discussed our concerns with you as a representative of your auditing firm, White, Johnson & Turner LLC. As a result of our conversation, we agreed that we should no longer record any previously deferred gains in income until tangible evidence of improvement at AGI was apparent. We feel that the previously deferred gains created an effective reserve against the equity of AGI on our balance sheet.

AGI engaged in several efforts to raise capital during 2010. Due to the operating losses the company had faced, the company was forced to offer convertible preferred stock to draw investor interest. The effect of the convertible preferred stock offering was to dilute its common equity. The capital-raising efforts of 2010 had the positive effects of raising sufficient cash to pay off its notes payable to us and reducing its Earnings before Interest, Taxes, Depreciation, and Amortization (EBITDA) to a loss of only $207,000 for the year. We feel that this increases the probability that the firm will soon become profitable. However, the issuance of preferred stock significantly diluted our common stock holdings in AGI by subordinating our equity position to the newly created liquidation rights of the new investors.

TIMETABLE 1

Graeber Investment in AGI

		Graeber	Result	Graeber	Investment	In Subs		
Event	Date	Gain/(Loss)	Cash	Notes	Equity	Reserve	**Exposure**	
Merger @ $0.981 per share	Aug-08	1,400,000	3,500,000	4,500,000	9,500,000	(5,600,000)	**8,400,000**	
Portion of note rec paid	Aug-09	600,000	1,500,000	3,000,000	9,500,000	(5,000,000)	**7,500,000**	
Another portion of note paid	Aug-10	400,000	1,000,000	2,000,000	9,500,000	(4,600,000)	**6,900,000**	
Last portion of note paid	Aug-11		2,000,000	0	9,500,000	(4,600,000)	**4,900,000**	
							9,681,784	Graeber Shares Owned
							$0.51	**Average Cost @ 12/31/11**
							4,720,000	**Reserve/Exposure @ 08/31/08**
							9,681,784	Graeber Shares Owned
							$0.49	**Average Cost @ 12/31/08**

2011 Test for Impairment

To assess the value of our investment in AGI, and to determine whether an impairment charge is necessary at December 31, 2011, we utilized three sources of information. The first source was a valuation assessment performed by VA, an independent valuation specialist; the second source was a "waterfall schedule" performed by AGI; and the third was information regarding a proposed transaction involving AGI. The details of each source and the conclusions derived from the information are detailed below. Note that prior-year tests for impairment in 2009 and 2010 were negative. That is, the asset was not seen as impaired because its value exceeded its cost. The valuation provided by VA in 2010 was ($0.51/share).

Valuation Study of AGI Performed by Valuation Associates (VA)

We obtained a December 31, 2011 valuation of AGI that was performed by Valuation Associates (VA), an independent company that specializes in these types of studies. This valuation study utilized such information as AGI's current financial statements, financial projections, and the values of comparable firms in the marketplace. VA used three different methods of valuation in this study. The first method is a Discounted Cash Flow Analysis, the second method is a Public Market Comparison Analysis, and the third method is a Precedent Transaction Analysis. Each of the methods used and the conclusions reached from each one are detailed below.

1. Discounted Cash Flow Analysis

In this analysis, VA arrived at an enterprise valuation for AGI based on five years of projected financial information. VA used *pro forma* statements that projected AGI's earnings for the years 2011 through 2016. The *pro forma* statements were derived from an exhibit used previously in presentations to the AGI board of directors. The study was performed using two different estimates of earnings. The first estimate is referred to as the "Management Case" and is an estimate based on information received from AGI. The second estimate is a more conservative estimate that is referred to as the "Downside Case."

VA performed the Discounted Cash Flow Analysis subject to the following assumptions:

- An effective tax rate of 37.5 percent for AGI's earnings was applied. This can be considered to be a conservative estimate, as AGI has net operating losses that can be used to offset earnings in the early years of the projections.
- The projections used a 29 percent compounded annual growth rate for revenues from 2012 through 2016. This rate of growth may seem aggressive initially, but it takes into account that NFP, SunAmerica, Transamerica, and other notable companies have chosen AGI as their provider for the future. AGI's management estimates that Transamerica alone could increase the firm's assets under management by $4 billion in the first year. This would represent a 27 percent increase in assets under management, and revenues should rise proportionately. This new business was not taken into account in AGI's initial revenue projections. When the revenue from these new customers is figured into the projections for the analysis, the 29 percent growth rate appears reasonable. Other assumptions embedded in the revenue projections include a 4 percent annual market appreciation (this seems reasonable when historical rates of return of 10 percent on equities and 5.5 percent on fixed income securities are considered) and an earnings rate on assets under management of 25 basis points on the average.
- Direct expenses are projected to grow at the same rate as revenues (29 percent, compounded annually), while personnel and other operating expenses are expected to grow at an 8 percent compounded annual rate.
- As a result of its positive operating leverage, AGI's EBITDA projected annual growth rate is 56 percent. This is not an uncommon result for a business that has a significant fixed cost infrastructure and a high gross margin, especially if that business is not operating near its maximum capacity. AGI is one such business.

2. Results of Discounted Cash Flow Analysis

- Management Case—VA multiplied the projected 2012 EBITDA by a market multiple of 12.5. The amount was discounted to the present using a 20 percent rate, resulting in an estimated enterprise value of $269 million, or $1.45/share of common stock using the waterfall schedule (see below for explanation). In addition, sensitivity analysis was performed using market multiples of 10.0, 12.5, and 15.0 times final EBITDA and discount rates of 15 percent, 20 percent, and 25 percent. The resulting valuations ranged from a high of $391 million ($6.17/share) to a low of $182 million ($0/share).

- Downside Case—VA recalculated the six-year projections reducing the revenue growth rate to 20 percent and reducing the EBITDA margins by 2 percent. The results were mean, high, and low enterprise valuations of $218 million ($0/share), $297 million ($2.52/share), and $139 million ($0/share), respectively.
- The above calculations were all based upon EBITDA. VA then recomputed the scenarios above using net income after tax with higher market multiples. Higher multiples were justified, as they were being applied to net income after taxes instead of EBITDA. While the valuation results derived by these numbers generally confirmed the initial set of valuation estimates, they were likely understated as they did not include the effect of the net operating loss carry-forward provisions mentioned above.
- Where the above valuations are equal to ($0/share), AGI's liabilities exceed assets, making the stock worthless. A ($0/share) valuation results when cumulative preferred stock dividends in arrears exceed the value of common stock that Graeber owns.

Management acknowledges that the Discounted Cash Flow Analysis includes numerous assumptions, and that the growth factors used in the analysis seem aggressive and rely upon new business relationships to a significant degree. However, management deems VA's justification for these factors as valid and believes the analysis is reasonable.

As noted above, two variations of income were used, EBITDA and net income after tax. We discount the latter as it ignored relevant net operating loss carry-forwards.

In the EBITDA version of the Discounted Cash Flow Analysis, we favor the conservative conclusion from the Downside Case, which is $218 million. This estimate tempers the effect of the high growth assumptions.

3. Public Market Comparable Analysis

Another method of valuation used by VA was the Public Market Comparable Analysis. In this method, the market values of comparable companies are analyzed in an attempt to value AGI. These comparable entities included SunGard, SEI Investments, and CheckFree.

The results of this analysis were ultimately rejected by VA, as the firms chosen were ultimately not considered sufficiently comparable to AGI.

Management agrees that the companies included in the analysis did not provide an adequate level of comparability to AGI and, like VA, discarded the Public Market Comparable Analysis.

4. Precedent Transaction Analysis

In this method, VA analyzed prior transactions that included companies with characteristics similar to those of AGI. VA analyzed transactions in the target industry and other relevant industries, and utilized the knowledge of merger professionals regarding the relevance and comparability of the transactions. VA employed a multiple of 2011 revenues in an attempt to estimate AGI's fair value. Firms used for comparative purposes in this analysis included Lockwood, Centurion Capital, and LPA.

The results provided median, high, and low valuations of $266 million ($1.32/share), $341 million ($2.80/share), and $190 million ($0/share), respectively. Again, ($0/share) valuations occur when AGI's liabilities exceed its assets, making the stock worthless.

In summary, the result of the study by VA was an enterprise value of $244 million (0.47/share).

Of the various analytical tools employed by VA, the Precedent Transaction Analysis contained the fewest assumptions and seemed to be the most realistic. As stated above, the median valuation was $266 million ($1.32/share).

Management believes that a range of values from $218 million ($0/share) to $266 million ($1.32/share), with a mean value of $242 million ($0.39/share), is a reasonable valuation. Management's mean value differs from VA's because Management chose to favor the conservative Downside Case in the Discounted Cash Flow Analysis above. VA's mean value accounted for a blending of the Management Case and Downside Discounted Cash Flow Analysis.

Waterfall Schedule Prepared by AGI

Another source of information utilized in the impairment study was a "waterfall schedule." This schedule outlines our claim to its valuation and assigns a value to the common stock depending on the valuation of the company. The schedule, which was prepared by AGI's chief financial officer, took into account all conversion rights, preferences, and cumulative preferred dividends. The waterfall schedule was performed using two different assumptions:

1. Going Concern Approach, whereby it was assumed that all convertible securities were converted into common shares.
2. Liquidation Approach, whereby it was assumed that investors with senior liquidation rights did not convert their securities into common shares, but instead extracted their cumulative preferred dividends from a presumed sale of AGI at the valuation price, leaving the residual to be divided among the common shareholders.

Fair value was computed as the lesser of the enterprise valuation multiplied by our ownership percentage computed using the Going Concern Approach, and the enterprise valuation multiplied by our ownership percentage computed using the Liquidation Approach.

The result of the waterfall schedule, using VA's enterprise valuation of $244 million, was a $1.28 per share fair value using the Going Concern approach, and $0.47 per share fair value using the more conservative Liquidation Approach.

Representatives of White, Johnson & Turner LLC reviewed the waterfall schedule compiled by AGI executives and deemed it to be accurately performed. The calculations and assumptions involved in the Going Concern Approach and Liquidation Approach described above were also confirmed as reasonable by our auditors.

Proposed Transaction Involving AGI

At the end of 2011, we became aware of the fact that AGI was in negotiations with a major investor for the latter to acquire a 4.9 percent stake in AGI at an implied valuation of $120 million. As this proposed transaction with this investor has an implied valuation of roughly one-half the valuation obtained from VA ($244 million), it seems prudent that we reconsider whether VA's representation of value provides a reasonable basis for valuing our holdings in AGI. Due to the dollar amount of the liquidation rights outstanding that exceed ours, if indeed AGI had a market value of only $120 million, then our common stock holdings in AGI would be worth little, if anything.

Although the pending deal is not close to being finalized, the price per share being discussed indicates an enterprise valuation of roughly $120 million for AGI. By most accounts, this result would seem to be far below the VA valuation.

We do not believe that a valuation based upon this proposed transaction is indicative of enterprise value for a couple of reasons. First, under terms of the proposal, the investor would only be acquiring a 4.9 percent interest in AGI. This investment, if and when acquired, certainly does not constitute a controlling interest. Second, AGI is very anxious to forge a business relationship with this investor. The investor has indicated that it intends to use AGI as its reporting platform. By doing so, this investor has the resources to increase AGI's assets under management by as much as

$4 billion in 2012. This would represent a significant increase in assets from their current levels. In essence, it is our belief it is reasonable to argue that this investor's proposed purchase price equals the sum of the cash paid up front plus the delivery of profitable assets under management going forward**.** Additionally, the investor has already requested a first right of refusal in the event of a sale of AGI. This may well be an indication of the investor's intent to eventually purchase the entire entity.

Management's Overall Conclusion

1. Our consensus is that the best indicator of enterprise value lies between the $218 million ($0/share) derived from the Discounted Cash Flow Analysis and the $266 million ($1.32/share) derived from the Public Market Transaction Analysis. These two amounts have a mean value of $242 million ($0.39/share), which we feel is reasonable.
2. VA concluded that the valuation of AGI is approximately $244 million ($0.47/share).
3. When applying the valuation of $244 million to the waterfall calculation, the fair value of AGI's shares would be $0.47 per share, which is on par with our current value of $0.49 per share. If the $218 million figure (the low end of the range mentioned above) is used, the shares would have no value. However, we feel that VA's enterprise value of $244 million that was used in the calculation is a reasonable estimate because it takes into account several relevant factors, such as AGI's status as an early stage company, as well as its expanding client base, which will substantially increase assets under management. Additionally, the estimate of $244 million can be considered a conservative estimate since estimates obtained using other methods were much higher. This is why we feel that $244 million is a more reasonable valuation scenario than $218 million.
4. As a result, we are comfortable that our carrying value of $0.49 per share at December 31, 2011 is reasonable.
5. However, given the high number of AGI preferred shares currently outstanding with unpaid cumulative dividends, it is also likely that the value of our common stock holdings is declining each year. In fact, our calculations indicate that barring any change in valuation and any further share dilution, the increase in annual cumulative dividends on the preferred stock is reducing the value of our holdings at the rate of about $0.11 per share per year. If this prediction holds true, this would likely necessitate footnote disclosure in our financial statements.

EXHIBIT 2: Valuation Associates (VA) Company Valuation Summary

Executive Summary

Company Valuation Summary ($ in mm)

- Based upon Discounted Cash Flow and Precedent Transaction analyses, our valuation results provide a median valuation of **$244 mm.**
- Including valuations from the Public Market Comparable Analysis, the median valuation declines to $220 mm. It should be noted that AGI's long-term growth rate is two to three times the growth rates of the three public comparables and, as a result, would likely merit a premium to the public comparables' current multiples.

Discounted Cash Flow Analysis

	EBITDA Method		
	High	**Low**	**Midpoint**
Management Case	$391	$182	$287
Downside Case	$297	$139	$218

	Net Income Method		
	High	**Low**	**Midpoint**
Management Case	$405	$173	$289
Downside Case	$308	$132	$220

Public Market Comparable Analysis

	EBITDA Method		
	High	**Low**	**Midpoint**
Management Case	$230	$179	$205
Downside Case	$192	$150	$171

	Net Income Method		
	High	**Low**	**Midpoint**
Management Case	$220	$190	$205
Downside Case	$183	$158	$171

Precedent Transaction Analysis

	High	**Low**	**Midpoint**
Valuation Based on Multiple of AGI's 2011, Q4 Run Rate Revenue	$341	$190	$266

EXHIBIT 3: Waterfall Schedule

Capital Ownership Structure and "Waterfall Schedule"

Multiple ownership classes of debt and preferred shares (all are senior securities relative to common shares)

Company Valuation	$244,000,000
Payout Summary	
Share Ownership in Order of Senior Preferences:	
Ownership Class 1	$138,416,410
Ownership Class 2—Series 1 Preferred	$15,094,832
Ownership Class 2—Series 2 Preferred	$34,359,476
Ownership Class 2—Series 3 Preferred	$10,881,115
Ownership Class 2—Series 4 Preferred	$33,121,874
Common Shares (Graeber Companies owns Common Shares)	$12,126,293
	$244,000,000
Total Common Shares Outstanding	25,805,109
Total Fully Diluted Shares Outstanding (Class 2 and Common)	82,497,677

Liquidation Approach: Assumes Investors Senior to Graeber do not Convert to Common	
Price Per Common Share	$0.47
(Common Shares $/Common Shares Outstanding)	
($12,126,293/25,805,109)	
Going Concern Approach: Assumes All Class 2 Shares Convert to Common	
Price Per Common Share—Assuming All Class 2 Shares Convert to Common	$1.28
(Class 2 $ + Common $/Total Fully Diluted Shares O/S)	
($105,583,590/82,497,677)	

EXHIBIT 4: Summary of Students' Feedback (n = 69)

	Mean
The case gave me an opportunity to formulate and present a recommendation based on the analysis of the team.	4.35
The case provided an example of a valuation issue, and helped me understand valuation issues facing companies today and the potential complexities that can be involved.	4.53
The case enhanced my understanding of FASB ASC 820 and its application in real-world situations.	4.41
The case provided me with exposure to different valuation techniques used in practice.	4.61
The case helped me appreciate that sometimes there are many different factors involved in making accounting decisions.	4.48
The case helped me strengthen my research skills.	3.76
The case challenged me to think critically.	4.42
The case was successful in facilitating group discussion and teamwork.	4.36
The case is useful and should be assigned to students in future case studies.	4.37
The case provided a valuable learning opportunity.	4.45
The instructions clearly described what was expected of the students.	4.14
Did you find the case interesting?	4.22
Do you think the case represents a realistic situation? (1 = not realistic, 5 = very realistic)	4.59
Overall, did you find the case to be a useful exercise? (1 = not useful at all, 5 = very useful)	4.44

In addition to rating the survey, students were asked to provide their comments on potential improvement areas or any other feedback they wanted to volunteer. Below are some of the comments from the students (paraphrased):

Positive:

- Gives the students a chance to present in front of peers, administration, academic, and business communities.
- The relevant accounting issues discussed.
- I really enjoyed listening to each of the students present their cases and come to various conclusions. I think each team has developed a strong understanding of FASB ASC 820 and its implications. I think it is important for students to learn about new pronouncements and industry developments as they develop.
- Challenging competition to the student groups.
- Gives students a relevant case with popular topics in the accounting industry.
- Students were allowed to develop and present their conclusions.
- Interesting topic, relevant, and good presentations.
- I liked hearing the different analyses by the groups regarding the same question. It was interesting to hear their different approaches and conclusions.
- Application of accounting concepts to real-life scenarios.
- Very realistic case approach. Applicable to the real world and well contextually organized.

Improvement Areas:

___ More time needs to be spent up front explaining the case.
___ Could have had more time to prepare.
___ Presentations were slightly long; could have been condensed.
___ Maybe someone could explain a little detail about the case and assumptions after the case and the judging.

The questions asked to the instructors (11 participated) are included in Exhibit 5, along with an average rating from the answers provided.

EXHIBIT 5: Summary of Instructors' Feedback (n = 11)

	Mean
The case gives students a valuable opportunity to formulate and present a recommendation based on the analysis of the team.	4.9
The case can help students understand valuation issues facing companies today and the potential complexities that can be involved.	4.7
The case can enhance the students' understanding of FASB ASC 820 by allowing them to interpret in a realistic situation.	4.8
The case can provide students with exposure to different valuation techniques they might use in their careers.	4.7
The case can reinforce the notion that sometimes there are many different factors involved in making accounting decisions.	4.9
The case offers students the opportunity to strengthen their research skills.	4.6
The case effectively challenges the students to think critically.	4.7

The case is structured in a manner that encourages group discussion and teamwork.	4.5
The case can provide a valuable learning opportunity for students.	4.8
Do you think the instructions clearly described what was expected of the students? (1 = unclear, 5 = very clear)	4.3
Did you find the case interesting? (1 = very boring, 5 = very interesting) (1 = not realistic, 5 = very realistic)	4.9
Do you think the case represents a realistic situation? (1 = not realistic, 5 = very realistic)	4.9
Overall, did you find the case to be a useful exercise? (1 = not useful at all, 5 = very useful)	4.9
Would you recommend that other instructors use this case? (1 = would not recommend, 5 = I would strongly recommend)	4.7

APPENDIX A

The Graeber Companies, Inc. and Subsidiaries

Consolidated Statements Of Financial Condition

As Of December 31, 2011 and 2010
(in thousands, except per share amounts)

ASSETS	**2011**	**2010**
Cash and cash equivalents	$ 27,173	$ 24,591
Securities owned	27,970	17,857
Receivables, net	4,544	5,155
Notes receivable, net	34,050	36,102
Other investments	17,902	24,568
Deferred income taxes	626	1,545
Land, buildings and equipment, at cost, net of accumulated depreciation of $9,404 and $14,297, respectively	3,335	5,696
Goodwill and other intangible assets	2,565	2,565
Other assets	3,098	2,981
Total assets	$121,263	$121,060

LIABILITIES AND STOCKHOLDERS' EQUITY		
Short-term notes payable	$ 6,305	$ 4,214
Note payable to banks	2,425	-
Securities sold under agreements to repurchase	9,895	13,669
Payable to broker-dealers	6,405	6,405
Accrued compensation	14,172	12,045
Long-term debt	24,455	24,860
Other liabilities and deferred items	3,556	4,892
Total liabilities	67,213	66,085
Minority interest	16,749	14,895
Commitments		
Stockholders' equity-		
Preferred stock, $1 par, 500 shares authorized, none issued	-	-
Common stock, $1 par, 7,500 shares authorized, 3,544 shares issued	3,544	3,544
Additional paid-in capital	6,226	6,226
Retained earnings	54,949	52,837
Treasury stock, at cost, 1,686 and 1,421 shares, respectively	(27,315)	(22,266)
Unearned compensation	(103)	(261)
Total stockholders' equity	37,301	40,080
Total liabilities and stockholders' equity	$121,263	$121,060

See accompanying notes to consolidated financial statements.

The Graeber Companies, Inc. and Subsidiaries

Consolidated Statements Of Income

For The Years Ended December 31, 2011, 2010 and 2009
(in thousands, except per share amounts)

	2011	2010	2009
Revenues:			
Investment banking	$32,119	$28,393	$30,730
Commissions	18,204	14,908	11,491
Investment management and advisory fees	13,605	12,075	9,707
Interest and dividends	5,868	7,168	5,474
Net trading profits	4,116	8,084	5,692
Gain on sale of operations	-	400	903
Other income	5,231	3,247	3,443
	79,143	74,275	67,440
Expenses:			
Employee compensation and benefits	45,502	43,711	40,499
Communications and data processing	4,901	5,830	6,402
Promotional	4,631	4,755	4,601
Occupancy	4,507	4,349	4,117
Brokerage commissions and clearing fees	2,822	2,758	3,032
Professional and regulatory	2,231	2,033	2,264
Investment manager and other	2,196	2,074	857
Interest	1,840	1,626	1,447
Other	2,043	1,938	1,438
	70,673	69,074	64,657
Income before income taxes and minority interest	8,470	5,201	2,783
Minority interest in net (income) loss of subsidiaries	(3,456)	(2,356)	10
Income before income taxes	5,014	2,845	2,793
Provision for income taxes	1,869	672	973
Net income	$ 3,145	$ 2,173	$ 1,820
Per share data:			
Basic earnings per share	$ 1.60	$ 1.01	$ 0.81
Diluted earnings per share	$ 1.59	$ 1.01	$ 0.81

See accompanying notes to consolidated financial statements.

The Graeber Companies, Inc. and Subsidiaries

Consolidated Statements Of Changes In Stockholders' Equity

For The Years Ended December 31, 2011, 2010 and 2009
(Dollars in thousands, except share and per share amounts)

	Common Stock	Additional Paid In Capital	Retained Earnings	Treasury Stock	Unearned Compen-sation	Total
BALANCE, December 31, 2008	$3,544	$6,250	$51,172	$(18,074)	$ (37)	$42,855
Net income	-	-	1,820	-	-	1,820
Dividends declared ($.52 per share)	-	-	(1,199)	-	-	(1,199)
Cost of treasury stock purchased (240,153 shares)	-	-	-	(3,674)	-	(3,674)
Stock issued as compensation (1,448 shares)	-	-	-	22	-	22
Restricted stock grant (29,000 shares)	-	(28)	-	440	(412)	-
Amortization of unearned compensation	-	-	-	-	218	218
BALANCE, December 31, 2009	3,544	6,222	51,793	(21,286)	(231)	40,042
Net income	-	-	2,173	-	-	2,173
Dividends declared ($.52 per share)	-	-	(1,129)	-	-	(1,129)
Cost of treasury stock purchased (83,693 shares)	-	-	-	(1,201)	-	(1,201)
Stock issued as compensation (1,438 shares)	-	-	-	22	-	22
Restricted stock grants (14,750 shares)	-	5	-	224	(229)	-
Restricted stock forfeitures (1,666 shares)	-	(1)	-	(25)	26	-
Amortization of unearned compensation	-	-	-	-	173	173
BALANCE, December 31, 2010	3,544	6,226	52,837	(22,266)	(261)	40,080
Net income	-	-	3,145	-	-	3,145
Dividends declared ($.52 per share)	-	-	(1,033)	-	-	(1,033)
Cost of treasury stock purchased (267,009 shares)	-	-	-	(5,084)	-	(5,084)
Proceeds from exercise of stock options (2,667 shares)	-	-	-	40	-	40
Restricted stock forfeitures (333 shares)	-	-	-	(5)	5	-
Amortization of unearned compensation	-	-	-	-	153	153
BALANCE, December 31, 2011	$3,544	$6,226	$54,949	$(27,315)	$ (103)	$37,301

See accompanying notes to consolidated financial statements.

The Graeber Companies, Inc. and Subsidiaries

Consolidated Statements Of Cash Flows

For The Years Ended December 31, 2011, 2010 and 2009
(in thousands)

	2011	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 3,145	$ 2,173	$ 1,820
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	1,372	1,585	1,965
Provision (reduction) for receivables allowances	(39)	45	(121)
Provision for notes receivable allowances	253	225	-
(Gain) loss on sale of property and equipment	(57)	(8)	60
Gain on sale of operations	-	(400)	(903)
Compensation expense paid in stock	153	195	240
Deferred income tax	919	422	1,038
Minority interest in net income (loss) of subsidiaries	3,456	2,356	(10)
Change in assets and liabilities:			
Decrease (increase) in –			
Securities owned	(10,113)	36,031	44,548
Receivables, net	650	(1,029)	290
Other assets	(130)	(332)	(604)
Increase (decrease) in -			
Payable to broker-dealers	-	(21,281)	(51,403)
Accrued compensation	2,127	980	2,178
Other liabilities and deferred items	(1,331)	459	732
Net cash provided by (used in) operating activities:	405	21,421	(170)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Proceeds from:			
Sale of property and equipment	1,938	31	25
Payments received on notes receivable	7,000	6,170	4,240
Sales/paydowns of other investments	14,342	8,689	16,795
Sale of operations, net		-	303
Payments for:			
Issuances of notes receivable	(5,201)	(19,655)	(19,821)
Capital expenditures	(879)	(1,917)	(1,978)
Purchases of other investments	(7,676)	(3,971)	(500)
Acquisition of mutual fund intangible assets	-	-	(2,019)
Net cash provided by (used in) investing activities	9,524	(10,653)	(2,955)

CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from -			
Issuance of short-term notes payable	$30,591	$36,346	$30,797
Short-term bank borrowing	32,326	17,100	12,000
Securities sold under agreements to repurchase	5,678	-	-
Issuance of long-term debt	-	9,150	14,515
Minority interest capital contributions	1,013	5,052	6,238
Exercise of employee stock options	40	-	-
Payments for -			
Maturities of short-term notes payable	(28,500)	(36,814)	(29,490)
Repayments of short-term bank borrowing	(29,901)	(17,100)	(12,000)
Securities sold under agreements to repurchase	(9,452)	(7,599)	(16,602)
Repayments of long-term debt	(405)	(405)	(1,700)
Purchase of treasury stock	(5,089)	(1,226)	(3,674)
Minority interest capital distributions	(2,615)	-	-
Cash dividends	(1,033)	(1,129)	(1,199)
Net cash provided by (used in) financing activities	(7,347)	3,375	(1,115)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	2,582	14,143	(4,240)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	24,591	10,448	14,688
CASH AND CASH EQUIVALENTS AT END OF YEAR	$27,173	$24,591	$10,448

See accompanying notes to consolidated financial statements.

Five Year Summary of Financial Data (Unaudited)

	For the years ended December 31,				
	2011	**2010**	**2009**	**2008**	**2007**
(Dollars in thousands except per share amounts)					
Operating Revenues	$79,143	$74,275	$67,440	$80,679	$83,808
Net Income (Loss)	3,145	2,173	1,820	1,314	(4,738)
Basic Earnings (Loss) Per Share	1.60	1.01	0.81	0.55	(1.97)
Diluted Earnings (Loss) Per Share	1.59	1.01	0.81	0.55	(1.97)
Cash Dividends Declared Per Share of Common Stock	0.52	0.52	0.52	0.52	0.52
Balance sheet data as of the end of the year:					
Total Assets[(a)]	121,263	120,951	137,799	185,956	124,647
Long-Term Obligations	24,455	24,860	16,115	3,300	3,302
Short-Term Notes Payable	6,305	4,214	4,682	3,375	2,993
End of Year Shareholders' Equity	37,301	40,080	40,042	42,855	43,154
Book Value Per Share	$20.07	$18.88	$18.27	$17.85	$17.80

(a) Total assets for 2002 and 2001 were adjusted to conform to current year presentation.

APPENDIX B

From Notes to the Financial Statements
For the Years Ended December 31, 2011, 2010, and 2009

Investment in AGI

On August 31, 2009, the Company exchanged all of its stock in a wholly owned subsidiary, for a minority interest in the Advisor Group, Inc. ("AGI"). In exchange for the shares in the subsidiary, the Company received 9,681,784 shares of AGI common stock, $4,500 in notes receivable, and $3,500 in cash at closing. In connection with the closing and the receipt of cash, the Company recognized a before-tax gain of $1,399. Because AGI, an early stage development company, was unprofitable at the date of the transaction, and the common stock received had no established market, the Company deferred an additional gain of $5,596 on the transaction, recognizing future gains only as cash was received. Since the date of disposition, the Company received principal payments of $4,500 on the notes receivable. Additional gains were recorded in the amounts of $600 in 2009 and $400 in 2010 in conjunction with the collections on the notes in those years. All notes have been fully collected as of December 31, 2011.

Since the 2009 transaction, AGI has engaged in several capital-raising efforts, which can generally be characterized as venture capital transactions. These capital-raising transactions have been necessary to cover monthly operating deficits, because AGI has not achieved a positive cash flow in its month-to-month operations. As a result of this situation, the remaining deferred gain was reclassified as a valuation allowance of $4,596 against the Company's carrying value of the AGI common stock prior to the receipt of the last note payment. The Company also suspended the recognition of interest income on the then outstanding note receivable and applied the interest to the valuation allowance, which further reduced the net carrying value of the AGI common stock.

The structure of AGI ownership equity includes a substantial number of preferred shares that include rights and liquidation preferences superior to the rights and preferences of common shareholders. Among the rights of preferred shareholders are rights to receive preferred dividends and other preferred returns in the event of the sale or liquidation of AGI. Unpaid dividends on the preferred shares of AGI accumulate, and the aggregate cumulative unpaid dividends of the preferred shareholders have continued to increase. The result of the issuances of preferred stock is that the Company's investment in AGI common stock has been diluted and subordinated to securities with preferential rights.

The fair value of the AGI common stock owned by the Company is determined periodically by management of the Company and is subject to accounting judgment. In making this determination, management evaluated relevant factors including the amount of dilution the Company has experienced since its investment in AGI, AGI's prospects for growth, market conditions for gathering and retaining assets under administration, AGI's continued ability to raise capital, and the prices obtained for the sale of similar firms in the marketplace. At December 31, 2011, the AGI common stock held by the Company was carried in the consolidated financial statements at $9,500, less the remaining valuation allowance of $4,776. The net carrying value for AGI common stock of $4,724 compares favorably to the last AGI arm's length equity capital raise in the first quarter of 2011, and to recent sales of similar enterprises, although different types of securities were issued which make valuation comparisons difficult.

The Company regularly reviews financial information provided by AGI to determine whether an addition to the valuation allowance is necessary. The Company believes that the financial information supplied by AGI is reliable, but has not undertaken independent verification of the information. In conjunction with the Company's evaluation as to whether the investment in AGI was impaired at December 31, 2011, AGI obtained and furnished to the Company an independent third-party going concern valuation. AGI also provided to the Company an analysis of AGI's ownership equity components to enable the Company to determine its fully diluted interest in AGI. The valuation relies in part on projected revenues and profits of AGI, the achievement of which is uncertain. On the basis of the third-party valuation of AGI and the Company's estimate of its interest in the fair value of AGI, the Company's net carrying value of its investment in AGI was determined not to be impaired at December 31, 2011. The Company continues to evaluate its investment in AGI for impairment on a quarterly basis. If any impairment is determined to exist in the future, it would be accounted for as a loss in the Company's Consolidated Statement of Income.

Despite the fact that the Company believes that the net carrying value of AGI common stock approximates fair value at December 31, 2011, the annual accrual of cumulative preferred dividends in arrears has had the effect of eroding the value of the Company's holdings. Should this continue at the current pace without adequate and offsetting increases in operating cash flows, the Company is likely to face impairment write-downs on this investment during 2012 and thereafter. Such write-downs would be a function of changes in the enterprise value of AGI, of future AGI issuances of dilutive securities, and of the accrual of cumulative dividends in arrears, among other factors. While such write-downs would not represent actual cash flows, they could materially affect the financial condition or results of operations of the Company in 2012 and beyond.

From Management's MD&A

Investment in AGI

As described in Notes 3 and 8 of the Notes to Consolidated Financial Statements, the current investment in Advisor Group, Inc. ("AGI") consists of common stock, originally valued at $9,500 with a valuation allowance of $4,776, bringing the net value in the Company's financial statements to $4,724 at December 31, 2011. Management believes that the investment is not impaired below a value of $4,724 at December 31, 2011. However, as discussed in Note 3, the Company is likely to face impairment write-downs in 2012, absent a significant increase in operating cash flows for AGI. Certain additional information helpful in understanding the circumstances related to AGI include:

- In January 2011, AGI issued senior debt securities convertible into common stock at a price of approximately $0.42 per share after taking into account the effects of conversion. A valuation of $0.42 per share is approximately 86 percent of the Company's current carrying value per share in AGI common stock.
- An independent appraisal of PMC International, Inc. ("PMC"), a subsidiary of AGI, as of March 31, 2011, resulted in an $8.9 million write-down of AGI's goodwill related to PMC. Most of the AGI goodwill write-down related to revenue losses by AGI's PMC subsidiary in 2010, 2009, and 2008. Half of those lost revenues were simply transferred from PMC to its parent company, AGI. As a result, these amounts were not considered revenues of PMC in the appraisal process.
- In the second quarter of 2011, a capital-raising effort from existing AGI shareholders was completed. The investors were aware of the goodwill write-down, the terms were the same as in the January 2011 transaction, and the fund raise was oversubscribed. Senior debt convertible into common stock of AGI at a price of approximately $0.42 per share was issued.
- In the second quarter of 2011, AGI re-priced most of the incentive options held by its management to purchase its shares to 10 cents per share in a negotiated transaction between AGI executives and its board of directors.
- The independent third-party valuation referred to in Note 3 contains significant future growth assumptions, the achievement of which is uncertain.

- The independent third-party valuation is based on a "going concern" value and did not consider liquidation or other costs.
- The Company was informed by AGI management that AGI has been negotiating a commercial arrangement with an unaffiliated third party, whereby AGI would issue new shares of preferred stock at a price that results in an implied valuation below the valuation of the independent third-party valuation consultant, which would indicate an impairment of the Company's investment. However, the Company believes that the favorable purchase price is indicative of AGI's desire to partner with this third party. The third party has the potential to provide substantial assets for investment management to AGI's operating subsidiaries that would generate significant revenues. However, there will likely be further dilution in the Company's common shares when these new shares are issued.
- AGI believes that the prospects for 2012 through 2016 continue to improve, due to expected revenues from newly obtained contracts and contracts under negotiation.
- The Company has been encouraged by the reduction in negative monthly cash flows as the year 2011 progressed. As AGI's management is able to restructure operations to reduce costs, additional savings are expected to occur. AGI management is also projecting significant increases in revenues. which have some justification given the mergers and the strategic alliances that are currently being negotiated, specifically with the commercial arrangement with an unaffiliated third party noted above. However, these strategic alliances have not yet been consummated and it remains to be determined whether the revenue increases will be realized. And even if revenues do increase, there is no assurance that the increase in monthly cash flows will be sufficient to fund the annual accrual of cumulative preferred dividends as discussed in Note 3. Given these circumstances, it is likely that an impairment write-down will occur in 2012, but the Company is unable to determine the magnitude of that write-down based on the information currently available.

CASE LEARNING OBJECTIVES AND IMPLEMENTATION GUIDANCE

Structure of the Case

This case provides opportunity for students to work in teams and assume the role of members of the White, Johnson & Turner LLC audit team in the audit of Graeber Companies. This case explores the complexities and professional judgments involved in evaluating the reasonableness of Graeber management's position that an equity investment in Advisor Group, Inc. is not impaired when there have been no recent market transactions to suggest a fair value for the investment. It provides an application of the new standards on fair value measurement, which is one major achievement of the FASB/IASB convergence project.

Case Learning Objectives

In undertaking this case, students will work in teams to:

- Use their analytical skills in calculating overall materiality and their professional judgment assessing the materiality of the equity investment (Assignment 1).
- Research the requirements of FASB ASC 820 and 825 (or IFRS 13 and IAS 39), and their implications on the accounting and auditing issues regarding fair value accounting (Assignment 2).
- Evaluate the effect of financial performance and future changes of the investee company's strategy on the impairment of an equity-owned investment (Assignment 3).
- Assess different valuation techniques and their usefulness in determining the fair value of an investment (Assignment 4).
- Formulate and communicate a recommendation with regard to management's position that no impairment of the equity investment has occurred (Assignment 5).

The Implementation Guidance

Suggested Audience and Background Knowledge

This case is appropriate for use in the first or second auditing course. Students should have had at least one intermediate accounting course. The subject matter covered in this case includes concepts that are usually discussed in intermediate or advanced accounting textbooks. Although impairment is covered in greater depth in more advanced textbooks, not all of these textbooks include examples that incorporate realistic events and specific examples of the variables and different types of information companies can face in determining fair value. We expect that the students will perform their own research to complete the case, which can be helpful in building skills they will utilize in their careers or on the CPA exam. Students are encouraged to use any and all tools that will allow them to research different aspects of the case. The instructor can recommend his/her preferred resources if the students encounter difficulties.

There are five assignments:

- Assignment 1 requires students to calculate overall materiality level for Graeber audit and assess whether the equity investment in AGI is material to Graeber's financial statements.
- Assignment 2 begins with researching and summarizing FASB ASCs 820 and 825 (section of Fair Value Options only) to reveal the implications of the standard on the accounting and auditing issues regarding fair value accounting as it applies to equity-owned investments. (International students may also complete this particular assignment by referencing IFRS 13, *Fair Value Measurement*, and IAS 39, *Financial Instruments: Recognition and*

Measurement. Format and general content of responses should be comparable to the FASB ASC 820 and 825 responses as a result of convergence.)

- Assignment 3 requires students to analyze and evaluate the relevant information regarding the investee company's persistent operating losses, issuance of preferred stock, and the proposed acquisition by a different investor company. Through their analysis of the financial performance, capital-raising activities, and possible acquisition of the investee company, students will discover the consequences and the implications for impairment test of an equity-owned investment.
- Assignment 4 then asks students to review and assess each valuation method used in the case, including Discounted Cash Flow Analysis, Public Market Analysis, Precedent Transaction Analysis, and the waterfall schedule technique in determining the fair value of an investment.
- Assignment 5 requires students to make a recommendation as to whether to accept management's conclusion that no impairment has occurred by providing support for their argument.

Suggestions for Instructional Use

This case is intended to place the student teams in a situation that simulates an actual audit situation in which uncertainty and judgment are paramount. Key points in its successful implementation are as follows:

- Teams should consist of four or five members and should be chosen randomly by the instructor, since staff accountants do not usually get to pick who they work with on a particular assignment.
- Use of groups on Blackboard or similar classroom management software is very helpful to communication among team members.
- The case works best when the instructor plays the role of partner on the audit in which the student teams develop recommendations with regard to the impairment decision.
- Approximately 30–45 minutes should be allowed to introduce the case in class. It is best for the instructor to present the basic facts of the case and the requirements. A PowerPoint presentation is available on request from the author for use in this presentation. This presentation takes about 20 minutes. Students should then be allowed to meet in their groups to organize their teams and plan their out-of-class meetings.
- Teams should be given two to three weeks to prepare the case. The instructor should be available to answer questions from the teams by email or office consultation, as the partner would be in an actual audit situation.
- It is helpful to schedule a class about one week before the reports are due in which the instructor (audit partner) is available for consultation with each member of the team individually to answer questions and give guidance as necessary.
- Usually, one class period is scheduled for team reports to the audit partner. Depending on the number of teams, it is ideal that each team has 12 minutes to present and five minutes to answer questions from the audit partner (instructor) and other students in the classes.
- Typically, each team will have differing levels of materiality and often come to very different recommendations with regard to impairment. It is helpful to capture these differences on the board or flipcharts so that the entire process can be debriefed with the entire class.
- To add an element of realism to the presentations, an alternative is to invite one or two audit professionals from a local CPA firm to attend the presentations and comment on them. Alternatively, other professors from the department may be invited.

- The case typically counts for 15 percent of the course grade. The research and technical content counts for 10 percent, and the memorandum and presentation for 5 percent. In addition, blind peer evaluations are important because the teams were chosen randomly and can be used to either raise or lower a team member's score. A technique for using peer evaluations may be obtained from the author.

Related Readings

Financial Accounting Standards Board (FASB). 2010. *Qualitative Characteristics of Useful Financial Information*. Statement of Financial Accounting Concepts No. 8. Norwalk, CT: FASB.

Financial Accounting Standards Board (FASB). 2011. *Fair Value Measurements & Disclosures*. Statement of Financial Accounting Standards (SFAS) ASC 820. Norwalk, CT: FASB.

Financial Accounting Standards Board (FASB). 2011. *Financial Instruments (Fair Value Option)*. Statement of Financial Accounting Standards (SFAS) ASC 825. Norwalk, CT: FASB.

IFRS Foundation. 2011. *Fair Value Measurement*. International Financial Reporting Standard (IFRS) 13. London, U.K.: IFRS Foundation.

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Experiential Feedback

This case was tested at the Fred Lang Case Competition at DePaul University. The Lang Case competition is an annual case competition where groups of students prepare presentations about the case and present to a panel of judges, and prizes are awarded to the winners. The Lang Case competition has a proud 20-year tradition at DePaul, and we felt it was a proper venue to present the case and evaluate it based on the quality of the student presentations and the results of evaluations completed by students.

Five student teams (involving 27 students) participated in the competition and, in most cases, were assisted by a member of the DePaul faculty. In total, 11 faculty members participated by assisting teams or by joining the presentations and discussions. The presentations were substantive and well constructed. One very encouraging sign was the diversity of the students' analyses. Each team reached conclusions based on a well-structured analysis that contained adequate detail and support for the final conclusion. As this is a case that requires judgment, it was encouraging to see conclusions were reached using different logic and reasoning. The case does not have a specific "correct" answer and is open to interpretation of the situation; its application to the relevant accounting literature and diverse answers is a positive sign.

At the conclusion of the case, evaluations were issued to the students and instructors. The evaluation forms asked the students and instructors to rate the case and provide their thoughts on possible improvements and other suggestions. The survey questions were in a number format, with a rating of 1 being the lowest and 5 being the highest. The questions asked of the students are included in Exhibit 4, along with an average rating from the answers provided.

TEACHING NOTES

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