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Insights on VALUATION

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Services Offered
Valuation for Litigation
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How to Select a Business Valuation Expert

The selection of a business valuation expert becomes critical if you or your clients have a need to “know” the value of a business. There are several considerations that must be made before selecting an expert. The primary consideration is the purpose of the valuation.

The following are qualifications and characteristics that would apply in any engagement:

- Are they certified by a recognized national credentialing organization and subject to standards of work and ethics by that organization?
- Are they current in their education and knowledge?
- Do they have deep and varied experience in valuing businesses (not just the type of business you want valued)?
- Do they have a depth of business knowledge outside of just valuing businesses?
- Do they and their firm have a reputation for being independent, objective, and reliable?
- Are they clear in their description of the work that is to be done, the information they will need to do the work, the time it will take, and the cost of the valuation engagement?

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The following are unique considerations in the context of some of the most common uses of a business valuation.

Litigation

Whether it is family court, civil court, probate, or criminal court, there is often a need to determine the value of a business or an ownership interest in the business in the context of conflict and emotion. In many cases, information and documentation is not readily available, complete, or accurate. The valuation expert must demonstrate the ability to:

- Make reasonable assumptions in the absence of reliable information
- Communicate and defend those assumptions and explain their ramification on the conclusions and opinions they express
- Maintain objectivity and independence in the face of significant pressure to become an advocate
- Deal with difficult people who may not want to be helpful

Estate/Gift

The Internal Revenue Service (IRS) is a highly experienced player on the other team when it comes to the valuation of business interests for estate and gift tax purposes. The valuation expert should have an excellent understanding of the reporting requirements imposed by the IRS, as well as a current and working knowledge of relevant court cases and IRS regulations. A valuation expert engaged early in a planning setting is invaluable to preventing problems "down the road." Strong knowledge and experience in this type of an engagement is essential. If a family limited partnership (FLP), or similar entity, is being contemplated by the taxpayer, a skilled valuation expert can help design the entity to avoid later issues. The valuation expert can be critical in defending the entity before the IRS.

Family Court

Every state's family court is different, but in their cases, they all have one thing is common: oftentimes the most significant asset to be handled is a closely held business. Very often this issue is, after child custody issues, the most emotional matter as accusations and allegations are traded about hidden income, personal expenses paid and deducted through the business, etc.

Therefore, the valuation expert should be experienced in this area of litigation and need to bring certain skills to the table including:

- Analytical skills in the area of forensic accounting;
- A level of objectivity and logical thinking in order to assist with settlement discussions;
- Skills in working with opposing experts to identify the areas that need to be litigated if settlement is not possible;
- A working knowledge of the legalities involved such as an understanding of the interaction between business income and income for purposes of determining support.

Where Do I Find an Expert?

Call us about your valuation needs. We have the business valuation knowledge and skills to handle most tasks. Or, we can help you locate an experienced professional for your specific situation.

Roles of the Business Broker and Business Valuation Analyst

Business owners look to ***business brokers*** for assistance in the valuation and sale of their business. The broker advises and represents the seller in their common goal to locate a buyer. They quickly become a team sharing their perspectives and experiences to find "a deal" they can accept. The broker uses his or her specific knowledge of the industry to focus efforts and create time efficiencies. The efficiencies include: establish a listing price, determine information to be disclosed, define buyer geographic scope, qualify potential buyers, and establish financial terms. The broker begins the search with the focus and motivation to find a buyer and negotiate a deal.

The deal is important to the broker as it triggers his or her compensation calculation. The broker makes a living closing deals. In fact, he or she was probably chosen based on the broker's "success ratio" at closing deals. The commission paid the broker is a good thing. It was the primary factor in 1) the seller and broker coming together, and, ultimately, 2) the seller and buyer coming

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together. The broker desires to earn his or her commission in the most efficient manner possible. Quick identification of qualified buyers is the efficiency most sought by the business broker. Without a qualified buyer, there will be no acceptable deal.

Business owners look to the ***business valuation analyst*** for an objective "conclusion of value." The valuation analyst gathers relevant industry and company specific data from the business owner for the purpose of determining a "conclusion of value." The valuation analyst will focus their efforts like the broker, but not at the sacrifice of limiting relevant information. For instance, the valuation analyst may take a broader geographic approach than the broker who limits geographic efforts for time and cost efficiencies. Remember, the broker is seeking "the deal" and the valuation analyst is seeking a "conclusion of value." The efficiency sought by the broker may be viewed as an unacceptable limitation by the valuation analyst.

A valuation analyst's fee is generally determined by the time spent to complete the valuation engagement and generate a valuation report. The fee is not determined by the conclusion of value or by the identification of a qualified buyer in a certain number of days. The fee is for the objective presentation of a "conclusion of value" in a report format consistent with certain professional standards. In so doing, the valuation analyst provides the business owner with an objective report telling the owner what the owner needs to hear about the business value rather than what the owner might want to hear.

The broker and valuation analyst bring very different perspectives to the business owner.

The broker seeks to be hired to find the highest bidder for the business owner, as that is their joint goal. The valuation analyst seeks to provide the business owner with an objective conclusion of value for widely different purposes. During the life of a business, a business owner may have the need of the services of both the business broker and the valuation analyst. In so doing, the business owner obtains access to an appropriate blend of objectivity and reality.

How to Review a Valuation Report

Business valuations are prepared for many purposes, including litigation, estate and gift tax, and the purchase or sale of a business. To properly understand and utilize a valuation, the reader should critically review the report to determine its accuracy and reasonableness.

In reviewing a business valuation report, the reader should determine if the report is prepared by a qualified appraiser, includes detailed planning, identifies the critical factors, and documents and analyzes specific information.

While reviewing the report, it should be evident that the appraiser has an understanding of the company's unique characteristics including the history, ownership, management, products, services, customers, suppliers, facilities, and personnel. It should be apparent that the valuator has analyzed and understands the risks involved with ownership, the stability or irregularity of the earnings as well as any other relevant factors that affect the company being valued. In the report, the appraiser should consider external factors that may affect the company as of the valuation date including the national and local economic conditions, relevant governmental regulations, and demographic trends.

In reviewing the business valuation report, the reader should look for common errors or deficiencies and ask the following questions:

- Does the appraiser possess the proper education or experience to perform the valuation?
- Is the report mathematically accurate?
- Does the appraiser properly apply case law and statutes? For instance in a marital case, is personal and business goodwill properly calculated and treated?

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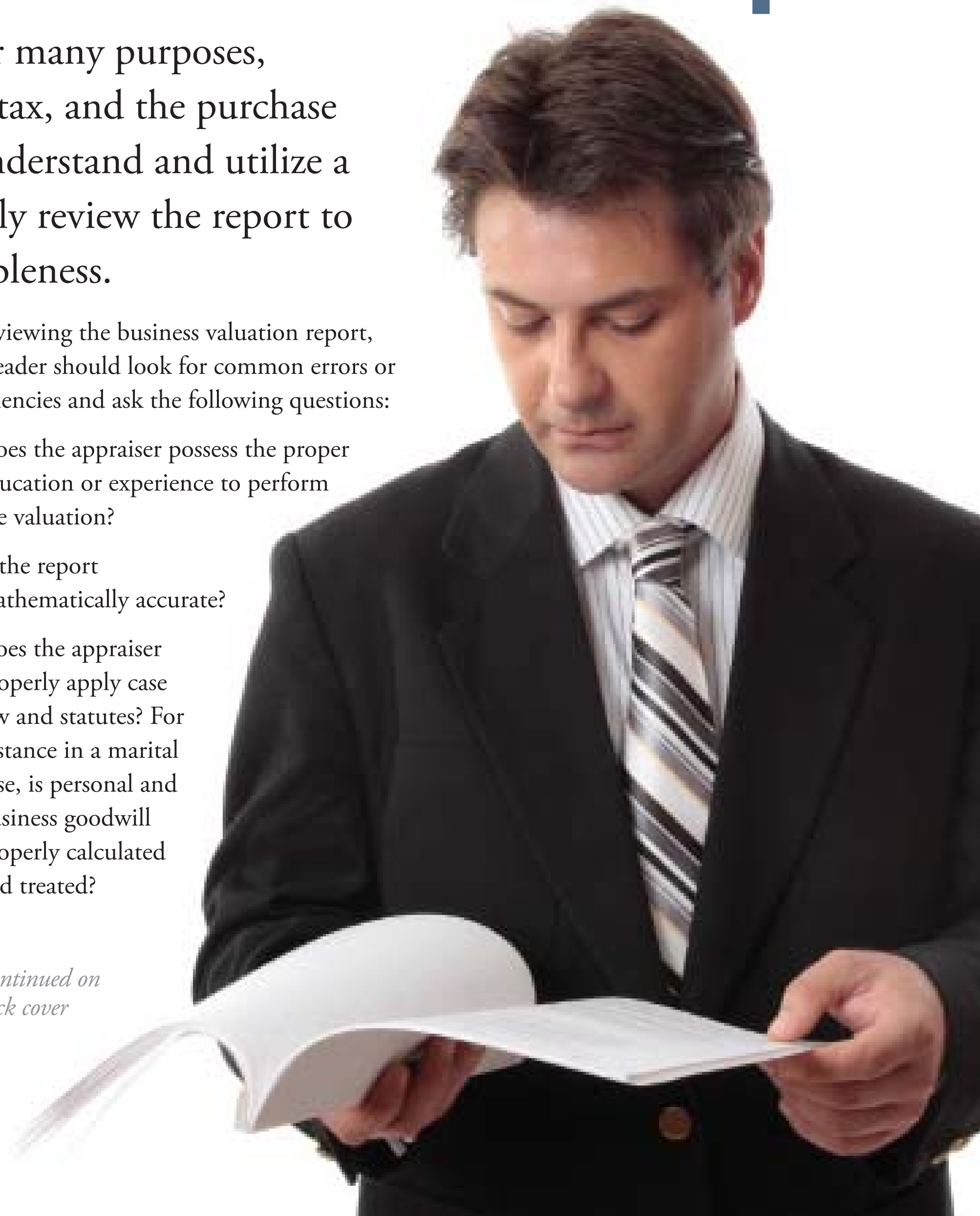

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- Has a site visit been performed? By performing a site visit the appraiser is better able to understand the business's products, assets, liabilities, and the competence of employees.
- Has the appraiser properly identified and valued the interest? For instance, is the interest a minority interest or controlling interest?
- Has the appraiser properly analyzed the books and records of the company and made appropriate adjustments? Was an analysis made to find material personal expenditures? It is important to understand the accounting methods being utilized by the company and to determine if they were being applied consistently. For instance, is the cash or accrual method being used? If it is a construction company, how are contracts being accounted for (under the percentage of completion method or the completed contract method)? Have there been proper allowances set up for accounts receivables or other contingencies?
- Has compensation been properly adjusted, if appropriate? Failure to properly adjust compensation could have a material impact on the valuation.
- Has the appraiser searched for and analyzed market data and its effect on the company's value?
- Have company documents and agreements been properly analyzed to determine their effect on value?
- Has there been a thorough and thoughtful analysis of the factors affecting risk?
- Has the appraiser considered the three generally accepted approaches to valuation—the Income, Market and Asset Approaches? The valuation report should discuss the rationale for the approach(s) that is most appropriate under the circumstances.
- How have growth rates been determined? Are they realistic? Do they require additional working capital or plant capacity? Were they considered in the valuation report?
- Has the appraiser addressed the discounts that were applied, how the specific discounts were computed and discussed empirical evidence and the company's unique characteristics?

After analyzing the valuation report, the reviewer should consider whether the conclusion of value determined by the valuation analyst makes economic sense for the purpose that the valuation was prepared for. Would the reader buy (sell) the business for the value stated?

As valuation reports can be very specific and detailed, one may find it necessary to engage another qualified valuation analyst to assist in the review.

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