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The Accounting Times

By Department of Accountancy, Patuck-Gala College, Santacruz (E)

Volume No.08 Issue No.34 September 2022

ICYMI | Nine Valuation Mistakes for Business Owners to Avoid

Whether or not a business owner plans to sell or transfer their business in the next few years, obtaining a proper business valuation is critical. A professional valuation performed by an accredited specialist, based on accurate modeling and sound numbers, is more likely to result in maximum financial returns for the business owner—either as an ongoing business or ultimate sale. This article examines nine common mistakes related to business valuations and offers some helpful guidance for business owners and their advisors as they navigate through the complexities of owning, selling, or transferring a business. **Failing to Value an Ongoing Business-**Even if an owner is not contemplating the imminent sale or transfer of business, a professional valuation of the business as a going concern is essential. To this point, a formal valuation or appraisal is exceedingly beneficial, so the owner will not be left unprepared for triggering events. For example, if there are buyout agreements in place (i.e., a buy-sell agreement), an estimation of the purchase price and establishing funding sources (e.g., insurance) will be known and can be planned for in advance. In addition, a highly valued business is likely to have estate tax ramifications that may require sophisticated estate planning. Finally, for an ongoing business, a current credible professional valuation could be instrumental in obtaining a loan, attracting key employees, and other considerations. Once the value of a business has been determined, the owner can focus on value enhancement adjustments to various aspects of the business, including personnel, business planning, sales, marketing, legal, and operations. These adjustments can potentially increase profitability as an ongoing business and likely result in a higher price when the business is sold. Choosing a professional valuator who has experience with value enhancement can help streamline this process. **Eleventh-Hour Valuation** - Unfortunately, too many business owners do not prepare a plan for the eventual sale of their company. According to a 2018 report by the Exit Planning Institute, many business owners "lack of readiness prevents them from harvesting the value of their business." Of those surveyed, 91% lacked a written personal plan of action following the transition of their business, and 30% never gave it a thought (The State of Owner Readiness 2018 Georgia Report). More commonly, business owners wait until the eve of the sale to commission a valuation. By doing so, they may not be able to hire the best possible professional valuator. Moreover, since time is of the essence, an ultimate valuation prepared in haste may fall short of expectations. **Marketability Discounts -** Two major valuation discounts are lack of control (DLOC) and lack of marketability (DLOM). DLOC is applicable in calculating the value of an interest held by a minority owner, and DLOM is applicable when there are issues that affect the business's marketability. Depending upon the circumstances, the discount and cap rate are adjusted by DLOC and DLOM. Rather than using data relevant to a particular valuation, some valuators rely on case law for the determination of valuation discounts [In *Berg Estate v. Commissioner* (T.C. Memo 1991-

279), the Tax Court rejected this practice because every case is different.] Consequently, a common mistake is failing to reconcile discount measurements with outside data sources and available studies that provide a quantitative reference point. But because these numbers can impact the valuation number significantly, extra attentiveness is essential. **Errors in Valuation Report Presentation -** The final valuation document could be in the form of a summary report or a detailed report. It can be a calculation assignment or a conclusion assignment. But whatever its format, it should follow a clear, logical flow and be free of mistakes and calculation errors. It should also be consistent and cohesive. Additionally, approaches both used and rejected in the valuation computation should be appropriately explained, with all assumptions defended and supported. In *Bailey Estate v. Commissioner* [T.C. Memo 2002-152, 83 TCM 1862 (2002)], the Tax Court criticized the appraiser for failing to do so. This is critical, because attorneys contesting valuations will focus on errors, omissions, and other mistakes to discredit the validity of the valuation as well as the expertise of the valuator. Due to the subjectivity of valuations, it is imperative that readers be aware that the valuation analysis is the opinion of the qualified professional, not fact. Regardless of how "correct" the conclusion of the valuation may appear; it will not be acceptable to a court in the absence of a complete and comprehensive analysis. In addition, the valuation must be replicable by another valuator who reviewed the relevant valuation documents. In *Winkler Estate v. Commissioner* [T.C. Memo 1989-231, 57 TCM 373 (1989)], the Tax Court articulated perhaps one of the best arguments for a freestanding, comprehensive appraisal report. **Hiring a Valuator Who Does Not Keep Current -** It is essential that anyone hired to do the valuation is current in their knowledge and skills. The art of valuation is dynamic and continually evolving. A valuator must be aware of new precedents and guidelines regularly emanating from court cases and IRS pronouncements. There are always new types of risks that need to be incorporated into valuations. For example, there is the risk of cyber-data breaches that could be detrimental to the value of a business. Historically, valuations for private companies have utilized traditional valuation methods. Valuators of public companies have been more innovative in the ways they view different businesses and industries, which has led to new methods that can be considered for certain private companies. One example of an innovative valuation method is customer-based corporate valuation (CBCV). Unlike the traditional top-down method, this valuation is a bottom-up method that considers each customer's value. CBCV can be applied to businesses with recurring types of revenue streams, such as subscription models. If performed correctly, a CBCV valuation could result in a higher valuation of a business than more traditional methods. A valuator who fails to consider newer and more modern approaches could be leaving money on the table. **One Size Does Not Fit All -** Business valuation is both an art and a science. Not one-size-fits-all proposition, credible and reliable valuations are based on a variety of factors, including historical facts, calculations using past and current data, and subjective judgments. To be assured of accuracy, the valuation should be performed by a qualified professional who is immersed in the relevant facts and details of the company and industry. The complex valuation process is prone to a multitude of common mistakes, errors, and omissions that can skew a final valuation number and render it inaccurate and legally inadequate. Hiring a business valuation professional requires thorough, diligent consideration to make sure an accredited, experienced, and reputable valuation partner has been chosen.

(Sheela Tukaram Rathod/ FYBBI/10)

FASB Scraps Project on Goodwill Accounting, Disclosure

The move by the U.S. accounting standard setter comes after four years of discussions about potential changes to current rules. Healthcare services firm Cardinal Health last year took a $1.3 billion pre-tax goodwill write-down as higher commodities and transportation costs weighed on profits. The Financial Accounting Standards Board scrapped plans to consider new rules on how companies account for and disclose goodwill, a blow to businesses and investors that have sought improvements to the current model. The U.S. accounting standard setter on Wednesday said it would remove the project from its technical agenda but said it could return to it at some point. The FASB in 2018 added the project to the agenda featuring its rule-making priorities, which often lead to new rules U.S. companies need to follow. Companies report goodwill when they buy a business for more than the value of its net assets. Under current U.S. rules, an acquiring business must measure the fair value of its reporting units annually and, if that figure is less than the amount recorded on the books, reduce the value of the goodwill. Many companies consider the current model costly and subjective, while investors want even greater disclosure on their goodwill. The seven-member board based its decision on stakeholder input it received on various accounting models it considered over the course of the four-year project as well as its agenda consultation last year, a FASB spokeswoman said. Companies frequently report goodwill impairment charges on their balance sheets. Healthcare services firm Cardinal Health Inc. last year took a $1.3 billion pretax charge—the largest impairment by a single U.S. company that year—as higher commodities and transportation costs weighed on profits. Businesses have also started racking up goodwill write-downs from exiting or cutting back operations in Russia following the country's invasion of Ukraine in February. Goodwill has been one of the FASB's most hot-button issues in recent years. The standard setter for a period leaned toward adding amortization, a method it eliminated in 2001, to the existing goodwill model. That method would force companies to write down a set portion of goodwill annually over 10 years or an estimated period of up to 25 years. The FASB also considered no longer requiring acquiring businesses to separately measure the value of customer relationships when calculating the intangible assets they gained from a transaction. Many investors have criticized the FASB's recent leanings, saying the amortization of goodwill doesn't help them conduct their investment analysis. Investors have also said they want the FASB to work closely with its international counterpart, the International Accounting Standards Board, to align any rule changes. Companies' calculation of goodwill impairments under U.S. accounting rules and international financial reporting standards are largely similar. The staff of the IASB, which sets standards for many jurisdictions outside the U.S., in May said it plans to ask the board to decide whether to move its goodwill project from its current research phase to a standard-setting phase in the fourth quarter. The IASB declined to comment on the FASB's move on Wednesday. The FASB may add the project back if it receives more information or encounters a new reason for making changes, Chairman Rich Jones said. "This would be a very significant change," Mr. Jones said. "I think you need a case for change. As I see it, as this is stacking up, it doesn't assemble."

(Prachi Rai/SYBCOM-B/56)